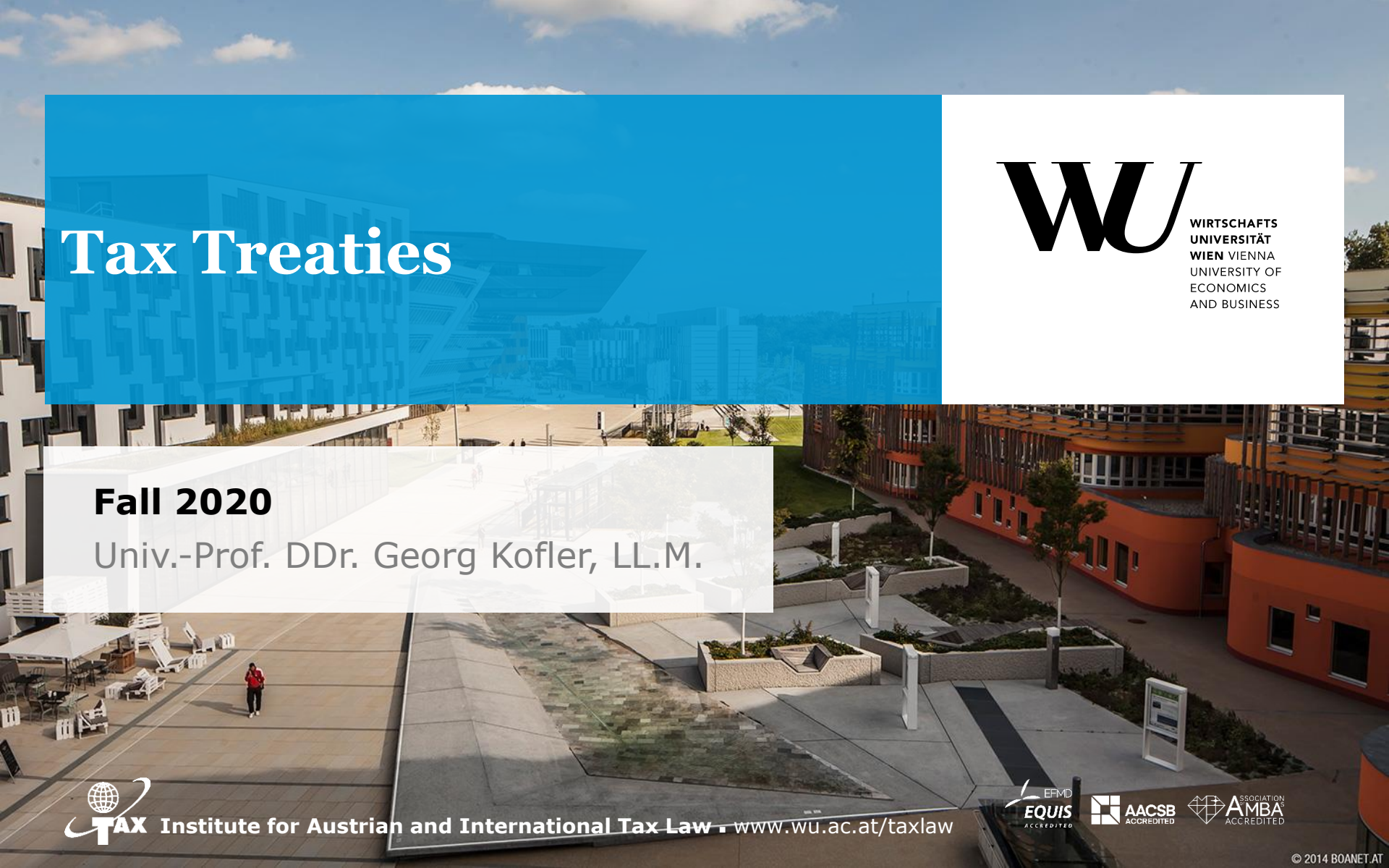
Tax Treaties

WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Fall 2020

Univ.-Prof. DDr. Georg Kofler, LL.M.



Overview

- ***Part I*** – Course Overview and Introduction (History, Policy, Context, BEPS)
- ***Part II*** – "Rules" of Application, Interpretation and Implementation, "Treaty Overrides"
- ***Part III*** – Scope of Application: Taxpayers, Taxes, Residence, Place and Time (Articles 1(1), (3), 2 and 4, 30, 31 and 31 OECD MC)
- ***Part IV*** – Distributive Rules
  - ***Chapter IV/1*** – Permanent Establishments and Business Profits (Articles 5, 7, 13(2) OECD MC, Articles 5(3), 7 and 12A UN MC) and Excursus on Associated Enterprises (Article 9 OECD MC)
  - ***Chapter IV/2*** – Immovable Property, International Transport (Articles 6, 8 and 13(1) and (3) OECD MC)
  - ***Chapter IV/3*** – Investment Income: Dividends, Interest, Royalties and Capital Gains (Articles 10, 11, 12 and 13 OECD MC)
  - ***Chapter IV/4*** – Employment, Directors' Fees and Pensions (Articles 15, 16 and 18 OECD MC)

Overview

- ***Part V*** **–** Methods for the Elimination of Double Taxation (Article 23A and 23B OECD MC)
- ***Part VI*** **–** "Special Provisions": Non-Discrimination, Mutual Agreement, Exchange of Information and Assistance in the Collection of Taxes (Articles 24, 25, 26 and 27 OECD MC)
- ***Part VII*** **–**Treaty Shopping and Tax Avoidance (Article 29 OECD MC)
- ***Part VIII*** **–** Excursus: Multilateral Instrument (MLI)

Part I
Course Overview and Introduction

Double Taxation | *Jurisdiction*

- ***Overlapping Taxing Jurisdiction***
  - Nationality (citizenship of individuals, incorporation of companies)
  - Territory
    - Persons – "Residence" – E.g., domicile, residence, place of management
    - Income – "Source" – E.g., permanent establishment, residence of the payor, situs of real estate
- ***Form of Taxation***
  - **Residence** – **"Principle of Universality"** = Taxation of Worldwide Income ("Unlimited Tax Liability")
  - **Source** – **"Principle of Territoriality"** ("Limited Tax Liability")
    - Exercise of Taxing Rights – "Normal" taxation (net base, regular progressive rate) versus withholding taxation (gross base, flat rate)
    - Taxing thresholds – E.g., Existence of a permanent establishment, duration of stay (183 days)
- ***Limits*?**
  - Substantive taxation? Nexus?
  - Enforcement? – PCIJ, 7 Sept. 1927, *The Case of the S. S. „Lotus"*, PCIJ Series A, No. 10 (1927)
  - EU Law (fundamental freedoms, directives)? EEA Agreement? Other international treaties?

Double Taxation | *Forms*

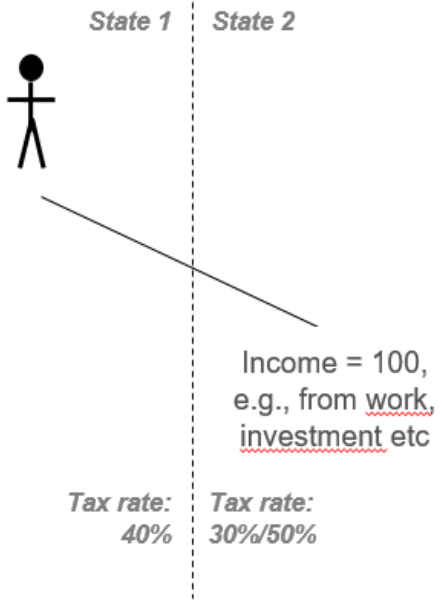
- ***Forms of Double Taxation***
  - Double Taxation → Intro no. 1 OECD MC Comm.

> 1. International juridical double taxation can be generally defined 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. Its harmful effects on the exchange of goods and services and movements of capital, technology and persons 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.

  - Juridical ("Real") Double Taxation – Double Taxation Conventions (DTCs) = Double Taxation Agreements (DTAs) = ***Tax Treaties***
    - ***Residence/Residence*** – Unlimited tax liability in two countries – "Tie Breaker"-Rules in DTCs (Art 4(2) and (3) OECD MC)
    - ***Residence/Source*** – Unlimited tax liability in one country, limited tax liability in the other country – Distributive Rules and Methods in DTCs (Art 6-21, 23 OECD MC)
    - ***Source/Source*** – Limited tax liability in two countries → Specific source rules (e.g., Art 10), triangular situations
  - Economic Double Taxation – E.g., transfer pricing and Art 9 OECD-MC

Double Taxation | *Relief*

- ***Juridical ("Real") Double Taxation***



- **Relief**
  - Unilateral relief → E.g., § 48 BAO
  - Bi- or multilateral relief → Tax treaties
- **Forms**
  - Credit in the residence State → *Capital Export Neutrality (CEN – Neutrality in the home market)* → Credit limitation? → Article 23B OECD MC
  - Exemption in the residence State → *Capital Import Neutrality (CIN – Neutrality in the host market)* → Progressivity? Losses? → Article 23A OECD MC
  - Deduction of the foreign tax from the tax base of the residence State → *National Neutrality (NN)*
  - Classification and assignment of sources → Source rules → Articles 7, 8 etc OECD MC
  - Limitation of source State taxation → Article 10, 11 OECD MC

Double Taxation | *Neutralities*

Neutrality	Standard	Benchmark	Achieved by
Location of Investment	Capital Export Neutrality (CEN)	Neutrality as regards domestic and foreign investments producing the same pre-tax rate of return	Immediate Taxation and Full Credit
	National Neutrality (NN)	Preference for domestic investments whenever the pre-tax rate of return exceeds the return on a foreign investment net of foreign taxes	Immediate Taxation and Deduction of Foreign Tax
Origin of Investment	Capital Import Neutrality (CIN)	Neutrality as regards whether an investment is made by a foreign or a domestic investor, i.e., equality of the after-tax rate of return for each investor	Adoption by *all* Countries of the Exemption Method
Identity of Investors	Capital Ownership Neutrality (CON)	Neutrality regarding which corporation owns ad exploits capital assets, i.e., corporations that exploit a given asset most efficiently are willing to pay the most to own that asset	Adoption by all Countries of either the Full Credit Method or the Exemption Method
	National Ownership Neutrality (NON)	Encourage residents to make foreign investments that yield a higher after-tax rate of return than domestic investments	Adoption by *all* Countries of the Exemption Method

Tax Treaties | *Objectives*

Eliminate Double Taxation and Prevent Tax Avoidance and Evasion

Remove Tax Obstacles and Distortions to Cross-Border Trade and Investment Flows

Maximize Global Wealth by Ensuring an Efficient Allocation of Resources

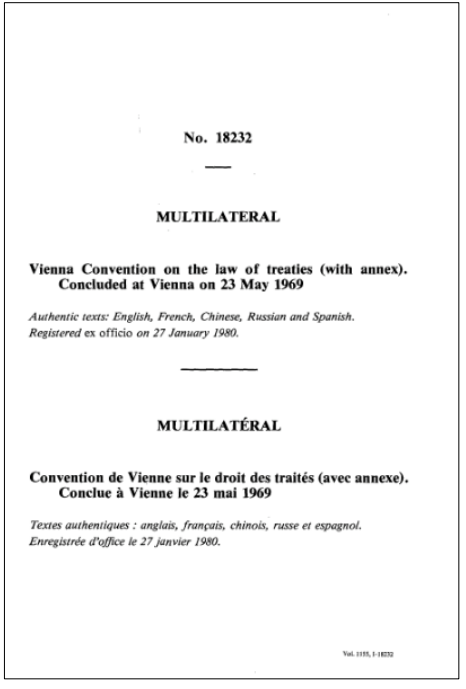
- Eliminate the most common ***forms of juridical and economic double taxation***
- Eliminate some forms of ***tax discrimination***
- Provide a standardized set of rules for ***dividing tax revenues*** between countries
- Address ***tax evasion and avoidance***
- Provide a framework for ***settling tax disputes***
- Provide a ***stable tax environment*** to foreign investors
- And increase the ***international competitiveness*** of the economy and to facilitate – specifically the UN MC – foreign investment, international trade and the transfer or technology
- Also: Considerations that are relevant to the decision of whether to enter into a tax treaty or amend an existing one (Intro nos 15.1-15.6 OECD MC Comm.)

Tax Treaties | *Operation*

- ***Restriction of domestic taxing rights ("stencil")***
  - ***Unlimited*** taxation in the ***source State*** and relief in the residence State (e.g., immovable property)
  - ***Limited*** taxation in the ***source State*** and relief in the residence State (e.g., dividends, interest)
  - ***Exclusive*** taxation in the ***residence State*** (e.g., business income, pensions, other income)
  - ***Exclusive*** taxation in the ***source State*** (e.g., government income)

Tax Treaties | *Legal Nature*

- ***There are currently around 3.000 bilateral tax treaties***
  - Part of the infrastructure of the global economy in the same way as the WTO agreements that regulate cross-border trade the bilateral investment agreements that regulate cross-border investment
  - Multilateral Instrument (MLI) to implement the OECD BEPS Project (BEPS Action 15)
- ***Tax treaties are international agreements between two or more States***
  - Art 2 of the Vienna Convention on the Law of Treaties (VCLT) → International agreement (in one or more instruments, whatever called) concluded between States and governed by International Law
  - Only creates rights and obligations for the States, not third parties
  - In some countries tax treaties are also enacted as statutes → Once implemented, they create rights for taxpayers



No. 18232

MULTILATERAL

Vienna Convention on the law of treaties (with annex).
Concluded at Vienna on 23 May 1969

Authentic texts: English, French, Chinese, Russian and Spanish.
Registered ex officio on 27 January 1980.

MULTILATÉRAL

Convention de Vienne sur le droit des traités (avec annexe).
Conclue à Vienne le 23 mai 1969

Textes authentiques : anglais, français, chinois, russe et espagnol.
Enregistrée d'office le 27 janvier 1980.

Vienna Convention on the Law of Treaties (VCLT)

Tax Treaties | *Legal Nature*

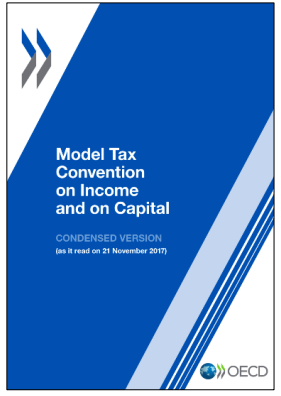
- ***Relationship between domestic law and tax treaty law***
  - Tax Treaties → International agreements
  - Tax treaties and domestic law → Monist versus dualist doctrine – Constitutional framework, implementation
  - Priority of tax treaties?
    - *Lex posterior* versus *lex specialis*
    - "Treaty Override"
      - Art 26, 27 VCTL → "Pacta sunt servanda"
      - OECD Report on Tax Treaty Override (adopted on 2 October 1989), and Recommendation of the OECD Council concerning Tax Treaty Override, OECD/LEGAL/0253 (2 October 1989):

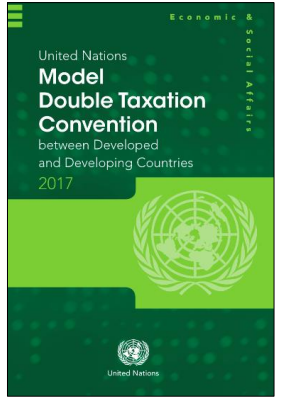
> **I. RECOMMENDS** Member countries;
>
> 1. To undertake promptly bilateral or multilateral consultations to address problems connected with tax treaty provisions, whether arising in their own country or raised by countries with which they have tax treaties;
>
> 2. To avoid enacting legislation which is intended to have effects in clear contradiction to international treaty obligations.
>
> **II. INSTRUCTS** the Committee on Fiscal Affairs to follow developments in this area and to bring to the attention of the Council any action which would constitute a material breach of Member countries' international treaty obligations.

      - Country practice (e.g., for Germany BVerfG, 15 December 2015, 2 BvL 1/12)
    - "Treaty Underride"

Tax Treaties | *Models*

- ***Relevance, purpose and impact/influence*** of Treaty Models (Intro nos 2-3 OECD MC Comm.)
  - DTCs generally follow the structure of the **OECD MC**, with variations to take account of national (e.g., **US MC**) and developing country requirements with more weight to the source principle (e.g., **UN MC**; Intro nos 12-17.1 UN MC Comm.)
- ***OECD MC 2017 and UN MC 2017***
  - Model Articles (generally "single rule", but degree of flexibility and alternative provisions)
  - Commentaries on the Articles
    - Relevance? Impact? (→ Intro nos 28-30 OECD MC Comm.)
    - References by the UN MC Comm. to the OECD MC Comm? (→ Intro nos 20-23 UN MC Comm.)
    - Amendments of the MC or the Commentaries? (→ Intro nos 33-36.1 OECD MC Comm.)
  - Note:
    - UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (2019) (→ Intro nos 17.2-17.3 UN MC Comm.)
    - PCT Toolkit for Treaty Negotiations (2020)





OECD MC | *Structure*

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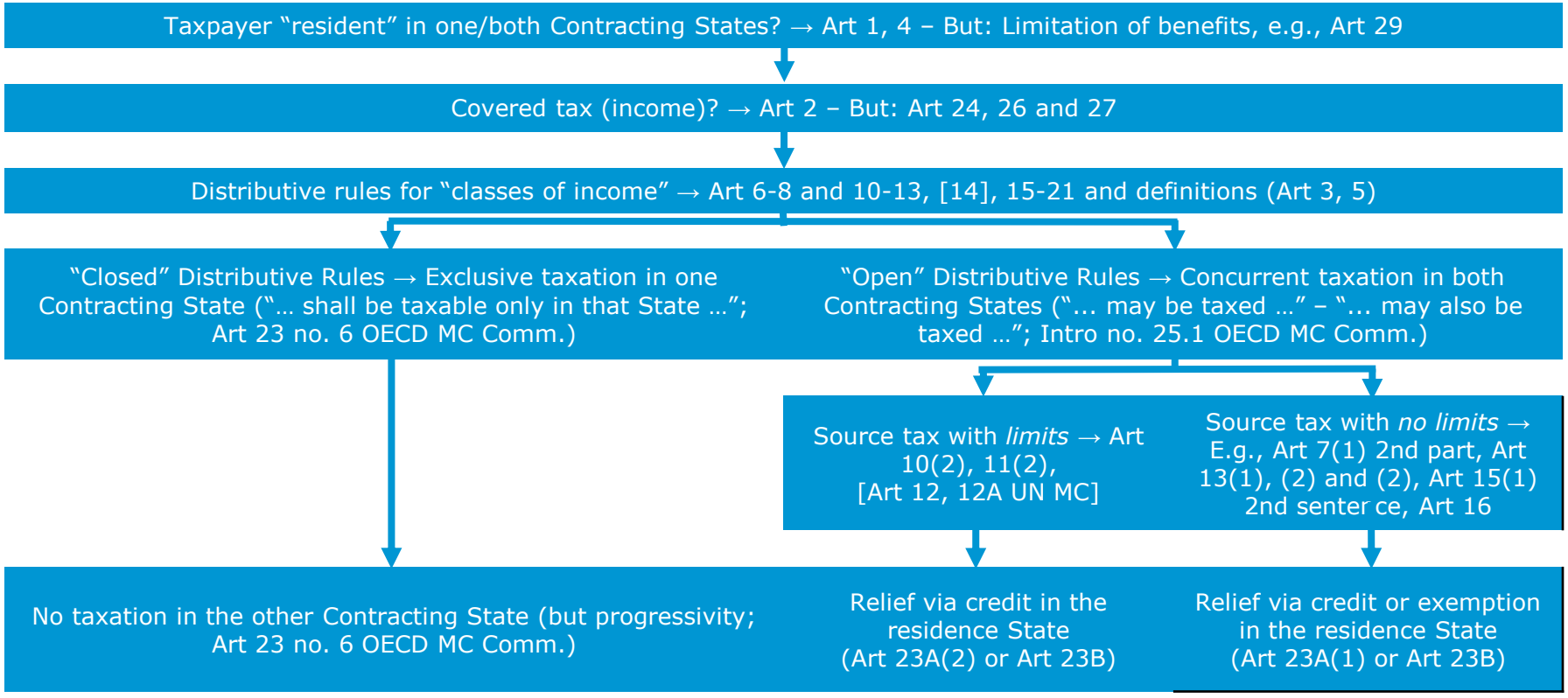
OECD MC | *Structure*



OECD MC | *Title and Preamble*

OECD MC 2014

TITLE OF THE CONVENTION

Convention between (State A) and (State B)
with respect to taxes on income and on capital[1]

PREAMBLE TO THE CONVENTION[2]

1 States wishing to do so may follow the widespread practice of including in the title a reference to either the avoidance of double taxation or to both the avoidance of double taxation and the prevention of fiscal evasion.
2 The Preamble of the Convention shall be drafted in accordance with the constitutional procedure of both Contracting States.

OECD MC 2017
(→ Intro nos 16-16.2 OECD MC Comm.)

TITLE OF THE CONVENTION

Convention between (State A) and (State B)
for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance

PREAMBLE TO THE CONVENTION

(State A) and (State B),

Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States),

Have agreed as follows:

OECD MC | *Recommendation*

- ***Recommendation*** of the OECD Council concerning the Model Tax Convention on Income and on Capital
- Recommendations (Article 5(b) of the Convention on the Organisation for Economic Co-operation and Development)
  - OECD **legal instruments** which are not legally binding but practice accords them **great moral force** as representing the political will of Adherents.
  - There is an expectation that Adherents will do **their utmost to fully implement a Recommendation**. Thus, Members which do not intend to do so usually abstain when a Recommendation is adopted, although this is not required in legal terms.

Taking note of the Model Tax Convention and the Commentaries thereon (as last modified by the 1997 Report), which may be amended from time to time hereafter;

I. RECOMMENDS the Governments of member countries:

1. to pursue their efforts to conclude bilateral tax conventions on income and on capital with those member countries, and where appropriate with non-member countries, with which they have not yet entered into such conventions, and to revise those of the existing conventions that may no longer reflect present-day needs;
2. when concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention, as interpreted by the Commentaries thereon;
3. that their tax administrations follow the Commentaries on the Articles of the Model Tax Convention, as modified from time to time, when applying and interpreting the provisions of their bilateral tax conventions that are based on these Articles.

II. INVITES the Governments of member countries to continue to notify the Committee on Fiscal Affairs of their reservations on the Articles and observations on the Commentaries.

III. INSTRUCTS the Committee on Fiscal Affairs to continue its ongoing review of situations where the provisions set out in the Model Tax Convention or the Commentaries thereon may require modification in the light of experience gained by member countries, and to make appropriate proposals for periodic updates.

OECD MC | *Members*

- ***Member Countries***
  - 37 OECD Member Countries
    - Australia, Austria, Belgium, Canada, Chile, Colombia (since 28 April 2020), the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.
    - The European Union takes part in the work of the OECD.
  - They may enter:
    - Reservations on the Articles (Intro nos 31-32 OECD MC Comm.)
    - Observations on the Commentaries (Intro no. 30 OECD MC Comm.)
- Positions of ***33 Non-Member Countries*** on the Articles and the Commentaries

Observation on the Commentary

110. With respect to paragraph 81, *Switzerland* considers that controlled foreign corporation legislation may, depending on the relevant concept, be contrary to the spirit of Article 7.

Reservations on the Article

111. The *United States* reserves the right, with certain exceptions, to tax its citizens and residents, including certain former citizens and long-term residents, without regard to the Convention.

112. *Canada* reserves the right to limit the entities or arrangements covered under paragraph 2 to those that are established in one of the Contracting States.

POSITIONS ON ARTICLE 1 (PERSONS COVERED) AND ITS COMMENTARY

Positions on the Article

1. The *Philippines* reserves the right to tax its citizens in accordance with its domestic law.

2. *Costa Rica*, *Serbia* and *Singapore* reserve their position on paragraph 2.

3. *India* reserves the right not to include paragraph 2 of Article 1 in its tax treaties.

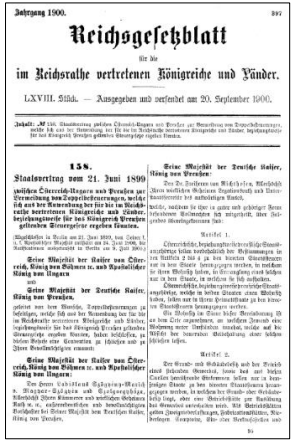
4. *Costa Rica*, *Serbia* and *Singapore* reserve their position on paragraph 3.

Position on the Commentary

5. *India* does not agree with the view expressed in paragraph 7 of the Commentary on Article 1 that the term "income derived by or through an entity or arrangement" includes income derived by or through an entity that may not be a resident of either of the Contracting States. India considers that this term includes only such income that is derived by or through entities that are resident of one or both Contracting States.

History | *League of Nations*

21 June 1899 – First international double taxation convention (between Austria-Hungary and Prussia) – Landmark and role model (e.g., concept of permanent establishment)



Jahrgang 1900. 897

Reichsgesetzblatt

für die

im Reichsrathe vertretenen Königreiche und Länder.

LXVIII. Stück. — Ausgegeben und versendet am 20. September 1900.

138.

Staatsvertrag vom 21. Juni 1899

zwischen Österreich-Ungarn und Preußen zur Verhütung von Doppelbesteuerungen, welcher sich auf der Hinterlegung der für die im Reichsrathe vertretenen Königreiche und Länder beziehungsweise für das Königreich Preußen geltenden Ratifikationsurkunden ergeben hinsichtlich der Besteuerung.

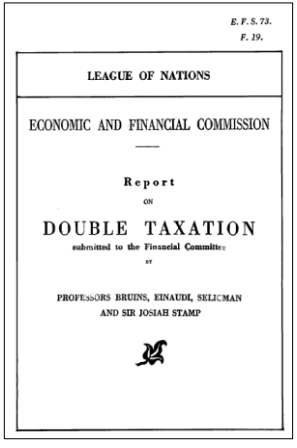
Seine Majestät der Kaiser, König von Preußen.

Seine Majestät der Kaiser von Österreich, König von Böhmen etc. und Apostolischer König von Ungarn

Seine Majestät der Kaiser von Österreich, König von Böhmen etc. und Apostolischer König von Ungarn:

1899

Report on Double Taxation submitted to the Financial Committee By Professors Bruins, Einaudi, Seligman And Sir Josiah Stamp (Doc.E.F.S.73.F.19.; April 5, 1923) – Concept of "economic allegiance"



E.F.S. 73.
F. 19.

LEAGUE OF NATIONS

ECONOMIC AND FINANCIAL COMMISSION

Report
ON
DOUBLE TAXATION
submitted to the Financial Committee
BY
PROFESSORS BRUINS, EINAUDI, SELIGMAN
AND SIR JOSIAH STAMP

1923

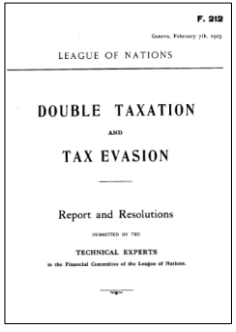
1920

League of Nations

Co-existence of source-based "impersonal taxes" ("impôts réels", "Sachsteuern", "l'imposta reale") and emerging of residence-based personal progressive taxes on a person's total (net) income ("impôts personnels", "Personalsteuern", "l'imposta personale") – Increasing tax rates during and after World War I – Potential conflicts of interest between creditor and debtor nations – Generally, (at most) deduction from the tax base for foreign taxes.

History | *League of Nations*

Double Taxation And Tax Evasion-Report and Resolutions Submitted By The Technical Experts to the Financial Committee of the League of Nations (Doc. F.212; February 7, 1925)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LEAGUE OF NATIONS

DOUBLE TAXATION
AND
TAX EVASION

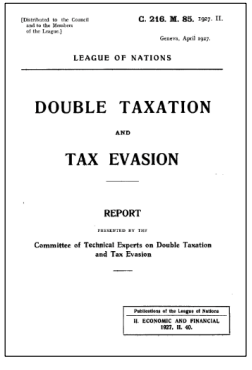
Report and Resolutions

TECHNICAL EXPERTS

1925

1927

Double Taxation and Tax Evasion-Report Presented By The Committee of Technical Experts on Double Taxation and Tax Evasion (Doc. c.216.M.85.1927.1I.; April, 1927)


C. 216. M. 85. 1927. II.

LEAGUE OF NATIONS

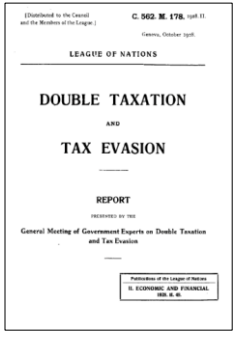
DOUBLE TAXATION
AND
TAX EVASION

REPORT

Committee of Technical Experts on Double Taxation and Tax Evasion

1928

Double Taxation And Tax Evasion-Report Presented By The General Meeting of Government Experts on Double Taxation and Tax Evasion (Doc. C.562.M.178.1928.I1.; October, 1928) – Three models (to accomodate personal and impersonal taxes)


C. 562. M. 178.

LEAGUE OF NATIONS

DOUBLE TAXATION
AND
TAX EVASION

REPORT

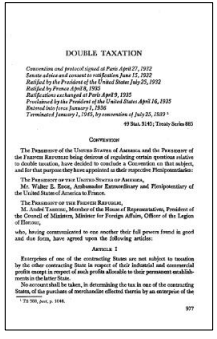
General Meeting of Government Experts on Double Taxation and Tax Evasion

1929

League of Nations: Fiscal Committee

History | *League of Nations*

27 April 1932 – First (limited) tax treaty concluded by the United States (with France; 9 Stat. 3145, T.S. No. 885) – Comprehensive treaties were concluded with Sweden and France in 1939 (54 Stat. 1759, T.S. No. 958 and 59 Stat. 893, T.S. No. 988)



DOUBLE TAXATION

Convention and protocol signed at Paris April 27, 1932
Senate advice and consent to ratification June 17, 1932
Ratified by the President of the United States July 25, 1932
Ratified by France April 8, 1935
Ratifications exchanged at Paris April 9, 1935
Proclaimed by the President of the United States April 16, 1935
Entered into force January 1, 1936
Terminated January 1, 1945, by convention of July 25, 1939 [1]

49 Stat. 3145; Treaty Series 885

CONVENTION

The President of the United States of America and the President of the French Republic being desirous of regulating certain questions relative to double taxation, have decided to conclude a Convention on that subject, and for that purpose they have appointed as their respective Plenipotentiaries:

The President of the United States of America,
Mr. Walter E. Edge, Ambassador Extraordinary and Plenipotentiary of the United States of America to France.

The President of the French Republic,
M. André Tardieu, Member of the House of Representatives, President of the Council of Ministers, Minister for Foreign Affairs, Officer of the Legion of Honor,

who, having communicated to one another their full powers found in good and due form, have agreed upon the following articles:

ARTICLE I

Enterprises of one of the contracting States are not subject to taxation by the other contracting State in respect of their industrial and commercial profits except in respect of such profits allocable to their permanent establishments in the latter State.

No account shall be taken, in determining the tax in one of the contracting States, of the purchases of merchandise effected therein by an enterprise of the

[1] TS 930, post, p. 1046.

977

League of Nations dissolved on 20 April 1946, succeeded by the United Nations. – The UN's Economic and Social Council (ECOSOC) (in resolution 2(III) of 1 October 1946) set up a Fiscal Commission and a Committee on International Tax Relations, which stopped functioning in 1954 → Focus of action in the field of international taxation shifted to the OEEC.

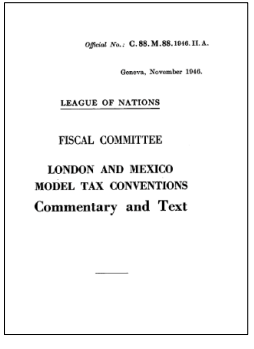
1932

1929

1943/1946

League of Nations: Fiscal Committee (10 regular members, 36 corresponding members) – 10 sessions between 1929 and 1946 – E.g., allocation of business income based on M.B. Carroll, Methods of Allocating Taxable Income, in League of Nations (Hrsg.), *Taxation of Foreign and National Enterprises*, Volume IV, Doc. C. 425(b).M 217(b).1933.II.A. (1933)

1943/1946 – London and Mexico Model Tax Conventions – Commentary and Text, Doc. C. 88. M.88.1946. II.A. (1946)



Official No.: C. 88. M. 88. 1946. II. A.

Geneva, November 1946.

LEAGUE OF NATIONS

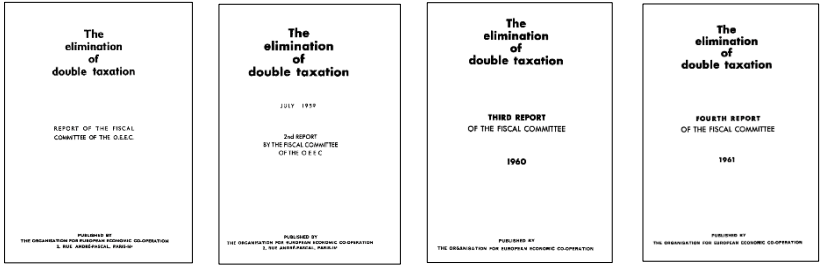
FISCAL COMMITTEE

LONDON AND MEXICO MODEL TAX CONVENTIONS

Commentary and Text

History | *OECD and UN*

1958-1961 – Four Reports of the Fiscal Committee of the OEEC on the Elimination of Double Taxation – Explanations, draft articles and commentaries



1955

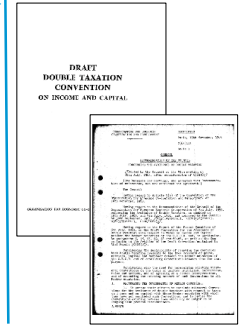
1958

1961

1963

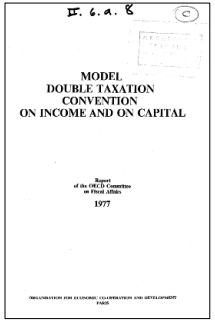
Organisation for European Economic Co-operation (OEEC) formed in 1948, in 1961 superseded by the Organisation for Economic Co-operation and Development (OECD) – First Recommendation on Double Taxation in 1955 (C(55)37); creation of the "Fiscal Committee" (FC) in 1956 (Resolution of the Council C(56)49(Final) of 16 March 1956), which was renamed in 1971 in "Committee on Fiscal Affairs" (CFA), tax treaty work by "Working Party No. 1"

1963 – Draft Double Taxation Convention on Income and on Capital, C(63)87 (parts 1 and 2), adopted by Council Recommendation C(63)113 of 19 November 1963 – Template for bilateral negotiations, promotion of trade and investment



History | *OECD and UN*

1977 – OECD Model Double Taxation Convention on Income and on Capital 1977



Updates ("ongoing process" rather than complete revision) of the OECD MC and its Commentaries in 1992, 1994, 1995, 1997, 2000, 2002, 2005, 2008, 2010, 2014 and 2017

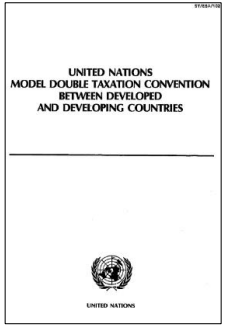
1967

Revision of the OECD MC 1963

1977

1980

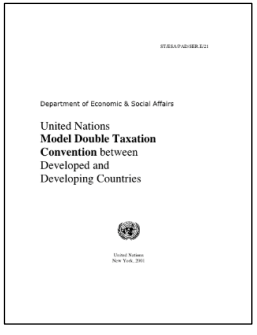
1980 – First UN Model Double Taxation Convention between Developed and Developing Countries



1992

2001

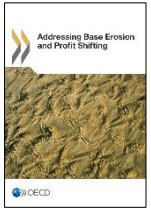
2001 – Second UN Model Double Taxation Convention between Developed and Developing Countries

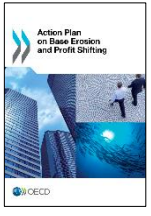


History | *OECD and UN*

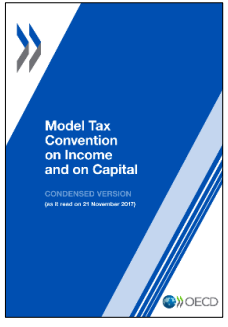
Updates of the OECD MC and its Commentaries in 1992, 1994, 1995, 1997, 2000, 2002, 2005, 2008, 2010, 2014 and 2017

BEPS ("Base Erosion and Profit Shifting")





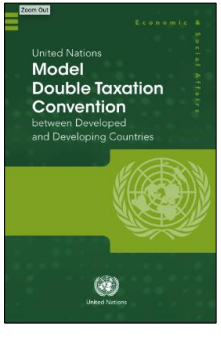
2017 – OECD Model Update 2017



2013

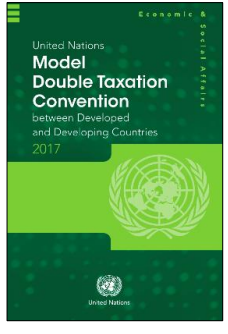
2011

2011 – Third UN Model Double Taxation Convention between Developed and Developing Countries



2017/2018

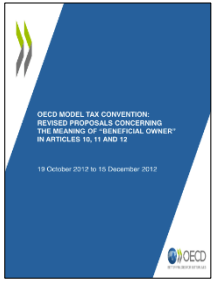
2017 – Fourth UN Model Double Taxation Convention between Developed and Developing Countries



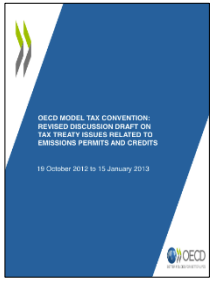
History | *OECD Updates*

- ***Example: 2014 Update***

Issues Related to Article 17 of the OECD MC

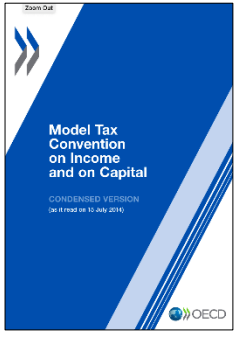


Beneficial Ownership

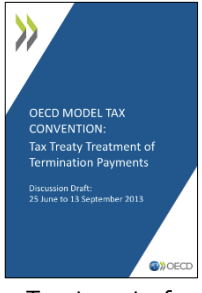


Emission Permits and Credits

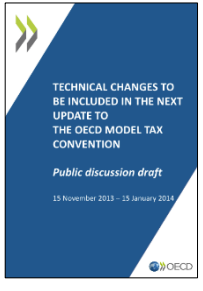
OECD 2014 Update



OECD 2014 Condensed Version



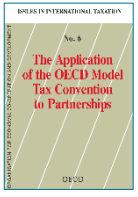
Treatment of Termination Payments



Technical Changes

History | *OECD Reports*

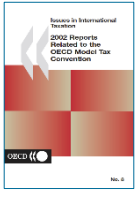
Tax Sparing [R(14)]



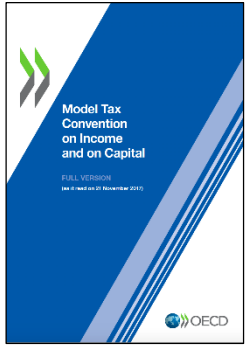
Partnership Report [R(15)]

Article 14 [R(16)]

Stock Options [R(20)]



2002 Reports: Treaty Benefits [R(17)], E-Commerce [R(18)] and Issues Arising Under Article 5 [R(19)]



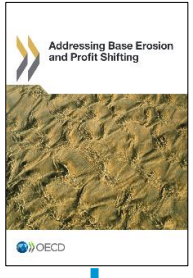
OECD MC – Full Version (2 Volumes, currently 2017) – MC and Commentaries in Volume 1, Reports in Volume 2

Volume II

BEPS | *OECD Updates*

- ***BEPS ("Base Erosion and Profit Shifting") …***

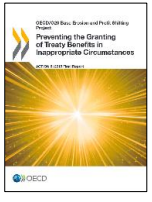
Issues and Action Plan (2013)



Final Reports on 15 Actions (2015) and Follow-up work (since 2016)

#	Topic
1	Addressing the Tax Challenges of the Digital Economy
2	Neutralising the Effects of Hybrid Mismatch Arrangements
3	Designing Effective CFC Rules
4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
5	Countering Harmful Tax Practices More Effectively
6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
7	Preventing the Artificial Avoidance of Permanent Establishment Status
8-10	Aligning Transfer Pricing Outcomes with Value Creation
11	Measuring and Monitoring BEPS
12	Mandatory Disclosure Rules
13	Transfer Pricing Documentation and Country-by-Country Reporting
14	Making Dispute Resolution Mechanisms More Effective
15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Tax Treaty Aspects



Action 2

Action 6

Action 14

Action 7

Action 15

BEPS | *OECD Updates*

- ***… and the OECD MC and the Multilateral Instrument ("MLI")***

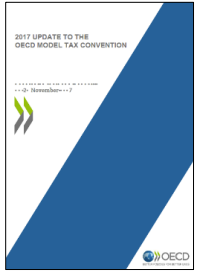
Action 2

Action 6

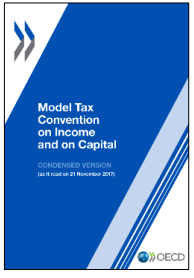
Action 14

Action 7

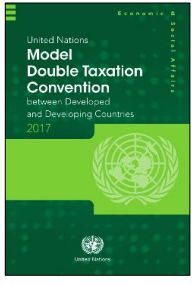
Action 15



2017 Update of the OECD MC and Commentary in November 2017



Condensed Version of the OECD MC and Commentary 2017



BEPS Implementation in the UN MC 2017

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS and Explanatory Memorandum (November 2016; 94 signatories as of July 2020)

Excursus I | *BEPS etc*

Final Reports on 15 Actions (2015)		*Follow-up work, e.g.,*	
#	**Topic**	**#**	**Topic**
1	Addressing the Tax Challenges of the Digital Economy	1	Tax Challenges Arising from Digitalisation – Interim Report 2018 – Inclusive Framework on BEPS (2018) etc etc
2	Neutralising the Effects of Hybrid Mismatch Arrangements	2	Neutralising the Effects of Branch Mismatch Arrangements, Action 2 – Inclusive Framework on BEPS (2017)
3	Designing Effective CFC Rules		
4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments	4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 Update (2016)
5	Countering Harmful Tax Practices More Effectively		
6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances		
7	Preventing the Artificial Avoidance of Permanent Establishment Status	7	Additional Guidance on the Attribution of Profits to Permanent Establishments (March 2018)
8-10	Aligning Transfer Pricing Outcomes with Value Creation	8-10	▪ 2017 OECD Transfer Pricing Guidelines (TPG) ▪ Revised Guidance on the Application of the Transactional Profit Split Method (June 2018) ▪ Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles (June 2018) ▪ Financial Transactions (February 2020)
11	Measuring and Monitoring BEPS		
12	Mandatory Disclosure Rules		
13	Transfer Pricing Documentation and Country-by-Country Reporting		
14	Making Dispute Resolution Mechanisms More Effective		
15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties		

Excursus I | *BEPS etc*

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Final Reports on 15 Actions (2015)

#	Topic
1	Addressing the Tax Challenges of the Digital Economy
2	Neutralising the Effects of Hybrid Mismatch Arrangements
3	Designing Effective CFC Rules
4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
5	Countering Harmful Tax Practices More Effectively
6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
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13	Transfer Pricing Documentation and Country-by-Country Reporting
14	Making Dispute Resolution Mechanisms More Effective
15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Four Minimum Standards

#	Topic
5	Preferential Regimes, Transparency of Tax Rulings
6	Preventing Tax Treaty Shopping (PPT, PPT + LoB or LoB + Anti Conduit Rule) → Article 29 OECD MC, MLI
13	Country-by-Country Reporting → CbCR MCAA
14	Effectiveness of Cross-Border Dispute Resolution (MAP)

Excursus I | *BEPS etc*

Four Minimum Standards → Implementation, Peer Reviews

#	Topic
5	Preferential Regimes, Transparency of Tax Rulings
6	Preventing Tax Treaty Shopping (PPT, PPT + LoB or LoB + Anti Conduit Rule) → Article 29 OECD MC, MLI
13	Country-by-Country Reporting → CbCR MCAA
14	Effectiveness of Cross-Border Dispute Resolution (MAP)

BEPS Inclusive Framework

- Collaboration on the implementation of the OECD/ G20 Base Erosion and Profit Shifting (BEPS) Package
- Work Programme
  - Standards on remaining BEPS issues
  - Review the implementation of the four BEPS minimum standards through a peer-review process.
  - Monitor new developments relating to the other BEPS measures and to measure the impact of those measures.
  - Support jurisdictions in the implementation of the BEPS measures
- 137 Member States (as of Dec. 2019)
- OECD/G20 Inclusive Framework on BEPS – Annual Progress Reports:

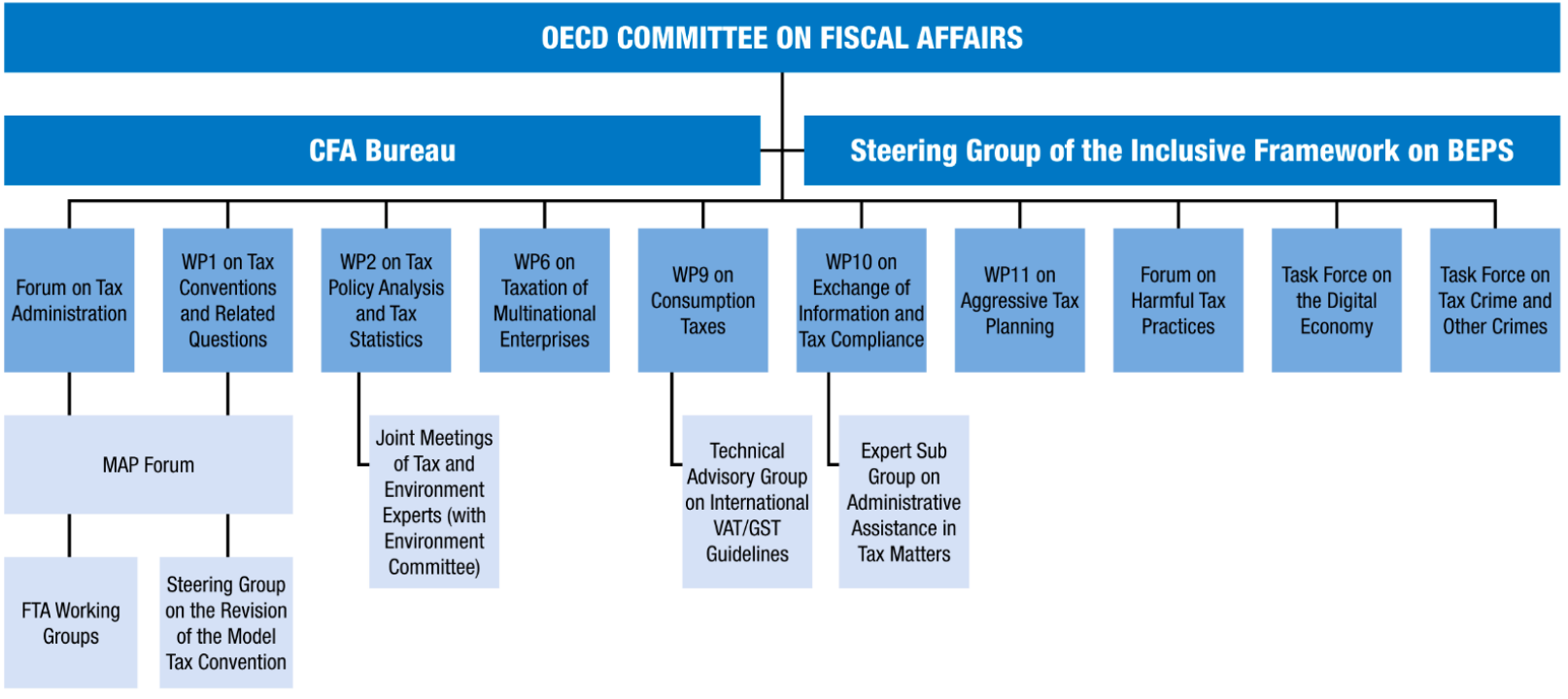
Excursus II | *Updates 2017*

Topic	MLI	OECD MC 2017	UN MC 2017
Preamble	Art 6	Title, Preamble	Title, Preamble
Hybrids	Art 3	Art 1(2)	Art 1(2)
Saving Clause	Art 11	Art 1(3)	Art 1(3)
Recognised pension fund	—	Art 3(1)(i), 4(1)	—
Tie-Breaker-Rule	Art 4	Art 4(3)	Art 4(3)
Prepartory and auxiliary activities	Art 13	Art 5(4), (4.1)	Art 5(4), (4.1)
Agency PEs	Art 12	Art 5(5), (6)	Art 5(5), (7)
Splitting-up of contracts	Art 14	—	
Definiton of dependent persons	Art 15	Art 5(8)	Art 5(9)
International shipping and air transport	—	Art 8 (and 3(1)(e), 13(3), 15(3), 22(3))	Art 8 Option A, B (and 3(1)(d), 13(3), 15(3), 22(3))

Excursus II | *Updates 2017*

Topic	MLI	OECD MC 2017	UN MC 2017
Corresponding Adjustments	Art 17	*(Art 9(2))*	*(Art 9(2))*
Minimum Holding Period	Art 8	Art 10(2)	Art 10(2)
Fees for technical services	—	—	Art 12A
Real Estate Companies	Art 9	Art 13(4)	Art 13(4)
No relief for residence taxation	—	Art 23A, 23B	Art 23A, 23B
Double-Non Taxation	Art 5	*(Art 23A(4))*	Art 23A(4)
Mutual Agreement Proceedings	Art 16	Art 25	—
Treaty Abuse (PPT, LoB)	Art 7	Art 29(1)-(7), (9)	Art 29(1)-(7), (9)
Third-Country PEs	Art 10	Art 29(8)	Art 29(8)
Dispute Resolution	Art 18-26	—	—

Excursus III | *OECD CFA*



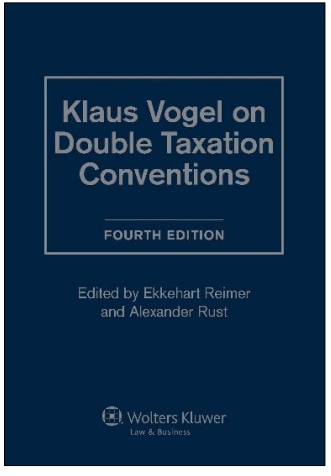
Source: OECD Work on Taxation 2018/2019 (2018) – Details on OECD Bodies: *https://oecdgroups.oecd.org/Bodies/ListByNameView.aspx*

Research | *Sources*

- ***Historical Tax Treaties***
  - League of Nations Treaty Series (1920-1946) – *https://treaties.un.org/pages/LONOnline.aspx*
  - United States
    - Treaties and International Agreements (1776-1949) – *http://www.loc.gov/law/help/us-treaties/*
    - Tax Treaties – Legislative History of United States Tax Conventions, Volume 1 and 2, 1962, available at *https://catalog.hathitrust.org/Record/000959701*
- ***Models: League of Nations, OEEC, OECD and UN***
  - 1923-1962 – Legislative History of United States Tax Conventions, Volume 4, 1962, available at *https://catalog.hathitrust.org/Record/000959701*
  - History of Tax Treaties Data Base - *http://www.taxtreatieshistory.org/*
  - OECD – *http://www.oecd.org/tax/treaties/*
  - UN – *https://www.un.org/development/desa/capacity-development/tools/category/tax/*
- ***Current Tax Treaties, e.g.,***
  - IBFD Tax Treaties Database – *https://online.ibfd.org/kbase/*
  - US Tax Treaties – *https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z* and *https://www.treasury.gov/resource-center/tax-policy/treaties*

Research | *Sources*

- ***Global Treatises***
  - E. Reimer & A. Rust (eds.), *Klaus Vogel on Double Taxation Conventions*, 4th edn. (Kluwer, 2015)
  - R. Vann et al (eds.), *Global Tax Treaty Commentaries (GTTC)*, IBFD Online
  - Book series, e.g., with IBFD and Kluwer
- ***Major International Journals on Tax Treaties***
  - British Tax Review (BTR) (via Westlaw)
  - Bulletin for International Taxation (BIT) (via IBFD)
  - Intertax (via Kluwer Law Online)
  - Tax Notes International (TNI) (via Tax Analysts)
  - World Tax Journal (WTJ) (via IBFD)
- ***Case Law***
  - IBFD Case Law Database – *https://online.ibfd.org/kbase/*
  - Domestic courts, e.g., British cases (*http://www.bailii.org/*), Tax Court of Canada (*http://www.tcc-cci.gc.ca/*), …
  - European Court of Justice – *https://curia.europa.eu*
- ***Other Ressources***
  - International Fiscal Association (IFA) and Cahiers (CDFI) – *https://www.ifa.nl/*



Part II
"Rules" of Application, Interpretation and Implementation

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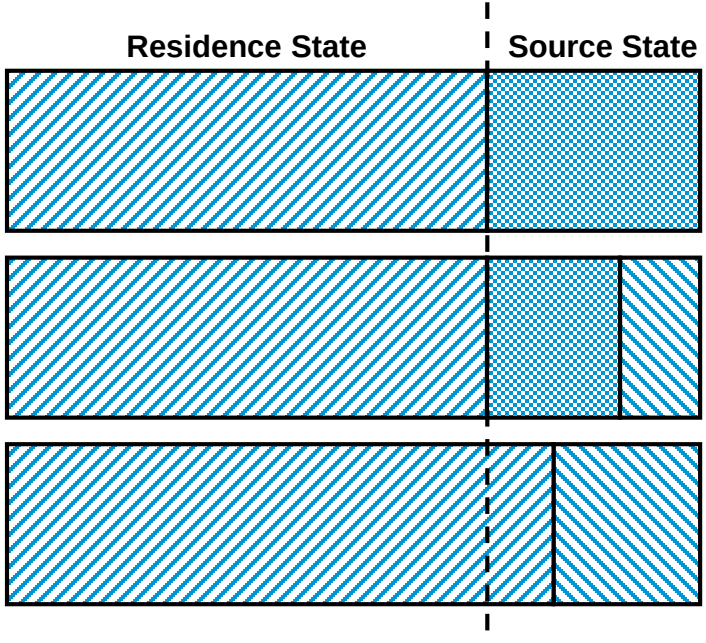
"Rules" of Treaty Application

- ***Rule 1 → Tax Treaties Restrict the Application of Domestic Tax Law ("Stencil")***
- Rule 2 → Tax Terms Can Have a Different Meaning in Domestic Tax Law and Treaty Law
- Rule 3 → Correct Understanding of the Terms in Distributive Rules – Residence versus Source
- Rule 4 → Correct Understanding of the Scope of Distributive Rules
- Rule 5 → Issues Not Covered by Tax Treaties

Rule #1 | *Restriction*

- Tax treaties ***restrict the application of domestic tax law*** in the residence State and in the Source state



Full taxation in both States

Unilateral relief in residence State

Application of DTC → Restriction of source State taxation and relief in residence State

Rule #1 | *Restriction*

- **Distributive Rules** – Articles 6-8, 10-22 "allocate taxing rights"
  - ***Exclusive Taxation*** – ***"… shall be taxable only …"*** (generally in the residence State), e.g. Art 8, 12 (≠ UN MC), Art 13(3), (5), 18, 20 – *Note:* Saving clause (Art 1(3) OECD MC)
  - ***Concurrent taxation*** – ***"… may be taxed in …"*** (generally in the source State) – Two types:
    - Source tax with ***no limits*** (e.g. Art 6, 7, 13(1), (2), (4), 16, 17, 19)
    - Source tax with ***limits*** (e.g. Art 10, 11)
- **Double Tax Relief**
  - Art 23 provides ***obligation to grant double tax relief (exemption or credit)*** → Income "which may be taxed in the other Contracting State in accordance with the provisions of this Convention".
  - ***Policy issues*** → (Voluntary or involuntary) "virtual double taxation" ("white income", double non-taxation), special clauses (e.g., "subject-to-tax-clauses", "switch-over clauses etc), conflicts of qualification

Rule #1 | *Restriction*

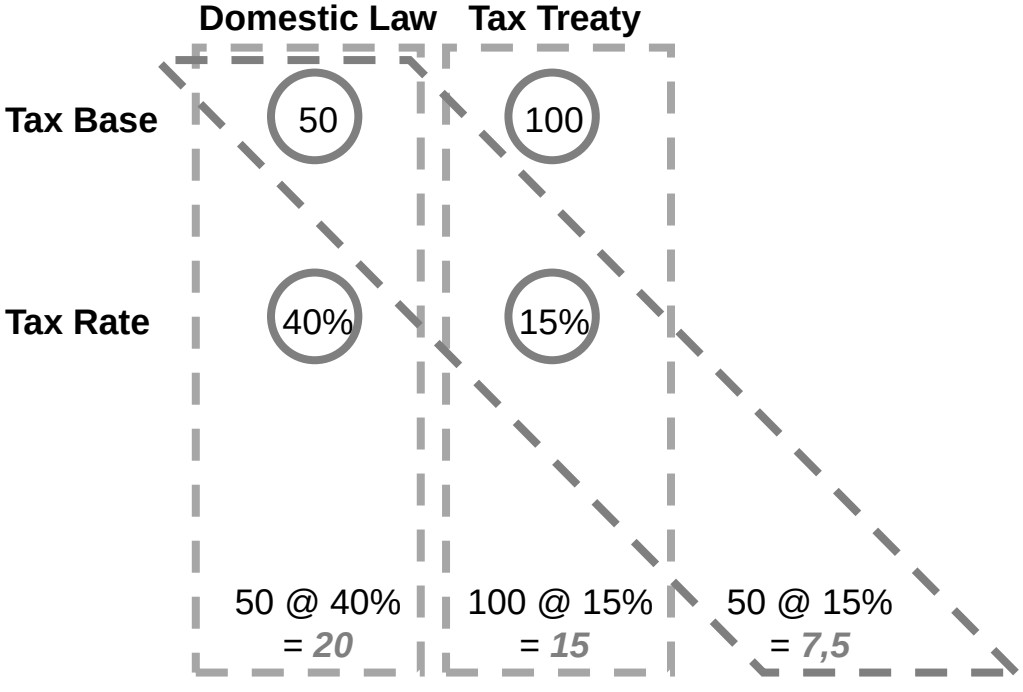
- **Tax treaties generally "restrict" domestic taxation**
  - ***Treaties (generally) do not create taxing rights*** → The issue is therefore not whether a tax treaty "permits" taxation, but rather ***whether it "prohibits" taxation***
  - Tax treaties "as a 'shield' rather than a 'sword' for taxing rights" (pt 29 et seq. of Australian Taxation Ruling TR 2001/13)
  - Operate like a ***"stencil"*** (© Klaus Vogel – "Lochschablone") → *Example: Domestic withholding tax on interest: 0% (alternatively: 25%), treaty rate: 10%*
  - Treaties might bar the domestic tax liability from coming into existence (e.g., with regard to interest on late payment, penalties etc)
  - Self executing? Constitutional framework? Implementation? Priority rules?

Rule #1 | *Restriction*

- **Scope of "restrictive effect"?**
  - Are treaties ***exclusively relieving***? What about ***"cherry picking"***? *(→ Tax Court of Canada, 26 February 2002, Merrins v. The Queen, [2002] 4 CTC 2085 (TCC))*
  - ***OECD*** → Provisions of domestic law are generally "restricted (and in some ***rare cases***, broadened) by the provisions of tax conventions" (Art 1 no. 58 OECD MC Comm.)
    - Examples of such ***"rare cases"***? → Losses? Expenses? Domestic source rules? *(Federal Court of Australia,11 October 2018, Satyam Computer Services Limited v Commissioner of Taxation, [2018] FCAFC 172)*
    - Other (potential) ***issues***:
      - Lack of domestic transfer pricing rules and Art 9 OECD MC? Is Art 9 OECD MC an independent legal basis for (upward) primary transfer pricing adjustments? *(pro: pt 33 of Australian Taxation Ruling TR 2001/13; contra: paras. 50-62 of Federal Court of Australia, 23 October 2015, Chevron Australia Holdings Pty Ltd v Commissioner of Taxation, [2015] FCA 1092)*
      - Domestic secrecy rules and Art 26 OECD MC?
      - Domestic appeal restrictions and Art 25 OECD MC?

Rule #1 | *Restriction*

- **Scope of restriction?** – Interplay of domestic law and tax treaty law



Rule #1 | *Treaty Override*

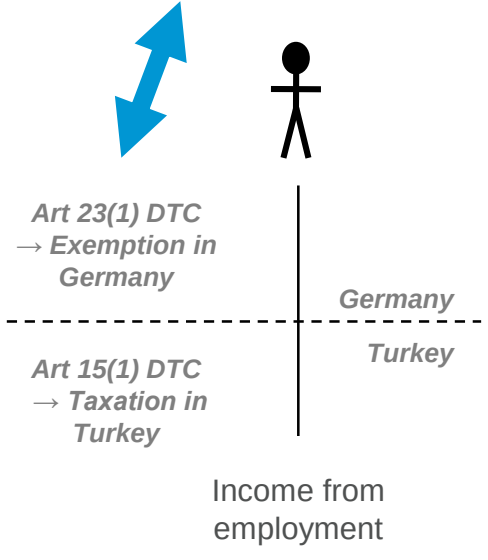
- **"Treaty Overrides"**
  - International law – Art 26, 27 VCLT → ***"Pacta sunt servanda"***
  - ***"Treaty Override"*** → "[S]ituation where the domestic legislation of a State overrules provisions of either a single treaty or all treaties hitherto having had effect in that State" (para. 2 of the OECD Report on Tax Treaty Override) ≠ Change of definitons under Art 3(2) OECD MC
  - Position of international agreements in the domestic legal order? – Viability of overrides depends on ***constitutional/legal framework*** (e.g., US and Germany versus France, Luxembourg, Netherlands) – Implementation – "Treaty Underride"
  - ***Report on Tax Treaty Override*** (adopted on 2 October 1989), and ***Recommendation of the OECD Council*** concerning Tax Treaty Override, OECD/LEGAL/0253 (2 October 1989):

> **I. RECOMMENDS** Member countries;
>
> 1. To undertake promptly bilateral or multilateral consultations to address problems connected with tax treaty provisions, whether arising in their own country or raised by countries with which they have tax treaties;
>
> 2. To avoid enacting legislation which is intended to have effects in clear contradiction to international treaty obligations.
>
> **II. INSTRUCTS** the Committee on Fiscal Affairs to follow developments in this area and to bring to the attention of the Council any action which would constitute a material breach of Member countries' international treaty obligations.

Rule #1 | *Treaty Override*

- **"Treaty Overrides"**
  - Typically accompanied by a so-called **"*Melford* clause"** (named for the reaction of the Canadian legislator to Supreme Court of Canada, 28 September 1982, *R. v Melford Developments Inc*, [1982] 2 SCR 504), e.g., "… irrespective of a tax treaty …", showing ***legislative intent to override***
  - Country practice (e.g., for Germany: BVerfG, 15 December 2015, 2 BvL 1/12) – *Relevance of the principle of democracy? Relevance of internal distribution of powers (termination of treaties)? International (rule of) law versus domestic law?*
  - Treaties concluded after a treaty override? (German BFH, 25 May 2016, I R 64/13)
  - Remedies for treaty partner States? Termination?
  - Note: Treaty overrides in the EU are **not a violation of primary EU law** (e.g., EuGH 19 September 2012, C-540/11, *Levy und Sebbag*, EU:C:2012:581), and EU law may even provide for the overriding of third-country tax treaties (e.g., Art 7 ATAD)

Explicit Override – § 50d(8) ITA → Exemption only if taxpayer shows that *(1)* source State has waived its taxing right or *(2)* tax on that income has been paid in the source State.



"Rules" of Treaty Application

- Rule 1 → Tax Treaties Restrict the Application of Domestic Tax Law ("Stencil")
- ***Rule 2 → Tax Terms Can Have a Different Meaning in Domestic Tax Law and Treaty Law***
- Rule 3 → Correct Understanding of the Terms in Distributive Rules – Residence versus Source
- Rule 4 → Correct Understanding of the Scope of Distributive Rules
- Rule 5 → Issues Not Covered by Tax Treaties

Rule #2 | *Interpretation*

- **Tax treaties = International agreements**
  - ***Vienna Convention on the Law of Treaties (VCLT)*** → Signed May 23, 1969, entered into force January 27, 1980. – *Note: Draft commentaries on the articles of the VCLT*
  - Largely codification of ***customary international law*** (e.g., Australian High Court, 22 August 1990, *Thiel v. FCT*, (1990) 21 ATR 531; UK High Court, 9 February 1990, *IRC v Commerzbank*, [1990] STC 285) and probably ***itself customary international law***
- **Conclusion of tax treaties**
  - Preparation phase → Negotiations (generally ~ 3 rounds) → Treaty text (protocols, letters) → Authentification (initials by negotiators) → Signing (by authorized signatories) → Generally, consent from national parliaments (Art 46(2) VCLT) → International declaration of consent (Art 9 VCTL, generally by Head of State) in the form of ratification and exchange (Art 14 VCTL and Art 31 OECD MC) or – in case of multilateral treaties – deposit of ratification instrument (Art 16 VCTL and Art 27 MLI) → Publication
  - International versus internal applicability of tax treaties → Domestic constitutions

Rule #2 | *Interpretation*

- **Interpretation**
  - Interpretation of international agreements versus interpretation of domestic law
  - ***Question of the relative weight*** of *(1)* ***text*** (objective expression), *(2)* ***intention*** (subjective element) and *(3)* ***object and purpose*** (declared or apparent)?
  - Principles for the interpretation of international agreements → ***Art 31, 32 and 33 VCLT*** →
    - The ordinary meaning of the words used are presumed to be "the authentic representation of the parties' intentions", with regard as well to the context, object and purpose of the treaty provisions. → ***Holistic approach***.
    - International agreements should be interpreted "liberally". Also, treaties often fail to demonstrate the precision of domestic legislation and should thus not be applied with "taut logical precision".
    - Also for ***tax treaties***: E.g., UK High Court, 9 February 1990, *IRC v Commerzbank*, [1990] STC 285; Australian High Court, 22 August 1990, *Thiel v. FCT*, (1990) 21 ATR 531; Supreme Court of Canada, 22 June 1995, *Crown Forest Industries Ltd. v. Canada*, [1995] 2 SCR 802; Federal Court of Australia, 29 April 2005, *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation*, [2005] FCAFC 67; High Court of Ireland, 31 July 2007, *Kinsella v. The Revenue Commissioners*, [2007] IEHC 250; England and Wales Court of Appeal, 15 November 2018, *Fowler v HM Revenue and Customs*, [2018], EWCA Civ 2544
  - ***"International tax language"*** → OECD MC and OECD MC Comm.

Rule #2 | *Interpretation*

- **Interpretation of tax treaties – *Building blocks***

Terms that are defined in the tax treaty (without the qualification "unless the context otherwise requires") or by explicit reference to domestic law, e.g., Art 4 (resident), Art 5 (permanent establishment), Art 6(2) (immovable property), Art 10(3), 11(3) and 12(2) (dividends, interest, royalties)

Terms that are defined in Art 3(1) OECD MC (subject to the context "otherwise requiring"), e.g., "person", "company", "enterprise", "international traffic", "competent authority" etc

Domestic law meaning for undefined terms under Art 3(2) OECD MC, unless the context otherwise requires.

Art 31, 32 and 33 VCLT

Rule #2 | *VCLT*

- **Art 31, 32 and 33 VCLT – *Interpretation of international treaties***

SECTION 3. INTERPRETATION OF TREATIES

Article 31. GENERAL RULE OF INTERPRETATION

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(*a*) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

(*b*) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(*a*) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(*b*) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(*c*) Any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Rule #2 | *VCLT*

- **Art 31, 32 and 33 VCLT – *Interpretation of international treaties***

Singular, not plural, signaling that the the process of interpretation is a unity and that Art 31 VCLT forms ***a single, closely integrated rule***.

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(*c*) Any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Three separate principles

— Pacta sunt servanda ("good faith")

— Textual approach ("ordinary meaning") → Everyday usage versus international tax language?

— Common sense, i.e., ordinary meaning not in the abstract, but in their "context" and in light of "object and purpose"

"Context" includes preamble (OECD MC 2017), but not unilateral material (e.g., US Tech. Expl., German "Denkschriften" etc)

Subsequent agreements between the parties and subsequent practice. → MAPs/Consultation agreements under Art 25(1), (3) OECD MC? Art 3(2) OECD MC?

Rule #2 | *VCLT*

- **Art 31, 32 and 33 VCLT – *Interpretation of international treaties***

Article 32. SUPPLEMENTARY MEANS OF INTERPRETATION

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(*a*) Leaves the meaning ambiguous or obscure; or

(*b*) Leads to a result which is manifestly absurd or unreasonable.

Rule #2 | *VCLT*

- **Art 31, 32 and 33 VCLT – *Interpretation of international treaties***

Article 33. INTERPRETATION OF TREATIES AUTHENTICATED IN TWO OR MORE LANGUAGES

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.

2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.

3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

Rule #2 | *Tax Treaties*

- **Special considerations for tax treaties**
  - Treaty interpretation that is accepted by both Contracting States → ***Common interpretation***
    - Take into consideration decisions etc in the other State *(see generally, e.g., UK House of Lords, 10 July 1980, Fothergill v Monarch Airlines Ltd, [1980] 3 WLR 209; UK High Court, 9 February 1990, IRC v Commerzbank, [1990] STC 285)*
    - Common interpretation of "terms" via Art 25 OECD MC (Art 3(2) OECD MC)
  - Interpretation based on the "object and purpose", "context" → ***Preamble (OECD MC 2017)***
    - Avoidance of ***double taxation*** (!) and ***double non-taxation*** (?)
    - But note in principle: ***Relief from source taxation*** is irrespective of actual taxation in the residence State (e.g., Italian Supreme Court, 11 October 2018, no. 25219), and ***exemption in the residence State*** is irrespective of actual taxation by the source State (Art 23 nos 34-35 OECD MC Comm.)
  - References to ***domestic law***? → Convenience versus congruence → Art 3(2) OECD MC
  - ***MAPs/Consultation agreements*** under Art 25(1), (3) OECD MC? Art 3(2) OECD MC?
  - Relevance of the ***OECD MC Comm.***? Observations? Non-member State positions? Treaties between OECD- and non-OECD countries?

Rule #2 | *Tax Treaties*

- Relevance of the **OECD/UN MC Comm.** for treaties based on the OECD/UN MC?
  - Official versions of the OECD MC and MC Comm. in ***English and French***
  - Use of the MC Comm. as a ***(mandatory) tool for treaty interpretation***?
    - ***Ordinary meaning*** under Art 31(1) VCLT?
    - Part of the ***context*** of the treaty under Art 31(1) VCLT? *(in this direction, e.g., Supreme Court of Canada, 22 June 1995, Crown Forest Industries Ltd., [1995] 2 SCR 802)*
    - ***Instrument*** related to the treaty under Art 31(2)(b) VCLT?
    - Subsequent ***agreement or practice*** of the treaty parties under Art 31(3)(a) VCLT? *(in this direction Court of Appeal of New Zealand, 7 February 2018, Patty Tzu Chou Lin, [2018] NZCA 38, leave to appeal declined by [2018] NZSC 54; explicitly contra, e.g., German BFH, 16 January 2014, I R 30/12)*
    - Relevant ***rule of international law*** under Art 31(3)(c) VCLT, by analogy? *(e.g., Tax Court of Canada, 18 August 2006, MIL (Investments) S A v. The Queen, 2006 TCC 460)*
    - ***Special meaning*** under Art 31(4) VCLT? *(in this direction, e.g., UK Special Commissioners, 19 February 2008, Trevor Smallwood Trust v. Revenue & Customs, [2008] UKSPC SPC00669)*
    - ***Supplementary means of interpretation*** under Art 32 VCLT? *(e.g., Australian High Court, 22 August 1990, Thiel v. FCT, (1990) 21 ATR 531; High Court of Ireland, 31 July 2007, Kinsella v. The Revenue Commissioners, [2007] IEHC 250)*

Rule #2 | *Tax Treaties*

- Relevance of the **OECD/UN MC Comm.** for treaties based on the OECD/UN MC?
  - ***Courts, negotiators, competent authorities and practitioners*** use the OECD/UN MC Comm.
    - Broad use of the OECD MC and MC Comm. *(Intro no. 3 and 28 et seq. OECD MC Comm.)*
    - Tax administrations of OECD States to folllow the OECD MC Comm. → Recommendation of the OECD Council concerning the Model Tax Convention on Income and on Capital and Intro no. 3 OECD MC Comm. → "Soft obligation", unless, e.g., observations have been entered
    - Relevance also accepted by domestic courts → *E.g., UK Court of Appeal, 12 June 1986, Sun Life Assurance Company of Canada, [1986] BTC 282; Supreme Court of Canada, 22 June 1995, Crown Forest Industries Ltd. v. Canada, [1995] 2 SCR 802 ("high persuasive value"); Federal Court of Australia, 29 April 2005, McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation, [2005] FCAFC 67; Tax Court of Canada, 18 August 2006, MIL (Investments) S A v. The Queen, 2006 TCC 460.*
    - Treaty practice → Relevance of the OECD MC Comm. sometimes explicitly confirmed in a treaty protocol *(e.g., Protocol no. 16 to the Austria-Germany Income and Capital Tax Treaty [2000])*

Rule #2 | *Tax Treaties*

- Relevance of the **OECD/UN MC Comm.**? – ***Timing: Static versus ambulatory?***
  - The OECD (and UN) MC Comm. is changed/updated/expanded frequently (e.g., 2017 Update) → ***Which version is relevant?***
  - OECD MC Comm. at ***the time the treaty is applied ("ambulatory approach")?***
    - Position held by the OECD *(e.g., Intro no. 3 and nos 33-36.1, Art 5 no. 3 OECD MC Comm.)*
    - Tax administrations of OECD States to folllow the OECD MC Comm. "as modified from time to time" → *Recommendation of the OECD Council concerning the Model Tax Convention on Income and on Capital*
    - Subsequent agreement or practice of the treaty parties under Art 31(3)(a) VCLT? *(explicitly contra, e.g., German BFH, 16 January 2014, I R 30/12)*
    - Also, domestic courts may find assistance in new OECD MC Comm. ("persuasive force") → *See, e.g., Canadian Federal Court of Appeal, 26 February 2009, Prévost Car Inc., 2009 FCA 57; UK Special Commissioners, 19 February 2008, Trevor Smallwood Trust v. Revenue & Customs, [2008] UKSPC SPC00669 (to avoid "shutting one's eyes to advances in international tax thinking"); UK Supreme Court, 20 May 2020, Fowler v Commissioners for Her Majesty's Revenue and Customs, [2020] UKSC 22*
    - Treaty practice → *Ambulatory approach sometimes explicitly confirmed in a treaty protocol (e.g., Protocol no. 16 to the Austria-Germany Income and Capital Tax Treaty [2000])*

Rule #2 | *Tax Treaties*

- Relevance of the **OECD/UN MC Comm.**? – ***Timing: Static versus ambulatory?***
  - OECD MC Comm. at ***the time the treaty was concluded ("static approach" – "frozen meaning")?***
    - Prevailing opinion in scholarship and case law for a number of – also constitutional – reasons *(e.g., distribution of powers etc) → See, e.g., Austrian VwGH, 31 July 1996, 92/13/0172; German BFH, 8 December 2010, I R 92/09; Tax Court of Canada, 18 August 2006, MIL (Investments) S A v. The Queen, 2006 TCC 460. – See also UK First Tier Tribunal, 12 April 2016, Fowler v Revenue and Customs, [2016] UKFTT 234 (TC) ("limited value")*
    - Static approach also conforms with Art 31(1) VCLT ("ordinary meaning") and Art 31(4) VCLT ("special meaning") of terms attributed to them by the contracting parties at the time of a treaty's conclusion
    - Triangle: Tax administrations (OECD) – legislator (consent to treaty) – courts (interpretation) – *Example: "Clarification" of the OECD MC Comm. on Art 24 by the 2008 Update to avoid expansion of non-discrimination rights similar to EU fundamental freedoms.*

Rule #2 | *Domestic Law*

- **Domestic law and treaty law**
  - Explicit ***references to domestic law***, e.g., Art 2(4), 4(1), 6(2), 10(3) – *Limits?*
  - Domestic law ***precedes the application of treaty*** law with regard to
    - the existence of subjective or objective tax liability,
    - the attribution of income to a person, and
    - the calculation/determination of income.
- **Art 3(2) OECD MC** – Domestic law meaning for undefined treaty terms
  - General ***interpretation rule for undefined treaty terms*** ("lex fori" clause)

> 2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

  - Art 3(2) OECD MC as a ***"special rule" under Art 31(4) VCLT*** (UK First Tier Tribunal, 12 April 2016, *Fowler v Revenue and Customs*, [2016] UKFTT 234 (TC))

Rule #2 | *Domestic Law*

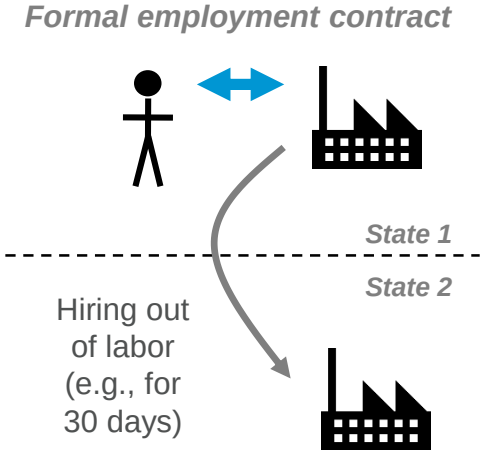
- **Art 3(2) OECD MC – Issues**
  - **Undefined terms**? Partially defined terms? Undefined terms used in treaty definitions? *(E.g., High Court of Ireland, 31 July 2007, Kinsella v. The Revenue Commissioners, [2007] IEHC 250)*
  - What if there are **multiple domestic meanings**? → *Tax law (Art 3 no. 13.1 OECD MC Comm.)* → What if there are two or more definitions in domestic tax law (e.g., of "employment" for collection, for fringe benefits etc)?
  - What if the domestic term is **similar, but not identical** (e.g., "disposal" in domestic law versus "alienation" in Art 13 OECD MC), or identical but in a different context?
  - What about **domestic deeming provisions**? → *E.g., if certain employed activities are deemed to be a trade or business (see UK Supreme Court, 20 May 2020, Fowler v Commissioners for Her Majesty's Revenue and Customs, [2020] UKSC 22, noting that tax treaties are to be applied to "the real world" rather than to "the fictional, deemed world", contra England and Wales Court of Appeal, 15 November 2018, Fowler v HM Revenue and Customs, [2018], EWCA Civ 2544), but limited by "good faith" and context (e.g., Art 15 no. 8.11 OECD MC Comm.)*
  - Which State **"applies"** the treaty? → *Always the source State? → Art 23(1) OECD MC ("in accordance with the provisions of this Convention")*

Rule #2 | *Domestic Law*

- **Art 3(2) OECD MC – Issues**
  - What does **"context"** mean? → *"Context" in Art 3(2) OECD MC ≠ "context" in Art 31 VCLT → Intention of the parties when signing the agreement, meaning given to the term in the legislation of the other State (Art 3 no. 12 OECD MC Comm.) → Any permitted interpretative material under the VCLT?*
  - When does the context "require" an **autonomous interpretation**? → *(Strong) peference for a treaty autonomous interpretation versus a reading "that the 'context' would have to present a strong case for a different meaning" (UK First Tier Tribunal, 12 April 2016, Fowler v Revenue and Customs, [2016] UKFTT 234 (TC))*
  - Is the operation of Art 3(2) excluded if a term is explained in the **OECD MC Comm.**? → *"International tax language" (e.g, the term "ship" in Art 8 no. 17 OECD MC Comm.; the notion of "being present" in Art 15 no. 5 OECD MC Comm)*
  - What about **competent authority agreements** under Art 25 OECD MC? → *Scope and limits? (Art 3 no. 13.2 OECD MC Comm.)*
  - **Static versus ambulatory**? → *Art 3 no. 11 OECD MC Comm. versus Supreme Court of Canada, 28 September 1982, R. v Melford Developments Inc, [1982] 2 SCR 504*

Rule #2 | *Domestic Law*

- **Art 3(2) OECD MC** – ***Diverging domestic laws*** and avoidance of double taxation → "in accordance with the provisions of this Convention" (Art 23 OECD MC)
- Example (e.g., Art 15 no. 8.10 et seq. OECD MC Comm.):



ARTICLE 15

INCOME FROM EMPLOYMENT

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and

b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

Chapter V

METHODS FOR ELIMINATION OF DOUBLE TAXATION

ARTICLE 23 A

EXEMPTION METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

Rule #2 | *Domestic Law*

- **Art 3(2) OECD MC** – ***Timing issues – Static versus ambulatory?***
  - At the ***time the treaty was concluded ("static approach" – "frozen meaning")?*** – *E.g., Supreme Court of Canada, 28 September 1982, R. v Melford Developments Inc, [1982] 2 SCR 504*
  - At the ***time the treaty is applied ("ambulatory approach")?***
    - Art 3(2) OECD MC since the 1995 Update (***"… at that time …"***)
    - Art 3 no. 11 OECD MC Comm.:

> 11. This paragraph provides a general rule of interpretation for terms used in the Convention but not defined therein. However, the question arises which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being between the legislation in force when the Convention was signed or that in force when the Convention is being applied, i.e. when the tax is imposed. The Committee on Fiscal Affairs concluded that the latter interpretation should prevail, and in 1995 amended the Model to make this point explicitly.

    - Widely shared by domestic courts for pre-1995 treaties *(e.g., Australian Federal Court, 10 October 2008, Virgin Holdings SA v. Federal Commissioner of Taxation, [2008] FCA 1503)*
    - For an *e contrario* reading for pre-1995 treaties (i.e., static) see, however, Austrian VwGH, 19 December 2016, 2005/15/0158, and 28 November 2017, 2006/14/0057

Rule #2 | *Domestic Law*

- **Change of definitions ≠ "Treaty Override" (?)**
  - Article 3(2) OECD MC as a ***balance*** between *(1)* the need to ensure the permanency of commitments entered into by States when signing a convention and *(2)* the need to be able to apply the Convention in a convenient and practical way over time (e.g., outdated concepts) (Art 3 no. 13 OECD MC Comm.)
  - ***Context or "good faith" as a limit?*** *(see, e.g., Art 15 no. 8.11 OECD MC Comm. and UK First Tier Tribunal, 12 April 2016, Fowler v Revenue and Customs, [2016] UKFTT 234 (TC), with regard to the reallocation of income from one article to another)*
  - But: Supreme Court of Canada, 28 September 1982, ***R. v Melford Developments Inc***, [1982] 2 SCR 504 (rejecting the "assertion that Canada can simply amend the Agreement by the device of redefining the term interest")
  - Para. 4(b) of the OECD Report on Tax Treaty Override:

> b) A State may change the definition of a term used in its domestic legislation which is also used in treaty provisions but which is not specifically defined for the purposes of the treaty. In this case there is no override where the treaty contains a provision essentially similar to that embodied in Article 3, paragraph 2, of the 1977 OECD Model Double Taxation Convention which provides that, as regards the application of a treaty by a Contracting State, any term not defined in the treaty shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the treaty applies. It cannot have been contemplated that, having once entered into a treaty, a State would be unable to change definitions of terms used in its domestic law provided such changes were compatible with the context of the treaty;

“Rules” of Treaty Application

- Rule 1 → Tax Treaties Restrict the Application of Domestic Tax Law (“Stencil”)
- Rule 2 → Tax Terms Can Have a Different Meaning in Domestic Tax Law and Treaty Law
- ***Rule 3 → Correct Understanding of the Terms in Distributive Rules – Residence versus Source***
- Rule 4 → Correct Understanding of the Scope of Distributive Rules
- Rule 5 → Issues Not Covered by Tax Treaties

Rule #3 | *Article 4*

- **Residence versus Source**
  - Main Principle – DTC applies only to ***residents of contracting states*** (Art 1) and definition of "resident of a Contracting State" in Art 4
  - Residence under **Art 4 OECD MC**
    - ***Paragraph 1*** – "Resident of a contracting state" is defined as a "person" (individual or company) who is ***liable to comprehensive taxation*** in the state on the basis of certain criteria
      - *Provides a definition of "resident of a Contracting State" for the purposes of applying other provisions of the DTC (e.g., Art 1)*
      - *"Full tax liability" – Based on the taxpayers' personal attachment to the State concerned*
      - *Existence of a "permanent establishment" or source tax liability does not result in residency status (Supreme Court of Canada, 22 June 1995, Crown Forest Industries Ltd. v. Canada, [1995] 2 SCR 802)*
    - ***Paragraph 2*** – Tie-Breaker Rule for Individuals
    - ***Paragraph 3*** – Tie-Breaker Rule for Other Persons

Rule #3 | *Article 4*

- **Residence under Art 4(1) OECD-MC**
  - ***Sentence 1:*** Based on domestic law → Person is resident of a country if liable to tax in the country by reason of his domicile, residence, place of management or similar criterion

ARTICLE 4

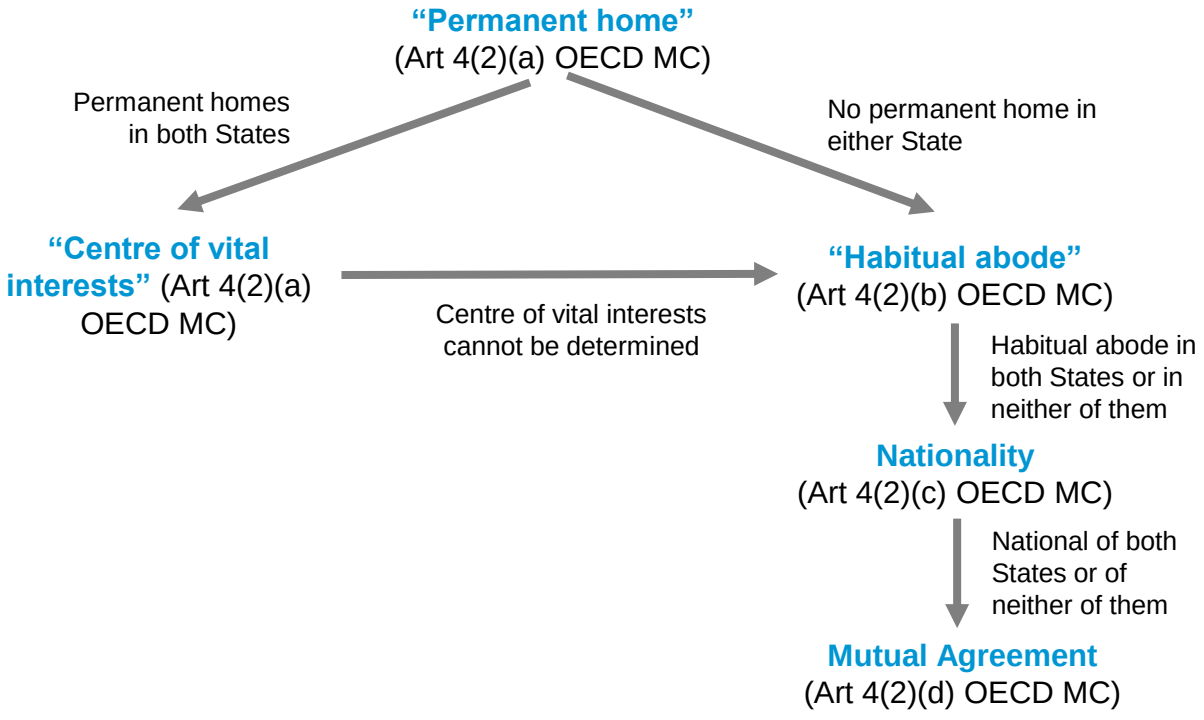
RESIDENT

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

  - ***Sentence 2:*** Foreign diplomatic and consular staff serving in a State's territory → Not meant to cover countries adopting a territorial principle in their taxation (Art 4 Para 8.3 OECD MC Comm) → Relevance for Dual Resident Companies? (Art 4 no 8.2 OECD MC Comm.)

Rule #3 | *Tie Breaker*

- "Tie Breaker Rule" for ***Dual Resident Individuals*** (Art 4(2) OECD-MC)



Rule #3 | *Tie Breaker*

- "Tie Breaker Rule" for ***Dual Resident Companies*** (Art 4(3) OECD MC)

OECD MC before 2017
PoEM (Place of Effective Management)

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

OECD MC 2017
MAP

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

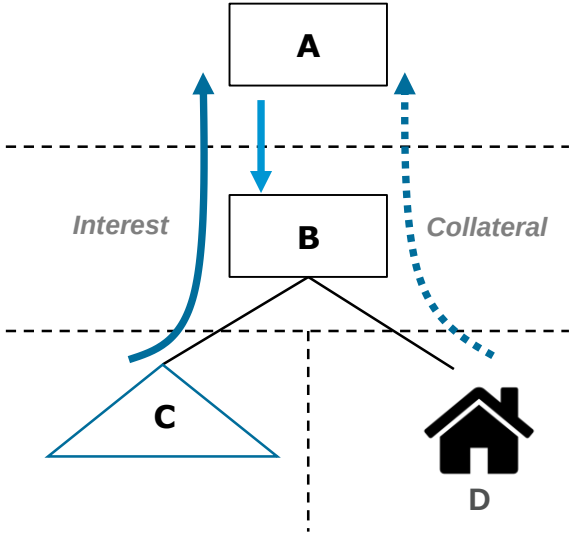
Before 2017: 2008 OECD Alternative (Art 4 no 24.1 OECD MC Comm. before 2017)

Rule #3 | *Source*

- **"The Other State" – *Source State***
  - **Art 1 OECD-MC** → "This Convention shall apply to ***persons who are residents*** of one or both of the Contracting States." → Refers to the ***recipient of the income***, not to the "payor" (= "source)!
  - **"Sources"** are defined in the DTC – E.g.,
    - Art 6(1) OECD MC: "Income derived by a resident of a Contracting State from immovable property […] ***situated*** in the other Contracting State may be taxed in that other State." → Relevant is the ***situs of the property***, not the residence of, e.g., the lessee.
    - Art 11(1) OECD MC ("Interest ***arising*** in a Contracting State") → Art 11(5) OECD MC: "Interest shall be deemed to arise in a Contracting State when the ***payer is a resident*** of that State."
  - Domestic versus treaty source rules? *(E.g., Federal Court of Australia,11 October 2018, Satyam Computer Services Limited v Commissioner of Taxation, [2018] FCAFC 172)*

Rule #3 | *Source*

- **"The Other State" – *Source State***
  - Note: Potentially ***different source rules in different tax treaties***
  - Example:
    - State A bank gives a loan to B Co. for use in its C permanent establishment and enters a mortgage on D real property as a collateral.
    - Which is the source country? *(B and C: Art 11(5) OECD MC, D potentially as per a non-OECD definition.)* How will double/multiple taxation be avoided?



“Rules” of Treaty Application

- Rule 1 → Tax Treaties Restrict the Application of Domestic Tax Law (“Stencil”)
- Rule 2 → Tax Terms Can Have a Different Meaning in Domestic Tax Law and Treaty Law
- Rule 3 → Correct Understanding of the Terms in Distributive Rules – Residence versus Source
- ***Rule 4 → Correct Understanding of the Scope of Distributive Rules***
- Rule 5 → Issues Not Covered by Tax Treaties

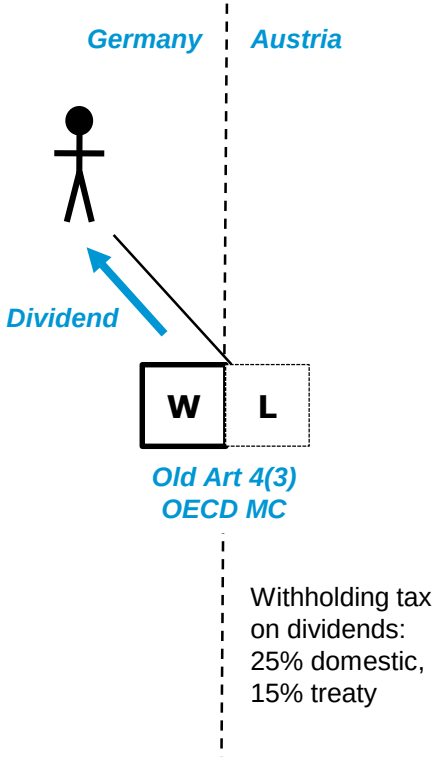
Rule #4 | *Territorial Scope*

- **Territorial Scope**
  - *Bilateral* Scope
    - *Art 6 – Immovable Property*
    - *Art 10 – Dividends*
    - *Art 11 – Interest*
    - *Art 12 – Royalties*
    - *Art 16 – Directors' fees*
    - *Art 17 – Entertainers etc*
  - *Worldwide Scope*
    - *Art 7 – Business Profits*
    - *Art 13 – Capital Gains*
    - *Art 15 – Employment*
    - *Art 18 – Pensions*
    - *Art 21 – Other Income*

E.g., "Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State …" (Art 10), "Interest arising in a Contracting State and paid to a resident of the other Contracting State …" (Art 11)

E.g., "The profits of an enterprise of a Contracting State shall be taxable only in that State …" (Art 7), "Items of income of a resident of a Contracting State, wherever arising, […] shall be taxable only in that State" (Art 21)

Rule #4 | *Territorial Scope*



- **Example: Territorial scope of Art 10 OECD MC**
  - Covered by ***Art 10 OECD MC***?

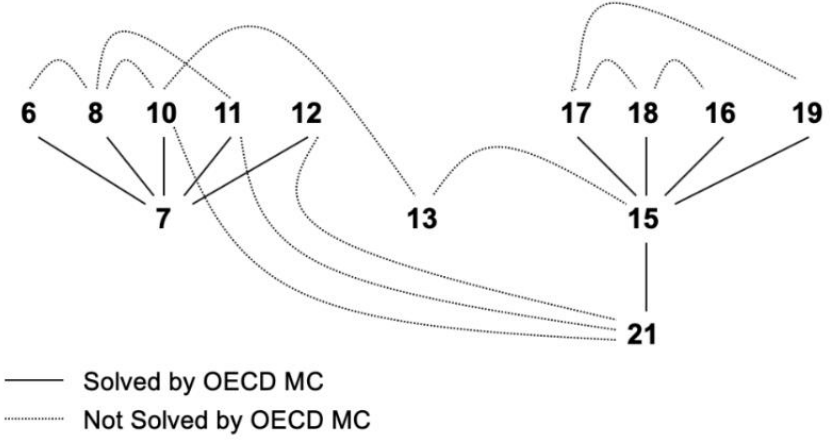
> 1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
>
> b) 15 per cent of the gross amount of the dividends in all other cases.

  - If items of income are in principle covered by a ***distributive rule with bilateral scope*** and are derived from sources
    - in a ***third state*** or
    - from the ***recipient's residence state***,

    then such items of income are **not** covered by this distributive rule!
  - Such items of income are covered by ***Art 7*** (for business profits) or by ***Art 21*** (for other income) → Exclusive taxation in the ***taxpayer's residence State***!

Rule #4 | *Substantive Scope*

- **Substantive Scope**
  - One Article is completely covered by the scope of another Article – ***Lex specialis vs lex generalis***
    - Examples: Art 7 vis-á-vis Art 8, Art 15 vis-á-vis Art 18
    - Generally solved by the DTC: Art 8 before Art 7 (Art 7(4), (7)); Art 18 before Art 15 (Art 15(1))
  - Two Articles overlap ***without one being clearly narrower or wider in scope***
    - Examples: Art 6 vis-á-vis Art 7, Art 17 vis-á-vis Art 18
    - In some cases solved by the DTC: Art 6 before Art 7 (Art 6(4) and Art 7(4), (7)), in others logical mutual exclusivity (e.g., Art 7 and 15 - England and Wales Court of Appeal, 15 November 2018, *Fowler v HM Revenue and Customs*, [2018], EWCA Civ 2544)
  - Note: Investment income excluded from Art 7 (Art 7(4), (7)), but **"throwback-rules"** if the investment income is effectively connected with a PE in the source State (Art 10(4), 11(4) and 12(3))



Rule #4 | *Legal Ramifications*

- **Scope of Legal Ramifications**
  - **"Closed" Distributive Rules** → Exclusive Taxation
    - ***"… shall be taxable only in that State …"*** (Art 23 no. 6 OECD MC Comm.)
      - Exclusive Taxation usually in the **residence** State → Art 7(1), Art 8(1) and (2), Art 12(1), Art 13(3), (5), Art 15(1) 1st sentence, Art 18, Art 19(1)(b) and (2)(b), Art 21(1)
      - Sometimes in the **source** State: Art 19 (1)(a) and (2)(a)
    - Income **exempt** in the other State (but may be included to calculate progressive rate – Art 23A(3); Art 23 no. 6 OECD MC Comm.)
    - *Note:* ***"Saving clause"*** and exceptions (Art 1(3) OECD MC)
  - **"Open" Distributive Rules** → Concurrent Taxation
    - ***"… may be taxed …" – "… may also be taxed …"*** (Intro no. 25.1 OECD MC Comm.)
      - Source tax with ***limits*** → Art 10(2) (5%/15%), Art 11(2) (10%)
      - Source tax *with* ***no limits*** → Art 7(1) 2nd part, Art 13(1), (2) and (3), Art 15(1) 2nd sentence and (3), Art 16, Art 17(1)
    - **Relief via credit or exemption in the residence State (Art 23A or Art 23B)** → Art 23 provides an obligation to grant double tax relief (income "which may be taxed in the other Contracting State in accordance with the provisions of this Convention").

Rule #4 | *Legal Ramifications*

- **Scope of Legal Ramifications**

"Closed" Distributive Rules →
Exclusive Taxation, e.g., Art 8 OECD MC

ARTICLE 8

INTERNATIONAL SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

2. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

"Open" Distributive Rules →
Concurrent Taxation, e.g., Art 11 OECD MC

ARTICLE 11

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

ARTICLE 23 B

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

Rule #4 | *Legal Ramifications*

Article		Income	Rule	Residence State	Source State
6		Immovable Property	***ALSO***	Relief – Art 23	Situs
7	(1)	Business Profits	***ONLY***	Residence	—
	(2)	PE in the Source State	***ALSO***	Relief – Art 23	PE
8		Shipping, Air Transport	***ONLY***	Residence	—
10		Dividends	***ALSO***	Relief – Art 23	5%/15%
11		Interest	***ALSO***	Relief – Art 23	10%
12		Royalties	***ONLY***	Residence	—
13	(1)	Gains – Immovable Property	***ALSO***	Relief – Art 23	Situs
	(2)	Gains – Business Assets	***ALSO***	Relief – Art 23	PE
	(3)	Gains – Ships, Planes	***ONLY***	Residence	—
	(4)	Gains – Shares in Real Estate Companies	***ALSO***	Relief – Art 23	Situs of Real Estate
	(5)	Gains – All Other Property	***ONLY***	Residence	—
15	(1)	Employment	***ALSO***	Relief – Art 23	Exercise
	(2)	< 183 days employment without sufficient nexus	***ONLY***	Residence	—

Rule #4 | *Legal Ramifications*

Article		Income	Rule	Residence State	Source State
16		Director's Fees	***ALSO***	Residence	Residency of Company
17		Entertainers and Sportspersons	***ALSO***	Relief – Art 23	Exercise ("look through")
18		Pensions	***ONLY***	Residence	—
19	(1)(a)	Active Government Service	***ONLY***	—	Paying State
	(1)(b)	Active Government Service if Taxpayer is a Resident and National of Activity State	***ONLY***	Residence	—
	(2)(a)	Government Pensions	***ONLY***	—	Paying State
	(2)(b)	Government Pensions if Taxpayer is a Resident and National of the other State	***ONLY***	Residence	—
20		Students	***ONLY***	Residence	*[Exception: Payments from Source State]*
21		Other Income	***ONLY***	Residence	—

“Rules” of Treaty Application

- Rule 1 → Tax Treaties Restrict the Application of Domestic Tax Law (“Stencil”)
- Rule 2 → Tax Terms Can Have a Different Meaning in Domestic Tax Law and Treaty Law
- Rule 3 → Correct Understanding of the Terms in Distributive Rules – Residence versus Source
- Rule 4 → Correct Understanding of the Scope of Distributive Rules
- ***Rule 5 → Issues Not Covered by Tax Treaties***

Rule #5 | *Covered?*

- To obtain most of the ***benefits of a tax treaty***
  - The taxpayer must be a ***resident*** of a Contracting State (Art 1 and 4 OECD MC), …
  - … the ***tax*** must be covered by the treaty (Art 2 OECD MC) and …
  - … the benefit is ***not excluded*** by specific provisions (e.g., a Limitation-of-Benefits-Clause, Art 29 OECD MC 2017 and MLI)
- But: Tax treaties generally do not determine ***who*** the taxable subject is
  - "derived" – Art 6(1), Art 13, Art 14, Art 15, Art 16 and Art 17 OECD MC
  - "paid" – Art 10, Art 11, Art 12, Art 18, Art 19 OECD MC
  - "receives" – Art 20 OECD MC
  - "profits of an enterprise" or "income of a resident" – Art 7, Art 21 OECD MC
- Consequences
  - Domestic rules on the **attribution of income, basis of taxation, mechanism of charging tax** (UK Supreme Court, 20 May 2020, *Fowler v Commissioners for Her Majesty's Revenue and Customs*, [2020] UKSC 22)
  - Domestic **anti-abuse rules** (e.g., GAARs, CFC, etc)
  - ***Treaties*** → E.g., "Saving Clause" (Art 1(3) OECD MC), beneficial ownership requirements (Art 10, 11 and 12 OECD MC), anti-abuse provisions (Art 29 OECD MC)

Part III
Scope of Application

Personal Scope | *Article 1*

- ***Article 1 OECD MC*** determines the ***personal scope*** of the tax treaty → ***"Persons covered"*** → ***Who is entitled to the benefits of the tax treaty?*** → Refers to the ***recipient of the income***, not to the "payor" (= "source)!

ARTICLE 1

PERSONS COVERED

1. This Convention shall apply to persons who are residents of one or both of the Contracting States.

2. For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 [A] [B], 24, 25 and 28.

Reservations on the Article

111. The *United States* reserves the right, with certain exceptions, to tax its citizens and residents, including certain former citizens and long-term residents, without regard to the Convention.

Personal Scope | *Article 1*

- **Example:** ***Treaty coverage?***
  - ***Facts*** → Austria currently (as of August 2020) has bilateral tax agreements with 89 jurisdictions, including treaties with all 8 neighboring countries. Taxpayer T is a resident of Austria and is employed by an Austrian employer. T receives wages from that employer.

  - ***Questions*** → How many of Austria's tax treaties apply to this situation? What are the legal consequences?

Personal Scope | *Entities*

- **Treaty entitlement of certain entities, conflicts of qualification etc**
  - Treaty entitlement of ***"hybrid" entities*** → Art 1(2) OECD MC and Art 1 nos 2-16 OECD MC Comm.
  - ***Collective investment vehicles (CIVs)*** → Art 1 nos 22-48 OECD MC Comm.
  - ***Entities set-up and/or wholly owned by the State*** → Art 1 nos 49-53 OECD MC Comm.
    - Sovereign wealth funds: ✓ (Art 4 no. 8.5 OECD MC Comm.)
    - Recognized pension funds: ✓ (Art 3(1)(i) and Art 4(1) OECD MC Comm [since 2017])
    - Specific rules in bilateral tax treaties, e.g., for legal persons of public law, central banks
  - ***Improper use of the Convention*** → Art 1 nos 54-108 OECD MC Comm.
  - Restriction of benefits in case of ***remittance based taxation***? → Art 4 no. 109 OECD MC Comm
  - Note: ***Exceptions from Art 1 OECD MC***
    - **Art 24(1) OECD MC** (nationality discrimination) applies irrespective of residency in one of the Contracting States (Art 24 m.mo. 6 OECD MC Comm.) and, more generally, Art 24 OECD MC is not limited to taxes covered by Art 2 OECD (Art 24(6) OECD MC)
    - **Art 26 OECD MC** (exchange of information) and **Art 27 OECD MC** (collection of taxes) are not restricted by Art 1 or 2 (i.e., may also cover information about non-residents or taxes other than those covered by Art 2 OECD) (Art 26 no. 2 OECD MC Comm. and Art 27 no. 4 OECD MC Comm.)

Personal Scope | *Saving Clause*

- Application of tax treaties to ***restrict a Contracting State's right to tax its own residents***? → "Saving Clause"
  - **Art 1(3) OECD MC 2017** (and Art 1(3) UN MC 2017, Art 11 MLI)

> 3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 [A] [B], 24, 25 and 28.

  - Introduced following **Action 6 of the BEPS Project** (para. 61 et seq. of the 2015 Final Report)
  - *Note:* "Saving Clause" in Art 1(4), (5) US MC includes citizenship-based taxation and can be traced back to US treaty policy since 1939

Personal Scope | *Saving Clause*

- Application of tax treaties to ***restrict a Contracting State's right to tax its own residents***? → "Saving Clause"
- Effects
  - "Saves" residence State taxation, e.g., with regard to ***CFC rules*** and ***taxation of partners in hybrid entities***, unless an exception (e.g., Art 19, 23, …) applies (see for CFC rules, e.g., Art 1 no. 81, Art 7 no. 14 OECD MC Comm.) – *Clarifying consequential amendment of Art 23 OECD MC → No reciprocal obligation to provide relief for residence taxation*
  - Arguably (see, e.g., 44 *Intertax* 574 (2016)) disapplies the "restrictive effect" of Art 9 OECD MC and the ***arm's length standard*** for primary transfer pricing adjustments → MAPs under Art 25 OECD MC ("taxation not in accordance with the provisions of this Convention")? Arbitration? → Directive (EU) 2017/1852, EU Arbitration Convention, [1990] OJ L 225/10
  - Does not override the **"tie breaker" rules** in Art 4(2) and (3) OECD MC! → *Art 1(3) OECD MC does not apply to a person who is a resident of that State under Art 4(1), but is tie-breaked to the other Contracting State under Art 4(2) or (3) (Art 1 no. 21 OECD MC Comm.)*

Material Scope | *Article 2*

- ***Article 2 OECD MC*** determines the ***material scope*** of the tax treaty → ***Taxes covered***

ARTICLE 2

TAXES COVERED

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are in particular:

a) (in State A): .....

b) (in State B): .....

4. The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws.

Reservations on the Article

10. *Canada*, *Chile* and the *United States* reserve their positions on that part of paragraph 1 which states that the Convention should apply to taxes of political subdivisions or local authorities.

Material Scope | *Taxes Covered*

Taxes "on behalf" of State, political subdivisions or local authorities (≠ e.g., US MC, Canada, Australia), irrespective of how levied (e.g., assessment, at source, surtax, …)

ARTICLE 2

TAXES COVERED

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   a) (in State A): .....

   b) (in State B): .....

4. The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws.

- Tax = Compulsory, unrequited monetary payment to government units
- Imposed on, e.g., "total income", "elements of income", capital gains, payroll. → *What about "gross basis" taxes? Tonnage tax regimes? Fictitious income (e.g., imputed rent, "exit tax", CFC income inclusion)? Disguised "consumption taxes"? Inheritance taxes?*
- Accessory duties or charges? *(✓; Art 2 no. 4 OECD MC Comm.)*
- Interest, penalties? *(Art 2 no. 4 OECD MC Comm.: MAP)*
- Not covered: Social security charges etc (Art 2 no. 3 OECD MC Comm.)

Material Scope | *Taxes Covered*

ARTICLE 2

TAXES COVERED

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are in particular:

   a) (in State A): .....

   b) (in State B): .....

4. The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws.

Subsequently introduced taxes can either fall under Art 2(4) or Art 2(2) *(→ High Court of Ireland, 31 July 2007, Kinsella v. The Revenue Commissioners, [2007] IEHC 250)*

- In general: Art 2(3) to expand, but not to limit Art 2(2)! *– But: "Limiting function" if an existing tax is not listed? (Art 2 no. 6 OECD MC Comm.)*
- Ambulatory understanding of the listed taxes, e.g., "income tax" *→ E.g., Federal Court of Australia, 3 February 2009, Undershaft (No 1) Limited v Commissioner of Taxation, [2009] FCA 41*
- Some treaties only include Art 2(3) and (4), i.e., a (complete) list of covered taxes (e.g., UK). → What about new/amended taxes?
  - Subsequently introduced comprehensive capital gains tax (CGT) as "income tax" in Australia? *→ ✓: Federal Court of Australia, 10 October 2008, Virgin Holdings SA v Commissioner of Taxation, [2008] FCA 1503; Federal Court of Australia, 3 February 2009, Undershaft (No 1) Limited v Commissioner of Taxation, [2009] FCA 41. – Contra: Australian Taxation Ruling TR 2001/12.*
  - UK diverted profits tax (DPT)? *→ ✗: HMRC Guidance DPT1690*

Material Scope | *Listed Taxes*

- **Example:** ***Relationship beween Art 2(2) and 2(3) OECD MC with regard to "old" but unlisted taxes?***
  - Austria levies a long-standing payroll tax ("Kommunalsteuer" = "municipal tax"), which is payable by the employer based on payroll. A Kosovar business has a small office in Austria with two Austrian employees, and the payroll would be subject to the special wage tax. However, the small office would not amount to a PE under the tax treaty between Austria and Kosovo (applicable since 2019). → *Is the tax barred by the tax treaty?*
    - Does the "Kommunalsteuer" qualify as "tax on the total amounts of wages or salaries paid by enterprises" under Art 2(2)? *(→ See Art 2 no. 3 OECD MC Comm., for the German "Lohnsummensteuer" and the French "taxe sur les salaires").*
    - The "Kommunalsteuer" is not listed in Art 2(3) of the tax treaty. → Exemplary list ("in particular") in Art 2(3), but nevertheless "limiting function" if an existing tax is not listed? *(~ Austrian VwGH 15 September 2016, 2013/15/0219, "Kommunalsteuer" likely not covered – Unclear and with an alternative text for an exhaustive list: Art 2 nos 5-6.1 OECD MC Comm.)*

(3) The existing taxes to which the Convention shall apply are in particular:

a) in Austria:

i. the income tax;
ii. the corporation tax;
(herein after referred to as "Austrian tax")

b) in Kosovo:

i. the personal income tax;
ii. the corporate income tax.
(herein after referred to as "Kosovo tax").

Material Scope | *Income Tax?*

- **Example:** ***Borderline between income and non-income taxes***
  - In light of the ongoing discussion on the taxation of the digitalized economy, the European Commission, in March 2018, has proposed a directive for a so-called **"Digital Services Tax"** ("DST" – COM(2018)148) with the following features:
    - It shall be levied on any (domestic or foreign) corporation that renders certain services (specifically placement of advertising, intermediary services and sale of user data) with the involvement of European users.
    - The tax shall be 3% of the turnover (revenue) from these services.
    - It will only be levied if the service provider exceeds 2 thresholds: € 750 million of total annual revenues and € 50 million of taxable digital revenues in the EU.
    - Politically, the tax was seen as an "equalization tax", i.e., a the "amounts raised would aim to reflect some of what these companies should be paying in terms of corporate tax".
  - Is the "Digital Services Tax" (DST) a **tax on "income" or "elements of income"** within the meaning of Art 2 OECD MC? If so, what would the legal consequences be?
  - For inspiration see the discussion by the OECD in the 2018 Interim Report (pp. 181-183) and some further thoughts in 47 *Intertax* 140 (2019)

Territorial Scope | *States*

- Neither the OECD MC nor the UN MC contain a definition of the ***terms "a Contracting State" and "the other Contracting State"*** or other territitorial aspects, but leave this open to bilateral negotiations. → Art 3 no. 1 OECD MC Comm.:

> In addition to the definitions contained in the Article, Contracting States are free to agree bilaterally on definitions of the terms "a Contracting State" and "the other Contracting State". Furthermore, Contracting States are free to agree bilaterally to include in the possible definitions of "Contracting States" a reference to continental shelves.

- Common practice, e.g., Art 3(1)(i) US MC:

> i) the term "United States" means the United States of America, and includes the states thereof and the District of Columbia; such term also includes the territorial sea thereof and the sea bed and subsoil of the submarine areas adjacent to that territorial sea, over which the United States exercises sovereign rights in accordance with international law; the term, however, does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory;

Territorial Scope | *States*

- **Territorial scope – *Further issues***
  - Inclusion or exclusion of territories (e.g., Art 3(1)(i) US MC)
  - Continental shelf (seabed and subsoil of the submarine areas outside territorial waters to outer edge of continental margin/200 nautical miles) (Art 3 no. 1 OECD MC Comm.)
  - Mismatch between the territorial scope of domestic tax law and a tax treaty → *See, e.g., Norwegian Supreme Court, 9 November 1992, Heerena Marine Contractors SA v. Ministry of Finance, no. 122/1992: continental shelf not covered by the tax treaty, i.e., only domestic tax law applies)*
  - State succession, e.g.,
    - Reunification of Germany (with the German Democratic Republic ceasing to exist)
    - Separation of the UdSSR (with Russia as the legal successor)
    - Dissolution of Czechoslovakia and Yugoslavia (with no State considering itself being the legal succesor)
  - Change of territories → *E.g., Hong Kong is not covered by Chinese tax treaties (Canadian Federal Court of Appeal, 14 October 2003, Edwards v. Canada, 2003 FCA 378)*
  - Outer space – airspace – Antarctica → *E.g., a satellite in geostationary orbit is not a permanent establishment, because outer space is not part of the territory of a Contracting State (Art 5 no. 27 OECD MC Comm.)*

Territorial Scope | *States*

- ***Article 30 OECD MC*** contains a specific rule for the (simplified) territorial extension of a tax treaty → *Historically used for dependent and overseas territories (UK, France)*

ARTICLE 30

TERRITORIAL EXTENSION[1]

1. This Convention may be extended, either in its entirety or with any necessary modifications [to any part of the territory of (State A) or of (State B) which is specifically excluded from the application of the Convention or], to any State or territory for whose international relations (State A) or (State B) is responsible, which imposes taxes substantially similar in character to those to which the Convention applies. Any such extension shall take effect from such date and subject to such modifications and conditions, including conditions as to termination, as may be specified and agreed between the Contracting States in notes to be exchanged through diplomatic channels or in any other manner in accordance with their constitutional procedures.

2. Unless otherwise agreed by both Contracting States, the termination of the Convention by one of them under Article 32 shall also terminate, in the manner provided for in that Article, the application of the Convention [to any part of the territory of (State A) or of (State B) or] to any State or territory to which it has been extended under this Article.

Residence | *Article 4*

- Tax treaties apply only ***to residents of Contracting States*** (Art 1 OECD MC)
- ***Art 4 OECD MC*** defines the notion of ***"resident"*** and contains ***"tie breaker" rules*** for individuals and for other persons (to resolve residence-residence conflicts)
  - "Resident of a contracting state" is defined as a "person" (individual or company) who is ***liable to comprehensive taxation*** in the state on the basis of certain criteria
  - ***"Tie breaker"*** rules for dual resident individuals (Art 4(2) OECD MC) and entities (Art 4(3) OECD MC)

ARTICLE 4

RESIDENT

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

   a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

   b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

   c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

   d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

31. The *United States* reserves the right to use a place of incorporation test for determining the residence of a corporation, and, failing that, to deny dual resident companies certain benefits under the Convention.

Residence | *Article 4*

- **Residence under Art 4(1) OECD-MC**
  - ***Sentence 1:*** Based on domestic law → Person is resident of a country if liable to tax in the country by reason of his domicile, residence, place of management or similar criterion → *Note: Proof of residence usually through a **"certificate of residence"***

ARTICLE 4

RESIDENT

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

  - ***Sentence 2:*** Foreign diplomatic and consular staff serving in a State's territory → Not meant to cover countries adopting a territorial principle in their taxation (Art 4 Para 8.3 OECD MC Comm) → Relevance for dual resident companies? (Art 4 no 8.2 OECD MC Comm.)

Residence | *Article 4*

- Concept of ***residence in domestic law*** → ***"Comprehensive"/"full" tax liability*** based on ***person-related criteria*** (domicile, residence, place of management and "any other criterion of a similar nature"), including domestic deeming provisions (Art 4 no. 8 OECD MC Comm.) → *Arguably includes unlimited tax liability based on a company's territorially defined statory seat (e.g., registration; Art 4 no. 21 OECD MC Comm.), but would exclude, e.g., purely legal criteria (e.g., citizenship, incorporation) or optional unlimited tax liability (e.g., based on the ECJ Schumacker case law)*
- ***Person "liable to tax"*** ≠ Income (effectively) taxed (Art 4 nos 8.11-8.12 OECD MC Comm.)

- Foreign ***diplomatic and consular staff*** serving in a State's territory (Art 4 Para 8.1 OECD MC Comm.), but also entities exempt from tax on foreign income (e.g., special tax regimes; Art 4 Para 8.3 OECD MC Comm.)
- Not meant to cover countries adopting a ***territorial principle*** in their taxation (e.g., Hong Kong, Panama; Art 4 Para 8.3 OECD MC Comm.)

ARTICLE 4

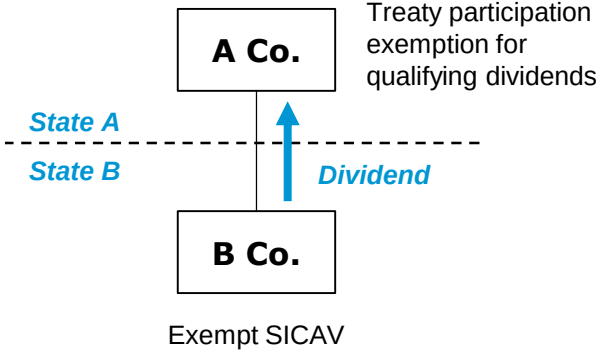
RESIDENT

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

- ***State, political subdivisions and local authorities***: ✓ (since 1995; Art 4 Para 8.4 OECD MC Comm.)
- Recognised ***pension funds***: ✓ (Art 3(1)(i) and Art 4(1) OECD MC Comm [since 2017])
- ***Sovereign wealth funds***: ✓ (Art 4 no. 8.5 OECD MC Comm.)
- Specific rules in bilateral tax treaties, e.g., for ***legal persons of public law, central banks***

Residence | *"Liable to Tax"*

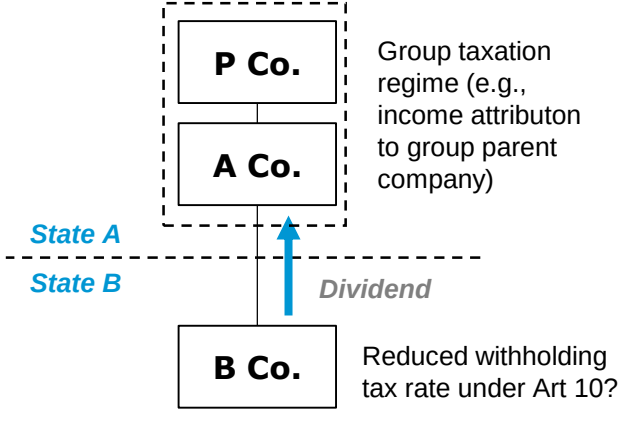
Example 1: SICAV



Exempt SICAV

Is B Co. (e.g., a SICAV = CIV) a "resident" of State B (so that State A has to grant the participation exemption) if its income is totally exempt but the entity as such is "abstractly" liable to tax? → ✓: *German BFH, 6 June 2012, I R 52/11 (virtual tax liability is sufficient)*

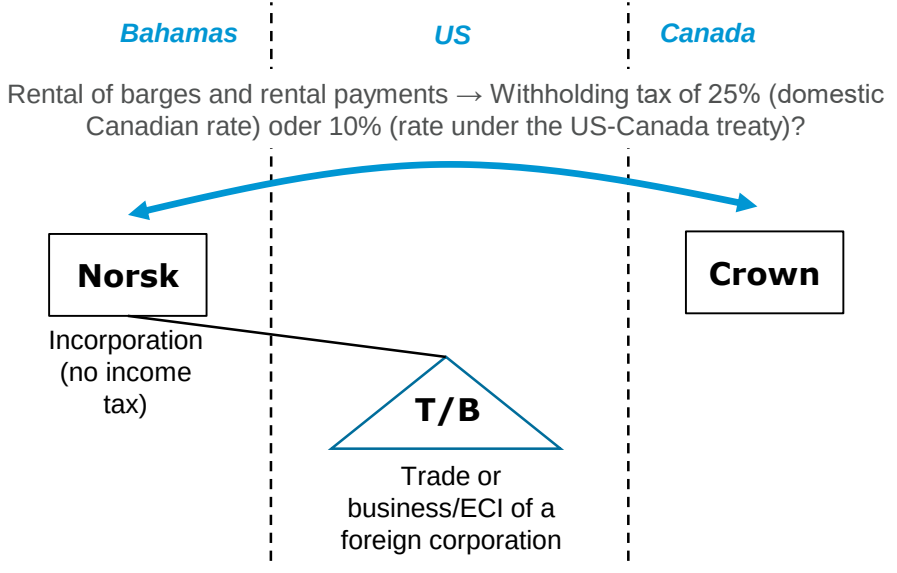
Example 2: Group Entities



Is A Co. a "resident" of State A (so that State B would have to grant a reduced dividend withholding tax rate and State A would have to give a credit) if A Co.'s income is effectively attributed to P Co. under a group taxation regime? → ✓: *E.g., Austrian VwGH, 21 March 2018, Ro 2017/13/0002*

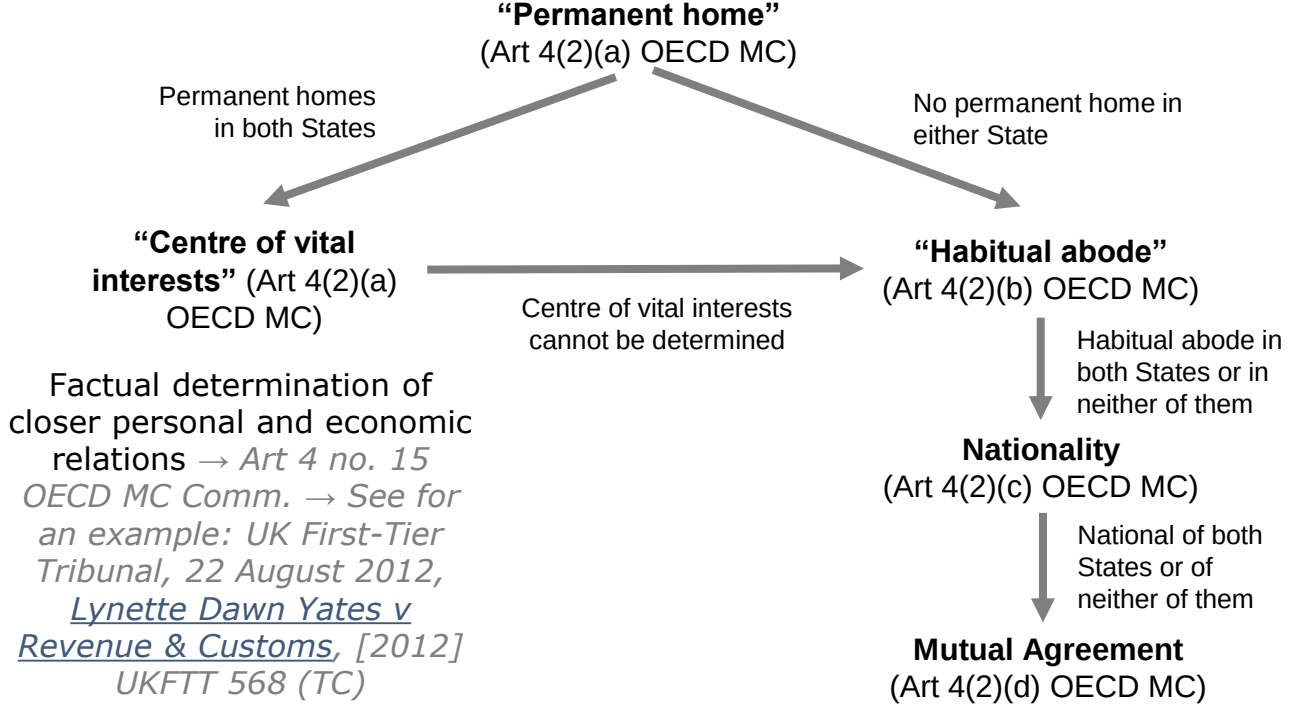
Residence | *Personal Attachment*

- **Liable to tax "by reason" of domicile, residence, place of management and "any other criterion of a similar nature"** → *Existence of a "permanent establishment" or source tax liability does not result in residency status (Supreme Court of Canada, 22 June 1995, **Crown Forest Industries Ltd. v. Canada**, [1995] 2 SCR 802):*



Tie Breaker | *Individuals*

- **"Tie Breaker Rule"** for ***Dual Resident Individuals*** (Art 4(2) OECD-MC; Art 4 nos9-20 OECD MC Comm)



Tie Breaker | *Companies*

- **"Tie Breaker Rule"** for ***Dual Resident Companies*** (Art 4(3) OECD MC)

OECD MC before 2017
PoEM (Place of Effective Management)

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

OECD MC 2017
MAP

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

Tie Breaker | *Companies*

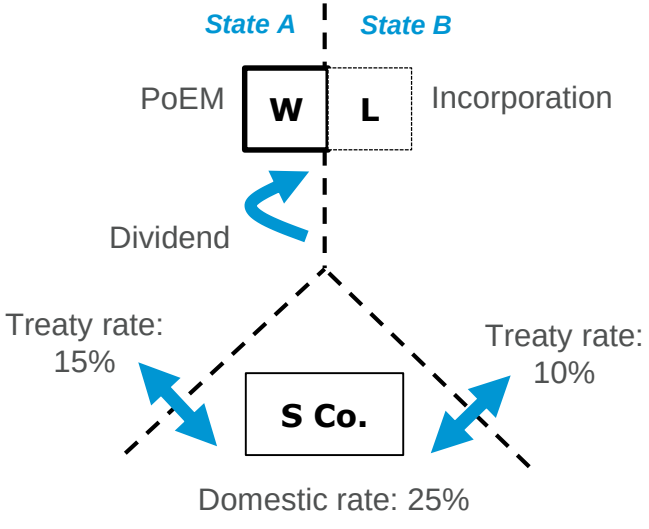
- **"Tie Breaker Rule"** for ***Dual Resident Companies*** (Art 4(3) OECD MC)

> 3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

- Introduction following Action 6 of the BEPS Project (para. 45 et seq. of the 2015 Final Report), also in Art 4 MLI – *Before 2017: 2008 OECD Alternative (Art 4 no 24.1 OECD MC Comm.)*
- Denial of benefits for lack of residency under Art 4(3) OECD MC not subject to arbitration under Art 16 et seq MLI (Art 4 para 58 of the MLI Explanatory Memorandum), because taxation would be "in accordance with the provisions of the Covered Tax Agreement" → *Directive (EU) 2017/1852 on tax dispute resolution mechanisms?*
- Falling out of and under treaty protection based on Art 4(3) OECD MC and competent authority agreement → *Import and exit? (ECJ, 23 January 2014, C-164/12, DMC, EU:C:2014:20, and ECJ, 21 May 2015, C-657/13, Verder LabTec, EU:C:2015:331)*

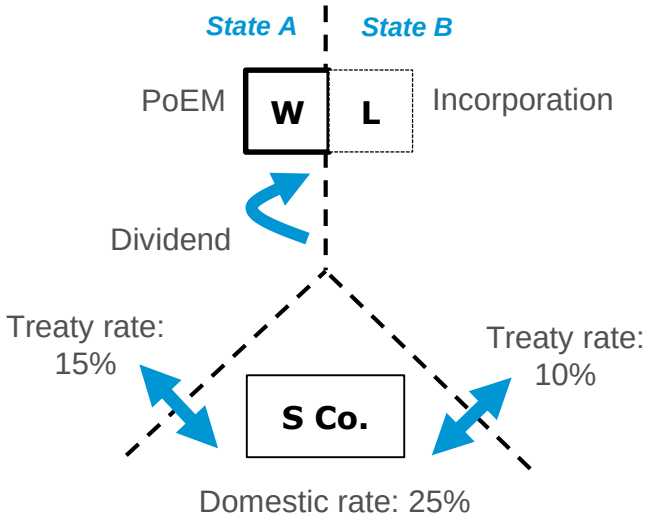
Residents | *Tie Breaker*

- **Example:** ***Dual-resident corporation and third-country income***
  - Company C is dual resident in States A and B and, under the respective domestic laws, subject to unlimited tax liability in both. The tax treaty between A and B "tie-breaks" company C to State A. C receives dividends from its subsidiary in State S, which has a domestic withholding rate of 25%. A's treaty with S reduces that rate to 15%, B's treaty with S to 10%. What is the applicable tax rate for a dividend from the subsidiary to C? → *Bilateral versus "collateral" focus?*



Residents | *Tie Breaker*

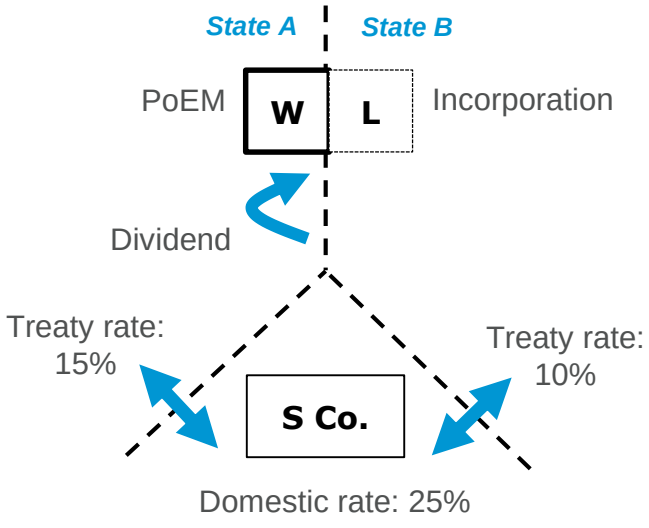
- **Example:** ***Dual-resident corporation and third-country income***



- ***Solution 1 (15%):*** "Collateral" approach based on Art 4(1) 2nd sentence OECD MC.
  - The term "resident" in the B-S-treaty "does not include any person who is liable to tax in that State ***in respect only of income from sources*** in that State or capital situated therein."
  - This would exclude State B, which lost the tie breaker in the A-B-treaty, from being the residence State also in relation to other tax treaties (i.e., the B-S-treaty) → *Art 4 no 8.2 OECD MC Comm. (2008) (and, e.g., US Rev. Rul. 2004-76): "It also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States."*

Residents | *Tie Breaker*

- **Example:** ***Dual-resident corporation and third-country income***



- ***Solution 2 (10%):*** Bilateral approach (at least for pre-2008 treaties).
  - Both, A and B are residence States under Art 4(1) of their respective treaties with S *(→ E.g., German BFH, 4 November 2014, I R 19/13)*
  - Hence, two treaty limitations apply to the taxation of the dividend, and the more far-reaching limitation prevails (i.e., 10%)

Timing Issues | *Overview*

- **Time and treaty application – *Overview***
  - **Entry into force, termination** (Art 31, 32 OECD MC; Art 28, 70 VCLT)
  - Time, e.g., in **distributive rules**, e.g.,
    - Art 5 OECD MC → "fixed", "more than twelve months", "habitually"
    - Art 10 OECD MC (2017 Update) → "throughout a 365 day period"
    - Art 13(4) OECD MC (2017 Update) → "at any time during the 365 days preceding the alienation"
    - Art 15 OECD MC → "183 days in any twelve month period"
    - Art 18 OECD MC → "consideration of past employment"
    - Art 20 OECD MC → "immediately before"
  - What is decisive to allocate income to a distributive rule? → **Causality *versus* cash flow? Accrual *versus* realization *versus* payment?**
    - Subsequent and preceding income
    - Gain or loss in taxing rights (entry and exit)

Timing Issues | *Entry into Force*

- ***Entry into force*** of tax treaties (Art 31 OECD MC)
  - Entry into force ≠ effect (application) of treaty provisions

ARTICLE 31

ENTRY INTO FORCE

1. This Convention shall be ratified and the instruments of ratification shall be exchanged at ..... as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

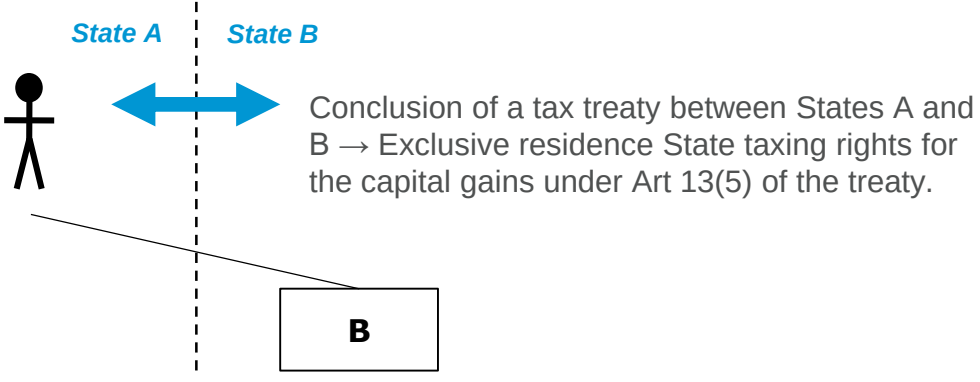
a) (in State A): .....

b) (in State B): .....

  - Various modifications and rules on effictiveness in treaty practice. → *Also: Retroactive application (theoretically) possible (Art 28 VCLT)*
  - **Note:** Quasi "retroactive" application of ***procedural treaty provisons*** (e.g., exchange of information under Art 26 OECD MC related to periods before the treaty entered into force or recovery of tax claims under Article 27 OECD MC for pre-treaty taxable years etc), unless explicitly addressed in a bilateral treaty → *See, e.g., Art 27 no. 14 OECD MC Comm.; England and Wales Court of Appeal, 23 May 2013, Ben Nevis (Holdings) Ltd & Anor v HM Revenue & Customs, [2013] EWCA Civ 578.*

Timing Issues | *Entry into Force*

- **Example:** ***Loss of taxing rights!?***
  - Taxpayer T lives in State A and owns some shares in a listed State B company; during years 1-5 those shares have appreciated in value from 100 to 1.000. In the past, there was no tax treaty treaty in force between States A and B. However, in year 6, A and B conclude a tax treaty based on the OECD MC; the treaty enters into force on 1 January 7 at 0:00 am. Under State B's domestic law any gain from the alienation of the shares by a non-resident is subject to income tax. *→ "Exit taxation" of 900 in State B? In which taxable year?*



  - But: Does State B really lose taxing rights under Art 13(5) OECD MC for the 900? *(→ Contra: German BFH, 17 July 2008, I R 77/06, with regard to business assets) –* Also: Art 13 no 32.1 OECD MC Comm. (observation by Austria and Germany)

Timing Issues | *Termination*

- ***Termination*** of tax treaties (Art 31 OECD MC)
  - Termination ≠ ceasing to have effect

ARTICLE 32

TERMINATION

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year ..... In such event, the Convention shall cease to have effect:

a) (in State A): .....

b) (in State B): .....

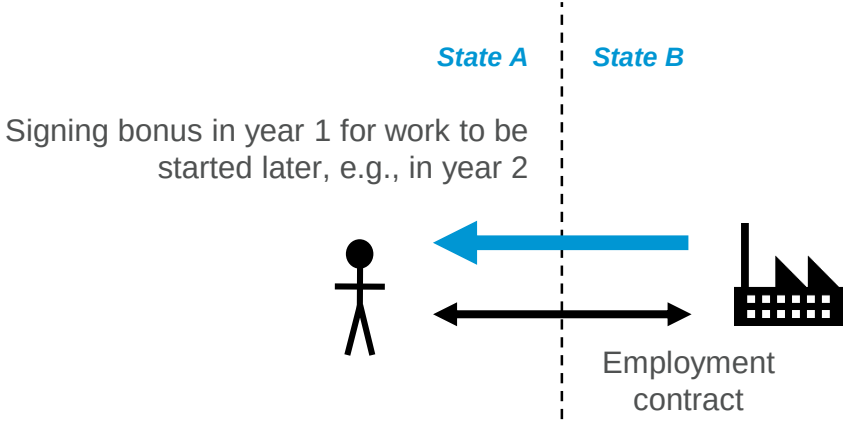
  - Various modifications (e.g., minimum period of treaty application) and rules on ceasing effictiveness in treaty practice. → *Also: (Implicit) termination through the conclusion of a new tax treaty.*
  - Various rules on suspension and termination of treaties in Art 54 et seq. VCLT

Timing Issues | *Income?*

- Tax treaties do not contain any rules about the ***timing of income***.
- Timing of income (gain) realization is a matter of ***domestic law*** (see, e.g., Art 13 nos 7-9 OECD MC Comm), including "fictitious" (deemed) realization events (e.g., "exit taxes")
- Which facts are relevant for the application of the tax treaty? Which distributive rule should apply? Which treaty governs the situation?
- Issues, e.g.,
  - Business profits and employment income → Activities versus cash flow (Art 7 and 15 OECD MC)
  - Capital gains → Accrual versus realization (Art 13 OECD MC)

Timing Issues | *Income?*

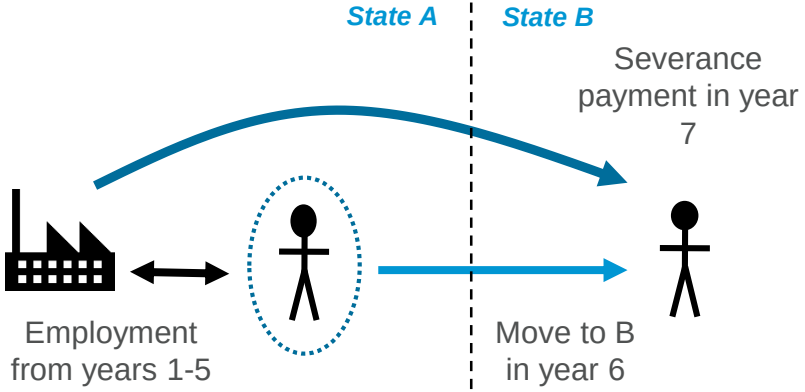
- **Example 1:** ***Signing bonus before employment***
  - Taxpayer T lives in State A and receives, in year 1, a bonus for the signing of an employment contract with company C in State B, starting in year 2. According to the employment contract the work is to be exercised in State B. The signing bonus must be repaid in case T terminates his contract within five years after the signature. *(→ German BFH, 11 April 2018, I R 5/16: Art 15(1) 2nd half-sentence = State of (future) activity.)*



  - Alternative: What if T has not received a signing bonus, but has rather incurred expenses for his future job in State B?

Timing Issues | *Income?*

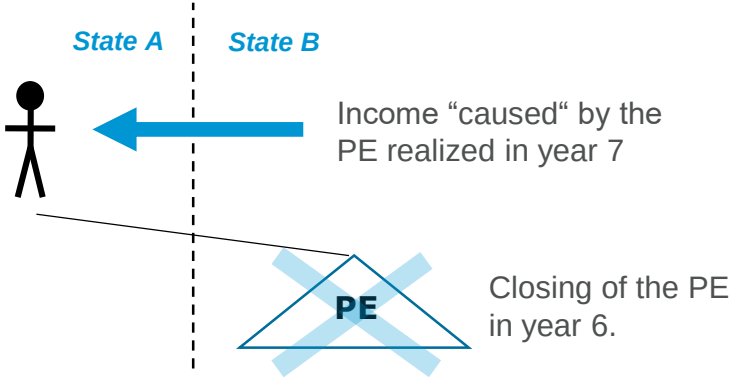
- **Example 2: *Severance payment after employment***
  - Taxpayer T lived and worked for company C in State A in years 1 to 5. In year 6 he moves to and becomes a resident of State B. Following litigation, T receives a severance payment from company C in year 7. *(→ Austrian VwGH, 23 March 2017, Ro 2014/15/0050: Art 15(1) 2nd half-sentence = State of (past) activity versus German BFH, 10 June 2015, I R 79/13: Art 15(1) 1st half-sentence = residence State.)*



  - Alternative: What if the payment in year 7 is a salary or bonus for the last period of work or commissions for sales made during that period? *(→ Art 15 no. 2.4 OECD MC Comm.: Art 15(1) 2nd half-sentence = State of (past) activity.)*

Timing Issues | *Income?*

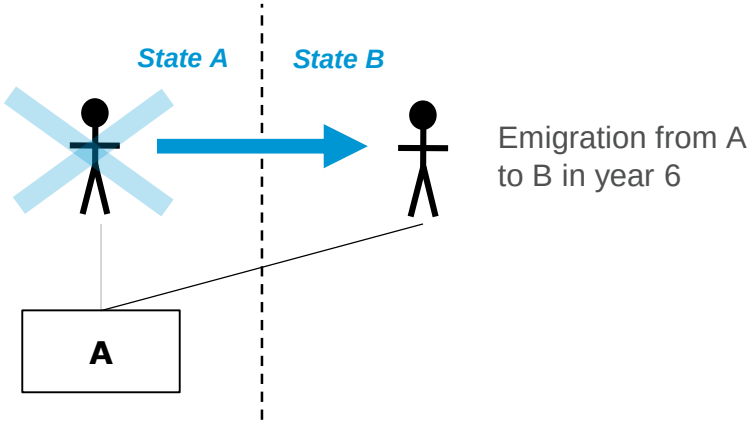
- **Example 3:** ***Income after closing a PE***
  - Taxpayer T is a resident of State A. He runs a business and, in years 1 to 5, has a permanent establishment (PE) in State B. However, in year 6 he closes the PE. In year 7 T realizes a profit that was caused by the activity of the PE (e.g., a customer's payment of a depreciated receivable). *(→ German BFH, 20 May 2015, I R 75/14: Art 7(1), (2) and Art 23 → causality of income, irrespective of whether the PE still exists.)*



  - Alternative: What if taxpayer X has incurred expenses in year 0 for the PE, which was opened in year 1? What if the project fails and the PE never comes into existence? *(→ German BFH, 26 February 2014, I R 56/12 → expenses allocated to the (potential) PE State, intention sufficient. – Note: EU fundamental freedoms and "final losses".)*

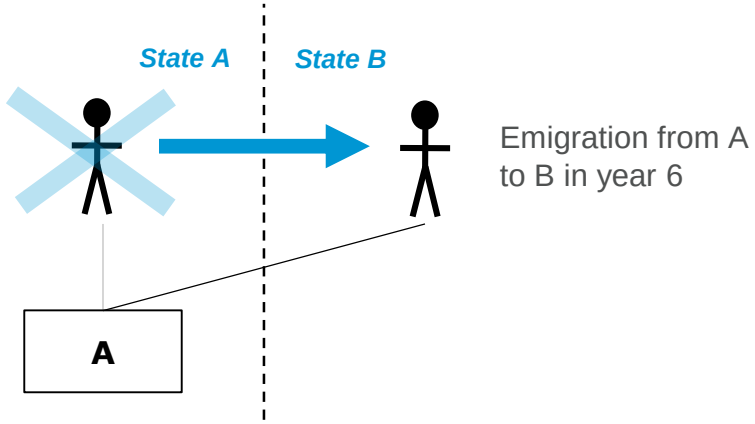
Timing Issues | *Income?*

- **Example 4:** ***Exit and entry***
  - Taxpayer T was a resident of State A in years 1 to 5. Since year 1, he owns some shares in a listed State A company; those shares have appreciated in value from 100 to 1.000. In year 6, T emigrates to State B. He sells the shares for 1.100 in year 7.
    - ***Issue 1:*** What may State A tax in light of Art 13(5) OECD MC? → *"Exit tax" (= deemed realization before change in residence) of the unrealized gain, i.e., 900 (nos 65-67 BEPS Final Report on Action 6 (2015); possibly contra: South African Supreme Court of Appeal, 8 May 2012, Tradehold Ltd, [2012] ZASCA 61) – Note: EU fundamental freedoms and requirement of proportionality (e.g., instalment option).*



Timing Issues | *Income?*

- **Example 4:** ***Exit and entry***
  - Taxpayer T was a resident of State A in years 1 to 5. Since year 1, he owns some shares in a listed State A company; those shares have appreciated in value from 100 to 1.000. In year 6, T emigrates to State B. He sells the shares for 1.100 in year 7.
    - ***Issue 2:*** What may State B tax in light of Art 13(5) OECD MC? *(Art 13 no. 3.1 OECD MC Comm.: Art 13(5) → Entire gain, i.e., 1.000 – No step-up required: E.g., nos 65-67 BEPS Final Report on Action 6 (2015) and Art 23 nos 4.1-4.3 OECD MC Comm. → MAP)*



Part IV
Distributive Rules

Overview

- ***Chapter IV/1*** **–** Permanent Establishments and Business Profits (Articles 5, 7, 13(2) OECD MC, Articles 5(3), 7 and 12A UN MC) and Excursus on Associated Enterprises (Article 9 OECD MC)
- ***Chapter IV/2*** **–** Immovable Property, International Transport (Articles 6, 8 and 13(1) and (3) OECD MC)
- ***Chapter IV/3*** **–** Investment Income: Dividends, Interest, Royalties and Capital Gains (Articles 10, 11, 12 and 13 OECD MC)
- ***Chapter IV/4*** **–** Employment, Directors' Fees and Pensions (Articles 15, 16 and 18 OECD MC)

Chapter IV/1
Permanent Establishments and Business Profits

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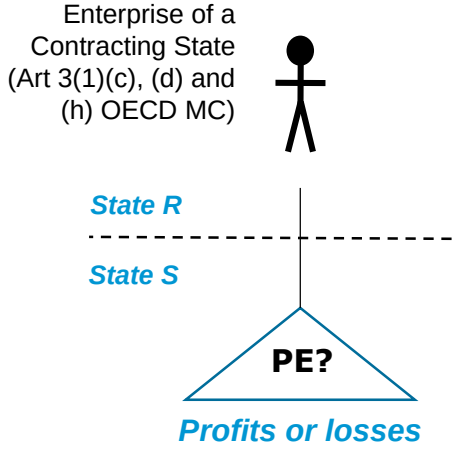
Overview

- ***Chapter IV/1.1*** – Introduction
- ***Chapter IV/1.2*** – The Concept of "Permanent Establishment" (Article 5 OECD MC)
- ***Chapter IV/1.3*** – Business Profits (Article 7 OECD MC)
- ***Chapter IV/1.4*** – Fees for Technical Services (Article 12A UN MC)
- ***Chapter IV/1.5*** – Excursus: Associated Enterprises and Transfer Pricing (Article 9 OECD MC)

Chapter IV/1.1
Introduction

Overview | *Structure*

- ***Principle:*** Source country has a prior unlimited right to tax business profits earned by a non-resident to the extent that those ***profits are attributable to a permanent establishment (PE) situated in the source country***! → Art 5, 7 OECD/UN MC and Art 14 UN MC (eliminated from the OECD MC in 2000)!



1 ***General rule → Art 7(1) OECD MC***: Only residence State may tax business profits (losses) unless attributable to a PE in the other State

Exceptions → Art 7(4) OECD MC: If business profits are covered by other distributive rules (Art 6, 8, 10, 11, 12, 13 and 17 OECD MC) – *Note also:* Art 12(3) and 12A UN MC

2 ***Taxing threshold (Art 5 OECD MC) = "nexus" rule:*** Permanent establishment ("PE")

Relevance → Definition in Art 5 OECD MC also relevant for Art 6, Art 11, 24 etc – *Art 5 no. 9 OECD MC Comm.*

3 ***PE taxation → Art 7(2) OECD MC***: Source State may (only) tax profits (losses) attributable to PE, residence State will give relief under Art 23 OECD MC

Losses? → What about "relief" for losses in exemption systems? → *"Final losses" in the EU (ECJ, 12 June 2018, C-650/16, Bevola, EU:C:2018:424)*

Overview | *Structure*

- What is a **"business"**? What is an **"enterprise"**? When is it an **"enterprise of a Contracting State"**?
  - (Partial) ***definitons Art 3(1)(c), (d) and (h) OECD MC*** (Art 3 nos 4, 10.2 OECD MC Comm.)

ARTICLE 3

GENERAL DEFINITIONS

1. For the purposes of this Convention, unless the context otherwise requires:

c) the term "enterprise" applies to the carrying on of any business;

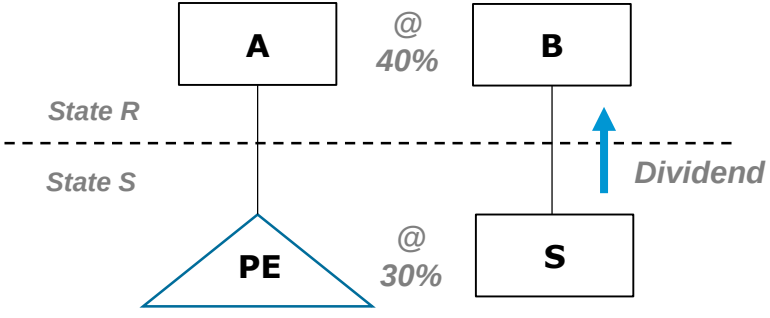
d) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

h) the term "business" includes the performance of professional services and of other activities of an independent character.

  - ***"Business" versus "employment"*** → *E.g., England and Wales Court of Appeal, 15 November 2018, Fowler v HM Revenue and Customs, [2018] EWCA Civ 2544, and UK Supreme Court, 20 May 2020, Fowler v Commissioners for Her Majesty's Revenue and Customs, [2020] UKSC 22 (employed professional diver's activities deemed to be carrying on of a trade under domestic law)*

Overview | *Structure*

- **Permanent establishment (PE) versus subsidiary** – *"PE:enterprise = yolk:egg" (© Kees van Raad), whereas the subsidiary is a separate, resident taxpayer (worldwide income)*

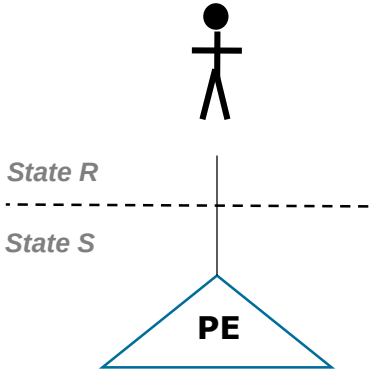


	Income in B	100	100
./.	Tax in B (30% on 100)	30	30
=	***After-tax income in B***	***70***	***70***
	Dividend	—	70
./.	Withholding tax on dividend in B (e.g., 25%)	—	17,5
=	***Distributed income***	***[70]***	***52,5***
./.	Tax in A (40% on 100/70)	40	28
=	***Overall after-tax income***	***30***	***24,5***

Assumptions: No relief from juridical double taxation; no participation exemption/indirect credit; no branch profits tax.

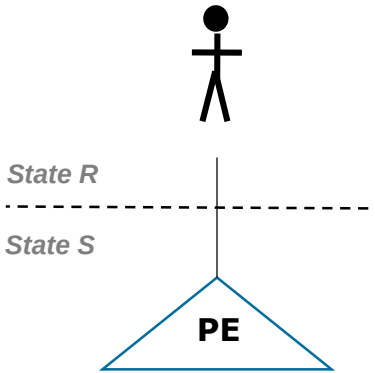
Overview | *Structure*

- **Step 1:** ***Is there a permanent establishment? → Art 5 OECD MC***



- ***Primary Rule*** → "For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of the enterprise is wholly or partly carried on." (Art 5(1) OECD MC)
- ***Illustrative (not exhaustive) list of PEs*** → Examples of typical fixed places of business (Art 5(2) OECD MC) – *Conditions of Art 5(1) OECD must be met! (Art 5 no. 45 OECD MC Comm.)*
- ***Construction/installation projects*** (12-month-threshold; Art 5(2) OECD MC)
- ***PE exceptions and anti-fragmentation*** (Art 5(4), (4.1) OECD MC) → Preparatory or auxiliary character – *2017 Update*
- ***Dependent agent is a PE for the enterprise*** (Art 5(5) OECD MC) – *2017 Update*
- ***Independent agent is not a PE*** (Art 5(6), (8) OECD MC) – *2017 Update*
- ***Control of a subsidiary*** does not constitute a PE of the parent (and *vice versa*) (Art 5(7) OECD MC)

- **Step 2:** ***How much profits are to be attributed to the PE? → Art 7 OECD MC***



- ***Historically*** → Various opinions on the degree of independence of a PE, e.g., the "relevant business activity" approach versus the "functionally separate entity" approach *(see, e.g., Canadian Federal Court of Appeal, 19 October 1998, Cudd Pressure Control Inc. v. Canada, [1998] FCA 1019 : "notional rent")*
- Work of the OECD since 1994 until 2008/2010 → ***"Authorized OECD Approach" ("AOA")***, based on the "Distinct and Separate Entity Principle"
- Two phases:
  - ***2008*** → Update of the OECD MC on Art 7 through the 2008 Update, insofar as the AOA was (arguably) in conformity with the language of the OECD MC at that time
  - ***2010*** → Update of Art 7 OECD MC and the OECD MC Comm. through the 2010 Update to give full effect to the AOA

Chapter IV/1.2
The Concept of „Permanent Establishment“

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PE | *Overview*

- **The "PE concept" in Art 5 OECD MC** – ***Primary rule in Art 5(1) and examples in Art 5(2) OECD MC*** **–** The ***key test*** which determines the right to tax business profits in the source State (≠ VAT/GST; Art 5 no. 5 OECD MC Comm.)

ARTICLE 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

   a) a place of management;

   b) a branch;

   c) an office;

   d) a factory;

   e) a workshop, and

   f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

PE | *Primary Rule*

- **"Building Blocks"** of the primary rule in Art 5(1) OECD MC – ***Overview***

"… place of business …"

- Any ***premises, facilities or installation*** used for carrying on the business whether or not used exclusively for that purpose (Art 5 no 10 OECD MC Comm.)
- Space is ***at its disposal***: effective power to use location and factual circumstances → Immaterial whether owned, rented or at the disposal of the enterprise, but mere presence of the enterprise is not sufficient (Art 5 nos 10-19 OECD MC Comm.)

"… fixed …"

Geographic → "Location test" (Art 5 nos 21-27 OECD MC Comm.)

Temporal → "Duration test" (Art 5 nos 28-34 OECD MC Comm.)

"… through which …"

- Wide meaning, "so as to apply to any situation where ***business activities are carried on at a particular location*** that is at the disposal of the enterprise for that purpose" (Art 5 no 20 OECD MC Comm.)

"… carried on …"

- Any situation where business activities are ***carried on (e.g., by employees) at a particular location*** at the disposal of the enterprise for that purpose (Art 5 no. 6 OECD MC Comm.)
- ***Special issues*** (Art 5 nos 36-41 OECD MC Comm.): Leasing of equipment and containers, roaming, subcontractors, automatic equipment

PE | *Primary Rule*

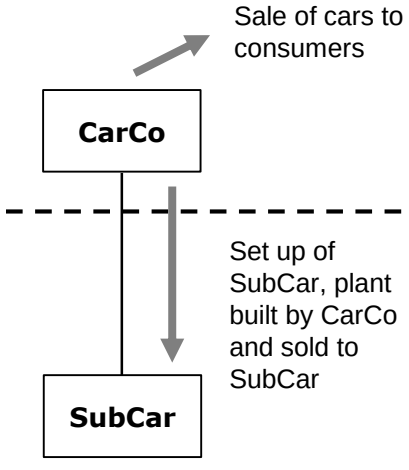
- **"Building Blocks"** of the primary rule in Art 5(1) OECD MC – ***"at the disposal" and "through which"***
  - "[W]ill depend on that enterprise having the ***effective power to use that location*** as well as the ***extent of the presence*** of the enterprise at that location and the activities that it performs there" (Art 5 no. 12 OECD MC Comm.):

> Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities (e.g. where it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time. This will not be the case, however, where the enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself. that location is clearly not at the disposal of the enterprise

  - ***Also:*** In the absence of employees, other factors are necessary to establish that a site is "at the disposal" of the enterprise, e.g., if it owns/has legal possession of that site and controls access to and use of the site (Art 5 no. 40 OECD MC Comm.)

PE | *Primary Rule*

- **"Building Blocks"** of the primary rule in Art 5(1) OECD MC – ***"at the disposal" and "through which"***
  - ***Example:*** Can the premises of a (converted) local entity constitute a permanent establishment of a foreign enterprise under Art 5(1) OECD MC? → *No, if the premises are not used by the enterprise (Art 5 no. 12 OECD MC Comm.)*
  - ***Further examples*** (Art 5 nos 13-19, 40 OECD MC Comm):
    - Salesman regularly visiting a major customer in the purchasing director's office (×)
    - Employees office in the headquarters of another company, e.g., a subsidiary (✓)
    - Regular use of a delivery dock at a customer's warehouse (×)
    - Painter, who spends two years, three days a week painting the large office building of its main client (✓)
    - Home office (~)
    - Hotel rooms are rented out via the Internet and the on-site operation is fully subcontracted to a third party (✓)
    - Premises of a client (~; e.g., Canadian Federal Court of Appeal, 24 Feb. 2000, *Dudney v. The Queen*, [2000] CTC 56 (FCA))



- Assembly of cars from parts owned and supplied by CarCo (and remain property of CarCo)
- Payment of royalties for the use of manufacturing processes developed and owned by CarCo
- Compensation for SubCar: Cost+

PE | *Primary Rule*

- **"Building Blocks"** of the primary rule in Art 5(1) OECD MC – ***"fixed"***

Geographic: "Location Test"	Temporal: "Duration Test"

▪ A ***specific geographical spot*** → Link between the place of business and a specific geographical point (Art 5 no. 21 OECD MC)
▪ Geographical fixedness has to be understood in the context of the business concerned – Mobile and recurrent activities (Art 5 nos 21-25 OECD MC) → ***"Coherent whole commercially and geographically"***
  ▪ ***Commercial coherence*** → E.g., a single contract (plus connected contracts), complementary functions
  ▪ ***Geographic coherence*** → E.g., limited geographic area, distinct place (mine, offices of a client)
▪ Normally, a (moving) ***ship*** and activities carried on aboard a ship (e.g., shops) are not "fixed" (Art 5 no. 26 OECD MC) – *But might lead to agency PEs!*
	▪ A ***certain degree of permanence***, i.e., not of a purely temporary nature
	▪ Practice → Rule of thumb: ***6-months-test*** (Art 5 no 28 OECD MC Comm.)
	▪ But further considerations with regard to the ***"nature of the business"*** (Art 5 nos 29-30 OECD MC Comm.):
	  ▪ Activities of a ***recurrent nature*** (e.g., drilling operations at a remote location fo 3 months every year over 5 years; "Christmas markets" etc)
	  ▪ Activities ***exclusively carried on in the source State*** (e.g., sole-proprietor catering for a film crew out of her parent's house over a period of 4 months)
	▪ Various ***considerations*** for temporary interruptions, splitting-up of contracts and activities that last longer/shorter than initially anticipated (Art 5 nos 32-34 OECD MC Comm)

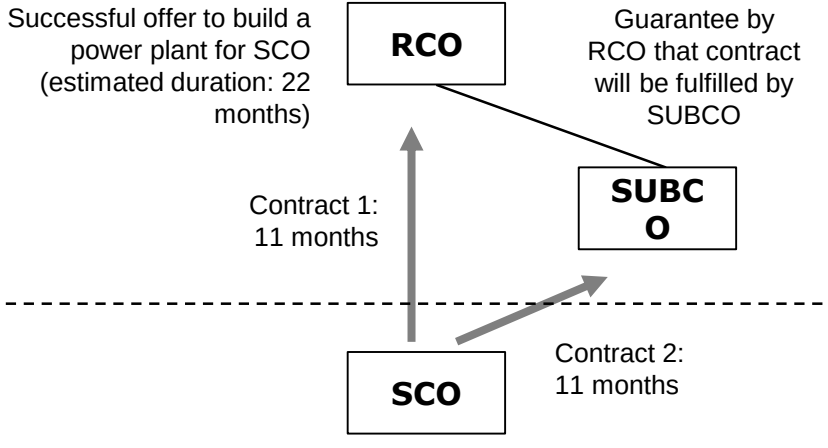
PE | *Construction*

- **Construction or installation projects** in Art 5(3) OECD MC
  - ***12-month-threshold*** → To address the inherently temporary nature of construction or installation projects (as opposed to the supposedly "permanent" places of business under Art 5(1), (2) OECD MC [?]) – *Note:* ***6-month-threshold in Art 5(3)(a) UN MC!***

> 3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

  - ***Building site*** → Construction (renovation) of buildings, roads, bridges or canals, the laying of pipe-lines and excavating and dredging
  - ***Installation project*** → Includes the installation of new equipment, such as a complex machine, in an existing building or outdoors
  - The ***twelve-month-threshold***
    - Applies to each individual site or project (even if continuously or from time to time relocated, e.g., construction of canals etc), but regarded as single unit if it forms a coherent whole commercially and geographically (even if based on several contracts; Art 5 nos 51, 57 OECD MC Comm.)
    - From the date on which the contractor begins his work (including any preparatory work and including subcontractors) until the work is completed or permanently abandoned (temporary or seasonal interruptions or discontinuations are included in determining the life of a site; Art 5 no. 55 OECD MC Comm.)

- **Construction or installation projects** in Art 5(3) OECD MC – ***Abusive "splitting-up of contracts"***
  - ***Example:*** RCO is a company resident of State R and has won a bid for the construction of a power plant for SCO, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months (one with RCO, the other one with RCO's subsidiary SUBCO, where RCO guarantees for SUBCO's performance). → *See para. 16 et seq. of the 2015 Final Report on BEPS Action 7*



- Alternative provision addressing ***contract splitting*** in Art 5 nos 52-53 OECD MC Comm.
- Special provision on ***contract splitting*** in Art 14 MLI
- Effectively addressed by the ***"Principle Purposes Test" (PPT)*** in Art 29(9) OECD MC → Art 29 no. 182 OECD MC Comm. (example J)

PE | *Exceptions*

- **PE exceptions** in Art 5(4) OECD-MC – ***Overview***

OECD MC before 2017
Mandatory (broad) exceptions

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs *a)* to *e)*, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

Art 5(4)(a) to (d) arguably were not subject to the additional condition that the relevant activity be of a preparatory or auxiliary character (as expressly included in Art 5(4)(e) and (f) OECD MC) → See Pt 12 of the 2012 Permanent Establishment Discussion Draft

OECD MC 2017
Only preparatory or auxiliary activities

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity;

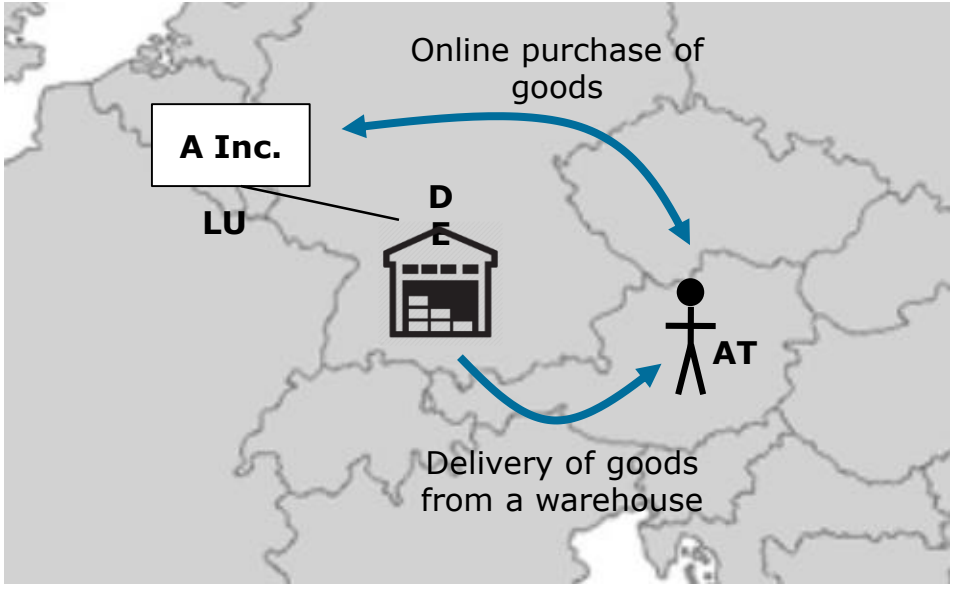
f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs *a)* to *e)*,

provided that such activity or, in the case of subparagraph *f)*, the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

- Supplemented by an anti-fragmentation clause in Art 5(4.1) OECD MC
- Amendment following Action 7 of the BEPS Project (para. 10 et seq. of the 2015 Final Report), also in Art 13 MLI
- Details → Art 5 nos 58-81 OECD MC Comm.

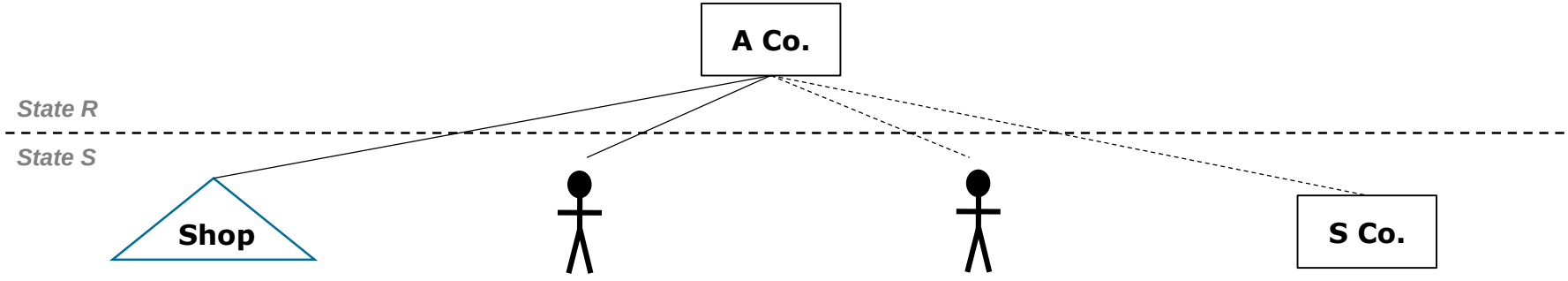
PE | *Exceptions*

- **PE exceptions** in Art 5(4) OECD-MC – ***Background of the 2017 Update***
  - ***Example***: Mr. K, the husband of an Austrian con law professor, orders compulsively from online retailer A Inc., which is a resident of Luxembourg. Following the conclusion of the contract, the goods will be delivered from a huge German warehouse to Mr. T in Austria, where retailer A Inc. has no physical presence. → *Art 5 no. 62 OECD MC Comm.*



PE | *Dependent Agent*

- The concept of **agency PEs** in the OECD MC – ***Overview***



Shop to sell products, e.g., vacuum cleaners

Shop = PE of A Co. In State B under Art 5(1) OECD MC – Note: Attribution of profits under Art 7(2) OECD MC

Travelling employee to sell products, e.g., vacuum cleaners

Employee = PE of A Co. in State B under Art 5(5) OECD MC – Note: The taxation of the agent's income is governed, e.g., by Art 15 OECD MC

Independent agent, e.g., selling A's vacuum cleaners in her ordinary course of business

Not a PE of A Co. in State B under Art 5(6) OECD MC – Note: The taxation of the independent agent itself is covered by Art 5, 7 OECD MC

Associated or third-party (low-risk) distributor

Not a PE of A Co. (Art 5(7) OECD MC), unless it is an agent under Art 5(5) – Note: Allocation of profits between assiciated enterprises based on the arm's length principle of Art 9 OECD MC

PE | *Dependent Agent*

- **Agency PE** in Art 5(5) OECD-MC → ***Dependent Agent***

OECD MC before 2017

"… in the name of …"

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

OECD MC 2017

"… principal role …"

5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

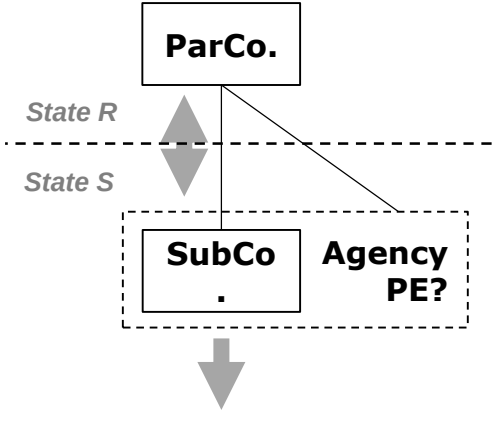
c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

- Supplemented by a new approach to independent agents (Art 5(6) and (8) OECD MC)
- Amendment following Action 7 of the BEPS Project (para. 5 et seq. of the 2015 Final Report), also in Art 12 MLI
- Details → Art 5 nos 82-101 OECD MC Comm.

PE | *Dependent Agent*

- **Agency PE in Art 5(5) OECD-MC → *Background of the 2017 Update***
  - ***Example***: SubCo is a wholly owned subsidiary of ParCo. It has been downsized from a fully-fledged distributor to a commissionnaire selling ParCo's products in State B to third-party customers in its own name but on behalf of ParCo, which is the owner of these products. SubCo receives (only) an arm's length remuneration for its services (i.e., a commission).



- Which country may tax the profits from the sales (≠ the commission fee)? Is there a PE of ParCo in State B?
- Heavily disputed under the ***pre-2017*** language of Art 5(4) OECD MC
  - SubCo must have had, and habitually had exercised, in that State an "authority to conclude contracts in the name of the enterprise".
  - Legal versus economic understanding of the notion **"in the name of"** → Is it necessary that the contract concluded by SubCo with customers legally binds ParCo? → ✓, *therefore no PE, e.g, French Conseil d'Etat, 31 March 2010, Zimmer, No. 304715 and No. 308525, Norwegian Supreme Court, 2 December 2011, Dell Products v. The State, HR-2011-02245-A, and in this direction also BEPS Action 7 2015 Final Report, p. 9-10;* ✗, *therefore PE, e.g., Spanish Supreme Court, 12 January 2012, Roche, nr. 1626/2008.*
- Now clearly covered by Art 5(5) OECD MC ***after the 2017 Update*** → Art 5 no. 89 OECD MC Comm. → ***Attribution of profits? Are there "extra" profits that are not reflected by the commission fee?***

PE | *Independent Agent*

- **Exception** in Art 5(6) OECD-MC → ***Independent Agent***

OECD MC before 2017
Independence

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

OECD MC 2017
Close relations

6. Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.

8. For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

- Connected with the new approach to dependent agents (Art 5(5) OECD MC)
- Amendment following Action 7 of the BEPS Project (para. 5 et seq. of the 2015 Final Report), also in Art 12, 15 MLI
- Details → Art 5 nos 102-114 and 119-121 OECD MC Comm.

Excursus | *Services*

- The "PE concept" – ***Services PE***
  - Income from services generally taxable in the source State only to the extent that there is a **PE** (Art 5 OECD MC) to which the fees are attributable → *Limits compliance and administrative burdens, problems with the calculation of the tax etc – Also note, e.g., Art 8, 17 OECD MC*
  - ***Balancing source versus residence***
    - **UN-MC** deems a PE to exist in respect of services performed for more than 183 (Art 5(3)(b) UN-MC – *Note: The previous limitation that the services be "for the same or a connected project" has been given up by the 2017 UN Update*)

> (*b*) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

    - ***OECD Alternative Provision*** → Art 5 nos 132-169 OECD MC Comm.
    - ***Note*:** Since the 2017 Update fees for technical services are addressed by Art 12A UN MC

Excursus | *Insurance*

- The "PE concept" – ***Insurance PE***
  - Generally, an **insurance company** of one State may be taxed in the other State on its insurance business if it has *(1)* a fixed place of business within the meaning of Art 5(1) OECD MC or *(2)* if it carries on business through a dependent agent under Art 5(5) OECD MC (Art 5 no. 114 OECD MC Comm.)
  - Before the 2017 Updates, ***agencies of foreign insurance companies*** sometimes did not meet either requirement (*inter alia* because those agents generally have no authority to conclude contracts), so that large-scale business in the source State remained untaxed in that State. → *See, e.g., Tax Court of Canada, 16 May 2008, Knights of Columbus v. The Queen, 2008 TCC 307.*
  - Those concerns are explicity addressed by ***Art 5(6) UN MC***

> 6. Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person..

  - ***Note:*** Extension of the ***dependent agent rules in Art 5(5) OECD and UN MC 2018*** → Art 5 no. 114 OECD MC Comm.

Outlook? | *"Digital PE"*

- Current status in the OECD MC
  - Discussion of ***electronic commerce and the PE concept*** in Art 5 nos 122-131 OECD MC Comm. → Based on a 2002 OECD Report
  - Equipment versus data and software → E.g., a server might be a PE (e.g., of the ISP), but a third-party server is not at the disposal of the enterprise running a hosted website
- Potential policy perspectives
  - ***OECD*** → Discussion (without recommendation) of a new nexus based on ***"significant economic presence"*** = "Digital PE" = "Virtual PE" → BEPS Action 1 Final Report (2015) (pp. 97-118) – *See also the more reserved 2018 Interim Report (pp. 165-176) – Now: Pillars 1 and 2!*
  - ***EU*** → EU Commission proposal for a Directive on the corporate taxation of ***"Significant Digital Presences" ("SDP")*** (COM(2018)147 and Recommendation C(2018)1650 regarding tax treaties with third-countries)

Outlook? | *"Digital PE"*

- EU Commission proposal for a **"Significant Digital Presence" ("SDP")**

Nexus
Art 4 of the Proposal

3. A 'significant digital presence' shall be considered to exist in a Member State in a tax period if the business carried on through it consists wholly or partly of the supply of digital services through a digital interface and one or more of the following conditions is met with respect to the supply of those services by the entity carrying on that business, taken together with the supply of any such services through a digital interface by each of that entity's associated enterprises in aggregate:

(a) the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7 000 000;

(b) the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100 000;

(c) the number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that Member State exceeds 3 000.

Attribution of profits
Art 5 of the Proposal

2. The profits attributable to or in respect of the significant digital presence shall be those that the digital presence would have earned if it had been a separate and independent enterprise performing the same or similar activities under the same or similar conditions, in particular in its dealings with other parts of the enterprise, taking into account the functions performed, assets used and risks assumed, through a digital interface.

3. For the purposes of paragraph 2 the determination of profits attributable to or in respect of the significant digital presence shall be based on a functional analysis. In order to determine the functions of, and attribute the economic ownership of assets and risks to, the significant digital presence, the economically significant activities performed by such presence through a digital interface shall be taken into account. For this purpose, activities undertaken by the enterprise through a digital interface related to data or users shall be considered economically significant activities of the significant digital presence which attribute risks and the economic ownership of assets to such presence.

4. In determining the attributable profits under paragraph 2, due account shall be taken of the economically significant activities performed by the significant digital presence which are relevant to the development, enhancement, maintenance, protection and exploitation of the enterprise's intangible assets.

5. The economically significant activities performed by the significant digital presence through a digital interface include, inter alia, the following activities:

(a) the collection, storage, processing, analysis, deployment and sale of user-level data;

(b) the collection, storage, processing and display of user-generated content;

(c) the sale of online advertising space;

(d) the making available of third-party created content on a digital marketplace;

(e) the supply of any digital service not listed in points (a) to (d).

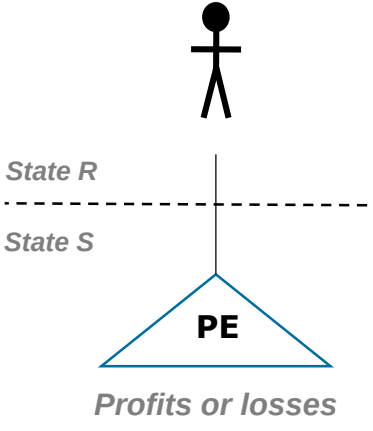
6. In determining the attributable profits under paragraphs 1 to 4, taxpayers shall use the profit split method unless the taxpayer proves that an alternative method based on internationally accepted principles is more appropriate having regard to the results of the functional analysis. The splitting factors may include expenses incurred for research, development and marketing as well as the number of users and data collected per Member State.

Chapter IV/1.3
Business Profits

WU WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Business Profits | *Overview*

- If there is a PE in the source State, ***how much profits are to be attributed to the PE? → Art 7 OECD MC 2010 (≠ Art 7 UN MC)***



- ***Art 7(1) OECD MC*** – Residence country has exclusive right to tax business profits, ***unless*** there is a ***PE in the source country***. → *No force of attraction in OECD MC, limited force of attraction in UN MC*.
- ***Art 7(2) OECD MC*** – Central directive for attribution of profits to PEs → ***"The Distinct and Separate Entity Principle" → AOA*** → OECD Update 2010
- ***Art 7(3) OECD MC*** – Mechanism to reach a common understanding between the States with regard to the interpretation of Art 7(2) OECD MC → ***Quantification of profits***
- ***Art 7(4) OECD MC*** – Ordering rule for "profits" that are covered by other distributive rules – *Note: "Throwback" rules in Art 10(4), 11(4), 12(3), 21(2) OECD MC*

Business Profits | *Overview*

- **Business profits – Art 7 OECD MC before and after 2010**

Before 2010 (and still in the UN MC)
Various principles

ARTICLE 7

BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Since 2010
Authorized OECD Approach

ARTICLE 7

BUSINESS PROFITS

1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

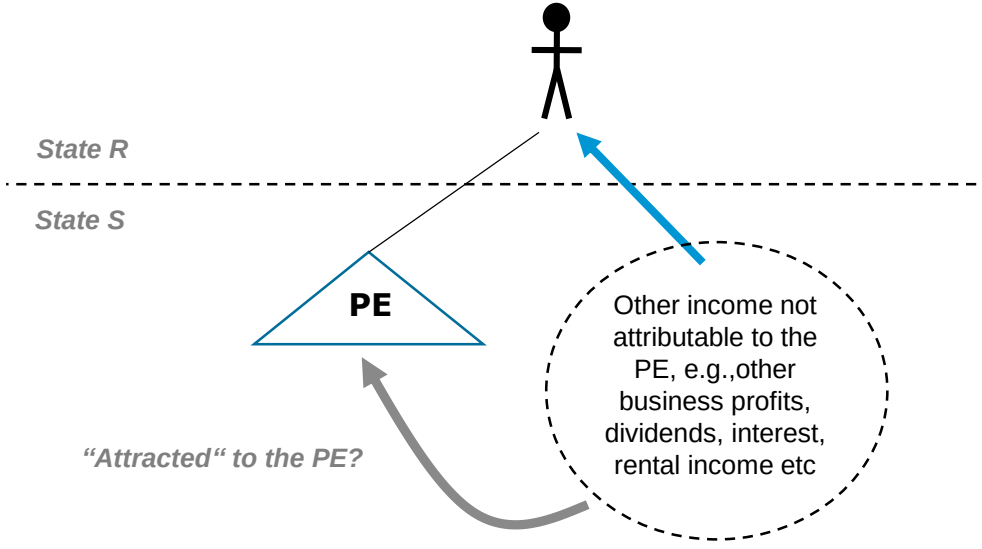
2. For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.

4. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

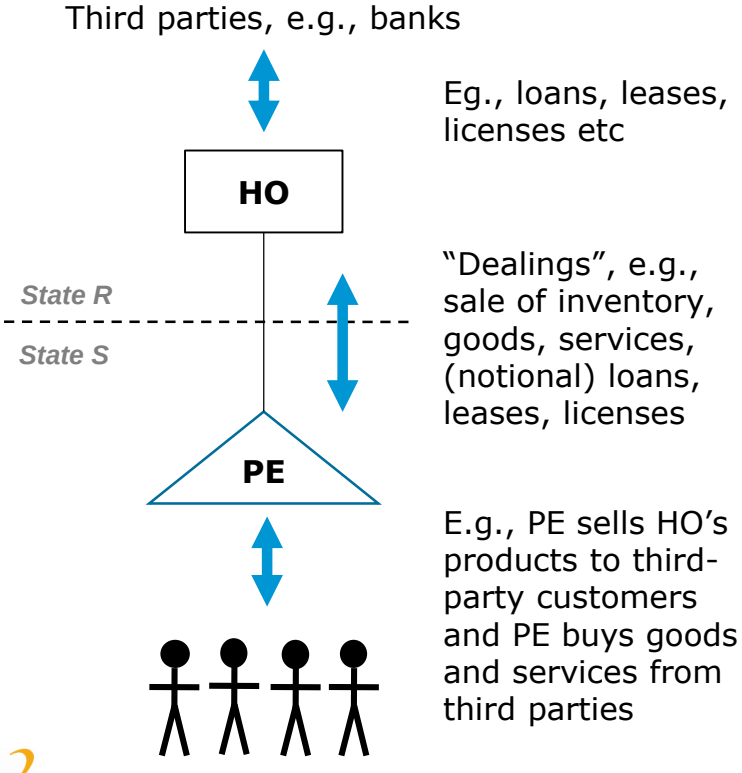
Business Profits | *Attraction*

- **"Force of attraction"?**
  - ***OECD MC*** rejects force of attraction (Art 7 no 12 OECD Comm.)
  - ***UN MC*** contains limited force of attraction (Art 7(1)(b) and (c) UN MC) for "sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment" and "other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment"



Business Profits | *Attribution*

- **Attribution of profits to a PE**



- Revenues and expenses of the PE – ***Fiction of independence!***
- Head office incurs expenses for the PE, e.g., interest on a loan that is used in the PE. → *Attribution of the external interest expense? (Pre-2010 Art 7(3) OECD MC)*
- Head office, e.g.,
  - produces goods and "sells" them to the PE for onselling to customers;
  - "allows" the PE to use an intangible or tangible asset;
  - extends a "loan" to the PE with or without external costs (i.e., "external" versus "internal" interest; paras. 152 et seq. of the 2010 AOA Report)

Business Profits | *Overview*

- **PE as "distinct and separate entity"**

Before 2010 (and still in the UN MC)
Limited "separateness"

ARTICLE 7

BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

Since 2010
(Full) fiction of independence

ARTICLE 7

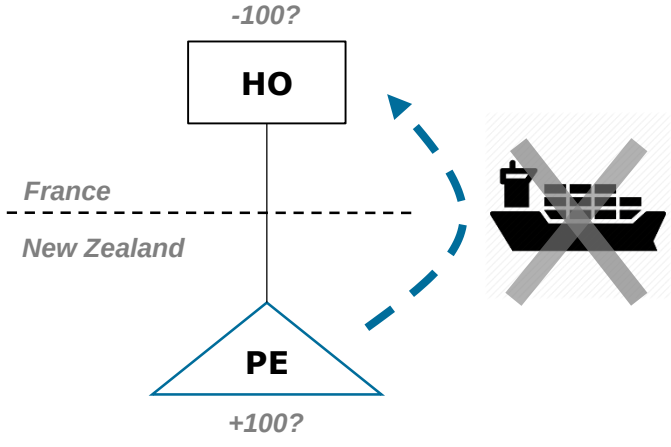
BUSINESS PROFITS

1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

2. For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

Business Profits | *Attribution*

- **PE as "distinct and separate entity"**
  - ***Example:*** A Co., a resident of France, produces wool pullovers. It has a PE in New Zealand, where sheep are bred and clipped. The raw wool is then put on a ship that sails to the factory of A Co. in France. However, a huge storm destroys the ship. A Co. has failed to buy insurance. → *Profit attribution? Assume that the PE, if it were a separate entity, had profits of 100, whereas A Co. has (real) losses of 100.*



- ***"Relevant Business Activity" Approach*** → "... so much of them ..." in Art 7(1) OECD MC before the 2010 Update (and still in Art 7(1) UN MC) → Potentially understood as limiting the PE State's right to tax in light of the overall enterprise profits → Rejected by Art 7 no. 11 OECD MC Comm. 2008 and Art 7 no. 8 UN MC Comm.
- ***"Functionally separate entity" approach*** → Art 7(2) OECD MC → "Distinct and Separate Entity Principle" → AOA (Art 7 m.mo. 17 OECD MC Comm. 2010)

AOA | *Background*

- **PE as "distinct and separate entity"**
  - ***"Consensus" in the 1930s*** → "Victory" of separate accounting over fractional apportionment
  - ***" Carroll Report"*** → M. B. Carroll, 'Methods of allocating taxable income', in: Taxation of Foreign and National Enterprises Vol. IV, League of Nations Document no. C.425(b).M.217(b).1933.II.A. (1933).
  - Art 3 of the ***"Draft Convention for the Allocation of Business Income between States for the Purposes of Taxation"***, Annex to League of Nations Document no. C.399.M.204.1933.II.A. [F./Fiscal. 76.] (June 1933).

Article 3.

If an enterprise with its fiscal domicile in one contracting State has permanent establishments in other contracting States, there shall be attributed to each permanent establishment the net business income which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions. Such net income will, in principle, be determined on the basis of the separate accounts pertaining to such establishment. Subject to the provisions of this Convention, such income shall be taxed in accordance with the legislation and international agreements of the State in which such establishment is situated.

The fiscal authorities of the contracting States shall, when necessary, in execution of the preceding paragraph, rectify the accounts produced, notably to correct errors or omissions, or to re-establish the prices or remunerations entered in the books at the value which would prevail between independent persons dealing at arm's length.

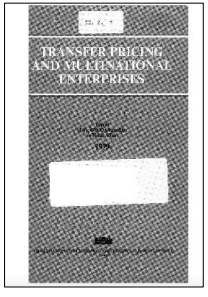
If an establishment does not produce an accounting showing its own operations, or if the accounting produced does not correspond to the normal usages of the trade in the country where the establishment is situated, or if the rectifications provided for in the preceding paragraph cannot be effected, or if the taxpayer agrees, the fiscal authorities may determine empirically the business income by applying a percentage to the turnover of that establishment. This percentage is fixed in accordance with the nature of the transactions in which the establishment is engaged and by comparison with the results obtained by similar enterprises operating in the country.

If the methods of determination described in the preceding paragraphs are found to be inapplicable, the net business income of the permanent establishment may be determined by a computation based on the total income derived by the enterprise from the activities in which such establishment has participated. This determination is made by applying to the total income coefficients based on a comparison of gross receipts, assets, number of hours worked or other appropriate factors, provided such factors be so selected as to ensure results approaching as closely as possible to those which would be reflected by a separate accounting.

AOA | *Background*

- **PE as "distinct and separate entity"**
  - ***Historically*** → Various opinions on the degree of independence of a PE, e.g., the "relevant business activity" approach versus the "functionally separate entity" approach *(see, e.g., Canadian Federal Court of Appeal, 19 October 1998, Cudd Pressure Control Inc. v. Canada, [1998] FCA 1019 : "notional rent")*
  - Work of the OECD since 1994 until 2008/2010
    - ***"Authorized OECD Approach" ("AOA")***, based on the "Distinct and Separate Entity Principle" (Art 7 nos 3-9 OECD MC Comm.), but not influenced by history
    - Work "not constrained by either the original intent or by the historical practice and interpretation of Article 7. Instead, the focus was on formulating the most preferable approach to attributing profits to a permanent establishment under Article 7 given modern-day multinational operations and trade" (Art 7 no 6 OECD MC Comm.)
  - Two phases:
    - ***2008*** → Update of the OECD MC on Art 7 through the 2008 Update, insofar as the AOA was (arguably) in conformity with the language of the OECD MC at that time
    - ***2010*** → Update of Art 7 OECD MC and the OECD MC Comm. through the 2010 Update to give full effect to the AOA

AOA | *Background*



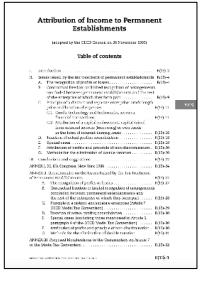
1995 OECD Transfer Pricing Guidelines

1995

2001

2008

1994

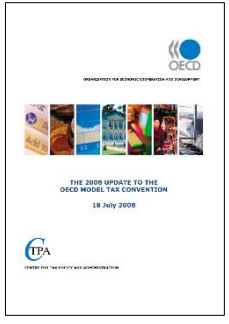


Report on "Attribution of Income to Permanent Establishments" (Issues in International Taxation No. 5, OECD, Paris, 1994) and changes to the Commentary on Art 7 OECD MC

Several drafts and reports on the attribution of profits and development of the "Authorized OECD Approach" (AOA) to PSs between 2001 and 2008:

- Part I – General (2001, revised 2004 and 2006)
- Part II – Banks (2003, revised 2006)
- Part III – Global Trading (2003, revised 2006)
- Part IV – Insurance (2005, revised 2008)

AOA | *Background*



2008 Update → Implementation of the work on the attribution of profits to PEs in the OECD MC Comm. insofar as it does not conflict with the existing interpretation of Art 7 OECD MC

2010 Update → New Art 7 OECD MC to fully reflect the AOA and corresponding OECD MC Comm. (The OECD MC Comm. as it read before that update is still available as an annex to the current OECD MC Comm. on Art 7.)

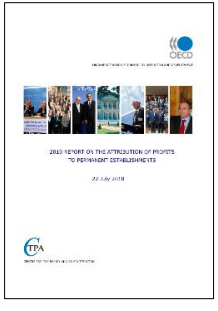
2008

2010

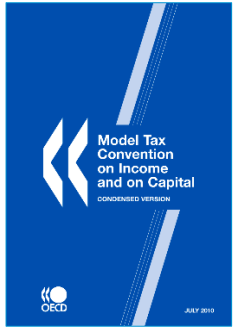
2007

2007-2010 → Discussion drafts for the 2008 and 2010 Updates

(Updated) 2010 version of the Attribution Report to reflect the new version of Art 7 OECD MC Comm.



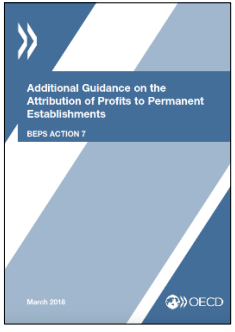
AOA | *Background*



2010 OECD MC Update → "Authorized OECD Approach" ("AOA")

2010

Additional Guidance on the Attribution of Profits to Permanent Establishments (March 2018)

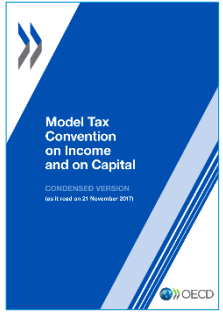


2018

2015

2015 BEPS Final Report on the Artificial Avoidance of PEs …

2017



… and 2017 OECD MC Update

Further development or modification of the attribution rules with regard to the digitalized economy?

Business Profits | *Structure*

- Art 7 on Business Profits (Update 2010)
  - ***Para 1*** – Residence country has exclusive right to tax business profits, unless there is a PE in the source country.
  - ***Para 2*** – For Art 7 and Art 23: Separate entity approach for profit attribution, in particular for "its dealings with other parts of the enterprise"
  - ***Para 3*** – Corresponding adjustments, MAP
  - ***Para 4*** – Profits that are covered by other Articles of the convention.

1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

2. For the purposes of this Article and Article [23 A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.

4. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Business Profits | *AOA*

- ***Principle*** – PE's profits determined as if it were a distinct and separate enterprise → ***Arm's Length Principle*** (OECD Transfer Pricing Guidelines – "TPG")
  - Absence of legally binding contracts between head office and PE → Requirement for an ***approach to attribute risks, economic ownership of assets and capital*** to the PE.
  - Recourse to ***functional analysis***, i.e. ***significant people functions*** (in banking and finance: KERT function) as basis for hypothesising the PE as distinct and separate enterprise and determining the profits of the PE
- Corresponding amendments, e.g., with regard to ***"economic ownership"*** of assets or property
  - ***Dividends*** — Art 10 nos 32.1 and 32.2 OECD MC Comm. 2010
  - ***Interest*** — Art 11 nos 25.1 and 25.2 OECD MC Comm. 2010
  - ***Royalties*** — Art 12 nos 21.1 and 21.2 OECD MC Comm. 2010
  - ***Gains*** — Art 13 m.nis 27.1 and 27.2 OECD MC Comm. 2010
  - ***Other Income*** — Art 21 nos 5.1 and 5.2 OECD MC Comm. 2010

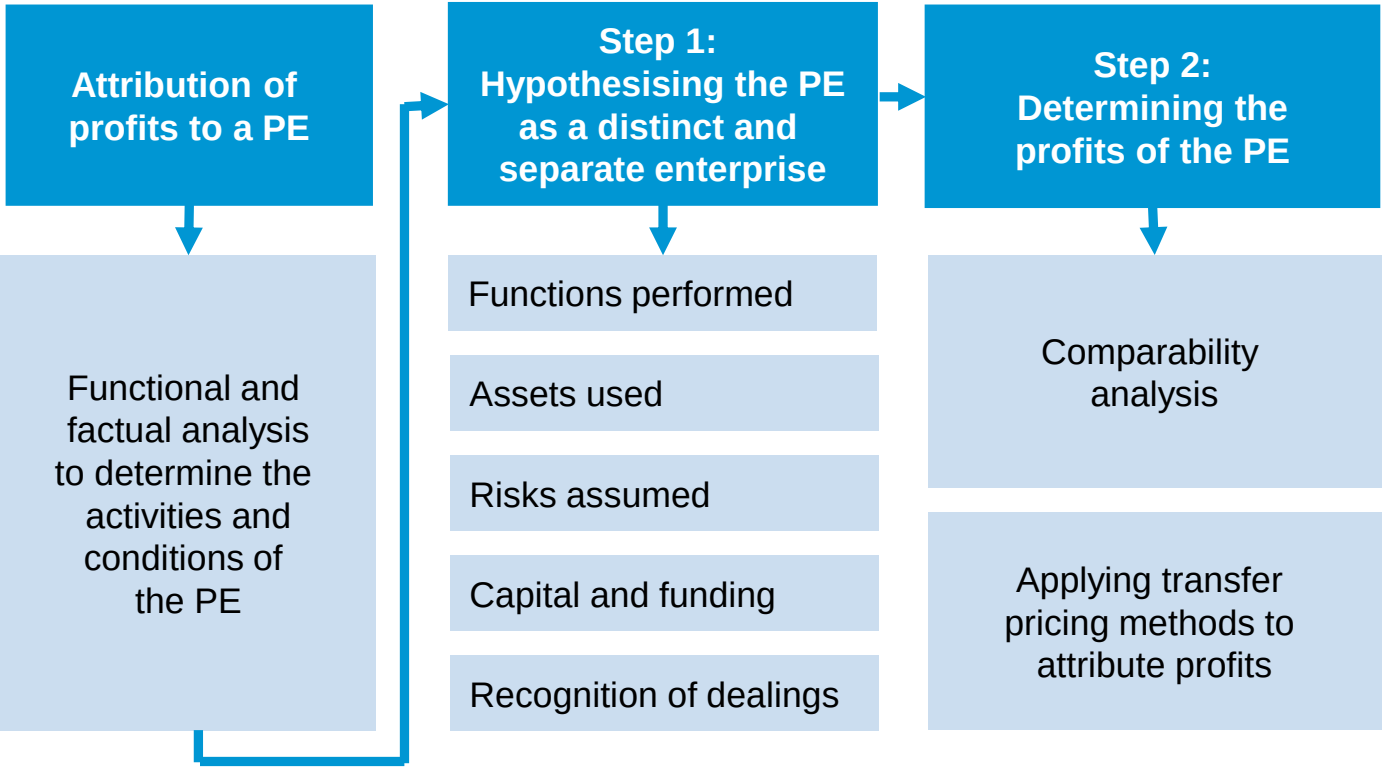
Business Profits | *AOA*

- **Two Step Approach**
  - ***Step 1*** — "Hypothesising the PE as a Disctinct and Separate Enterprise" (Part I.D-2 of the 2010 AOA Report; Art 7 no. 21 OECD MC Comm. 2010)
    - ***Functional and Factual Analysis*** → Functions of the hypothesised separate and independent enterprise and the economically relevant characteristics → ***Significant people functions (SPF)***
    - ***Attribution of Risks*** → SPF with regard to the assumption of risks
    - ***Attribution of Assets*** → SPF with regard to economic ownership of assets
    - ***Attribution of Free Capital*** → Free capital and interest-bearing debt → Attribution of the external (!) interest expense of the enterprise to its PE
    - ***Recognition of Dealings*** → Real and identifiable event (e.g. the physical transfer of stock in trade, the provision of services, use of an intangible asset, a change in which part of the enterprise is using a capital asset, the transfer of a financial asset, etc.)

Business Profits | *AOA*

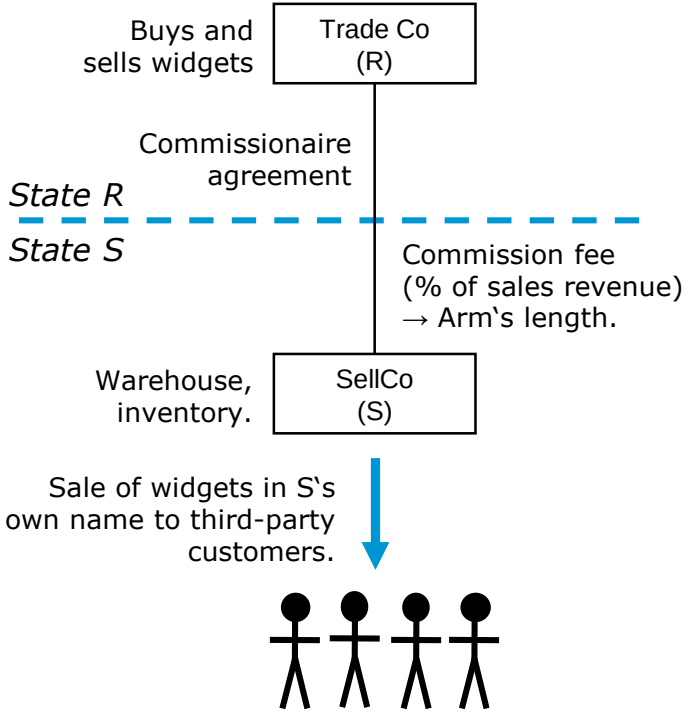
- **Two Step Approach**
  - ***Step 2*** — "Determining the Profits of the Hyothesised Disctinct and Separate Enterprise Based Upon a Comparability Analysis" (Part I.D-3 of the 2010 AOA Report; Art 7 no. 21 OECD MC Comm. 2010)
    - ***Comparability Analysis***
    - Applying by analogy the transfer pricing methods in the ***OECD Transfer Pricing Guidelines (TPG)*** → Guidance, e.g., for the change in the use of a tangible asset (e.g., sale, lease), intangible property (notional royalties), cost contribution arrangements, Internal services

Business Profits | *AOA*



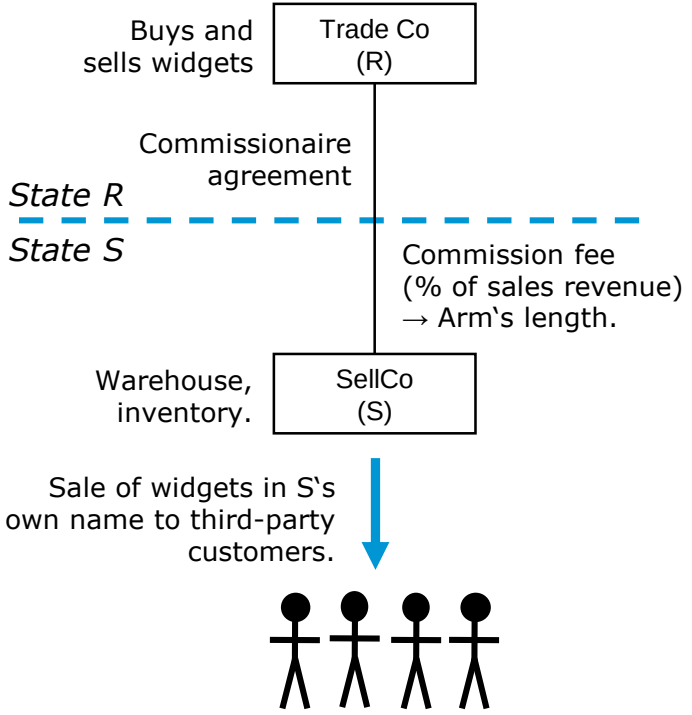
Business Profits | *Example*

- Attribution of profits – ***Example:***
  - TradeCo, resident in State R, buys and sells widgets. SellCo, a 100% subsidiary, performs marketing and sales activities on behalf of TradeCo in Sate S as a commissionaire (i.e., in its own name but based on an agreement with TradeCo, which will satisfy the obligation to deliver the widgets to the buyers).
  - SellCo does not own the widgets at any point, nor does it have any entitlement to the amounts paid by the buyers for the widgets.
  - Personnel of SellCo are responsible for warehousing the inventory and determining, monitoring the appropriate inventory levels.
  - TradeCo pays SellCo a commission equal to a percentage of the sales revenue, and that payment is at arm's length.
  - (= Example 2 in the Additional Guidance on the Attribution of Profits to Permanent Establishments [March 2018])



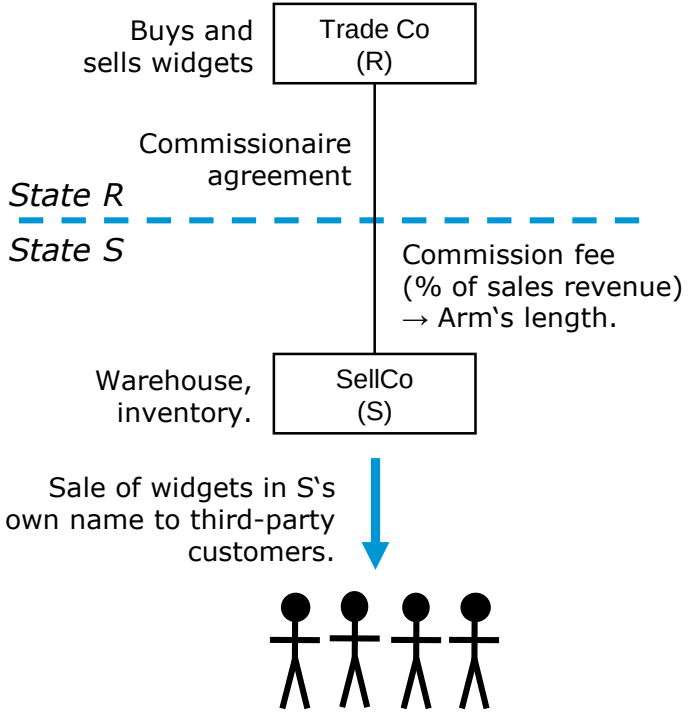
Business Profits | *Example*

- Attribution of profits – ***Example:***
  - ***Step 1 of the AOA***
    - TradeCo → Purchasing widgets from third parties
    - SellCo = PE (Art 5(5) OECD MC 2017 → Sale to final customers in S
    - PE is hypothesised to
      - have TradeCo's rights and obligations from the transactions between TradeCo and *(1)* final customers and *(2)* SellCo
      - be the economic owner of the inventory and the party assuming inventory risks
      - have dealings, i.e., the sale of goods between by the head office to the PE



Business Profits | *Example*

- Attribution of profits – ***Example:***
  - ***Step 2 of the AOA***
    - TPG applied by analogy to price the dealing (i.e., sale of the goods between head office and PE)
    - Pricing = Amount that TradeCo would have received if it had sold the goods to an unrelated party performing the same or similar activities in the same or similar conditions that SellCo performs on behalf of TradeCo
    - In PE's tax computation this amount would be deducted as COGS and the remuneration paid to SellCo (commission fee) would also be a deductible expense as well as all other expenses incurred for the purpose of the PE



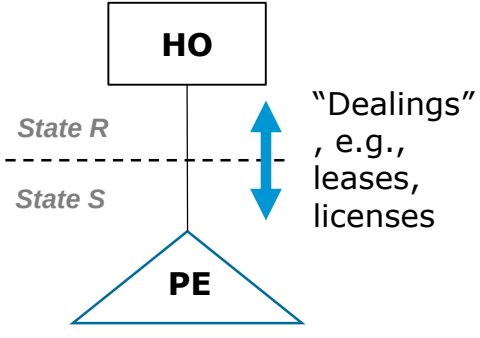
Business Profits | *AOA*

- Scope of the AOA – ***Art 7(2) OECD MC***
  - ***Example:*** A Co. has a PE in State S. Its dealings with the PE include *(1)* "leasing" it real estate in State S and *(2)* letting it use intangible property economically owned by A Co. → *What are the effects on the PE's profits? May State S tax A Co.'s notional rental income or the notional royalties (if the R-S-treaty provides for such taxation in Art 12)?*

General directive in Art 7(2) OECD MC 2010

(Full) fiction of independence

2. For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.



Attribution | *OLD versus NEW*

- Limited fiction of a "separatedness" of the PE before 2010
  - Profits that can be attributed to a PE are not limited to the amount of profits of the enterprise as a whole (Art 7 m.n.o 11 OECD MC Comm. 2008)
  - Trading accounts of the PE are the starting point for profit allocation (Art 7 no. 19 OECD MC Comm. 2008)
  - PE State may tax notional profits when an asset leaves the State (Art 7 no. 21 OECD MC Comm).
  - But: ***Conflicts with the "AOA"***
    - E.g., allocation of economic ownership of certain assets (e.g. intangibles) and explicit recognition of internal dealings (internal services at arm's length prices, internal dealings in the form of licenses, internal dealings in the form of loans when there is a treasury function)
    - Arm's length or actual cost? (Art 7(3) OECD MC 2008)
    - "Exceptions" to the arm's length principle with regard to temporary transfer of assets (Art 7 no. 33 OECD MC Comm. 2008), intangibles (Art 7 no 34 OECD MC Comm. 2008), services (Art 7 nos 35-37 OECD MC Comm. 2008), good management (Art 7 nos 38-40 OECD MC Comm. 2008) and transfer of funds (Art 7 nos 41-48 OECD MC Comm. 208)
  - ***Note: UN-MC*** – No deduction for internal royalties, fees, other similar payments, commissions, interest etc (Art 7(3) UN MC)

Capital Gains | *Business Assets*

- **Article 13 OECD MC → *"Treaty within the treaty" for capital gains***
  - Art 13(1)-(5) OECD MC resembles the allocation of taxing rights for "ongoing" income (Art 6, 7, 8, 10, 11, 12, [14], 15, 16, 17, 18, 19, 20 and 21 OECD MC)
  - ***"Income" ("profits") versus "capital gains"?*** → E.g., ongoing sale of products (Art 7 OECD MC) versus extraordinary enrichment from the alienation of operating assets (e.g., Art 13(1) OECD MC)
  - No "gap" between the rules, e.g., Art 13(2) OECD MC:

> 2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

Chapter IV/1.4
Fees for Technical Services

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"Nexus" | *Taxing Rights*

- **Services in the OECD and UN MC – *"Nexus"? Adminstrability?***

	OECD MC	UN MC
Art 5 (PE definition)	▪ 12-months-threshold for "construction PE" (Art 5(3)) ▪ No services PE (Art 5 nos 132-169 OECD MC Comm.)	▪ 6-months-threshold for "construction PE" (Art 5(3)(a)) ▪ Limited services PE (Art 5(3)(b)) ▪ "Insurance PE" (Art 5(6))
Art 12 (royalties)	▪ No source taxation rights (Art 12(1)) ▪ Since 1992, definition does not include payments for "the use of, or the right to use, industrial, commercial or scientific equipment" (e.g., containers)	▪ Source taxation rights (Art 12(2)) ▪ Definition includes payments for "the use of, or the right to use, industrial, commercial or scientific equipment" (e.g., containers) (Art 12(3)) ▪ Further differences in E/C.18/2014/3
Art 12A (fees for technical services)	▪ — (Note: Art 5 no. 139 OECD MC Comm.: Consensus that there should be no source taxation rights on income from "services performed by a non-resident outside that State")	▪ Source taxing rights over fees for technical services, inter alia, if payer is a source State resident (Art 12A)
Art 14 (professional services)	▪ — (Elimination of Art 14 OECD MC in 2000, *inter alia*, because of no intended differences between PE, as used in Art 7, and fixed base, as used in Art 14).	▪ Professional or independent personal services through a fixed base in the source State (Art 14 UN MC)

Fees | *Art 12A UN MC*

- **Since 2017: "Fees for technical services" in Art 12A UN MC**

Article 12A

FEES FOR TECHNICAL SERVICES

1. Fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, notwithstanding the provisions of Article 14 and subject to the provisions of Articles 8, 16 and 17, fees for technical services arising in a Contracting State may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ percent of the gross amount of the fees [the percentage to be established through bilateral negotiations].

3. The term "fees for technical services" as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:

(a) to an employee of the person making the payment;
(b) for teaching in an educational institution or for teaching by an educational institution; or
(c) by an individual for services for the personal use of an individual.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for technical services arise through a permanent establishment situated in that other State, or performs in the other Contracting State independent personal services from a fixed base situated in that other State, and the fees for technical services are effectively connected with:

(a) such permanent establishment or fixed base, or
(b) business activities referred to in (c) of paragraph 1 of Article 7.

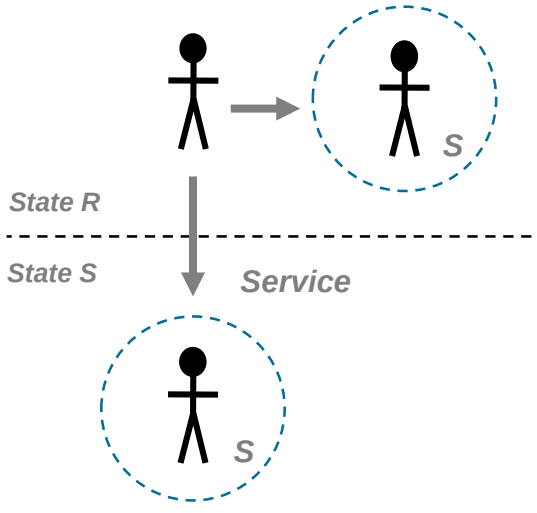
In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. For the purposes of this Article, subject to paragraph 6, fees for technical services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment or fixed base.

6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent personal services through a fixed base situated in that other State and such fees are borne by that permanent establishment or fixed base.

Fees | *Art 12A UN MC*

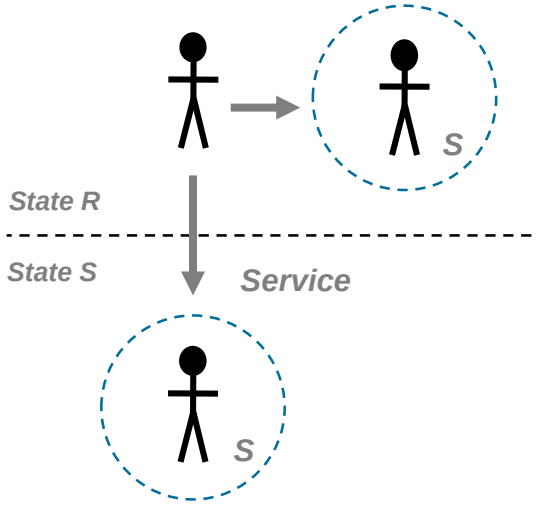
- Fees for technical services" in Art 12A UN MC – ***Policy considerations*** (Art 12A no. 1 et seq. UN MC)



- ***Substantial cross-border services*** and therefore a ***significant economic presence*** in the source State without having any fixed place of business there. → *Digitalized economy*
- Unclear ***scope*** of the notion "information concerning industrial, commercial or scientific experience" in Art 12(3) UN MC
- ***Base erosion*** through deductibility of service charges without corresponding taxation of the non-resident recipient, ***profit shifting*** under transfer pricing rules.
- ***Majority (but not unanimous) opinion*** in the UN → Deduction of fees against that State's tax base is enough justification for source taxation, irrespective of where the service is rendered
- ***Issues***, e.g., rate for gross basis taxation in light of excessive taxation and avoidance of double taxation? Price increases because of gross-ups? Scope and definition of "technical services"?

Fees | *Art 12A UN MC*

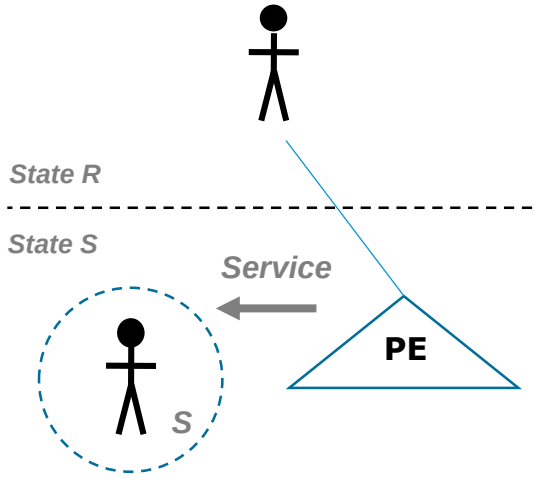
- "Fees for technical services" in Art 12A UN MC – ***Structure***



- *Residence state* taxing right (Art 12A(1) UN MC)
- ***But:*** Source state ***taxing right*** for fees from technical services on a ***gross basis***, reduced to an ***agreed percentage*** (Art 12A(2) UN MC) under the condition that the recipient is the benefcial owner → *Note: Credit method in the residence State under Art 23A(2) UN MC*
- ***Scope*** (Art 12A(3) UN MC)
  - Defined as ***"payment" for managerial, technical or consulting services*** (Art 12(3) UN MC), including, e.g., fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering and dentistry
  - ***Excluding***,
    - payments of saleries, wages etc to employees,
    - fees for teaching at an educational institution, and
    - payments by individuals for services for personal use (e.g., surgery, etc → Excluded mainly because no base erosion concerns and enforcement/compliance problems with regard to withholding taxation)

Fees | *Art 12A UN MC*

- "Fees for technical services" in Art 12A UN MC – ***Structure***



- ***Ordering rules*** →
  - Priority of Art 7, 14 over Art 12A if there is a PE or fixed place in the source State (Art 12A(4) UN MC)
  - Priority of Art 8, 16 and 17 over Art 12A (Art 12A(2) UN MC)
- **Definition of source** →
  - Residence of the payer or fees connected with a PE or fixed place in the source State (Art 12A(5) UN MC)
  - But no source in the payer's residence State if fees are incurred in a PE or fixed place in the other Contracting State (Art 12A(6) UN MC)
- Limitation of source taxation only for the non-excessive portion of fees (Art 12A(7) UN MC)

Chapter IV/1.5
Excursus: Associated Enterprises and Transfer Pricing

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Transfer Pricing | *Article 9*

- Article 9 OECD MC as an "alien" element among the distributive rules?
- ***Arm's Length Principle (ALP)*** between associated enterprises
  - Primary, corresponding and secondary adjustments
  - OECD Transfer Pricing Guidelines 2017 (includes BEPS Actions 8-10 and 13; 608 pages) – "TPG"

ARTICLE 9

ASSOCIATED ENTERPRISES

1. Where

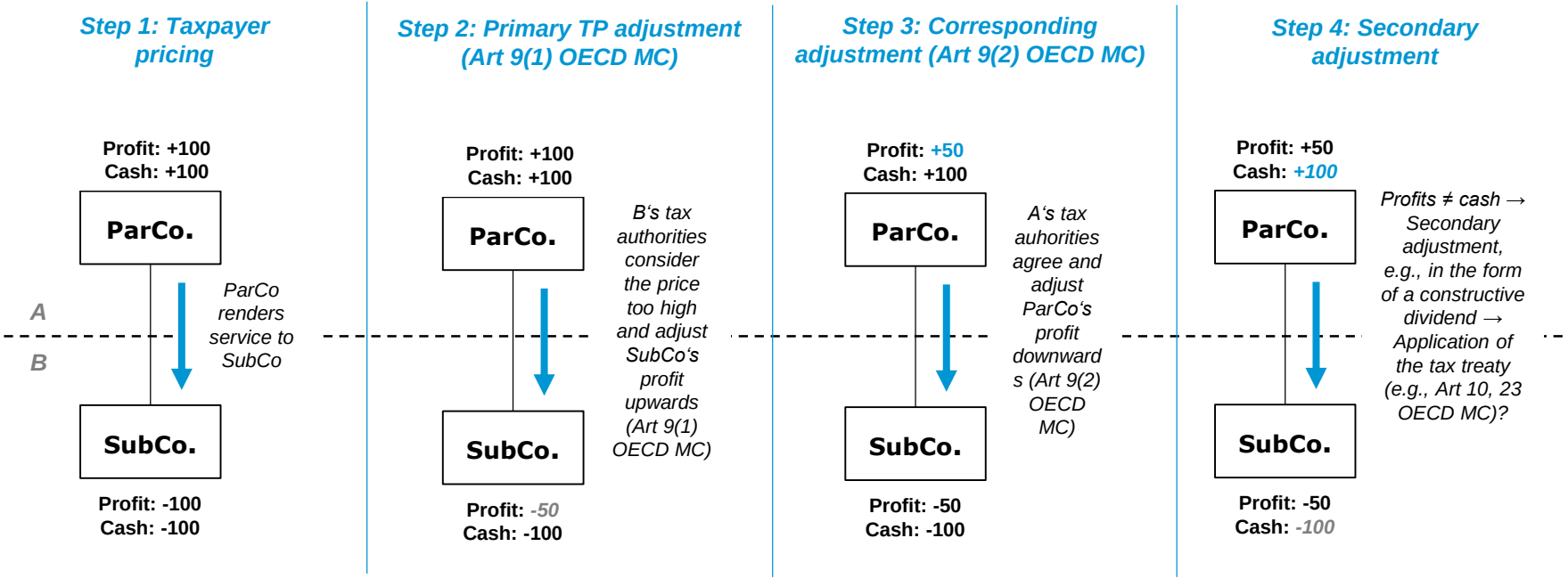
   a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

   b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

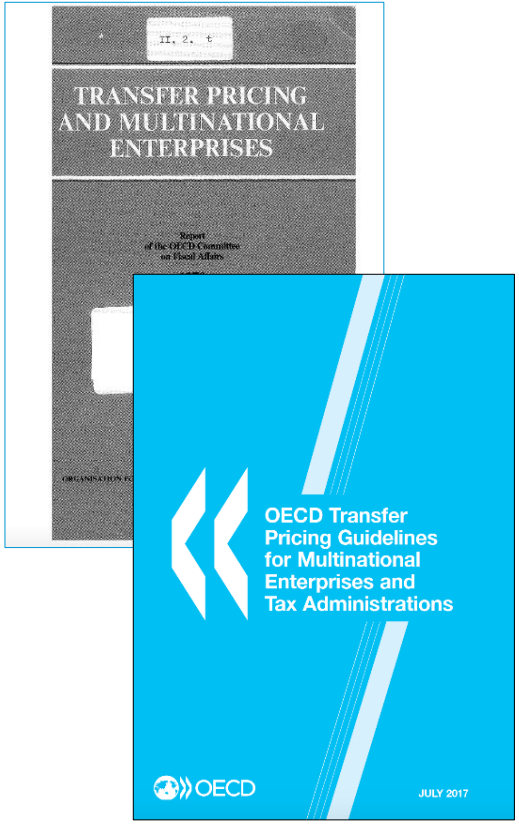
2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Transfer Pricing | *Adjustments*



Transfer Pricing | *Article 9*

- **OECD Transfer Pricing Guidelines (TPG)**
  - OECD guidance for transfer pricing → 1979 Report, 1995 Guidelines and, most recently in 2017, inclusion of BEPS Actions 8-10 and 13
  - OECD ***Transfer Pricing Guidelines 2017***
    - *Chapter I:* The Arm's Length Principle
    - *Chapter II:* Transfer Pricing Methods
    - *Chapter III:* Comparability Analysis
    - *Chapter IV:* Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes
    - *Chapter V:* Documentation
    - *Chapter VI:* Special Considerations for Intangibles
    - *Chapter VII:* Special Considerations for Intra-Group Services
    - *Chapter VIII:* Cost Contribution Arrangements
    - *Chapter IX:* Transfer Pricing Aspects of Business Restructurings
    - *Chapter X:* Financial Transactions (Feb. 2020)
    - Annexes



Article 9 | *What does it do?*

- Article 9 OECD MC in tax treaties? – ***What does it do? How far does it go?***
  - Merely programmatic statement? → *Arm's Length Principle (ALP) between associated enterprises → Criticism? Alternatives? Too much fiction?*
  - "Permit" adjustments? Prevent abuse? → *Domestic law! Or: What would happen without Article 9? – Test question: Does Article 9 "apply" to transactions between two corporations each of which is wholly owned by husband and wife?*
  - Remove double taxation? → *Article 9(1) OECD MC "creates" double taxation, Article 9(2) OECD MC was only introduced in 1977.*
  - Legal basis for adjustments outside domestic law? → × *(e.g., Federal Court of Australia, 23 October 2015, Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4) [2015] FCA 1092, para. 51-62)*
  - Restrictive force? → ✓ (e.g., Article 9 no. 2 OECD MC Comm.; OECD 1986 Report on "Thin Capitalisation", pars 27-32 and 48-49), but "saving clause" in Article 1(3) OECD MC
  - Carve out from non-discrimination rules? → *Art 24(4) OECD MC ("[e]xcept where the provisions of paragraph 1 of Article 9 … apply") and Art 24(4) OECD MC (Art 24 no. 79 OECD MC Comm.)*

Article 9 | *What does it do?*

- Article 9 OECD MC in tax treaties? – ***What does it do? How far does it go?***
  - Quantification of business profits (Article 7 OECD MC)? Pricing versus characterization ("object qualification")? Allocation of overall profits or transactional approach? Relevance of deductibility of arm's length payments *(e.g., undertaxed payment rule under Pillar 2?)* or inclusion of payments?
  - Is Article 9(2) OECD MC "self executing"? → *Do we need Article 9(2) OECD MC? Wording ("… shall …")? MAP under Article 25 OECD MC? Corresponding adjustments outside MAPs? MLI? Statute of limitation?*

Chapter IV/2
Immovable Property, International Transport

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Overview

- ***Chapter IV/2.1*** **–** Immovable Property (Article 6 OECD MC)
- ***Chapter IV/2.2*** **–** Shipping and Air Transportation (Article 8 OECD MC)

Chapter IV/2.1
Immovable Property

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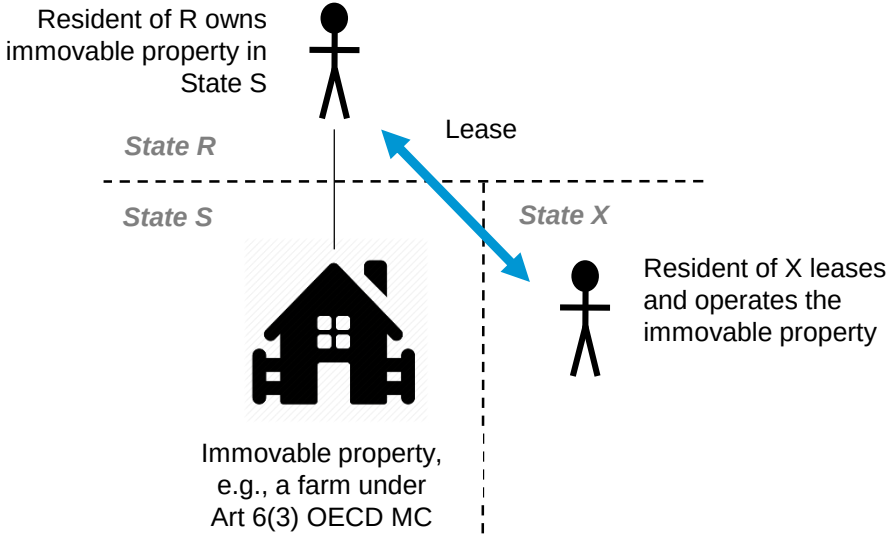
Immovable Property | *Overview*

- **Article 6 OECD MC** → "Open", bilateral distributive rule for income derived from "immovable property" ("real property" ≠ "movable property", "personal property") → ***"Situs" principle*** → *"[V]ery close economic connection between the source of this income and the State of source" (Art 6 no. 1 OECD MC Comm.) – Rationales: Old land taxes – territorial sovereignty – administrative convenience*



Immovable Property | *Structure*

- Article 6 OECD MC → ***"Situs" principle***
- ***General Rule*** →
  - (Unlimited) taxation where the ***immovable property is located*** ("situs"), irrespective of the residence of the payor (Art 6(1) OECD MC), (ideally) on a net basis (Art 6(5) US MC and the US reservation in Art 6 no. 10 OECD MC) – *Relief from double taxation under Art 23 OECD MC*
  - Includes income from ***agriculture and forestry*** (Art 6 nos 1, 2.1 OECD MC Comm. – Note: Farm might still be a PE under Art 5 OECD MC → Relevant, e.g., for Art 11(5), 24(3) OECD MC) – Selling agricultural and forestry production, but also income that is an integral part of that activities (e.g., trading of emission permits) – *Application of Art 6 or Art 7 OECD MC with regard to "side-enterprises" (e.g., agricultural tourism, butcheries, restaurants etc)?*

Chapter III

TAXATION OF INCOME

ARTICLE 6

INCOME FROM IMMOVABLE PROPERTY

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

Immovable Property | *Structure*

- Article 6 OECD MC → ***"Situs" principle***
- ***"Immovable property"*** (Art 6(2) OECD MC)
  - Reference to ***domestic law*** of the situs State (Art 6 no. 2 OECD MC Comm.)
  - ***"In any case"*** (i.e., even if deviating from domestic law) accessory property, livestock, equipment in agriculture and forestry , rights, usufruct, rights with regard to mineral deposits, natural resources (i.e., mineral royalties)
  - ***Excluded*** is, e.g., income from
    - ships and aircraft (Art 8 OECD MC),
    - use of real estate by shareholders or distributions form real-estate corporations (see for REITs Art 10 nos 67.1-67.7 OECD MC Comm.),
    - interest from debt secured by immovable property (Art 11 OECD MC).

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Immovable Property | *Structure*

- Article 6 OECD MC → ***"Situs" principle***
- **"From"** in Art 6(1) OECD MC → Substantiated through ***"derived from … use"*** in Art 6(1) OECD MC
  - Includes ***direct and indirect use*** of immovable property, e.g., through direct use by the owner and rental income from the letting of immovable property.
  - Some argue that the notion of "use" might limit the scope of Art 6 OECD MC, e.g., where immovable property is concerned (e.g., wind, water and solar energy facilities, beekeeping etc), but its operation has no relation to the natural resources of the earth.

Chapter III

TAXATION OF INCOME

ARTICLE 6

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4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

Immovable Property | *Structure*

- **Article 6 OECD MC** → ***"Situs" principle***
- Art 6 takes precedence ***over Art 7 OECD MC*** (Art 6(4) OECD MC)
  - Economic perspective of income from immovable property versus business income (e.g., operation of a hotel falls under Art 7 OECD MC, although part of room prize reflects the "rental" of real estate)
  - "Use" versus "alienation" (Art 13(1) OECD MC)

Chapter III

TAXATION OF INCOME

ARTICLE 6

INCOME FROM IMMOVABLE PROPERTY

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

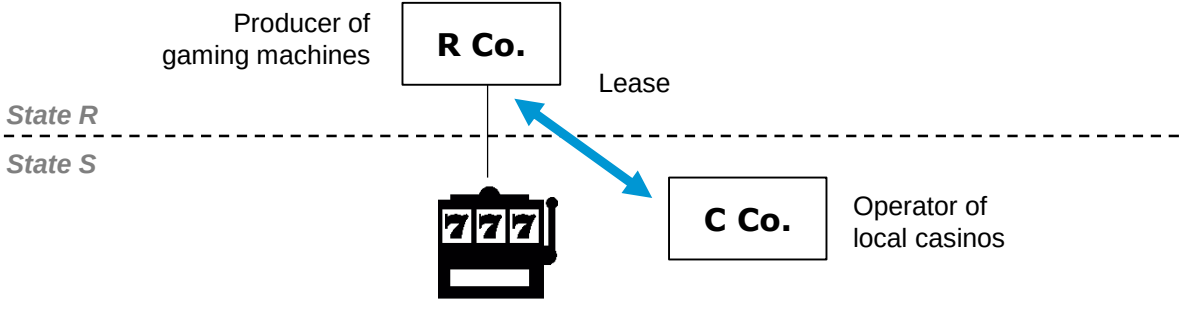
2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

Immovable Property | *Defintion*

- Article 6 OECD MC → ***Immovable property and domestic law***
  - ***Example:*** R Co. produces and leases gaming machines. It places them also in various locations in State S and leases them to a local casino operator, C Co. State S wants to tax those profits and, therefore, changes its domestic law so that the term "immovable property" now includes gaming machines. → *Which State may tax the rental income?*



  - ***Assumptions:*** The tax treaty between R and S is old and based on the OECD MC. Moreover, the gambling machines do not constitute a PE under Art 5 OECD MC for R Co. (Art 5 m.no. 41 OECD MC Comm.) and the rental payments are not royalties under Art 12 OECD MC (even though they might well be "commercial equipment" under Art 12(3) UN MC – *See, e.g., US Tax Court, 22 July 1966, London Displays Company v. Commissioner, 46 T.C. 511, concerning payments for wax figures by Madame Tussauds Wax Museums*)

Capital Gains | *Immovables*

- Art 13(1) and (4) OECD MC → ***Capital gains from the alienation of immovable property***
  - ***"Situs" principle*** under Art 13(1) OECD MC (Art 13 nos 22 – 23 OECD MC Comm.)

> 1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

  - Supplemented by Art 13(4) OECD MC for gains from the alienation of all or part of ***a "real estate company"*** (Art 13 nos 28.3 – 28.13 OECD MC Comm.)

> 4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

Chapter IV/2.2
Shipping and Air Transportation

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Transport | *Overview*

- Art 8 OECD MC → "Closed", worldwide distributive rule for profits from the operation of ships or aircraft in international traffic (Art 3(1)(e) OECD MC → ***Exclusive taxation in the residence State!***

OECD MC before 2017
PoEM, inland waterways

ARTICLE 8

SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT

1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

3. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.

4. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

OECD MC 2017
Residence, international traffic

ARTICLE 8

INTERNATIONAL SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

2. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

2017 OECD/UN Update based on a 2013 Discussion Draft that considered the treaty practice of OECD Member States

Transport | *Background*

- Art 8 OECD MC → ***Background*** – Domestic rules (reciprocity), international shipping agreements
  - Double Taxation And Tax Evasion-Report and Resolutions Submitted By The Technical Experts to the Financial Committee of the League of Nations (Document F.212; February 7, 1925):

> One particular class of industrial and business enterprise, namely *maritime shipping concerns*, has engaged our special attention, and forms, as will be seen, the subject of a special resolution. The International Chamber of Commerce and the special Sub-Committee of the League of Nations which deals with maritime transit communicated to us their views on this subject. For several years past, negotiations have been in progress between seven or eight leading countries for the regulation, by bilateral agreements, of the system of taxation to be applied (on the basis of reciprocal exemption) to maritime shipping concerns. England, the Netherlands, the United States and Japan have enacted domestic laws providing for such exemption, applicable to all taxes without exception, both taxes *in rem* and the general tax on income. The United States, Norway, Sweden and Denmark have recently concluded conventions of this kind [37] with Great Britain.
>
> We have taken these recent cases into account, but have paid even greater attention to the very special character of the maritime transport industry. When an industrial concern carries on its activities throughout the whole world, the importance of the actual headquarters, or the "brain" of the enterprise, becomes paramount; and, above all, very serious technical difficulties may be encountered in determining an apportionment of the profits. The representatives of the Maritime Sub-Committee of the League of Nations have asked how it is possible to determine the profits earned in each of the twenty or twenty-five ports at which a vessel belonging to a trans-Atlantic company may have loaded or discharged cargo, when ten or fifteen different countries have to be taken into consideration.

Transport | *Background*

- Art 8 OECD MC → ***Background***
  - Multiple port calls in an ocean carrier's service:
  - At each port, some of the cargo (and the carrier's responsibility) will be
    - destined for that port;
    - destined for inland points within the country of the port of call;
    - destined for inland points within a country different from the country of the port of call (e.g. cargo is discharged in Rotterdam, Netherlands and barged, railed or trucked to Germany); or
    - trans-shipped in this port onto different vessels used by the carrier to transport the cargo to other ports not on the first vessel's itinerary (e.g. cargo discharged in Colombo may be relayed to a different vessel that will call at Mumbai), which may then be further transported to various destinations.

Source: International Chamber of Shipping (ICS) and the World Shipping Council (WSC)

Transport | *Overview*

- Art 8 OECD MC → ***Main features***
  - ***Exclusive taxation ("shall be taxable only")*** in the residence State of the shipping or air transportation enterprise (pre 2017: PoEM = "brain" of the enterprise ≠ „flag state") = Art 8 Alternative A OECD MC

ARTICLE 8

INTERNATIONAL SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

2. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

  - Martime shipping and air navigation (Geneva model 1928), inland waterways transport (included in the OECD MC 1963, removed by the 2017 OECD Update) – *Not included, e.g., railway, road transportation, cables, pipelines etc (left to bilateral negoitions: Art 8 no. 7 UN MC Comm.)*
  - ***Pools etc*** – E.g, pooling supplies of spare parts at airports or alternating operation of certain flight routes. – *In aviation: International Airlines Technical Pool ('ATP)*

Transport | *Overview*

- Art 8 OECD MC → ***Main features***
  - ***Overrides the "PE principle"*** to take into account the nature of the industry – E.g., terminal facilities, baggage and ground handling, load control, ramp services, security services, catering, aircraft servicing and maintenance, hangars. → *Avoids fragmented taxation of profits*
  - ***Terms***
    - "Operation" → Transportation + connected activities + ancillary acitivites
    - "Ships" or "aircraft"
      - ***Ship*** → Any vessel used for water navigation, i.e., broad meaning including "boats" etc (Art 8 no. 17 OECD MC Comm.), but – in the context of Art 8 OECD MC ("transport") – not, e.g., drilling units, museum ships, icebreakers, crane ships, research vessels, floating docks and floating desalination facilities
      - ***Aircraft*** → All flying machines including, e.g., helicopters
    - International traffic → Defined in Art Art 3(1)(e) OECD MC 2017 (= Art 3(1)(d) UN MC 2017)
  - ***Shipping*** → Zero/low tax industry, mainly because of special tax regimes (e.g., tonnage taxation) → Potential treaty problems with regard to Art 2 OECD MC (covered tax) and Art 4 OECD MC („liable to tax")

Transport | *Int'l Traffic*

- **International traffic** → Defined in Art 3(1)(e) OECD MC 2017 (= Art 3(1)(d) UN MC 2017)
- ***Does that term cover …***
  - … transport between the residence State and the other Contracting State and/or a third State? → ✓
  - … transport between two points in a third State? → ✓
  - … transport between two points in the residence State? → ✓ (Art 3 no. 6 OECD MC Comm. ≠ Art 3(1)(f) US MC)
  - … transport between places in the non-residence State in relation to a particular voyage? → ✗
  - … between places in the non-residence State, e.g., two ports or airports (the "internal leg"), as part of a longer cross-border voyage of that ship or aircraft? → ✓ (Art 3 no. 6.2 OECD MC Comm.)
  - … inland transportation to and from the airport or port as part of a longer cross-border voyage of that ship or aircraft? → ✓ (Art 3 no. 6 OECD MC Comm. – Even clearer: Art 3(1)(f) US MC)
  - … a cruise beginning and ending in that State without a stop in a foreign port ("voyage to nowhere") → ✗ (Art 3 no. 6.4 OECD MC Comm.)
  - … a cruise where passengers are permitted to go ashore at a foreign port? → ✓ (Art 3 no. 8 UN MC Comm.)

ARTICLE 3

GENERAL DEFINITIONS

1. For the purposes of this Convention, unless the context otherwise requires:

e) the term "international traffic" means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State;

Transport | *Scope*

Carriage of passengers and freight	Directly connected or ancillary activities (e.g., Art 8 nos 4-10.1 OECD MC Comm. and – since 2017 – Art 8 nos 10.2 and 11 UN MC Comm.)

▪ Profits directly obtained by the enterprise from the **transportation of passengers (including cruises) or cargo** by such ship or aircraft (whether owned, leased or otherwise placed at the disposal of the enterprise) – *Also: Chartering of a slot or space?*
▪ Includes, e.g.,
  ▪ **chartering fully equipped, crewed and supplied ships or aircraft** ("time charter-party"' or "voyage charter-party" in the shipping industry, "wet lease" in the airline industry)
  ▪ **sales of tickets** of the enterprise;
  ▪ restaurants, snack bars, shops etc on board a ship operated by the enterprise
▪ Not, e.g.,
  ▪ fishing, offshore drilling, seismological research, construction, dragging, paragliding schools et
  ▪ **bareboat charter leases** ("demise" or "bareboat charter-party" in the shipping industry, "dry lease" in the airline industry) → Generally Art 7 OECD MC, Art 12(3) UN MC (e.g., Art 8 no. 5 OECD MC Comm. ≠ Art 8 US MC)
	▪ **Transportation** (Art 8 nos 6, 7 OECD MC Comm.)
	  ▪ Code-sharing or slot chartering arrangements
	  ▪ Bus service to the airport for international flights
	  ▪ Inland transportation legs of international transport
	▪ **Services** (Art 8 nos 8-10.1 OECD MC Comm.)
	  ▪ Tickets sales on behalf of other transport enterprises
	  ▪ Advertising for third parties, e.g., in onboard entertainment
	  ▪ Leasing containers in international transport (i.e., not Art 12 UN MC if an ancillary activity; Art 8 no. 5 OECD MC Comm.; Art 8 no. 11 UN MC Comm.)
	  ▪ Provision of goods (e.g., spare parts) and services (e.g., maintenance, repair and other ground handling) by a shipping or air transport enterprise to other enterprises
	▪ Certain **investment income** (Art 8 no. 14 OECD MC Comm.)
	▪ Trade with **emissions permits and credits** (Art 8 no. 14.1 OECD MC Comm.)

Capital Gains | *Ships, Aircraft*

- **Alienation of ships or aircraft → *Art 13(3) OECD MC***
  - Exclusive taxation in the ***residence State***

> 3. Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or of movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

  - ***Scope***
    - Covers, e.g., obsolete ships or aircraft as well as engines and spare parts
    - Does not apply, e.g., to the alienation of immovable property, even if that property was used to derive income covered by Art 8 OECD MC (e.g., maintenance hangers) → *Potential mismatch between the taxing right for "ongoing" income under Art 8 OECD MC (e.g., depreciation deductions) and capital gains from an alienation under Art 13(1) OECD MC!*

Chapter IV/3
Investment Income: Dividends, Interest, Royalties and Capital Gains

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Overview

- ***Chapter IV/3.1*** – Introduction and Common Features
- ***Chapter IV/3.2*** – Dividends (Article 10 OECD MC)
- ***Chapter IV/3.3*** – Interest (Article 11 OECD MC)
- ***Chapter IV/3.4*** – Royalties (Article 12 OECD and UN MC)
- ***Chapter IV/3.5*** – Capital Gains (Article 13(4), (5) OECD MC, Article 13(4), (5) and (6) UN MC)

Chapter IV/1.1
Introduction and Common Features

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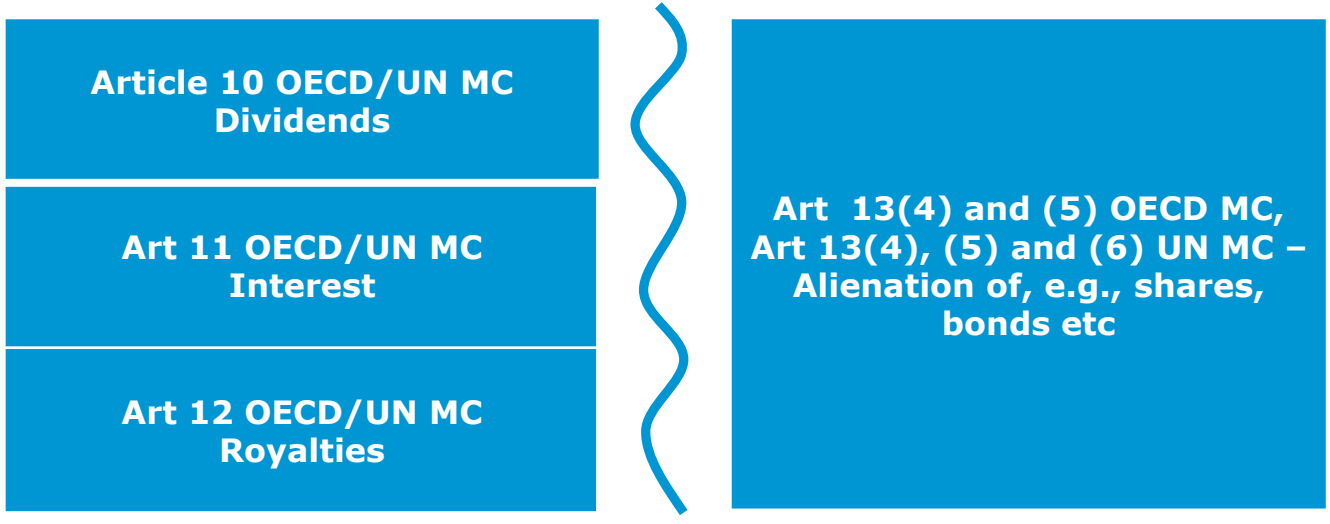
Overview | *Common Features*

	Art 10 Dividends	Art 11 Interest	Art 12 Royalties
Territorial scope	*Bilateral**	*Bilateral**	*Bilateral*
Source taxation on "gross amount"	✓ (Art 10(2))	✓ (Art 11(2))	✕ (OECD MC) ✓ (Art 12(2) UN MC)
Maximum source State taxation	*5%/15%*	*10%*	✕ *(OECD MC)* __% *(UN)*
#1 – Beneficial ownership requirement	✓ (Art 10(2))	✓ (Art 11(2))	✓ (Art 12(1) OECD MC, Art 12(2) UN MC)
#2 – PE provision	✓ (Art 10(4))	✓ (Art 11(4))	✓ (Art 12(3) OECD MC, Art 12(4) UN MC)
#3 – Special relationship clause	—	✓ (Art 11(6))	✓ (Art 12(4) OECD MC, Art 12(6) UN MC)
#4 – Procedural rules	—		

* *Except for "sandwich" situations Art 10 no. 8 and Art 11 no. 6 OECD MC Comm.*

Overview | *Common Features*

- **Investment income versus capital gains** – *Relative scopes and borderline*



Borderline cases, e.g., liquidations, redemptions of shares, reduction of paid up capital (Art 13 no. 31 OECD MC Comm.), sale of a bond with accrued interest (Art 11 nos 20, 21.1 OECD MC versus Austrian MoF, EAS 3293)

Topic #1 | *Beneficial Ownership*

- **Beneficial ownership requirement for source State tax reduction** → *Art 10(4), Art 11(4) and Art 12(3) (OECD MC), Art 12(4) (UN MC) ≠ Anti-money laundering provisions!*

ARTICLE 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

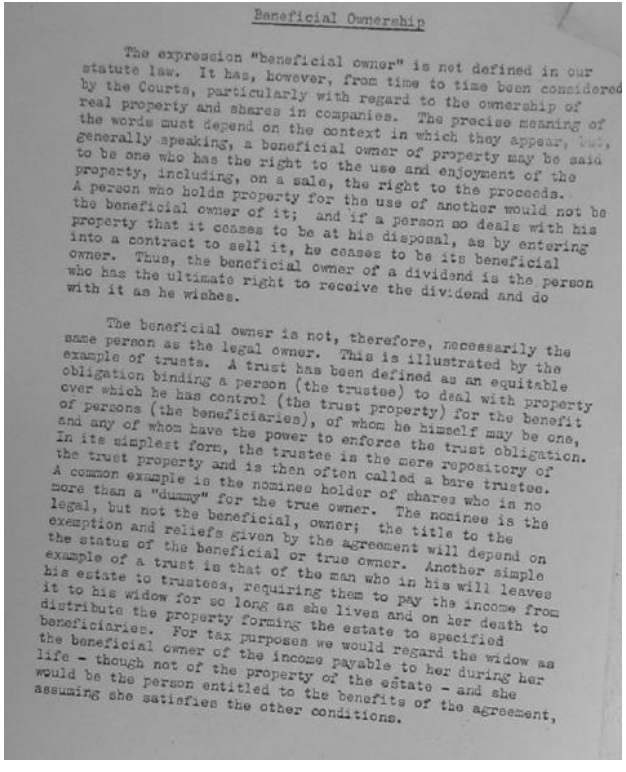
   a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

   b) 15 per cent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Topic #1 | *Beneficial Ownership*

- **Beneficial Ownership**
  - Clarification of "paid to"? Anti-abuse provision?
  - ***Origins? → The "Holy Grail" of interpretation? →*** The United Kingdom Inland Revenue file on the negotiation of the 1967 United Kingdom-Australia treaty contains a – quite unhelpful – note commenting on the meaning of "beneficial owner".



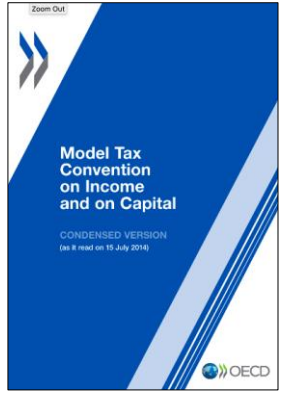
Beneficial Ownership

The expression "beneficial owner" is not defined in our statute law. It has, however, from time to time been considered by the Courts, particularly with regard to the ownership of real property and shares in companies. The precise meaning of the words must depend on the context in which they appear, but, generally speaking, a beneficial owner of property may be said to be one who has the right to the use and enjoyment of the property, including, on a sale, the right to the proceeds. A person who holds property for the use of another would not be the beneficial owner of it; and if a person so deals with his property that it ceases to be at his disposal, as by entering into a contract to sell it, he ceases to be its beneficial owner. Thus, the beneficial owner of a dividend is the person who has the ultimate right to receive the dividend and do with it as he wishes.

The beneficial owner is not, therefore, necessarily the same person as the legal owner. This is illustrated by the example of trusts. A trust has been defined as an equitable obligation binding a person (the trustee) to deal with property over which he has control (the trust property) for the benefit of persons (the beneficiaries), of whom he himself may be one, and any of whom have the power to enforce the trust obligation. In its simplest form, the trustee is the mere repository of the trust property and is then often called a bare trustee. A common example is the nominee holder of shares who is no more than a "dummy" for the true owner. The nominee is the legal, but not the beneficial, owner; the title to the exemption and reliefs given by the agreement will depend on the status of the beneficial or true owner. Another simple example of a trust is that of the man who in his will leaves his estate to trustees, requiring them to pay the income from it to his widow for so long as she lives and on her death to distribute the property forming the estate to specified beneficiaries. For tax purposes we would regard the widow as the beneficial owner of the income payable to her during her life - though not of the property of the estate - and she would be the person entitled to the benefits of the agreement, assuming she satisfies the other conditions.

Topic #1 | *Beneficial Ownership*

- **Beneficial Ownership**
  - Art. 10, 11 and 12 OECD-MC 1977 ("agent or nominee")
  - Report on Double Taxation Conventions and the Use of Conduit Companies (1986)
  - Report on Restricting the Entitlement to Treaty Benefits (in: Issues in International Taxation No. 8, Paris 2002) → Amendment of Art 1 Paras 7 – 26 OECD Comm and OECD MC Comm on Art 10, 11 and 12
  - Report on The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles (2010) and Art 1 Paras 6.8 to 6.34 OECD Comm (Update 2010)
  - OECD Discussion Draft Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention (2011) and Revised Proposals Concerning the Meaning of Beneficial Owner in Articles 10, 11 and 12 or the OECD Model Tax Convention (2012)
  - OECD MC Update 2014 (not yet in the UN MC: E/C.18/2019/CRP.21)



Topic #1 | *Meaning*

- **Autonomous treaty meaning** (Art 10 nos 12, 12.1, Art 11 nos 9, 9.1 and Art 12 no. 4 OECD MC Comm.) → *Alternatives: (1) Art 3(2) OECD MC (i.e., domestic law of the source State), (2) common law meaning (which would, however, largely refer to property and not to income; also, in 1977 18 of 24 OECD members were civil law countries).*

> 12. The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 to clarify the meaning of the words "paid ... to a resident" as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention.
>
> 12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to ... a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context, in particular in relation to the words "paid ... to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

- **Agent, nominee, conduit** (Art 10 nos 12.2, 12.3, Art 11 nos 10, 10.1 and Art 12 nos 4.1, 4.2 OECD MC Comm.)

> 12.2 Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.
>
> 12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[2] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

Topic #1 | *Meaning*

- **Definition of beneficial ownership** (Art 10 no. 12.4, Art 11 no. 10.2 and Art 12 no. 4.3 OECD MC Comm.) – *Income, not shares! Legal or contractual obligation! (~ entitlement in bankruptcy) → But: "In substance", facts, circumstances? Just a tool to prove the existence of a legal obligation!?*

12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the "beneficial owner" because that recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 22 to 48 of the Commentary on Article 1. Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that dividend. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases.

As regards the sentence referring to obligations that "may also be found to exist on the basis of facts and circumstances", the Working Party concluded that the sentence was appropriate because contracts and formal legal obligations may not always reflect reality and this was therefore an area where it was appropriate to look at facts and circumstances.

From the explanation of the 2014 OECD Update, p. 2.

- **Relationship to anti-abuse provisions** (Art 10 no. 12.5, Art 11 no. 10.3 and Art 12 no. 4.4 OECD MC Comm. – *2017 Update*)

> 12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 22 below). The provisions of Article 29 and the principles put forward in the section on "Improper use of the Convention" in the Commentary on Article 1 will apply to prevent abuses, including treaty-shopping situations where the recipient is the beneficial owner of the dividends. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

Topic #1 | *Meaning*

- **Delimitation to other uses of the term** (Art 10 no. 12.6, Art 11 no. 10.4 and Art 12 no. 4.5 OECD MC Comm)

> 12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 *a*), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Article 10, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement."[1]

The footnotes refer to the Report by the Financial Action Task Force concerning the definition of "beneficial ownership" for purposes of combating money laundering and terrorism financing, which rely on the natural person that ultimately owns or controls a customer.

- **Application of the treaty when the beneficial owner is resident of a Contracting State** (Art 10 no. 12.7, Art 11 no. 11 and Art 12 no. 4.6 OECD MC Comm.)

> 12.7 Subject to other conditions imposed by the Article and the other provisions of the Convention, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).

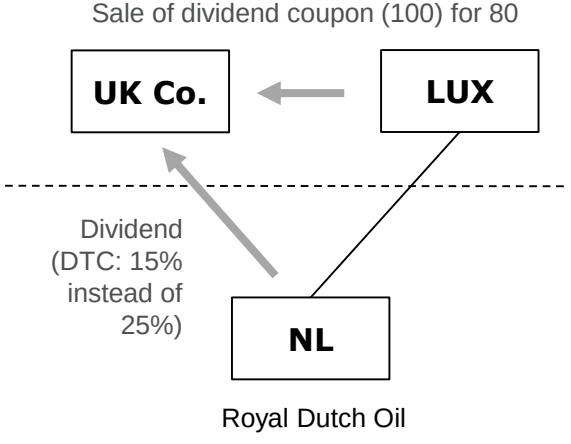
Topic #1 | *Meaning*

- **CIVs** – *Note:* A Collective Investment Vehicle (CIV) is the "beneficial owner" of the income (if the CIV is a "person" and a "resident") so long as the managers of the CIV have the discretionary power to manage the assets on behalf of the holders of interests in the CIV → Art 1 no. 28 OECD MC Comm.

> 28 Some countries have questioned whether a CIV, even if it is a "person" and a "resident", can qualify as the beneficial owner of the income it receives. Because a "CIV" as defined in paragraph 22 above must be widely-held, hold a diversified portfolio of securities and be subject to investor-protection regulation in the country in which it is established, such a CIV, or its managers, often perform significant functions with respect to the investment and management of the assets of the CIV. Moreover, the position of an investor in a CIV differs substantially, as a legal and economic matter, from the position of an investor who owns the underlying assets, so that it would not be appropriate to treat the investor in such a CIV as the beneficial owner of the income received by the CIV. Accordingly, a vehicle that meets the definition of a widely-held CIV will also be treated as the beneficial owner of the dividends and interest that it receives, so long as the managers of the CIV have discretionary powers to manage the assets generating such income (unless an individual who is a resident of that State who would have received the income in the same circumstances would not have been considered to be the beneficial owner thereof).

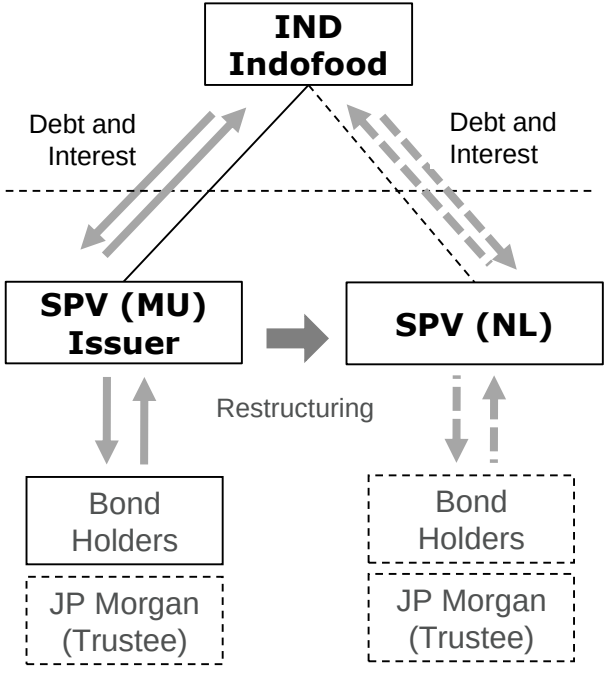
Topic #1 | *Royal Dutch (1994)*

- Dutch Hoge Raad, 6 April *1994*, ***Royal Dutch***, BNB1994/217 ("dividend stripping")
  - UK Co. had become the owner of the coupons and after the purchase it had the right of free disposal of the coupons and of their proceeds
  - UK Co. did not act as an agent or nominee for other persons and therefore UK Co. had to be considered as the beneficial owner of the dividends
  - Beneficial ownership only excluded if there is a contractual obligation to pay the largest part of the income to a third party
  - The fact that the Dutch refund form required the taxpayer to be also the owner of the underlying shares had no relevance according to the Court because there was nothing stating so in the relevant treaty
  - *But: Principal Purposes Test since the 2017 Update (Art 29 no. 182 OECD MC Comm. [Examples A and B])*



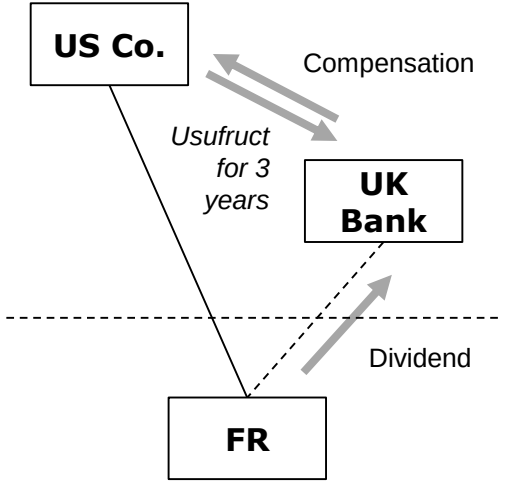
Topic #1 | *Indofood (2006)*

- England and Wales Court of Appeal, 2 March 2006, ***Indofood International Finance Ltd v. JP Morgan Chase Bank N.A. London Branch***, [2006] EWCA Civ 158
  - SPV (NL) was not beneficial owner of interest under the IND-NL treaty (under an international fiscal meaning)
  - Although SPV (NL) earned a small spread and satisfied the substance and risk requirements under Dutch tax law, it had only limited powers over the interest income
  - It did not derive any direct benefit from interest received and was obliged to use the interest received from to pay the interest due within tight payment dates



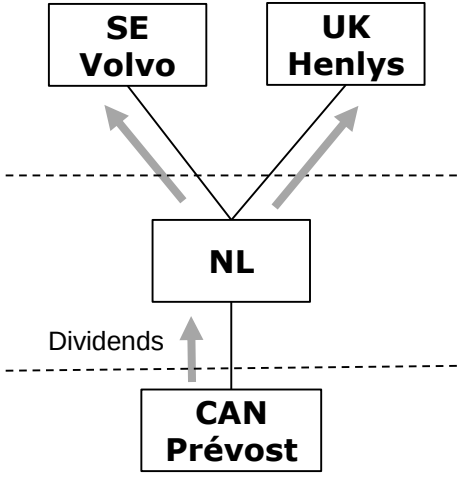
Topic #1 | *Bank of Scotland (2006)*

- French Conseil d'Etat, 29 December 2006, ***Socété Bank of Scotland***, No. 283314
  - UK Bank received dividends subject to 25% withholding tax and filed an application for a refund of *avoir fiscal* and withholding tax under the UK-FR tax treaty
  - French Supreme Court denied the FR-UK tax treaty benefits to the UK Bank based on abuse of law principle, considering that UK bank was not the beneficial owner of dividend and the structure was a loan granted by UK Bank to US Co.
  - *See also: Principal Purposes Test since the 2017 Update (Art 29 no. 182 OECD MC Comm. [Examples A and B])*



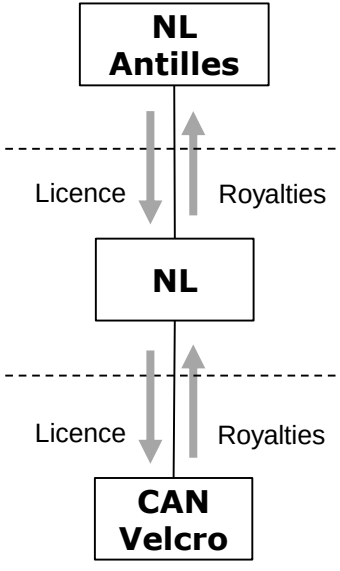
Topic #1 | *Prévost (2008)*

- Tax Court of Canada, 22 April 2008, ***Prévost Car Inc. v. The Queen***, 2008 TCC 231 (affirmed by 2009 FCA 57)
  - "Beneficial owner" of dividends means the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control over the income
  - When corporate entities are concerned, it is the corporation that is the beneficial owner of its assets and the income therefrom unless the corporation is a conduit
  - A conduit for another person must have no discretion as to the use or application of funds it receives or acts only on the instructions of another person without any right to do otherwise
  - Appellate Court confirmed that the Court correctly based its decision on OECD Conduit Report and the 2003 OECD Comm. (2009 FCA 57)



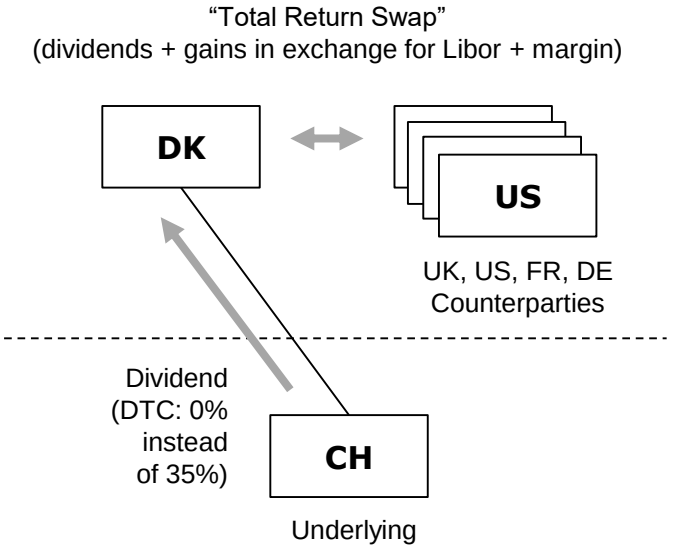
Topic #1 | *Velcro (2012)*

- Tax Court of Canada , 24 February 2012, ***Velcro Canada Inc. v. Her Majesty the Queen***, 2012 TCC 57
- ***Facts***
  - VIBV (Antilles) undertook a corporate migration and continued under the laws of the NL Antilles (no treaty with CAN), VIBV assigned its rights under the license agreement with Velcro to a wholly-owned Dutch subsidiary (Dutch Co).
  - Velcro was required to pay all royalties to Dutch Co and Dutch Co was required to pay a certain percentage of all such royalties onward to VIBV.
- ***Tax Court***
  - Dutch Co received funds from multiple income sources (including the royalties from Velcro), funds became comingled in Dutch Co's bank account and were used at Dutch Co's discretion to carry out a variety of its business activities and to satisfy a variety of its legal obligations; interest accrued to Dutch Co, it also bore currency risk.
  - Dutch Co had possession, use, risk and control of the royalties from Velcro; it had some discretion as to the use of the royalties an hence was not a conduit or agent.



Topic #1 | *Swiss Swap Case (2015)*

- Swiss Supreme Court, 5 May 2015, 2C_364/2012 (***"Swiss swap case"***)
- ***Facts***
  - Danish Co has entered into a total return swap agreement with several counterparties and has purchased the underlying swiss equities (without a contractual obligation to do so)
- ***Supreme Court***
  - The derivatives contracts entered into by the Danish banks were accurately matching their investment in the underlying, both in volume and timing.
  - Hence, at the time when the dividend was received by the Danish banks, they had an obligation to pass it on to third parties under the Total Return Swap or Futures contracts, so that both the risks and rewards of the investment in the Swiss shares were substantially with the third parties and not with the Danish banks, which made only a small profit from these transactions.



Topic #2 | *PE Provision*

- **"Throwback" Rule:** Application of Art 7 if the income "belongs" to a PE → *Art 10(4), Art 11(4) and Art 12(3) OECD MC, Art 12(4) UN MC*
- **"Effective connection"** → Economic ownership (e.g., Art 10 no. 32.1 OECD MC Comm.)

ARTICLE 10

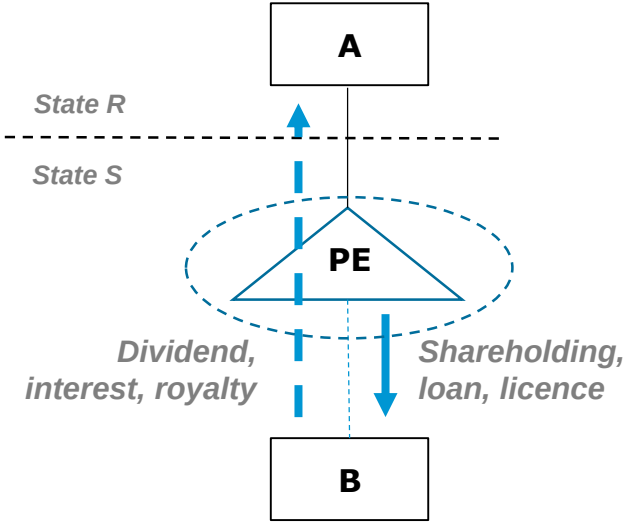
DIVIDENDS

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

32.1 A holding in respect of which dividends are paid will be effectively connected with a permanent establishment, and will therefore form part of its business assets, if the "economic" ownership of the holding is allocated to that permanent establishment under the principles developed in the Committee's report entitled *Attribution of Profits to Permanent Establishments*[1] (see in particular paragraphs 72 to 97 of Part I of the report) for the purposes of the application of paragraph 2 of Article 7. In the context of that paragraph, the "economic" ownership of a holding means the equivalent of ownership for income tax purposes by a separate enterprise, with the attendant benefits and burdens (e.g. the right to the dividends attributable to the ownership of the holding and the potential exposure to gains or losses from the appreciation or depreciation of the holding).

Topic #2 | *PE Provision*

- **"Throwback" Rule:** Application of Art 7 if the income "belongs" to a PE → *Art 10(2), Art 11(2) and Art 12(1) (OECD MC), Art 12(2) (UN MC)*
- **Effect** → Taxation in the source State on a net basis (Art 7 OECD MC), but without any rate limitation (Art 10, 11 and 12 OECD MC) → *E.g., Federal Court of Australia, 7 October 2015, Tech Mahindra Limited v Commissioner of Taxation, [2015] FCA 1082*



Topic #3 | *Special Relationship*

- No limitation of source State taxation for **"excessive" interest or royalties** payments → *Art 11(6) and Art 12(4) (OECD MC), Art 12(6) (UN MC)*

ARTICLE 11

INTEREST

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Topic #4 | *Procedure*

- **Procedural questions** with regard to the ***limitation of source State taxation*** are not addressed by the OECD MC (but sometimes in bilateral tax treaties) → *Art 1 no. 109 OECD MC Comm. (→ Art 10 no. 18, 19 and Art 11 no. 12 OECD MC Comm.):*

> 109. A number of Articles of the Convention limit the right of a State to tax income derived from its territory. As noted in paragraph 19 of the Commentary on Article 10 as concerns the taxation of dividends, the Convention does not settle procedural questions and each State is free to use the procedure provided in its domestic law in order to apply the limits provided by the Convention. A State can therefore automatically limit the tax that it levies in accordance with the relevant provisions of the Convention, subject to possible prior verification of treaty entitlement, or it can impose the tax provided for under its domestic law and subsequently refund the part of that tax that exceeds the amount that it can levy under the provisions of the Convention. As a general rule, in order to ensure expeditious implementation of taxpayers' benefits under a treaty, the first approach is the highly preferable method. If a refund system is needed, it should be based on observable difficulties in identifying entitlement to treaty benefits. Also, where the second approach is adopted, it is extremely important that the refund be made expeditiously, especially if no interest is paid on the amount of the refund, as any undue delay in making that refund is a direct cost to the taxpayer.

Chapter IV/3.2
Dividends

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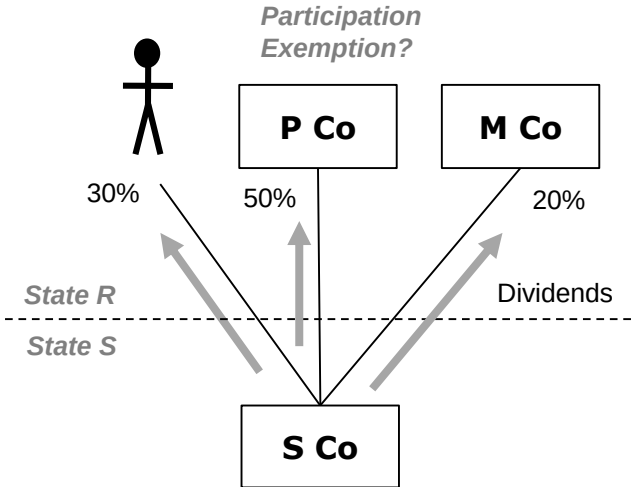
Dividends | *Overview*



Art 10 OECD MC does not address *(1)* the (net) taxation in the shareholder's residence State, *(2)* the various regimes of corporate-shareholder-intergration (Art 10 no. 40 et seq. OECD MC Comm.) or *(3)* economic double taxation of the underlying corporate profits (Art 10(2) last sentence OECD MC; Art 23 nos 49-54 OECD MC Comm.)

ARTICLE 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

   a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

   b) 15 per cent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

ARTICLE 23 B

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

Dividends | *Overview*

- **Structure of Art 10 OECD MC**
  - ***Art 10(1) OECD MC*** – Residence State may tax (without limitation) – *Does not address domestic relief regimes (e.g., deemed paid/indirect credit, participation exemption, DRD)*
  - ***Art 10(2) OECD MC*** – Maximum source State tax rate (5%/15%) → **"Beneficial Ownership"-requirement** → Relief in the residence State through direct credit (Art 23A(2) or Art 23B(1) OECD MC)
  - ***Art 10(3) OECD MC*** – Definition of dividends
  - ***Art 10(4) OECD MC*** – Art 10 does not apply to dividends from holdings connected with a PE in the source country → Art 7
  - ***Art 10(5) OECD MC*** – Prohibition of extraterritorial taxation

ARTICLE 10

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   b) 15 per cent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

Dividends | *Limits*

- **Limits to source State taxation**
  - ***"Beneficial Ownership"***-requirement
  - Source tax on ***"gross amount"*** (!)
  - ***Rate***
    - ***5%*** (Art 10(2)(a) OECD MC) → Company shareholder with a capital holding of at least 25% → "Capital" under company law, but consideration of domestic tax law (e.g., "thin capitalisation", or assimilation of a loan to share capital; Art 10 no. 15 OECD MC Comm.) – "Look through" for transparent entities (Art 10 nos 11, 11.1 OECD MC Comm.)
    - ***15%*** (Art 10(2)(b) OECD MC) → All other cases (e.g., individual shareholders, corporate shareholders with a holding < 25% etc)
  - ***Minimum holding period*** for the 5% rate under Art 10(2)(a) OECD MC to address so-called "dividend transfer transactions"
    - ***365 day minimum holding period*** around the payment date since the 2017 Update (following Action 6 of the BEPS Project (paras 34-36 of the 2015 Final Report), also in Art 8 MLI
    - Before 2017: No minimum holding period in the OECD MC, but alternative provision in former Art 10 no. 17 OECD MC Comm.: "… provided that this holding was not acquired primarily for the purpose of taking advantage of this provision".

2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

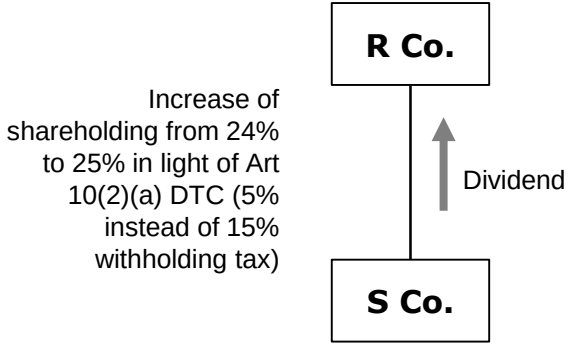
   a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

   b) 15 per cent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Dividends | *Limits*

- Limits to source State taxation – ***5% "super-reduced" rate for intercompany dividends***
  - ***Example:*** R Co. is a company resident of State R and, for the last 5 years, has held 24% of the shares of company S Co., a resident of State S. Following the entry-into-force of a tax treaty between States R and S, R Co. decides to increase to 25% its ownership of the shares of S Co. The facts and circumstances reveal that the decision to acquire these additional shares has been made primarily in order to obtain the benefit of the lower rate of tax provided by Art 10(2)(a) of the treaty. → *Is State S's taxing right reduced to 5% or is this transaction "abusive"? (Art 29 no. 182 OECD MC Comm. [Example E])*



Dividends | *Definition*

- **"Dividends"**
  - Distribution of profits to the shareholders by companies limited by shares, limited partnerships with share capital, limited liability companies or other joint stock companies → Legal entities with ***a separate juridical personality*** distinct from all their shareholders (≠ transparent partnerships; Art 10 no. 27 OECD MC Comm.)
  - Definition in Art 10(3) OECD MC

> 3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

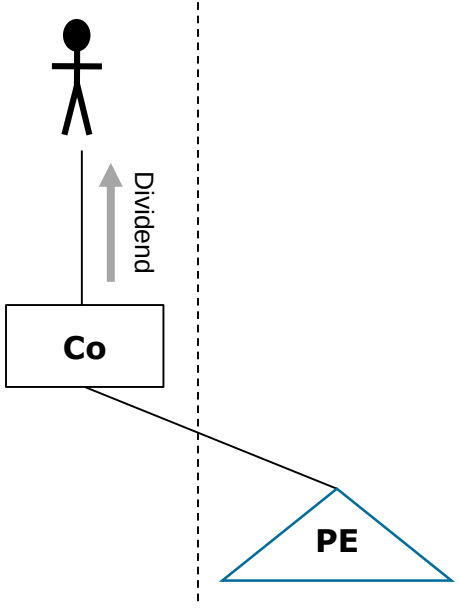
Dividends | *Definition*

- **"Dividends"**
  - Definition in Art 10(3) OECD MC
    - Three prongs → *(1)* Income from ***shares*** etc, *(2)* income from ***"other rights, not being debt-claims, participating in profits"***, and *(3)* income from ***"other corporate rights" treated like dividends*** under domestic tax law → *E.g., not income from "ownerless" entities, such as "distributions" to beneficiaries of private foundations*
    - Includes, at least under the last prong of Art 10(3) OECD MC, not only "open" distributions of profits decided by annual general meetings of shareholders, but also other ***benefits in money or money's worth, such as bonus shares, bonuses, profits on a liquidation or redemption of shares and disguised distributions of profits*** (Art 10 no. 28 OECD MC Comm.) → *For the potential treatment of liquidations and redemptions as capital gains see Art 13 no. 31 OECD MC Comm.*
    - Might include payments treated as dividends under domestic ***thin capitalization rules*** or on loans if the ***lender effectively shares the risks run by the company*** (Art 10 no. 25 OECD MC Comm.).
    - Excluded are payments on ***debt-claims participating in profits*** (Art 10 no. 24 and Art 11 no. 19 OECD MC Comm.) and on ***convertible debentures*** (Art 10 no. 24 OECD MC Comm.)

Dividends | *Extraterritoriality*

- Art 10(5) OECD MC – ***Extraterritorial Taxation***
  - ***Situation 1:***

> 5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.



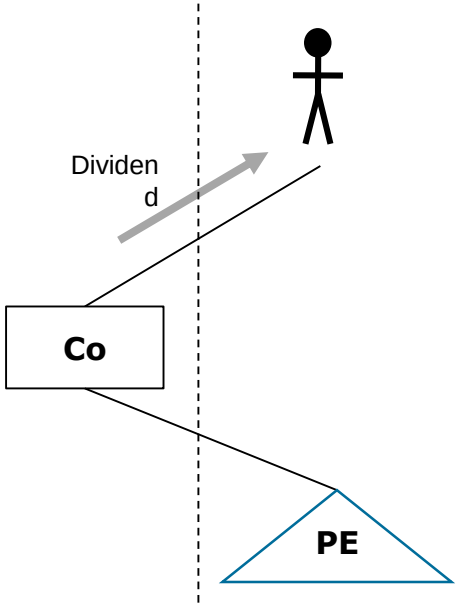
  - Prohibition of extraterritorial taxation by PE State
    - of ***dividends*** (i.e., "second tier withholding taxation") and
    - the company's ***undistributed profits*** – *Does, however, not limit taxation in the shareholder's residence State, e.g., under CFC rules (Art 10 no. 37 OECD MC Comm.)*
  - ***Note:*** Unclear if that prohibition addresses so-called ***"branch profits taxes"*** (see Art 10(8) US MC and Art 10 nos 18-25 UN MC Comm.), but in the OECD-framework those are usually prohibited by Art 24(3) OECD MC (Art 24 no. 60 OECD MC Comm., with a number of observations – See, however, Art 24(6) US MC)

Dividends | *Extraterritoriality*

- Art 10(5) OECD MC – ***Extraterritorial Taxation***
  - ***Situation 2:***

> 5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

  - Shareholder's residence State may tax dividend under Art 10(1) OECD MC

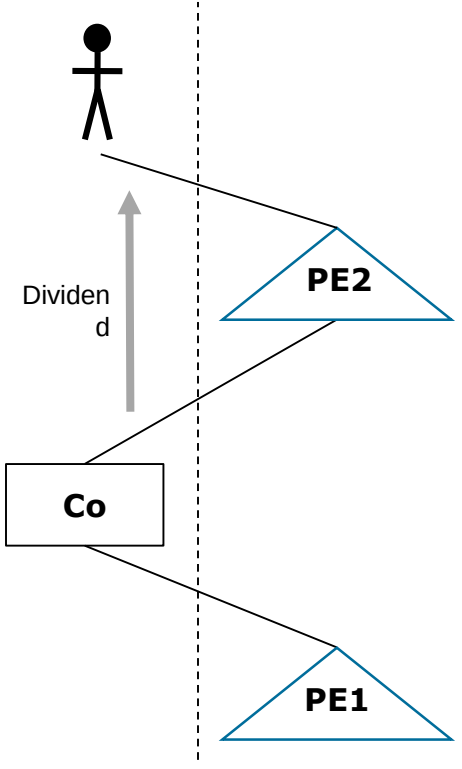


Dividends | *Extraterritoriality*

- **Art 10(5) OECD MC – *Extraterritorial Taxation***
  - ***Situation 3:***

> 5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

  - PE State may tax dividend (in PE2) under Art 7 OECD MC (Art 21(2) OECD MC)



Dividends | *Procedure*

- **Art 10(2) OECD MC –** No procedural arrangements in the MC (Art 10 nos 18-19 OECD MC Comm.), but sometimes procedural rules in treaties or protocols (especially with regard to proof, timing etc)!

> 18. Paragraph 2 lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment.
>
> 19. The paragraph does not settle procedural questions. Each State should be able to use the procedure provided in its own laws. It can either forthwith limit its tax to the rates given in the Article or tax in full and make a refund (see, however, paragraph 109 of the Commentary on Article 1). Potential abuses arising from situations where dividends paid by a company resident of a Contracting State are attributable to a permanent establishment which an enterprise of the other State has in a third State are dealt with in paragraph 8 of Article 29. Other questions arise with triangular cases (see paragraph 71 of the Commentary on Article 24).

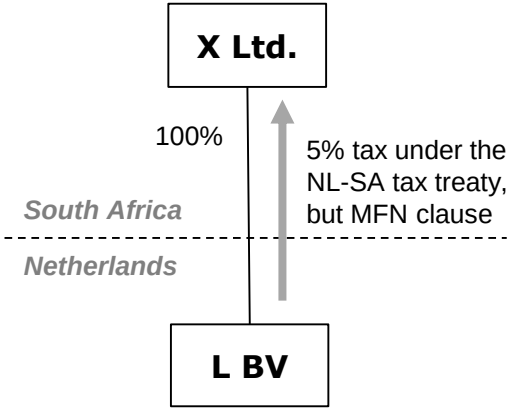
Dividends | *Special Issues*

- Exemption for dividends paid to (exempt) ***pension funds*** etc? *(→ Art 10 no. 13.1 OECD MC Comm.)*
- Exemption for dividends paid to other ***States*** (and political subdivisions) and some of their ***wholly-owned entities***? *(→ Art 10 no. 13.2 OECD MC Comm.)*
- Super-reduced rate for dividends paid by a ***collective investment vehicle***? *(→ Art 10 no. 17 OECD MC Comm.)*
- Special rules for dividends paid to companies that enjoy ***preferential taxation treatment*** (e.g., private investment companies)? *(→ Art 10 no. 22 and Art 1 nos 82-100 OECD MC Comm.)*
- Restriction of source taxation for distributions by ***"Real Estate Investment Trusts" (REITs)***? *(→ Art 10 nos 67.1-67.7 OECD MC Comm. – See also the 2008 OECD Report "Tax Treaty Issues Related to REITS")*
- Also: ***Most-favored nation clauses (MFN)***

Dividends | *Special Issues*

- **Most-favored nation clauses (MFN) – *Example:***
  - The dividend article in the 2008 South Africa-Netherlands tax treaty foresees a 5% withholding tax on intercompany dividends, but also includes a MFN clause in Art 10(10):

> 10. If under any convention for the avoidance of double taxation concluded after the date of conclusion of this Convention between the Republic of South Africa and a third country, South Africa limits its taxation on dividends as contemplated in subparagraph a) of paragraph 2 of this Article to a rate lower, including exemption from taxation or taxation on a reduced taxable base, than the rate provided for in subparagraph a) of paragraph 2 of this Article, the same rate, the same exemption or the same reduced taxable base as provided for in the convention with that third State shall automatically apply in both Contracting States under this Convention as from the date of the entry into force of the convention with that third State."

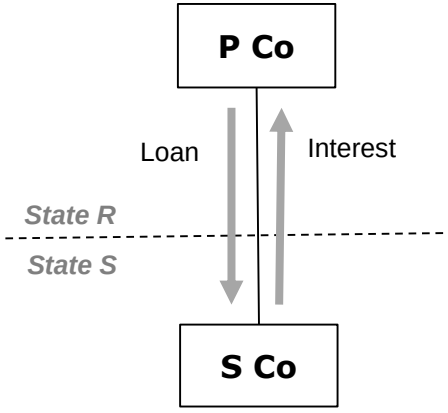


  - The South Africa-Kuwait treaty is from 2006 and foresees an exemption at source. In 2010/2012 the South Africa-Sweden treaty has been amended through a protocol to include an MFN clause that applies irrespective of when the treaty with the "other country" was concluded.
  - *What is the maximum withholding tax on the distribution from L BV to X Ltd? (Answer: 0%)* → *Dutch Supreme Court, 18 January 2019, no. 17/04584, ECLI:NL:HR:2019:57, and, Tax Court of South Africa, ABC Proprietary Limited, [2019] ZATC 9 (12 June 2019)*

Chapter IV/3.3
Interest

WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Interest | *Overview*



Compromise solution of shared taxing rights between residence and source State (Art 11 nos 1-3 OECD MC – See Art 11(2) US MC for a general exclusion of source taxation.) – Art 11 OECD MC does not address the deductibility of interest payments in the source State (→ Art 24(4) OECD MC)

ARTICLE 11

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

ARTICLE 23 B

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

Interest | *Overview*

- **Structure of Art 11 OECD MC**
  - ***Art 11(1) OECD MC*** – Residence State may tax (without limitation)
    - ***"... paid ..."*** → Fulfillment of the obligation
    - ***"... arising ..."*** → Art 11(5) OECDMC
  - ***Art 11(2) OECD MC*** – Maximum source State taxation rate (10%) → "Beneficial Ownership"-requirement → Relief in the residence State through a credit (Art 23A(2) or Art 23B(1) OECD MC)
  - ***Art 11(3) OECD MC*** – Definition of Interest
  - ***Art 11(4) OECD MC*** – Art 11 does not apply to interest from debt-claims connected to a PE in the source State → Art 7 OECD MC
  - ***Art 11(5) OECD MC*** – Sourcing rule → Residence of the payer, State of the PE
  - ***Art 11(6) OECD MC*** – "Special Relationship Clause" → The restriction on the source State right to tax does not apply to the excess amount which has its basis in a "special relationship" ("arm's length")

ARTICLE 11

INTEREST

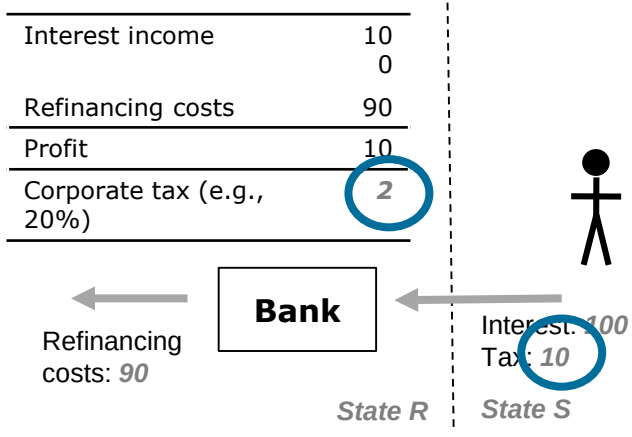
1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

Interest | *Limits*

- **Limits to source State taxation**
  - ***"Beneficial Ownership"***-requirement
  - Source tax on ***"gross amount"*** (!) → *Incidence of the tax?*
  - ***Rate*** → 10%
  - Risk of ***inappropriate over-taxation*** → Optional Exclusion from Source Taxation (Art 11 no. 7.4-7.10 OECD MC Comm.), e.g.,
    - Interest paid ***to a State***, its political subdivisions and to central banks
    - Interest paid ***by a State*** or its political subdivisions
    - Interest paid pursuant to ***export financing programmes***
    - Interest paid ***to financial institutions***
    - Interest paid ***to some tax-exempt entities*** (e.g., pension funds)



Interest | *Defintion*

- **"Interest"**
  - Definition in Art 11(3) OECD MC

> 3. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

  - Details
    - E.g., cash deposits and security in the form of money, government securities, bonds and debentures (including premiums or prizes attaching thereto) → *No reference to domestic law! (Art 11 no. 21 OECD MC Comm.)*
    - Whether or not ***secured by mortgage*** (Art 11 no. 18 OECD MC Comm.)
    - Includes ***participating and convertible bonds*** (Art 11 no. 19 OECD MC Comm.), but treatment as dividend if a ***loan effectively shares the risks*** run by the debtor company (Art 10 no. 25 OECD MC Comm.)
    - Generally does not apply to payments made under certain kinds of ***nontraditional financial instruments*** where there is no underlying debt (e.g., interest rate swaps; Art 11 no. 21.1 OECD MC Comm.)
    - Explicitly excluded → Penalty ***charges for late payment*** (Art 11 no. 22 OECD MC Comm.)

Interest | *Source*

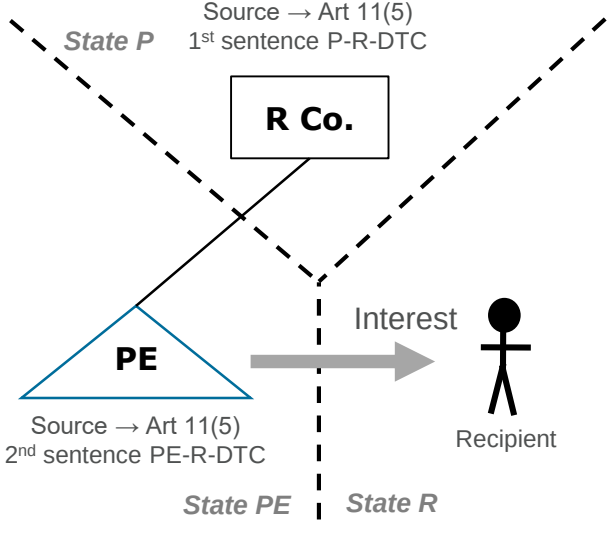
- **"Source" of interest → *Art 11(5) OECD MC***
  - Principle: ***Single source*** → PE takes precedence over payer (Art 11 no. 27 OECD MC Comm.)
  - But: Dual source in ***triangular situations*** → Payer in one State and PE in another State! (Art 11 nos 28-30 OECD MC Comm.) – ***Solutions?***
    - Multilateral convention (Art 11 no. 29 OECD MC Comm.)
    - Mutual Agreement Proceeding (MAP; Art 11 no. 29 OECD MC Comm.)
    - "Australian Clause" (Art 11 no. 30 OECD MC Comm.), so that the 2nd sentence of Art 11(5) OECD MC would read:

      Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.

ARTICLE 11

INTEREST

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.



Interest | *Procedure*

- **Art 11(2) OECD MC** – No procedural arrangements in the MC (Art 10 no. 12 OECD MC Comm.), but sometimes procedural rules in treaties or protocols (especially with regard to proof, timing etc)!

> 12. The paragraph lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment. Procedural questions are not dealt with in this Article. Each State should be able to apply the procedure provided in its own law (see, however, paragraph 109 of the Commentary on Article 1). Potential abuses arising from situations where interest arising in a Contracting State is attributable to a permanent establishment which an enterprise of the other State has in a third State are dealt with in paragraph 8 of Article 29. Other questions arise with triangular cases (see paragraph 71 of the Commentary on Article 24).

Chapter IV/3.4
Royalties

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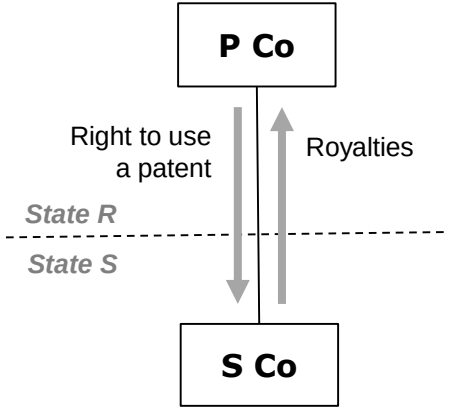
Royalties | *Overview*



Exclusive taxation in the residence State (OECD MC) versus primary source State taxaing right (UN MC) – Art 12 OECD/UN MC does not address the deductibility of royalty payments in the source State (→ Art 24(4) OECD MC)

OECD MC:

ARTICLE 12

ROYALTIES

1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

UN MC:

Article 12

ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Royalties | *OECD versus UN*

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OECD MC

Exclusive taxation in the residence State

ARTICLE 12

ROYALTIES

1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

4. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

UN MC

Limited source State taxation, broader scope

Article 12

ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ____ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (*a*) such permanent establishment or fixed base, or with (*b*) business activities referred to in (*c*) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Royalties | *OECD versus UN*

- **Royalties in the OECD and UN MC – *"Nexus"? Adminstrability?***

	OECD MC	UN MC

Art 12 OECD/UN MC (royalties)	▪ Exclusive taxation in the residence State, no source taxation rights
	▪ Since 1992, definition does not include payments for "the use of, or the right to use, industrial, commercial or scientific equipment" (e.g., containers)
	▪ But note:
	  ▪ Many OECD countries have reservations on Art 12 → E.g., equipment leasing, source right to tax, source rule equivalent to interest
	  ▪ UN-MC (Art 12(2)) and ~ 75% of tax treaties provide for a limited right of taxation for the source State
		▪ Source taxation right (Art 12(2))
		▪ Definition includes payments for "the use of, or the right to use, industrial, commercial or scientific equipment" (e.g., containers)
		▪ Further differences discussed in E/C.18/2014/3

Art 12A UN MC (fees for technical services)	▪ — (Note: Art 5 no. 139 OECD MC Comm.: Consensus that there should be no source taxation rights on income from "services performed by a non-resident outside that State")	▪ Source taxing rights over fees for technical services, inter alia, if payer is a source State resident (Art 12A)

Royalties | *Overview*

- **Structure of Art 12 OECD MC**
  - ***Art 12(1) OECD MC*** – Residence State has exclusive right to tax royalties
    - Source ("arising") = Residence of the payor (explicit sourcing rule analogous to Art 11(5) in Art 12(5) UN-MC)
    - "… may be taxed …" in Art 12(1) UN MC and limited source tax in Art 12(2) UN MC → Considerations for the level of source taxation in Art 12 nos 8-9 UN MC (including, e.g., considerations concerning the shift of the tax burden to the licensees in the licensing arrangement)

ARTICLE 12

ROYALTIES

1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

  - ***Art 12(2) OECD MC*** – Definition of royalties (broader: Art 12(3) UN-MC)
  - ***Art 12(3) OECD MC*** – Art 12 does not apply to royalties from property effectively connected to a PE in the source country (~ Art 12(4) UN-MC) → Art 7
  - ***Art 12(4) OECD MC*** – "Special Relationship Clause" (~ Art 12() UN-MC) → The restriction on the source country right to tax does not apply to the excess amount which has its basis in a "special relationship" ("arm's length")

Royalties | *Definition*

- **"Royalties" → *Art 12(2) OECD MC, Art 12(3) UN MC***

OECD MC
No equipment leasing (since 1992)

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

UN MC
Equipment leasing, films, tapes etc

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

Royalties versus services versus sales?

Services (Art 7, 12A, 14 OECD/UN MC)

- Supply of know-how versus payments for the provision of services (Art 12 nos 11.1-11.6 OECD MC) → *E.g., US Tax Court, 16 October 1984, Boulez v. Commissioner, 83 T.C. 584 (musical conductor of world-wide reputation was employed to make recordings for CBS Records)*

Sales (Art 7, 11, 13, 14 OECD/UN MC)

- Operating versus financal leases (Art 12 no. 13.3 UN MC)
- Purchase of copyright-protected software or other digital products (Art 12 nos 12-17.4 OECD MC)

Royalties | *Definition*

- **"Royalties" – OECD and UN MC** → "Royalties" means payments of any kind received as a consideration for the ***use of, or the right to use***, …
  - ***"… any copyright of literary, artistic or scientific work including cinematograph films …"***
    - Software, digital products → Mere purchase of software protected by copyright is not a royalty (Art 12 nos 12-17.4 OECD Comm)
  - ***"… any patent, trade mark, design or model, plan, secret formula or process …"***
    - Payment for the development of a design, model or plan that does not already exist is not a royalty, even if the designer (e.g. an architect) retains all rights, including the copyright (Art 12 no. 10.2 OECD MC Comm.)
  - ***"… for information concerning industrial, commercial or scientific experience."***
    - Know-How → Supply of pre-existing information, remains secret, can be used repetitively, risk on user, does not require individual skill in each application (Art 12 no. 11.3 OECD MC Comm.)
    - Distinguish from services → May require use of special knowledge, skill or expertise but not the transfer of that special knowledge, skill or expertise – E.g., after-sales service, services under a guarantee, technical assistance, an opinion, advice provided electronically (Art 12 no. 11.4 OECD MC Comm.)

Royalties | *Definition*

- **"Royalties" – *Additional scope of the UN MC***
  - ***"… films or tapes used for radio or television broadcasting …"***
  - ***"… industrial, commercial or scientific equipment"***
    - Includes (outside of a consumer context), e.g., leasing of containers (unless covered by Art 8), ships and aircraft (unless covered by Art 8), cars and other vehicles, cranes, containers, satellites, pipelines and cables etc (Art 12 no. 13-13.2 UN MC Comm.) – *See, e.g., US Tax Court, 22 July 1966, London Displays Company v. Commissioner, 46 T.C. 511, concerning payments for wax figures by Madame Tussauds Wax Museums.*
    - Does not include, e.g., use in a consumer context (e.g., car rental by a tourist; Art 12 no. 13.2 UN MC Comm.), immovable property (covered by Art 6; Art 12 no. 13.2 UN MC Comm.), "transponder leasing" (for satellite capacity), "roaming" agreements between telecommunications network operators, "spectrum license" (for radio frequency) (Art 12 nos 9.1-9.3 OECD MC, and similar Art 12 no. 13.4 UN MC Comm., referring also to Art 12A UN MC)
    - Policy
      - Viewed as having significance similar to that of a PE by the UN MC (Art 12 no. 13.1 UN MC Comm.)
      - Removed from Art 12 OECD MC by the 1992 Update following the 1983 report "The Taxation of Income Derived from the Leasing of Industrial, Commercial or Scientific Equipment" → *Nature of income is business profits and practice of source State tax on gross income seemed too high.*

Chapter IV/3.5
Capital Gains

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Capital Gains | *Overview*

ARTICLE 13

CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

3. Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or of movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

5. Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.

- **"Mini-treaty" within the treaty for capital gains in Art 13 OECD MC**
- **Structure of Art 13 OECD MC**
  - ***Art 13(1) OECD/UN MC*** – Alienation of immovable property → ***Art 6***
  - ***Art 13(2) OECD/UN MC*** – Alienation of movable property forming part of the business property of a PE/fixed base → ***Art 7 (and Art 14 UN MC)***
  - ***Art 13(3) OECD/UN MC*** – Alienation of ships or aircraft → ***Art 8***
  - ***Art 13(4) OECD/UN MC***– Alienation of shares deriving more than 50% of their value directly or indirectly from immovable property in the source State → ~ ***Art 6 OECD MC***
  - ***UN MC: Art 13(5)*** – Alienation of significant participations
  - ***Art 13(5) OECD MC/Art 13(6) UN MC*** – Alienation of other property (e.g., shares other than Art 13(4) OECD/UN MC, Art 13(5) UN MC), securities, bonds, debentures) → ***Art 21***

Capital Gains | *Residual rule*

- **"Residual rule"** in Art 13(5) OECD MC and Art 13(6) UN MC
  - Alienation of ***other property*** (e.g., shares other than Art 13(4) OECD/UN MC, Art 13(5) UN MC), securities, bonds, debentures) → ***Art 21***
  - Exclusive taxation ("shall … only") in the ***alienator's residence State***:

> 5. Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.

  - Residency of ***"alienator"*** is decisive, even if domestic law would attribute the gain to another person *(e.g., in a situation involving trusts – Tax Court of Canada, 14 April 2011, Sommerer v. The Queen, 2011 TCC 212, concerning an Austrian Privatstiftung)*
  - ***"Alienation"*** is a "neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains" *(South African Supreme Court of Appeal, 8 May 2012, Tradehold Ltd, [2012] ZASCA 61)*
  - ***Borderline cases***, e.g., liquidations, redemptions of shares, reduction of paid up capital (Art 13 no. 31 OECD MC Comm.), sale of a bond with OECD or accrued interest (Art 11 nos 20, 21.1 OECD MC versus Austrian MoF, EAS 3293)

Capital Gains | *Real Estate*

- **"Real estate" companies → *Art 13(4) OECD/UN MC***

OECD MC before 2017
Shares

4. Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

OECD MC 2017
Timing and scope

4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

- Amendment following Action 6 of the BEPS Project (paras 41-44 of the 2015 Final Report), also in Art 9 MLI
- Details → Art 13 nos 28.3-28.13 OECD MC Comm.

Capital Gains | *Real Estate*

- **"Real estate" companies → *Art 13(4) OECD/UN MC***
  - Source State taxation right of the alienation of shares or comparable interests in a ***"real estate" entity*** ("indirect asset transfers")

> 4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

Capital Gains | *Real Estate*

- **"Real estate" companies → *Art 13(4) OECD/UN MC***
  - ***Main featues***
    - ***"All-or-nothing"***, i.e., taxation in the source State also where substantial assets of the entity are not immovable property (Art 13 no. 28.4 OECD MC Comm.)
    - No minimum ***shareholding requirement*** (Art 13 no. 28.6 OECD MC Comm.), no exception for ***listed companies*** (Art 13 no. 28.7 OECD MC Comm.), no regard as to who is the ***shareholder*** (e.g., pension funds; Art 13 no. 28.8 OECD MC Comm.)
    - ***365-day-rule*** to prevent dilution of the value (Art 13 no. 28.5 OECD MC Comm.) → *But: (1) Easy to circumvent and (2) potential double source taxation if real estate and the shares are sold in succession within the 365-day-period (Art 13 no. 28.9 OECD MC Comm.) – For "avoiding" the application of Art 13(4) OECD MC see also Tax Court of Canada, 18 August 2006, MIL (Investments) S A v. The Queen, 2006 TCC 460 (no implicit GAAR)*
    - ***REITS?*** (Art 13 no. 28.10-28.12 OECD MC Comm.)
    - ***Credit instead of exemption*** in the residence State, as many source States might not tax such alienations (Art 13 no. 28.6 OECD MC Comm.)
  - ***Administration, compliance***
    - How to gather information on "indirect asset transfers"? Compliance? Enforcement?
    - Guidance for implementation of domestic rules by the Platform for Collaboration on Tax, "The Taxation of Offshore Indirect Transfers—A Toolkit" (2020)

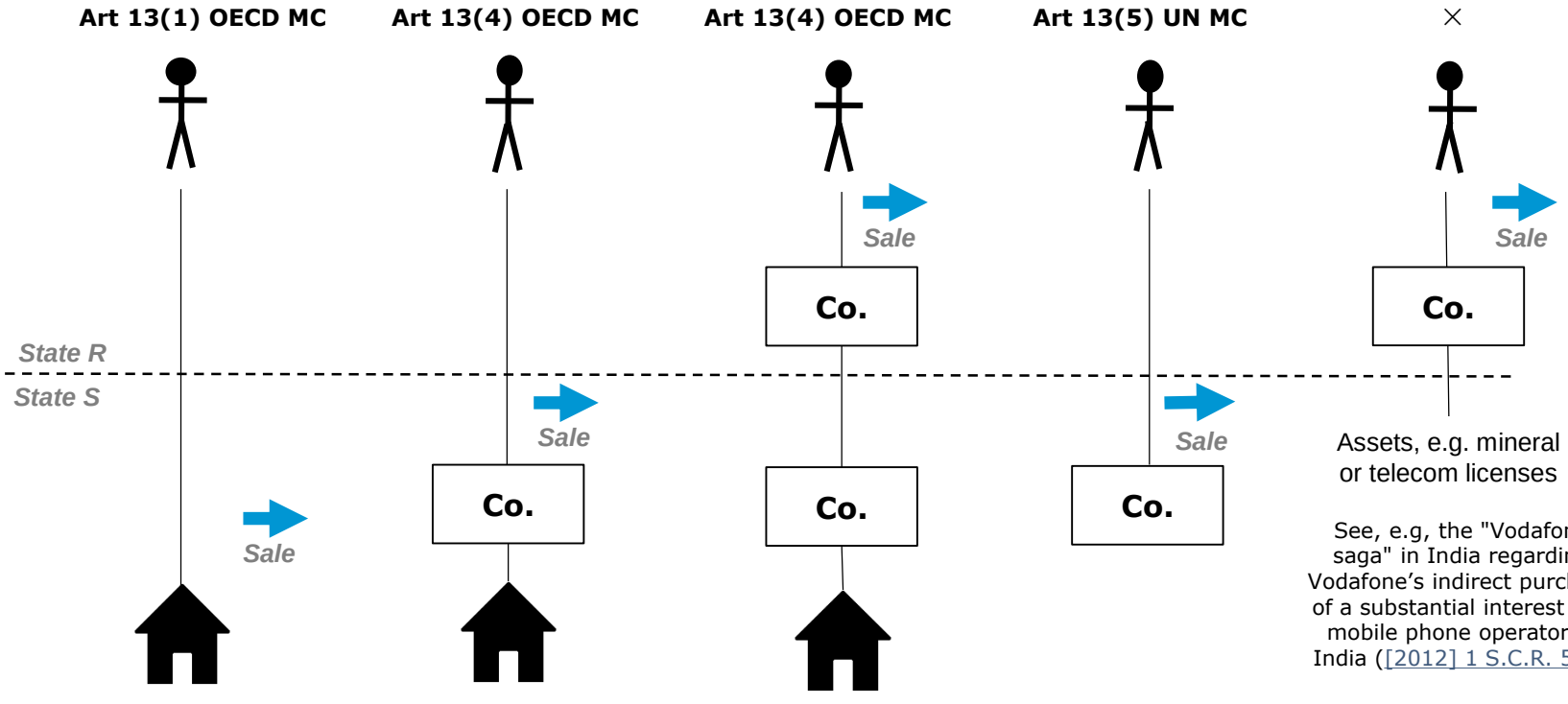
Capital Gains | *Substantial Interest*

- **"Substantial" participations → *Art 13(5) UN MC***
  - Alienation of shares, partnership or trust interests if there is significant (substantial) holding → *Expansion of source taxation versus administrative considerations (Art 13 no. 9 UN MC Comm.)*

> 5. Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests, such as interests in a partnership or trust, which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.

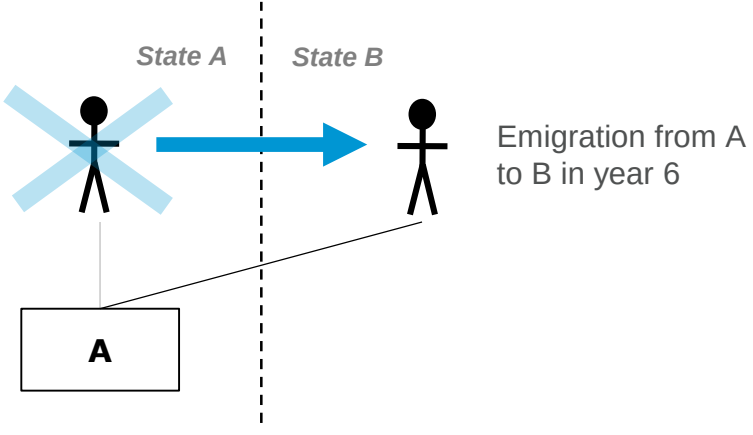
  - ***Features and administration*** (Art 13 nos 11-16 UN MC Comm.) → Direct and indirect holdings? Concessionary rate of tax (compared with the normal domestic rate)? Shares that are traded on a recognized stock exchange? Source taxation independently from the location of the company's assets? Corporate reorganizations?

Capital Gains | *Indirect transfers*



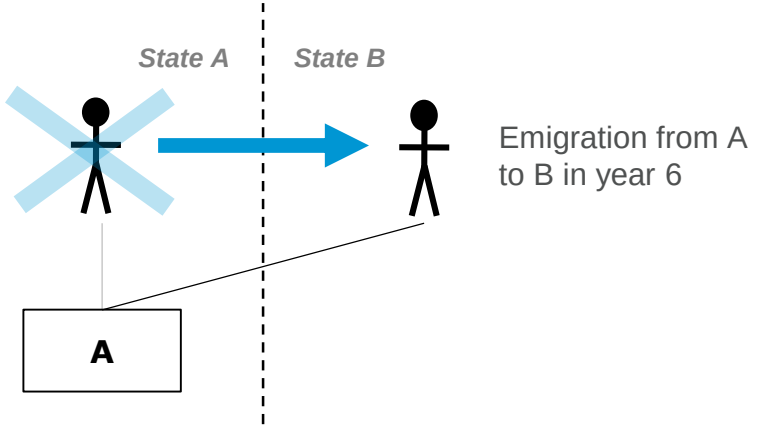
Capital Gains | *Exit Taxation*

- **Example:** ***Exit and entry***
  - Taxpayer T was a resident of State A in years 1 to 5. Since year 1, he owns some shares in a listed State A company; those shares have appreciated in value from 100 to 1.000. In year 6, T emigrates to State B. He sells the shares for 1.100 in year 7.
    - ***Issue 1:*** What may State A tax in light of Art 13(5) OECD MC? → *"Exit tax" (= deemed realization before change in residence) of the unrealized gain, i.e., 900 (nos 65-67 BEPS Final Report on Action 6 (2015); possibly contra: South African Supreme Court of Appeal, 8 May 2012, Tradehold Ltd, [2012] ZASCA 61) – Note: EU fundamental freedoms and requirement of proportionality (e.g., instalment option).*



Capital Gains | *Exit Taxation*

- **Example:** ***Exit and entry***
  - Taxpayer T was a resident of State A in years 1 to 5. Since year 1, he owns some shares in a listed State A company; those shares have appreciated in value from 100 to 1.000. In year 6, T emigrates to State B. He sells the shares for 1.100 in year 7.
    - ***Issue 2:*** What may State B tax in light of Art 13(5) OECD MC? *(Art 13 no. 3.1 OECD MC Comm.: Art 13(5) → Entire gain, i.e., 1.000 – No step-up required: E.g., nos 65-67 BEPS Final Report on Action 6 (2015) and Art 23 nos 4.1-4.3 OECD MC Comm. → MAP)*



Chapter IV/4
Employment, Director's Fees and Pensions

WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Overview

- ***Chapter IV/4.1*** – Employment Income (Article 15 OECD MC)
- ***Chapter IV/4.2*** – Director's Fees (Article 16 OECD MC)
- ***Chapter IV/4.3*** – Pensions (Article 18 OECD MC)

Chapter IV/4.1
Employment Income

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Employment | *Structure*

ARTICLE 15

INCOME FROM EMPLOYMENT

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

   a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and

   b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

   c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the other Contracting State, shall be taxable only in the first-mentioned State.

- ***Art 15 (1) OECD MC*** – Taxable "only" in the residence State unless exercised in the source State → *Subject to Art 16 (Director's Fees), 17 (Entertainers and Sports-persons), 18 (Pensions) and 19 (Government Service)*
- ***Art 15 (2) OECD MC*** – Restriction of source taxation even if the employment is exercised in the source State
- ***Art 15 (3) OECD MC*** – Crews – Employment exercised aboard a ship or aircraft operated in international traffic → *Art 8 OECD MC*

Employment | *Overview*

- **General principle of Art 15(1) OECD MC** → Taxation in the State where the employment is actually exercised:

> 1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

- ***Details***
  - ***"Exercised"*** → In the place where the employee is physically present when performing the activities for which the employment income is paid (Art 15 no. 1 OECD MC Comm.) → *Bars States from taxing remuneration "merely because the results of this work were exploited in that other State"*
  - ***"Salaries, wages and other similar remuneration"*** → Includes benefits in kind received in respect of an employment (e.g., stock-options, the use of a residence or automobile, health or life insurance coverage and club memberships; Art 15 no. 2.1 OECD MC Comm.)

Employment | *Overview*

- **General principle of Art 15(1) OECD MC** → Taxation in the State where the employment is actually exercised:

> 1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

- ***Details***
  - ***Timing: Principle of causality*** → Relevant is the exercise of employment in that State, regardless of when that income may be paid to, credited to or otherwise definitively acquired by the employee. → Issues:
    - ***Payments made after the termination of employment*** (Art 15 nos 2.3-2.16 OECD MC Comm.) → *2014 Update of the OECD MC Comm. based on the Discussion Draft on "Tax Treaty Treatment of Termination Payments" (25 June 2013)*
    - ***Stock options*** (Art 15 nos 12-12.15 OECD MC Comm.) – Delimitation between Art 15 and Art 13 OECD MC → *2005 Update of the OECD MC Comm based on the Report "Cross-Border Income Tax Issues Arising From Employee Stock Option Plans" (adopted by the OECD Committee on Fiscal Affairs on 16 June 2004).*

Excursus | *Timing issues*

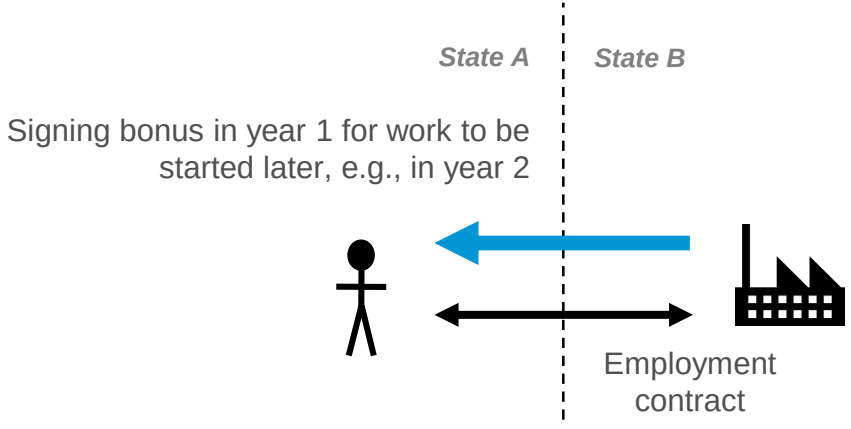
Payment	Taxation	Comm.
Payments after termination for work done before termination of employment (e.g., bonus)	State, where employment was exercised	No. 2.4
Unused holidays, sickness that accrued during the last year of employment or even in previous periods	Generally: Alllocated on a pro-rated basis to the States, where employment was exercised in the last 12 months of employment	No. 2.5
Payment during notice-period before termination if the employee is told not to work during the notice period	State where it is reasonable to assume that the employee would have worked during the period of notice	No. 2.6
Severance Payments ("redundancy payment") which an employer is required (by law or by contract) to make to an employee whose employment has been terminated	Generally: Alllocated on a pro-rated basis to the States, where employment was exercised in the last 12 months of employment	No. 2.7
Damages etc for illegal termination (e.g., in violation of the contract of employment, the law or a collective agreement)	Depends on what remuneration these damages replace, e.g., punitive damages or damages for discriminatory treatment or injury to one's reputation fall under Art 21	No. 2.8

Excursus | *Timing issues*

Payment	Taxation	Comm.
Payment in consideration for an obligation not to work for a competitor of his ex-employer (non-competition agreements)	Generally residence State, unless it is in substance remuneration for activities performed during employment	No. 2.9
Reimbursement of pension contributions (e.g. after temporary employment)	State where employment was exercised when it was terminated (Art 14 nos 4-6 OECD MC Comm.)	No. 2.10
Deferred remuneration arrangements	State, where employment was exercised	No. 2.11
Medical or life insurance coverage or other benefits for a certain period after termination of the employment	State where the employment was exercised when the employment was terminated	No. 2.13
Compensation payment for loss of future earnings following injury or disability suffered during the course of employment	Depends on the legal context (Art 15/18/19/21)	No. 2.14
Payment to a salesperson in relation to the loss of future commissions.	Depends on the legal context , generally place of employment	No. 2.15
Reduced salary during transitional arrangements leading to termination	Hypothetical place of employment	No. 2.16

Excursus | *Timing issues*

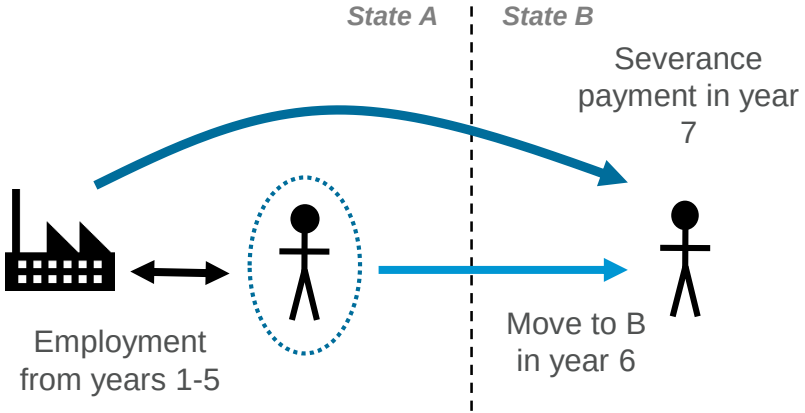
- **Example 1:** ***Signing bonus before employment***
  - Taxpayer T lives in State A and receives, in year 1, a bonus for the signing of an employment contract with company C in State B, starting in year 2. According to the employment contract the work is to be exercised in State B. The signing bonus must be repaid in case T terminates his contract within five years after the signature. *(→ German BFH, 11 April 2018, I R 5/16: Art 15(1) 2nd half-sentence = State of (future) activity.)*



  - Alternative: What if T has not received a signing bonus, but has rather incurred expenses for his future job in State B?

Excursus | *Timing issues*

- **Example 2:** ***Severance payment after employment***
  - Taxpayer T lived and worked for company C in State A in years 1 to 5. In year 6 he moves to and becomes a resident of State B. Following litigation, T receives a severance payment from company C in year 7. *(→ Austrian VwGH, 23 March 2017, Ro 2014/15/0050: Art 15(1) 2nd half-sentence = State of (past) activity versus German BFH, 10 June 2015, I R 79/13: Art 15(1) 1st half-sentence = residence State.)*



  - Alternative: What if the payment in year 7 is a salary or bonus for the last period of work or commissions for sales made during that period? *(→ Art 15 no. 2.4 OECD MC Comm.: Art 15(1) 2nd half-sentence = State of (past) activity.)*

Employment | *Source Taxation*

- **Limitation of source (work) State taxation (Art 15(2) OECD MC) →**
  - Avoids source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the State of source (Art 15 no. 6.2 OECD MC Comm.)
  - Three ***cumulative criteria for exclusive residence State (!) taxation***:

> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
>
> *a)* the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
>
> *b)* the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
>
> *c)* the remuneration is not borne by a permanent establishment which the employer has in the other State.

  - Note: For allocating the salary to a taxing jurisdiction, however, the focus normally is on the ***actual working days***!

Employment | *Source Taxation*

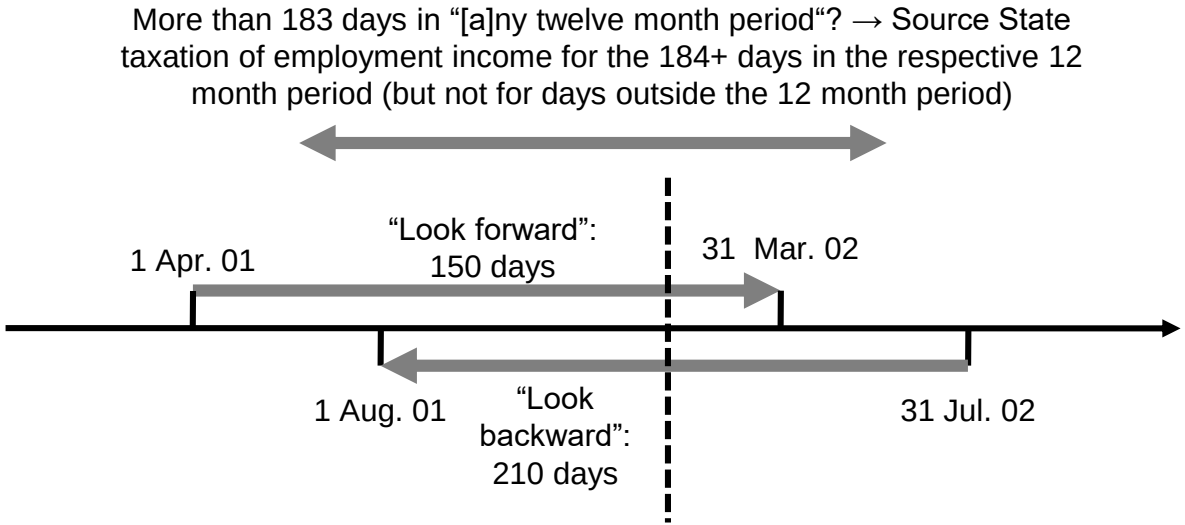
- **Limitation of source (work) State taxation (Art 15(2) OECD MC)** – Stated "positively", the source State may tax if ***one of the following alternative criteria*** is met …
  - ***… the recipient is present in the source State for a period or periods of more than 183 days in any twelve month period commencing or ending in the fiscal year concerned, or …***
    - Short periods are aggregated, "days of physical presence" method (Art 15 nos 5, 5.1 OECD MC Comm.)
    - Twelve-month period (Art 15 nos 4, 4.1 OECD MC Comm.)
  - ***… the remuneration is paid by, or on behalf of, an employer who is a resident of the source State, or …***
    - Issue → "International Hiring-Out of Labour", delimitation between a service and employment → Employer is the person having rights on the work produced and bearing the relative responsibility and risks
    - OECD Update 2010 → Art 15 nos 8.1 to 8.28 OECD MC Comm. — *Residence State accepts for relief to be given under Art 23 OECD MC the source State's determination of "employer" under Art 3(2) OECD MC (insofar as this assessment is based on objective criteria) – Also: Alternative provision in Art 15 no. 8.3 OECD MC Comm.*
  - ***"… the remuneration is borne by a permanent establishment of the employer has in source State"*** (→ Art 15 nos 7-7.2 OECD MC Comm.)

Employment | *183 Days*

- **Limitation of source (work) State taxation (Art 15(2) OECD MC)** – More than 183 days in 12 months
  - ***"Days of physical presence"***
    - Included → Part of a day (however brief; no 8-hour-threshold, no overnight-threshold), day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before, during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness and death or sickness in the family (Art 15 no. 5 OECD MC Comm.)
    - Not Included, e.g., entire days spent outside the State of activity, whether for holidays, business trips, or any other reason, days of transit in the course of a trip between two points outside the State of activity, days while taxpayer was a resident of the source State (Art 15 no. 5.1 OECD MC Comm.)
    - See also OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis (3 April 2020)
  - ***12-Month-Period***
    - "… in any twelve month period commencing or ending in the fiscal year concerned …" → i.e., Fiscal year of the source State (Art 5 no. 4.1 OECD MC Comm.)
    - Previously (in the 1977 OECD MC): "… in the fiscal year concerned …" — Problem: Taxpayer is present last 5 ½ months of one year and the first 5 ½ months of the following year → OECD considered this "opportunities for tax avoidance"
    - Note: In some countries the "fiscal year" for individuals does not coincide with the calendar year, e.g., India and New Zealand (1 April – 31 March), the UK (6 April – 5 April) etc

Employment | *183 Days*

- **Limitation of source (work) State taxation (Art 15(2) OECD MC) –** More than 183 days in 12 months → *"… in any twelve month period commencing or ending in the fiscal year concerned …" (→ Art 15 no. 4, 4.1 OECD MC Comm.)*



Employment | *Employer*

- **Limitation of source (work) State taxation** (Art 15(2) OECD MC)
  - Who is the "employer" under Art 15(2)(b) OECD MC?
  - Contractual versus economic? Employment versus services? Nature of the services (integral part of whose business)? Additional criteria? → Art 15 nos 8.1 to 8.28 OECD MC Comm.

8.14 Where a comparison of the nature of the services rendered by the individual with the business activities carried on by his formal employer and by the enterprise to which the services are provided points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:

— who has the authority to instruct the individual regarding the manner in which the work has to be performed;

— who controls and has responsibility for the place at which the work is performed;

— the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below);

— who puts the tools and materials necessary for the work at the individual's disposal;

— who determines the number and qualifications of the individuals performing the work;

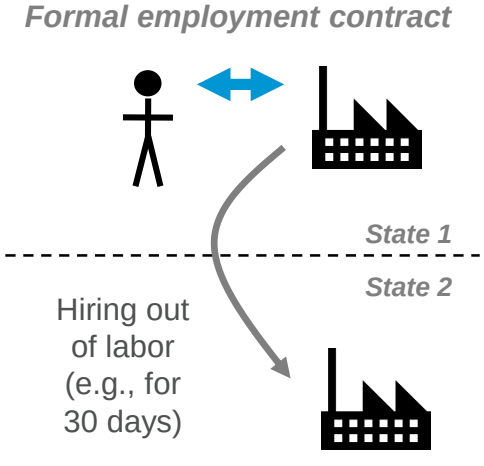
— who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;

— who has the right to impose disciplinary sanctions related to the work of that individual;

— who determines the holidays and work schedule of that individual.

Employment | *Employer*

- Art 3(2) OECD MC – ***Diverging domestic laws*** and avoidance of double taxation → "in accordance with the provisions of this Convention" (Art 23 OECD MC)
- Example (e.g., Art 15 no. 8.10 et seq. OECD MC Comm.):



ARTICLE 15

INCOME FROM EMPLOYMENT

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and

b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

Chapter V

METHODS FOR ELIMINATION OF DOUBLE TAXATION

ARTICLE 23 A

EXEMPTION METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

Government service | *Article 19*

- **Structure of Art 19 OECD MC**
  - ***Art 19(1) OECD MC*** – Exclusive taxation in the paying State (including political subdivisions and local authorities) is for salaries, wages and other similar remuneration. – *Exception: Certain categories of personnel of foreign diplomatic missions and consular posts, who are permanent residents or nationals of that State.*
  - ***Art 19(2) OECD MC*** – Exclusive taxation in the paying State for pensions and other similar remuneration. – *Exception: Taxpayer is resident and national of other State.*
  - ***Art 19(3) OECD MC*** – Art 15, 16, 17 or 18 OECD MC if services are performed in connection with a business carried on by the State.

ARTICLE 19

GOVERNMENT SERVICE

1. *a)* Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

   b) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:

   (i) is a national of that State; or

   (ii) did not become a resident of that State solely for the purpose of rendering the services.

2. *a)* Notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

   b) However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.

3. The provisions of Articles 15, 16, 17, and 18 shall apply to salaries, wages, pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Chapter IV/4.2
Director‘s Fees

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Director's Fees | *Overview*

- **Art 16 OECD MC** → "Open", bilateral distributive rule for director's fees →
  - Simplification → „It might sometimes be difficult to ascertain where the services are performed", so that „the provision treats the services as performed in the State of residence of the company" (Art 16 no. 1 OECD MC Comm.)
  - *Different scopes in the OECD and UN MC:*

OECD MC

ARTICLE 16

DIRECTORS' FEES

Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

UN MC

Article 16

DIRECTORS' FEES AND REMUNERATION OF TOP-LEVEL MANAGERIAL OFFICIALS

1. Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the Board of Directors of a company which is a resident of the other Contracting State may be taxed in that other State.
2. Salaries, wages and other similar remuneration derived by a resident of a Contracting State in his capacity as an official in a top-level managerial position of a company which is a resident of the other Contracting State may be taxed in that other State.

Director's Fees | *Overview*

- **Art 16 OECD MC** → "Open", bilateral distributive rule for director's fees
  - ***Rule:*** Taxation in the residence State of the company, relief under Art 23 OECD MC in the residence State of the director etc

> Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

  - ***Details***
    - ***Different board structures*** – Monist (e.g., "Verwaltungrat", "Board of Directors") versus dualist (e.g., "Vorstand" and "Aufsichtsrat"), management versus supervisory/governance etc
    - ***"Board of directors"*** → Unclear scope of Art 16 OECD MC → "Board of directors" (English), "conseil d'administration ou de surveillance d'une société" (French), "Aufsichts- oder Verwaltungsrat" (German) → *Extension in Art 16(2) UN MC to "top-level managerial positions"*
    - ***"Fees and other similar payments"*** → Benefits in kind received by a person in that person's capacity as a member of the board of directors of a company (e.g. stock-options, the use of a residence or automobile, health or life insurance coverage and club memberships; Art 16 no. 1.1 OECD MC Comm.).
    - ***"Capacity as a member …"*** → Art 16 does not apply to remuneration for other functions with the company, e.g. as ordinary employee, adviser, consultant, etc (Art 16 no. 2 OECD MC Comm.)

Chapter IV/4.3
Pensions

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Pensions | *Overview*

- **Art 18 OECD MC** → Exclusive taxation in the residence State versus broader source taxation? – *Different scopes in the OECD and UN MC:*

OECD MC

ARTICLE 18

PENSIONS

Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

UN MC

Article 18

PENSIONS AND SOCIAL SECURITY PAYMENTS

Article 18 (alternative A)

1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

2. Notwithstanding the provisions of paragraph 1, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Article 18 (alternative B)

1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment may be taxed in that State.

2. However, such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by a resident of that other State or a permanent establishment situated therein.

3. Notwithstanding the provisions of paragraphs 1 and 2, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Pensions | *Overview*

- **Art 18 OECD MC**
  - ***Rule:*** Exclusive taxation in the residence State of the recipient (≠ UN MC)

> Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

  - ***Details***
    - Covers pensions directly paid to former ***employees but also to other beneficiaries*** (e.g. surviving spouses, companions or children of the employees) and other similar payments, such as annuities, paid in respect of past employment (Art 18 no. 3 OECD MC Comm.)
    - Covers ***periodic payments and non-periodic payments*** (e.g., lump-sum payment in lieu of periodic pension) (Art 18 no. 5 OECD MC Comm.)
    - Includes ***statutory social security schemes*** for employees (Art 16 no. 24 OECD MC Comm)
    - Does not cover, e.g., pensions paid for ***previous independent personal services*** (Art 18 no. 7 OECD MC Comm.)

Pensions | *Policy Issues*

- **Art 18 OECD MC – *Residence versus source State? Cross-border problems?***
  - ***"Clash" of different domestic approaches***
    - ***EET*** → Contributions are ***e***xempt (= deductible = paid from pre-tax income), investment income and capital gains of the pension fund are also ***e***xempt and benefits are ***t***axable under the income tax.
    - ***ETE*** → Contributions are ***e***xempt (= deductible = paid from pre-tax income), investment income and capital gains of the pension fund are ***t***axed and benefits are also ***e***xempt from personal income taxation.
    - ***TEE*** → Contributions are ***t***axed (= not deductible = paid from after-tax income), investment income and capital gains of the pension fund are ***e***xempt and benefits are also ***e***xempt from personal income taxation.
  - ***"Clash" of different domestic pension arrangements, e.g.,***
    - Statutory social security schemes
    - Occupational pension schemes
    - Individual retirement schemes

Pensions | *Policy Issues*

- **Art 18 OECD MC – *Residence versus source State?***
  - ***Ability to pay*** → Art 18 no. 1 OECD MC Comm.
  - ***Issues***:
    - General: Taxing rights with respect to pension benefits (Art 18 no 12-21 OECD MC Comm.)
    - Statutory social security schemes (Art 18A(2) UN MC; Art 18 no 24-28 OECD MC Comm.)
    - Individual retirement schemes (Art 18 nos 29-30 OECD MC Comm.)
    - Tax treatment of contributions to foreign pension schemes (Art 18 nos 31-65 OECD MC Comm.)
    - Cross.border portability of pensions rights (Art 18 nos 66-68 OECD MC Comm.)
    - Exemption of the income of a pension fund (Art 18 no. 69 OECD MC Comm.)

1. According to this Article, pensions paid in respect of private employment are taxable only in the State of residence of the recipient. Various policy and administrative considerations support the principle that the taxing right with respect to this type of pension, and other similar remuneration, should be left to the State of residence. For instance, the State of residence of the recipient of a pension is in a better position than any other State to take into account the recipient's overall ability to pay tax, which mostly depends on worldwide income and personal circumstances such as family responsibilities. This solution also avoids imposing on the recipient of this type of pension the administrative burden of having to comply with tax obligations in States other than that recipient's State of residence.

2. Some States, however, are reluctant to adopt the principle of exclusive residence taxation of pensions and propose alternatives to the Article. Some of these alternatives and the issues that they raise are discussed in paragraphs 12 to 21 below, which deal with the various considerations related to the allocation of taxing rights with respect to pension benefits and the reasons supporting the Article as drafted.

Part V
Methods for the Elimination of Double Taxation

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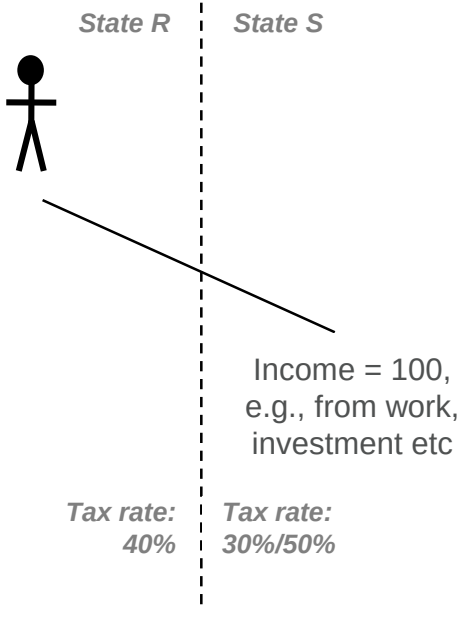
Methods | *Overview*

- ***Juridical ("Real") Double Taxation***

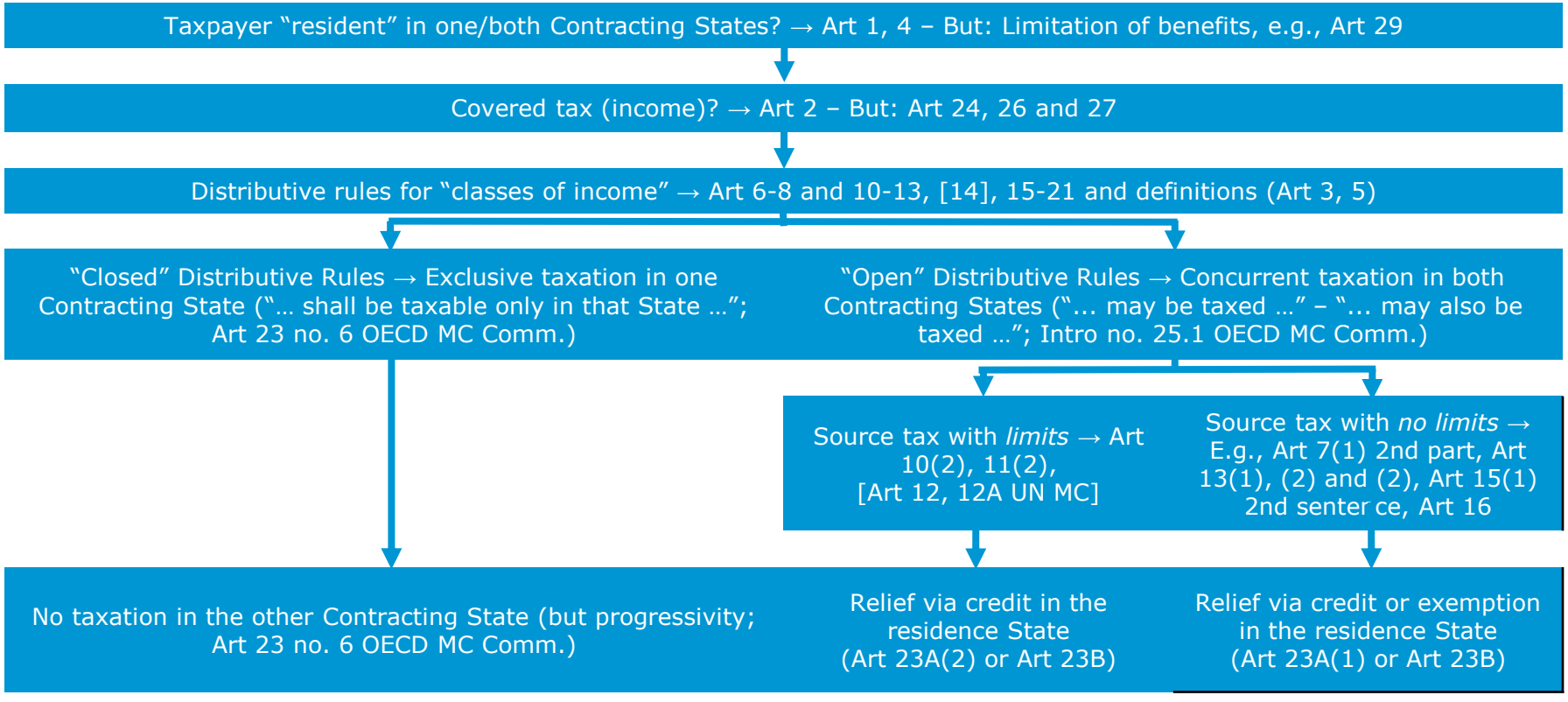


- **Relief**
  - Unilateral relief → E.g., § 48 BAO
  - Bi- or multilateral relief → Tax treaties
- **Forms**
  - Credit in the residence State → *Capital Export Neutrality (CEN – Neutrality in the home market)* → Credit limitation? → Article 23B OECD MC
  - Exemption in the residence State → *Capital Import Neutrality (CIN – Neutrality in the host market)* → Progressivity? Losses? → Article 23A OECD MC
  - Deduction of the foreign tax from the tax base of the residence State → *National Neutrality (NN)*
  - Classification and assignment of sources → Source rules → Articles 7, 8 etc OECD MC
  - Limitation of source State taxation → Article 10, 11 OECD MC

Methods | *Overview*

- **Distributive rules and methods**
  - **"Closed" Distributive Rules** → Exclusive Taxation
    - ***"… shall be taxable only in that State …"*** (Art 23 no. 6 OECD MC Comm.)
      - Exclusive Taxation usually in the **residence** State → Art 7(1), Art 8(1) and (2), Art 12(1) (≠ UN MC), Art 13(3), (5), Art 15(1) 1st sentence, Art 18, Art 19(1)(b) and (2)(b), Art 21(1)
      - Sometimes in the **source** State: Art 19(1)(a) and (2)(a)
    - Income **exempt** in the other State (but may be included to calculate progressive rate – Art 23A(3); Art 23 no. 6 OECD MC Comm.)
    - *Note:* ***"Saving clause"*** and exceptions (Art 1(3) OECD MC)
  - **"Open" Distributive Rules** → Concurrent Taxation
    - ***"… may be taxed …" – "… may also be taxed …"*** (Intro no. 25.1 OECD MC Comm.)
      - Source tax with ***limits*** → Art 10(2) (5%/15%), Art 11(2) (10%)
      - Source tax *with* ***no limits*** → Art 7(1) 2nd part, Art 13(1), (2) and (3), Art 15(1) 2nd sentence and (3), Art 16, Art 17(1)
  - **Relief via credit or exemption in the residence State (Art 23A or Art 23B)** → Art 23 provides an obligation to grant double tax relief with regard to income "which may be taxed in the other Contracting State in accordance with the provisions of this Convention".

OECD MC | *Structure*



Methods | *Exemption and Credit*

- **Art 23A and 23B OECD MC** → Choice between (only) two methods in the OECD and UN MC:

Article 23A OECD MC

ARTICLE 23 A

EXEMPTION METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2. Where a resident of a Contracting State derives items of income which may be taxed in the other Contracting State in accordance with the provisions of Articles 10 and 11 (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State), the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.

Article 23B OECD MC

ARTICLE 23 B

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

   a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;

   b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

- **Exemption and credit**
  - Art 23 OECD MC only addresses the taxpayer's residence State! (Art 23 no. 3(b) OECD MC Comm.) – *Extension to the PE State via the non-discrimination principle in Art 24(3) OECD MC → Also: Guidance on triangular situations involving PEs (Art 23 nos 9-10 OECD MC Comm.)*
  - Two methods
    - ***Exemption method with progression*** (Art 23A OECD MC) →
      - But switch zu credit in Art 23A(2) OECD MC in cases of limited source taxation (Art 10, 11 OECD MC, Art 12, 12A UN MC)
      - Progressivity under Art 23A(3) OECD MC also for income that is exempt under closed distributive rules (Art 23 no. 6 OECD MC Comm.)
    - ***Ordinary credit method*** (Art 23B OECD MC) → *But progressivity under Art 23A(2) OECD MC for income that is exempt under closed distributive rules.*

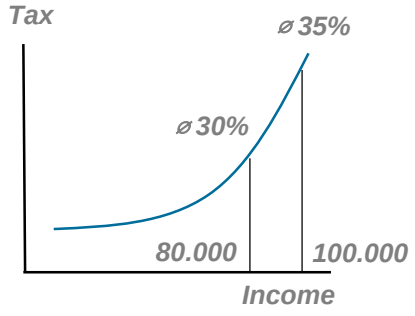
- **Exemption and credit**
  - Contracting States have the choice between methods and may use both of them or a mix (Art 23 nos 30-31 OECD MC Comm.) – *Unlike with regard to distributive rules, the OECD MC accepts asymmetrical approaches with regard to the relief from double taxation!*
    - Constitutional issues with regard to a State's choice of method in *(1)* one and the same tax treaty or *(2)* in different tax treaties? *(Generally: No! → See, e.g., Austrian Constitutional Court (VfGH), 23 June 2014, SV 2/2013)*
    - Treaty choices sometimes deviate from choices under domestic law → *E.g., Germany and Hungary use the credit method under domestic law, but generally negotiate the exemption method in tax treaties.*
  - Art 23A and 23B "drafted in a general way", much is "left to the domestic laws and practice" (Art 23 no. 32 OECD MC) → Art 23 OECD MC "more honored in the breach than the observance" (© R. Couzin)
  - Relevance of treaty sourcing rules for relief (Art 23(3) US MC) → *See, e.g., UK Supreme Court, 1 July 2015, Anson v Revenue and Customs, [2015] UKSC 44*

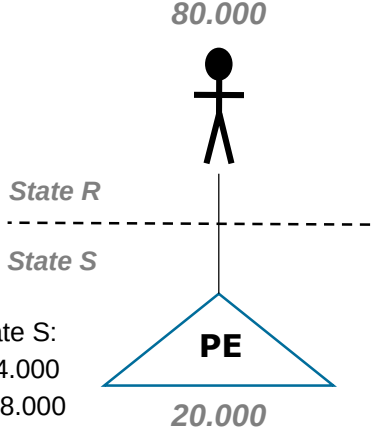
- **Exemption and credit**
  - Art 23 OECD MC does not deal with **economic double taxation**
    - E.g., no rules on indirect or deemed paid credit, participation exemption (Art 23 nos 49-54 OECD MC Comm.) – *Further guidance with regard to participation exemption regimes and deduction/non inclusion outcomes (Art 5 MLI and para. 444 of the 2015 Final Report on BEPS Action 2)*
    - Also: Since the 2017 Update no relief for the other State's residence-based taxes ("except to the extent …") to supplement Art 1(2) and (3) OECD MC – *Also in the 2017 UN Update and Art 3(2) MLI!*
  - Art 23A(4) OECD MC addresses **conflicts of qualification** that are based on a different (autonomous) interpretation of the treaty or a different understanding of the facts (also in the UN MC since the 2017 Update):

> 4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.

Methods | *Operation*

- **Exemption and credit** → ***Operation and effects of the methods – Example:***
  - Total income of the taxpayer: 100.000, of which 80.000 is derived from State R and 20.000 from State S.
  - Tax rate in State R on an income of 100.000 is 35% and on an income of 80.000 is 30%. State S tax rate is 20% (case (i)) or 40% (case (ii)), so that the tax payable therein on 20.000 is 4.000 in case (i) or 8.000 in case (ii).
  - Baseline:
    - If the taxpayer's total income of 100.000 arises in State R, his tax would be 35.000.
    - If the taxpayer's total income of 100.000 arises as set out above (80.000 in State R and 20.000 in State S) and if no relief is provided for in the domestic laws of State R and no conventions exists between State R and State S, then the total amount of tax would be, in case (i): 35.000 + 4.000 = 39.000, and in case (ii): 35.000 + 8.000 = 43.000.





Rate in State S:
(i): 20% = 4.000
(ii): 40% = 8.000

Methods | *Operation*

- **Exemption and credit** → Operation and effects of the methods – Example: Exemption (Art 23 nos 20-22 OECD MC Comm.)

a) Full exemption

State R imposes tax on 80,000 at the rate of tax applicable to 80,000, i.e. at 30 per cent.

	Case (i)	Case (ii)
Tax in State R, 30% of 80,000	24,000	24,000
Plus tax in State S	4,000	8,000
Total taxes	28,000	32,000
Relief has been given by State R in the amount of	11,000	11,000

b) Exemption with progression

State R imposes tax on 80,000 at the rate of tax applicable to total income wherever it arises (100,000), i.e. at 35 per cent.

	Case (i)	Case (ii)
Tax in State R, 35% of 80,000	28,000	28,000
Plus tax in State S	4,000	8,000
Total taxes	32,000	36,000
Relief has been given by State R in the amount of	7,000	7,000

Methods | *Operation*

- **Exemption and credit** → Operation and effects of the methods – Example: Credit (Art 23 nos 23-27 OECD MC Comm.)

a) Full credit

State R computes tax on total income of 100,000 at the rate of 35 per cent and allows the deduction of the tax due in State S on the income from S.

	Case (i)	Case (ii)
Tax in State R, 35% of 100,000	35,000	35,000
less tax in State S	- 4,000	- 8,000
Tax due	31,000	27,000
Total taxes	35,000	35,000
Relief has been given by State R in the amount of	4,000	8,000

b) Ordinary credit

State R computes tax on total income of 100,000 at the rate of 35 per cent and allows the deduction of the tax due in State S on the income from S, but in no case it allows more than the portion of tax in State R attributable to the income from S (maximum deduction). The maximum deduction would be 35 per cent of 20,000 = 7,000.

	Case (i)	Case (ii)
Tax in State R, 35% of 100,000	35,000	35,000
less tax in State S	- 4,000	
less maximum tax		- 7,000
Tax due	31,000	28,000
Total taxes	35,000	36,000
Relief has been given by State R in the amount of	4,000	7,000

Methods | *Operation*

- **Exemption and credit** → Operation and effects of the methods – Example: Total amount of tax and amount of tax given up (Art 23 tables 23-1 and 23-2 OECD MC Comm.)

Table 23-1 Total amount of tax in the different cases illustrated above

A. All income arising in State R	Total tax = 35,000	
B. Income arising in two States, *viz.* 80,000 in State R and 20,000 in State S	Total tax if tax in State S is	
	4,000 (case (i))	8,000 (case (ii))
No convention (19)[a]	39,000	43,000
Full exemption (20*a*)	28,000	32,000
Exemption with progression (20*b*)	32,000	36,000
Full credit (23*a*)	35,000	35,000
Ordinary credit (23*b*)	35,000	36,000

a Numbers in brackets refer to paragraphs in this Commentary.

Table 23-2 Amount of tax given up by the state of residence

	If tax in State S is	
	4,000 (case (i))	8,000 (case (ii))
No convention	0	0
Full exemption (20*a*)[a]	11,000	11,000
Exemption with progression (20*b*)	7,000	7,000
Full credit (23*a*)	4,000	8,000
Ordinary credit (23*b*)	4,000	7,000

Methods | *Principles*

- **Principles of the methods**
  - ***Exemption looks at income, credit looks at tax!*** (Art 23 no. 17 OECD MC Comm.)
  - "Full" exemption ("income exemption") versus ***exemption "with progression"*** ("tax exemption") (Art 23 nos 13-14 OECD MC)
    - Source State tax is decisive, i.e., taxation level of the source State "stands"! → *Ability to pay? WTO, EU state aid?*
    - Note: Losses → Negative Progression → *Applying a lower tax rate as a consequence of losses from foreign sources may result in zero-taxation where the total income is lower than the tax free amount in State R*
  - "Full" credit versus ***"ordinary" credit*** (Art 23 nos 15-17 OECD MC)
    - "Residual" residence State tax if higher than source State tax, no refund if lower than source State tax! → *Sufficient for the avoidance of double taxation as it is not the "function of a convention to provide relief in one State from the effects of a higher level of tax in the other" (FC/WP15(59))*
    - But: Credit method "eliminates" the benefits of incentives and concessions in the source State → *Tax sparing (Art 23 nos 72-78.1 OECD MC Comm).*

Exemption | *Policy Issues*

- **Policy issues with regard to the the exemption method**
  - "Virtual double taxation" ("white income", double non-taxation)
  - In principle: "Unconditional exemption"
    - Exemption in the residence State is irrespective of actual taxation by the source State (Art 23 nos 34-35 OECD MC Comm.) and even irrespective of the reason for non-taxation by the source State (German Bundesfinanzhof (BFH), 10 January 2002, I R 66/09)
    - Conversely: Relief from source taxation does not depend on actual taxation in the residence State (e.g., Italian Supreme Court, 11 October 2018, no. 25219)
  - Ability to pay? → *No concerns, e.g., by the German Bundesfinanzhof (BFH), 10 January 2012, I R 66/09, and the Austrian Constitutional Court (VfGH), 23 June 2014, SV 2/2013*
  - WTO, EU state aid? → *Likely no concerns, see, e.g., the Commission's final position in the McDonald's case (SA.38945) and paras 146-147 in the Appellate Body's Report in the FSC case (WT/DS108/AB/RW)*

Exemption | *Policy Issues*

- **Policy issues with regard to the the exemption method**
  - Special clauses in treaty practice (e.g., "subject-to-tax-clauses", "switch-over clauses", "activity clauses" etc)
  - Credit method under Art 23A(2) OECD MC in cases …
    - … of limited source taxation (Art 10, 11 OECD MC, Art 12, 12A UN MC)
    - … in treaty practice e.g. with regard to income under Art 13(4), 16, 17 OECD MC (see, e.g., Art 13 no. 28.12, Art 17 no. 12 OECD MC Comm.)
    - … or for income subject to a special tax regime introduced after the conclusion of the treaty (Art 23 no. 31.1 OECD MC Comm.)
  - Conflicts of qualification …
    - … based on a different reading of the treaty based on reliance on domestic law under Art 3(2) OECD MC (Art 23 nos 32.1-32.7 OECD MC Comm.)
    - … based on a different (autonomous) interpretation of the treaty or a different understanding of the facts (Art 23A(4) OECD MC and Art 23 nos 56.1-56.3 OECD MC Comm.)

Credit | *Technical Issues*

- **Some technical issues with regard to the credit method**
  - Relevant is the tax on income that "may be taxed" by the source State – *Relevance of treaty sourcing rules for relief (e.g., Art 23(3) US MC)*
  - (Wordwide, domestic and source State) income calculated according to residence State's law
  - Credit and limitations
    - ***First limit:*** Credit for amount equal to the income "tax paid in the other State"
      - Effective payment of tax (by the taxpayer, a withholding agent etc)
      - To be understood in the context of "may be taxed", i.e., credit only in the treaty amount (e.g., Art 10, 11 OECD MC)
      - Voluntary overpayments, exhaustion of legal possibilities to reduce the foreign tax, claim of discretionary deductions etc (not to be overstretched; see, e.g., Tax Court of Canada, 4 March 2004, *Philip A. Meyer v. The Queen*, 2004 TCC 199)
      - Exception: Tax sparing (Art 23 nos 72-78.1 OECD MC Comm).
    - ***Second limit:*** Maximum deduction → Residence State's income tax "which is attributable […] to the income […] which may be taxed in the other State" → Credit limitation

Credit | *Technical Issues*

- **Some technical issues with regard to the credit method**
  - ***Maximum deduction*** → Residence State's income tax "which is attributable […] to the income […] which may be taxed in the other State" → Credit limitation

$$\text{Maximum deduction} = \text{Residence State tax} \cdot \frac{\text{Income in the source State}}{\text{Total income}}$$
$$= \frac{\text{Residence State tax}}{\text{Total income}} \cdot \text{Income in the source State}$$

  - ***Example:*** The taxpayer's total income is 100.000, of which 80.000 is derived from State R and 20.000 from State S. In State R the rate of tax on an income of 100.000 is 35%. The maximum deduction would be 35% of 20.000 = 7.000:

$$\text{Maximum deduction} = \frac{35.000}{100.000} \cdot 20.000 = 7.000$$

Methods | *Issues and Problems*

- **Issues not solved by Art 23 OECD MC or the Commentaries**
  - Generally: Calculation of amount to be exempted (Art 23 nos 39-43 OECD MC Comm.) – *Tax base and tax rate!*
  - Specifically: Allocation of costs etc to foreign income (Art 23 nos 39-41, 44 and 62 OECD MC Comm.) → *EU law limits with regard to personal and family benefits (e.g., ECJ, 23 February 2013, C-168/13, Beker and Beker, EU:C:2013:117), but also with regard to income-related expenses (e.g., EFTA Court, 7 May 2008, E-7/07, Seabrokers, [2008] EFTA Court Report 172)*
  - Treatment of losses in exemption systems (Art 23 no. 44 OECD MC Comm.) and in credit systems (Art 23 nos 65-66 OECD MC Comm.) → *"Final losses" in EU law (ECJ, 12 June 2018, C-650/16, Bevola, EU:C:2018:424)*
  - Treatment of a basic tax free amount in exemption systems (Art 23 no. 45 OECD MC Comm.)
  - Timing issues and currency fluctuations (Art 23 no. 61 OECD MC Comm.)
  - Credit limitation ("overall", "per country", "per item") (Art 23 nos 62-64 OECD MC Comm.) → *"Excess credits" (→ No EU law obligation to grant a carry-forward; see, e.g., ECJ, 10 February 2011, C-436/08 and C-437/08, Haribo and Salinen, EU:C:2011:61)*
  - Tax sparing (Art 23 nos 73 et seq. OECD MC Comm.)

Methods | *Issues and Problems*

- Issues not solved by Art 23 OECD MC or the Comm. → ***Issue 1: Additional deductions*** *(Art 23 no. 41 OECD MC Comm.)*

41. Problems arise from the fact that most countries provide in their respective taxation laws for additional deductions from total income or specific items of income to arrive at the income subject to tax. A numerical example may illustrate the problem:

a)	Domestic income (gross less allowable expenses)	100
b)	Income from the other State (gross less allowable expenses)	100
c)	Total income	200
d)	Deductions for other expenses provided for under the laws of the State of residence which are not connected with any of the income under a or b, such as insurance premiums, contributions to welfare institutions	-20
e)	"Net" income	180
f)	Personal and family allowances	-30
g)	Income subject to tax	150

The question is, what amount should be exempted from tax, e.g.

— 100 (line *b*), leaving a taxable amount of 50;

— 90 (half of line *e*, according to the ratio between line *b* and line *c*), leaving 60 (line *f* being fully deducted from domestic income);

— 75 (half of line *g*, according to the ratio between line *b* and line *c*), leaving 75;

— or any other amount.

Methods | *Issues and Problems*

- Issues not solved by Art 23 OECD MC or the Commentaries → ***Issue 2: Allocation of costs etc to foreign income*** *(Art 23 nos 39-41, 44 and 62 OECD MC Comm.)*
  - ***Example:*** The taxpayer's pre-interest income is 100.000, of which 80.000 is derived from State R and 20.000 from State S. The taxpayer also has interest expenses of 10.000, which solely relate to her residence State income. However, State R requires a proportionate allocation of interest expense to domestic and foreign income. In State R the rate of tax is flat 30%. *→ See also EFTA Court, 7 May 2008, E-7/07, Seabrokers, [2008] EFTA Court Report 172*

$$\text{Maximum deduction} = \frac{\text{Residence State tax}}{\text{Total income}} \cdot \text{Income in the source State}$$

  - ***Proportionate expense allocation:***

$$\frac{27.000\ (= 30\%\ \text{of}\ 90.000)}{90.000} \cdot 18.000\ \left(= 20.000 - \frac{20.000}{100.000} 10.000\right) = 5.400$$

  - ***Economic expense allocation:***

$$\frac{27.000\ (= 30\%\ \text{of}\ 90.000)}{90.000} \cdot 20.000 = 6.000$$

Methods | *Issues and Problems*

- Issues not solved by Art 23 OECD MC or the Commentaries → ***Issue 3: Credit limitation ("overall", "per country", "per item")*** *(Art 23 nos 62-64 OECD MC Comm.)*
  - ***Example:*** Taxpayer's total income is 100.000, of which 50.000 is derived from State R and 50.000 from State S.
    - The 50.000 derived from the source State consist of
      - 20.000 business profits (taxable in S under Art 7, tax of 1.000),
      - 10.000 dividends (taxable in S under Art 10, tax of 2.500),
      - 10.000 interest (taxable in S under Art 11, tax of 500) and
      - 10.000 pension (not taxable in S under Art 18).
    - The overall tax in S is therefore 4.000. Assume that R's tax on 100.000 is 20%.

Methods | *Issues and Problems*

- Issues not solved by Art 23 OECD MC or the Commentaries → ***Issue 3: Credit limitation ("overall", "per country", "per item")*** *(Art 23 nos 62-64 OECD MC Comm.)*
  - ***Per-country limitation*** (= overall limitation in a two-State scenario) → All items of income from S except the pensions (those "may" not be taxed in S under Art 18) are aggregated and used for calculating the maximum deduction, i.e., 8.000 ([20.000/100.000]*40.000), and all foreign tax (4.000) could therefore be credited.
  - ***Per-item limitation*** → Requires a determination of the maximum deduction for each item of income, i.e.,

Item of income	Tax in S	Maximum deduction	Credit
Business profits (20.000)	1.000	4.000	1.000
Dividends (10.000)	2.500	2.000	2.000
Interest (10.000)	500	2.000	500
Pension (10.000)	0	2.000	0
			3.500

Methods | *Issues and Problems*

- Issues not solved by Art 23 OECD MC or the Comm. → ***Issue 4: Tax sparing*** *(Art 23 nos 73 et seq. OECD MC Comm.)*
  - Under a credit system, any benefits in the source State (e.g., incentives, low rates, exemptions etc) result in a corresponding increase in the residence State's tax, which would ***nullify the effect of the tax incentives***
  - ***Development aid, investment stimulation*** → Tax sparing credit (for tax spared by a special source State regime) or matching credit (where taxpayer is deemed to have paid tax at a specified rate) → *Neither in the OECD nor the UN MC, but in a number of real treaties (see, e.g., for the Brazil-Canada treaty Canadian Federal Court of Appeal, 10 January 2017, Société Générale Valeurs Mobilières Inc. v. Canada, 2017 FCA 3)*

Methods | *Issues and Problems*

- Issues not solved by Art 23 OECD MC or the Comm. → ***Issue 4: Tax sparing*** *(Art 23 nos 73 et seq. OECD MC Comm.)*
  - OECD, *Tax Sparing: A Reconsideration* (1998) → Critical report pointing out harmful effects, opportunities for planning and avoidance, undermine the policy behind the credit method (because they make foreign investment more favourable than domestic investment) *– Incorporated in Art 23 nos 73 et seq. OECD MC Comm – Many non-Member Country positions (see nos 1-4 of the positions on Art 23).*
  - But: Tax sparing provisions have a ***positive impact on foreign direct investment*** (see, e.g., 169 Journal of Public Economics (2019) 89-108)

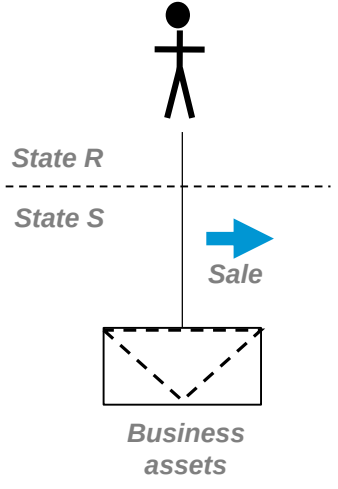
Conflicts | *Qualification*

- **Conflicts of qualification**
  - ***What is a conflict of qualification?*** → Two treaty States apply different provisions (distributive rules) of their treaty to one and the same tax case.
  - ***Three Types***
    - Facts and circumstances are evaluated differently by the two States
    - Different treaty provisions are applied because of a different interpretation of the treaty
    - Different treaty provisions are applied as a result of diverging domestic laws
  - ***OECD MC and MC Comm.*** (Update 2003)
    - Art 23 nos 32.1-32.7 OECD MC Comm. → Interpretation of Art 23 OECD MC (taxation in the source State "in accordance with the provisions of the Convention") — Treaty relief in the residence State in cases of qualification conflicts based on differences in domestic laws, if the source State rightly refers to its domestic law under Art 3(2)
    - Insertion of Art 23A(4) OECD MC and Art 23 nos 56.1-56.3 OECD MC Comm. → Avoidance of double-non taxation that would result from a disagreement on the facts or the interpretation of the tax treaty
    - If no solution → Mutual Agreement Proceeding (MAP) under Art 25 OECD MC

Conflicts | *Qualification*

- **Example 1:** ***Double taxation – Different qualification in domestic law***
  - ***Art 23A(1) OECD MC***

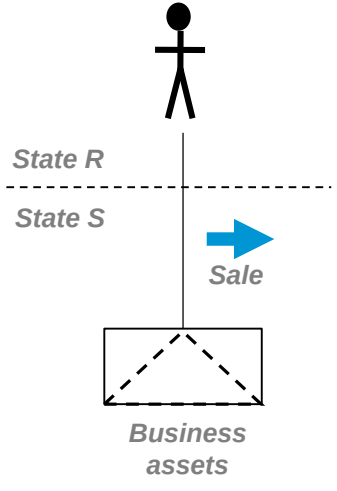
> 1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.



  - ***Conflict***
    - State R → "Hybrid" = Corporation, i.e., Art 13(5) OECD MC → *Exclusive taxation in residence State ("complete" distributive rule)*
    - State S → "Hybrid" = Transparent, i.e., Art 13(2) OECD MC → *Taxation in PE State*
  - ***Solution*** – State R ***must exempt*** (or grant a credit), since State S has taxed "in accordance with the provisions of this Convention" (Art 23 nos 32.3 and 32.4 OECD MC Comm; PSR Ex 14)

- **Example 2:** ***Double non-taxation – Different qualification in domestic law***
  - ***Art 23A(1) OECD MC***

> 1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

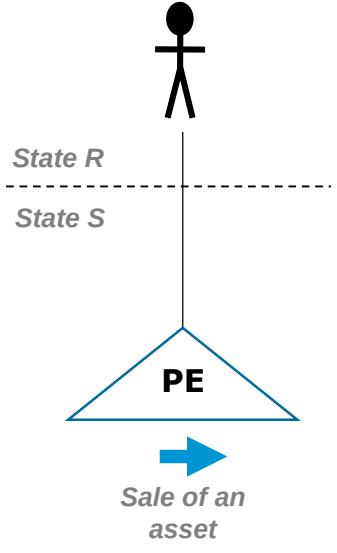


  - ***Conflict***
    - State R → "Hybrid" = Transparent, i.e., Art 13(2) OECD MC → *Taxation in PE State*
    - State S → "Hybrid" = Corporation, i.e., Art 13(5) OECD MC → *Exclusive taxation in residence State*
  - ***Solution*** – State R ***need not exempt***, since State S may not tax "in accordance with the provisions of this Convention" if it sees itself barred from exercising an existing domestic taxing right (Art 23 nos. 32.6 and 32.7 OECD MC Comm.)

Conflicts | *Qualification*

- **Example 3:** ***Double taxation – Different interpretation of the tax treaty***
  - ***Art 23A(1) OECD MC***

> 1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.



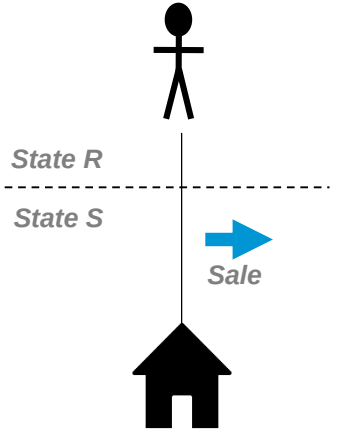
  - ***Conflict***
    - State R → Asset is not part of PE's assets (not "forming part of the business property"), i.e., Art 13(5) OECD MC → *Exclusive taxation in residence State*
    - State S → Property is part of PE's assets, i.e., Art 13(2) OECD MC → *Taxation in PE State*
  - ***Solution*** – State R ***need not exempt***, since the conflict is based on a different interpretation of facts or a diverging treaty interpretation (Art 23 no. 32.5 OECD MC Comm) → ***MAP***

Conflicts | *Qualification*

- **Example 4:** ***Double non-taxation – Domestic Law***
  - ***Art 23A(4) OECD MC***

> 4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.

  - ***Issue*** → State S may tax according to Art 13(1) OECD MC, but *exempts under its domestic law* (e.g., because a holding period has expired or because it simply does not tax such capital gains)
  - ***Solution*** – State R ***must nevertheless exempt*** → Effective double-non taxation (Art 23 no. 56.2 OECD MC. Comm) → *E Contrario* Art 23A(4) OECD MC ("this Convention")



Conflicts | *Qualification*

- **Conflicts of qualification → *Summary***

	Result: Double taxation	Result: Double non-taxation
Reason for conflict: Domestic law	Art 23A(1) OECD MC: ***Double taxation → Single taxation (i.e., residence State must exempt)***	*E contrario* Art 23A(4) OECD MC: ***Double non-taxation → Double non-taxation***
Reason for conflict: Tax treaty	Art 23A(1) OECD MC: ***Double taxation → Double taxation (MAP)***	Art 23A(4) OECD MC: ***Double non-taxation → Single taxation (i.e., residence State need not exempt)***

Part VI
"Special Provisions"

WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Overview

- ***Chapter VI/1*** – Non-Discrimination (Article 24 OECD MC)
- ***Chapter VI/2*** – Mutual Agreement Procedure ("MAP") and Arbitration (Article 25 OECD MC)
- ***Chapter VI/3*** – Exchange of Information ("EOI") (Article 26 OECD MC)
- ***Chapter VI/4*** – Assistance in the Collection of Taxes (Article 27 OECD MC)

Chapter VI/1
Non-Discrimination

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Non-Discrimination | *Overview*

ARTICLE 24

NON-DISCRIMINATION

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

- ***Art 24(1) OECD MC – Nationality*** → No other or more burdensome taxation or requirement connected therewith
- ***Art 24(2) OECD MC – "Stateless" persons***
- ***Art 24(3) OECD MC – Permanent establishments*** → No less favourable taxation for non-residents with a PE in the taxing State
- ***Art 24(4) OECD MC – Debtors*** → Deductibility of interest and royalties under the same circumstances when made to residents of the other State
- ***Art 24(5) OECD MC – Foreign shareholders*** → No other or more burdensome taxation levied on companies with non-resident shareholders
- ***Art 24(6) OECD MC – Scope of application*** → Discrimination may arise from any tax (irrespective of Art 2 OECD MC)

Non-Discrimination | *Overview*

- **General remarks**
  - No prohibition of ***indirect discrimination*** (Art 24 nos 1, 8 OECD MC Comm.)
  - Applied after distributive rules → Distributive rules themselves cannot lead to discrimination
  - Directly targeting *domestic taxation* → "Second circle of protection" for the taxpayer → Covers all kinds of taxes (Art 24(6) OECD MC) and also residents of neither Contracting State (irrespective of Art 1 OECD MC)
  - Does not normally prevent ***double taxation*** → But: Triangular situations (Art 24 nos 48-72 OECD MC Comm.
- Note: Art 24 OECD MC and **EU fundamental freedoms**
  - Many issues are covered by both sets of rules, but EU freedoms cover much wider range of cases (e.g., indirect/covert discrimination, outbound cases etc)
  - EU freedoms provide an additional remedy for taxpayers within the EU → No direct impact of EU Freedoms on treaty non-discrimination, but Art 24 OECD MC may effectively extend fundamental freedoms to third State nationals under certain conditions.
  - Important difference: No concept of justification for Art 24 OECD MC!

Non-Discrimination | *Nationality*

- Prohibition of discrimination based on **nationality** (Art 24(1) OECD MC)
  - ***Nationality ≠ residence*** → No prohibition of indirect discrimination (Art 24 nos 1, 8 OECD MC Comm.)

> 1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

  - Definition of **"national"** in Art 3(1)(g) OECD MC:

> *g)* the term "national", in relation to a Contracting State, means:
>
> *(i)* any individual possessing the nationality or citizenship of that Contracting State; and
>
> *(ii)* any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State;

Non-Discrimination | *Nationality*

- Prohibition of discrimination based on **nationality** (Art 24(1) OECD MC)
  - Some details (Art 24 nos 5-25 OECD MC Comm.)
    - ***Nationality ≠ residence*** → No prohibition of indirect discrimination (Art 24 nos 1, 8 OECD MC Comm.) – *Residents and non-residents are not similiarly situated (Art 24 no. 8 OECD MC Comm.)*
    - Covers cases where ***residence has no relevance*** with respect to the difference in treatment (e.g., for corporations with regard to incorpoiration versus place of management; Art 24 nos 20-25 OECD MC Comm.) – *No prohibited discrimination if difference in treatment would persist after the taxpayer were deemed to be a national of the relevant State.*

Non-Discrimination | *Stateless*

- National treatment for **stateless persons** (Art 24(2) OECD MC)
  - ***Status of stateless persons*** → Art 29 of the 1954 UN Convention on the Status of Stateless Persons reads:

> *Article 29*
>
> **FISCAL CHARGES**
>
> 1. The Contracting States shall not impose upon stateless persons duties, charges or taxes, of any description whatsoever, other or higher than those which are or may be levied on their nationals in similar situations.

  - ***National treatment*** for stateless persons who are resident in one of the Contracting States (Art 24 nos 26 et seq. OECD MC Comm.):

> 2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

Non-Discrimination | *PE*

- Prohibition of **PE discrimination** (Art 24(3) OECD MC)
  - ***PEs of residents of the other Contracting State*** → Prohibition of more burdensome taxation based on the residence of the taxpayer

> 3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

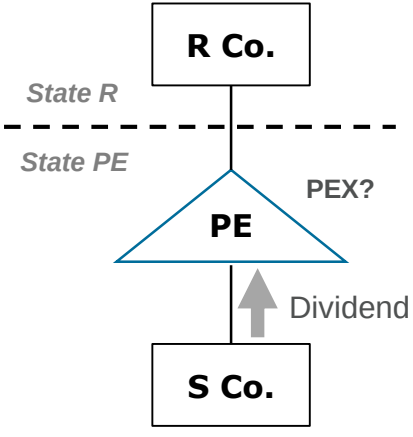
  - Some details (Art 24 nos 33-72 OECD MC Comm.)
    - Generally: Hypothetical comparison with a (purely domestic) resident enterprise (Art 24 nos 37-39 OECD MC Comm.)
    - "[L]ess favourably levied" → More burdensome (Art 24 nos 34-35 OECD MC Comm.; see, e.g., England and Wales Court of Appeal, 21 February 2007, *HM Revenue & Customs v UBS AG*, [2007] EWCA Civ 119, concerning an imputation credit)
    - Excluded are personal allowances, reliefs etc (Art 24 no. 36 OECD MC Comm.)

Non-Discrimination | *PE*

- Prohibition of **PE discrimination** (Art 24(3) OECD MC)
  - Implications of the principle of **equal treatment** (Art 24 nos 40-47 OECD MC Comm.)
    - Concerns, e.g., deduction of trading expenses from taxable profits, facilities with regard to depreciation and reserves, carrying forward or backward of losses, taxation of capital gains
    - Also includes, e.g., tax incentives such as exemptions etc (Art 24 nos 43-46 OECD MC)
    - Not: Consolidation/group taxation provisions (Art 24 no. 41 OECD MC Comm.)
  - Special issues (Art 24 nos 48-72 OECD MC Comm.)
    - ***Dividends received*** in respect of holdings owned by PEs (Art 24 nos 48-54 OECD MC Comm.)
    - ***Structure and rate of tax*** (Art 24 nos 55-61 OECD MC Comm.)
    - ***Withholding tax*** on dividends, interest and royalties received by a PE (Art 24 nos 62-66 OECD MC Comm.)
    - ***Credit for foreign tax*** under domestic rules (Art 24 no 67 OECD MC Comm.) and under tax treaties concluded with third States (Art 24 nos 68-72 OECD MC Comm.)
    - ***Note:*** EU fundamental freedoms strictly prohibit PE discriminations with regard to the base and the rate → *See, e.g., ECJ, 21 September 1999, C-307/97, Saint-Gobain, EU:C:1999:438*

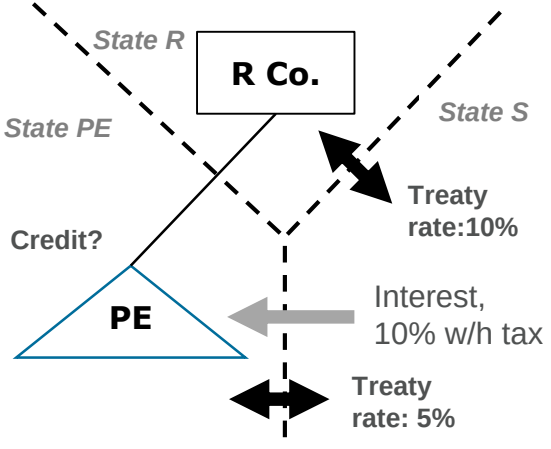
Non-Discrimination | *PE*

Example 1: Dividends received by a PE



Does State PE have to grant its domestic participation exemption ("PEX") that would be available to domestic corporations receiving such domestic dividends? → ~ *(Art 24 no. 67 OECD MC Comm.) – ✓ for EU situations: ECJ, 21 September 1999, C-307/97, Saint-Gobain, EU:C:1999:438*

Example 2: Credit for foreign taxes



Does State PE have to give a credit *(1)* under domestic law and/or *(2)* by (hypothetically) applying its treaty with State S? How much? → *✓ (for credit under domestic law: Art 24 no. 67 OECD MC Comm.), ✓/~ (for credit under tax treaties; Art 24 nos 69-70 OECD MC Comm.) – ✓ for EU situations: ECJ, 21 September 1999, C-307/97, Saint-Gobain, EU:C:1999:438*

Non-Discrimination | *Debtors*

- Prohibition of discrimination with regard to **deductibility of interest, royalties and other disbursements** (Art 24(4) OECD MC)
  - ***Payments to non-residents*** → Prohibition of disriminatory non-deductibility

> 4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

  - Some details (Art 24 nos 73-75 OECD MC Comm.)
    - Subject to Art 9 and 11(6) OECD MC → Thin capitalization (see also France's reservation in Art 24 no. 91 OECD MC Comm.)
    - Additional information requirements for cross-border payments (compliance, verification)

Non-Discrimination | *Owners*

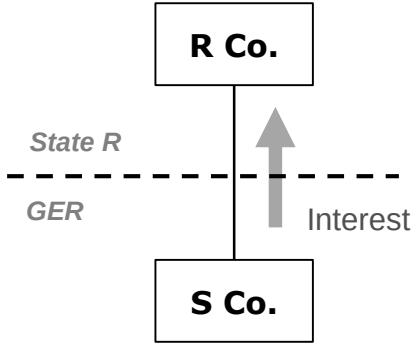
- Prohibition of discrimination based on **foreign ownership** (Art 24(5) OECD MC)
  - ***Ownership non-discrimination*** → Prohibition of discrimination based on foreign residency of capital owners (Art 24 nos 76 et seq. OECD MC Comm.)

> 5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

  - Some details (Art 24 nos 76-80 OECD MC Comm.)
    - Relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital → *Not covered: Rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership, withholding tax obligations (Art 24 no. 77-78 OECD MC Comm.)*
    - All member States consider that for transfer pricing "additional information requirements which would be more stringent than the normal requirements, or even a reversal of the burden of proof, would not constitute discrimination within the meaning of the Article" (Art 24 no. 80 OECD MC Comm.)

Non-Discrimination | *Owners*

- Prohibition of discrimination based on **foreign ownership** (Art 24(5) OECD MC) – ***Example:*** Did the German thin capitalization rule (old § 8a of the German CIT) violate Art 24(5) OECD MC?
  - ✓ (German Bundesfinanzhof (BFH), 8 September 2010, I R 6/09) – *Same for the EU freedoms: ECJ, 12 December 2002, C-324/00, Lankhorst-Hohorst, EU:C:2002:749*
  - But:
    - The German rules did not technically refer to foreign ownership but rather to the question whether the recipient was entitled to a German imputation credit → Falls under Art 24(5) OECD MC since the major group of covered shareholders are non-residents (German Bundesfinanzhof (BFH), 8 September 2010, I R 6/09)
    - What about Art 9 OECD MC, which "allows" certain thin capitalization rules (Art 9 no. 3 OECD MC Comm.)?
    - And would not Art 24(5) OECD MC – just like Art 24(4) OECD MC does explicitly – step back if a thin capitalization rule is "permitted" by Art 9 OECD MC (so, e.g., Art 24 no. 79 OECD MC Comm.)?



Under old § 8a of the German CIT, interest payments to foreign shareholder-lenders were not deductible (but rather re-qualified as profit distributions) if the debt-equity ratio was above a certain threshold.

Chapter VI/2
Mutual Agreement Procedure („MAP“) and Arbitration

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MAP | *Overview*

ARTICLE 25

MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.

- ***Art 25(1) and (2) OECD MC – Individual MAP*** – The competent authorities shall endeavor by mutual agreement to ***resolve the situation of taxpayers subjected to taxation not in accordance with the provisions of the Convention***.
- ***Art 25(3) OECD MC – Consultation procedure*** – Invites and authorizes the competent authorities of the two States to resolve by mutual agreement ***problems relating to the interpretation or application of the Convention*** and to consult together for the elimination of double taxation ***in cases not provided for in the Convention***.
- ***Art 25(4) OECD MC*** – Authorizes the competent authorities to ***communicate with each other directly***.

MAP | *Overview*

- **"Specific case MAP" (Art 25(1) and (2) OECD MC)**
  - ***First stage:*** Presentation of the case to the competent authority (Art 25(1) and (2) OECD MC) → and domestic review of prior to intergovernmental MAP → Issue may be resolved unilaterally (Art 25(2) first alternative OECD MC; Art 25 no 31-32 OECD MC Comm.)
  - ***Second stage***: Intergovernmental MAP (Art 25(2) second alternative OECD MC)
  - ***Third stage***: Implementation of the MAP (Art 25(2) last sentence OECD MC) → Irrespective of time limits! Relation to pending litigation etc? (Art 24 nos 42 et seq. OECD MC Comm.)
- **"Consultation MAP" (Art 25(3) OECD MC)**
  - MAP for ***resolving difficulties or doubts*** arising with regard to the interpretation of the tax treaty (e.g., definitions, effects of changes in domestic laws, application of thin capitalization rules etc; Art 24 nos 50 et seq. OECD MC Comm.) → Note: Relevance of agreements under Art 3(2) OECD MC!
  - MAP for ***filling gaps*** (e.g., MAP between two source States)

Arbitration | *Overview*

5. Where,

a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the date when all the information required by the competent authorities in order to address the case has been provided to both competent authorities,

any unresolved issues arising from the case shall be submitted to arbitration if the person so requests in writing. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

- ***Art 25(5) OECD MC – Arbitration*** – Provides a mechanism that allows a taxpayer to request the arbitration of unresolved issues that have prevented competent authorities from reaching a mutual agreement within two years.

Arbitration | *Overview*

- **Arbitration → *Part of the MAP***
  - I.e., neither an alternative nor an additional recourse → No arbitration if the competent authorities have reached an agreement even if the taxpayer disagrees (Art 25 no. 64 OECD MC Comm.)
  - Two year period (Art 25 nos 70 et seq.)
  - Relationship with domestic legal remedies
    - Final domestic remedies → No arbitration "if a decision on these issues has already been rendered by a court or administrative tribunal of either State" (see also Art 25 no. 76 OECD MC Comm.)
    - Potential (future) domestic remedies → Suspension of legal remedies pending arbitration (Art 25 no. 76 OECD MC Comm.)
- Arbitration requires a more detailed set of rules → ***"Sample Mutual Agreement on Arbitration" as Annex to the OECD MC Comm. on Art 25.***
  - Three arbitrators
  - "Last best offer" process ("baseball arbitration") as main form of arbitration, but optional "independent opinion" process
  - Final decision and implementation

Arbitration | *Overview*

- **Arbitration and constitutional barriers preventing arbitrators from deciding tax issues**
  - Art 25 no. 65 OECD MC Comm.:

> 65. Before 2017, a footnote to paragraph 5 indicated that in some States, national law, policy or administrative considerations may not allow or justify the type of arbitration process provided for in the paragraph and gave the example of constitutional barriers preventing arbitrators from deciding tax issues. The footnote was deleted, however, in recognition of the importance of including an arbitration mechanism that ensures the resolution of disputes between the competent authorities where these disputes would otherwise prevent the mutual agreement procedure from playing its role.

  - The pre-2017 footnote read:

> 1 In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph 65 of the Commentary on the paragraph. As mentioned in paragraph 74 of that Commentary, however, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals.

  - Some reservations and non-Member Country positions (e.g., Brazil, India, China)

Arbitration | *Overview*

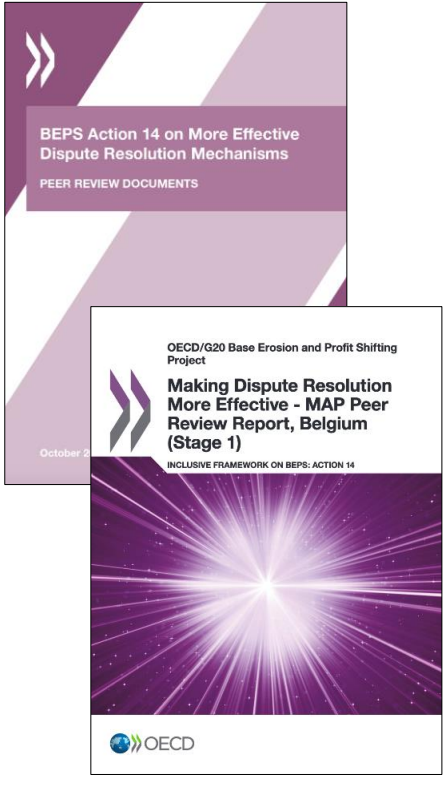
- **Alternative legal bases for arbitration in the tax area**
  - ***OECD***
    - Part V (Art 18 et seq.) of the Multilateral Instrument
    - Chosen by 30 jurisdictions, most of them opting for "baseball arbitration":

Final offer ("baseball")	Independent opinion
Australia, Austria, Barbados, Belgium, Canada, Curacao, Denmark, Fiji, Finland, France, Germany, Ireland, Italy, Liechtenstein, Luxembourg, Mauritius, Netherlands, New Zealand, Singapore, Spain, Switzerland and the UK	Andorra, Greece, Japan, Malta, Papa New Guinea, Portugal, Slovenia, and Sweden

  - ***European Union***
    - Dispute Resolution Directive → Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, [2017] OJ L 265/1
    - Arbitration Convention → Convention 90/463/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, [1990] OJ L 225/10, as amended

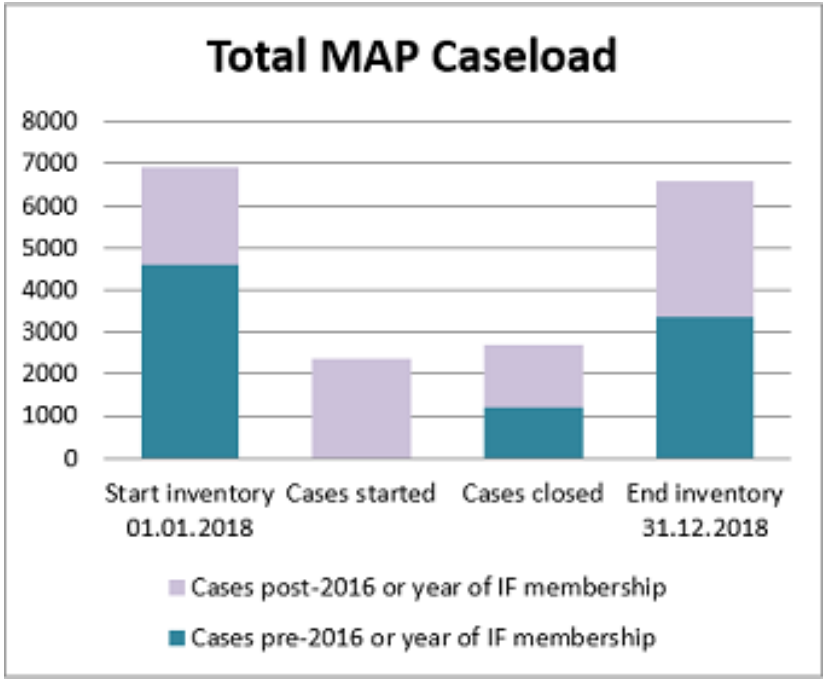
MAP | *Developments*

- Improving dispute resolution is a ***BEPS minimum standard*** → OECD, BEPS Action 14 on More Effective Dispute Resolution Mechanisms – Peer Review Documents (October 2016)
- ***Peer review and monitoring*** in several batches of countries until 2021
- ***21 elements in four key areas***:
  - Preventing disputes:
  - availability and access to MAP;
  - resolution of MAP cases; and
  - implementation of MAP agreements.
- The BEPS Action 14 minimum standard also requires countries to
  - provide timely and complete ***reporting of MAP statistics*** based on a new MAP statistics reporting framework.
  - publish their ***MAP profiles*** pursuant to an agreed template.



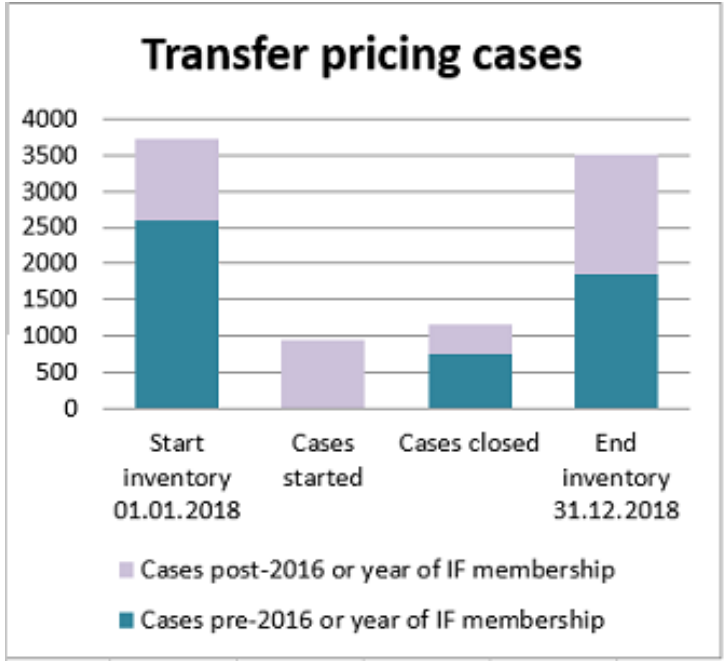
MAP | *Developments*

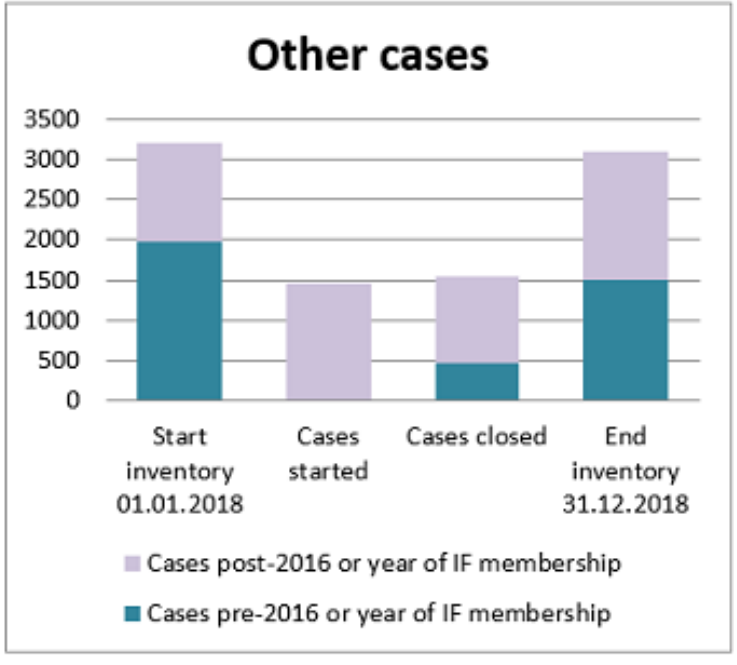
- MAP Statistics for 2018



MAP | *Developments*

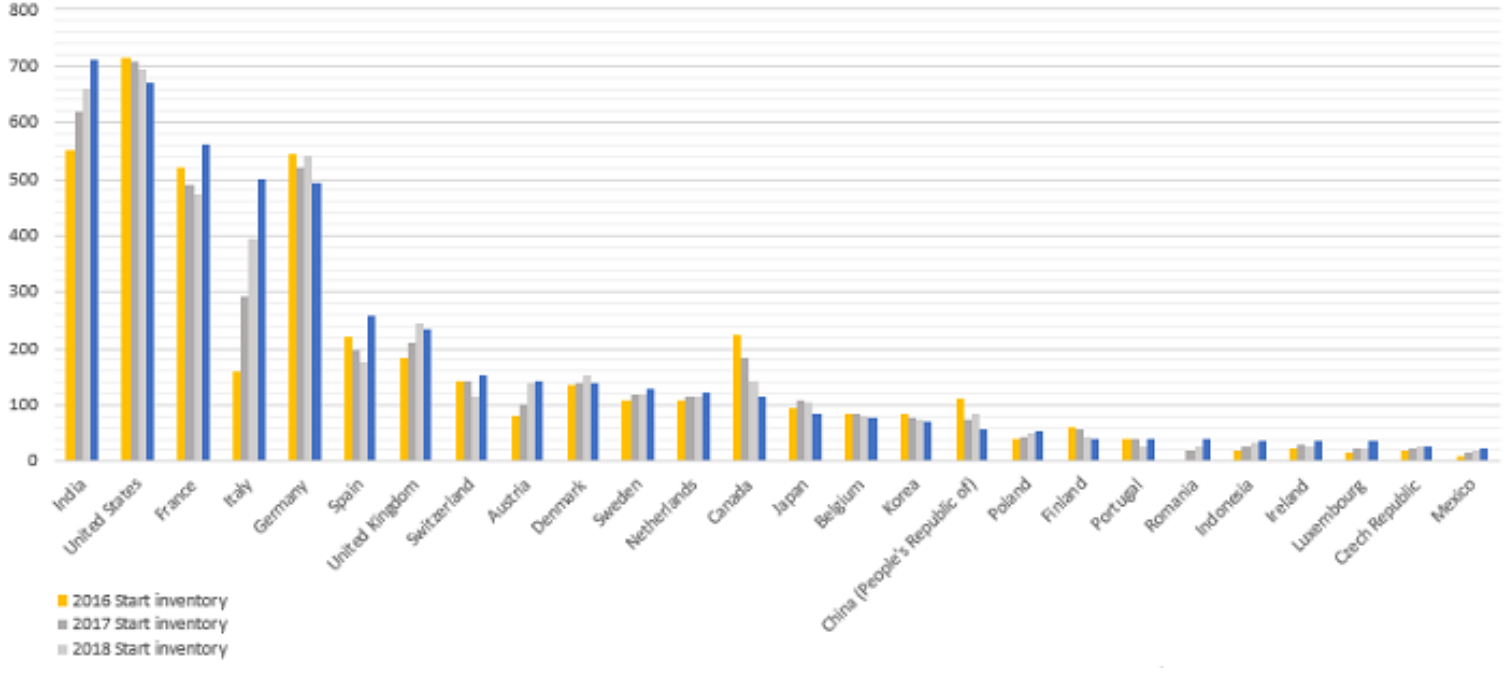
- MAP Statistics for 2018





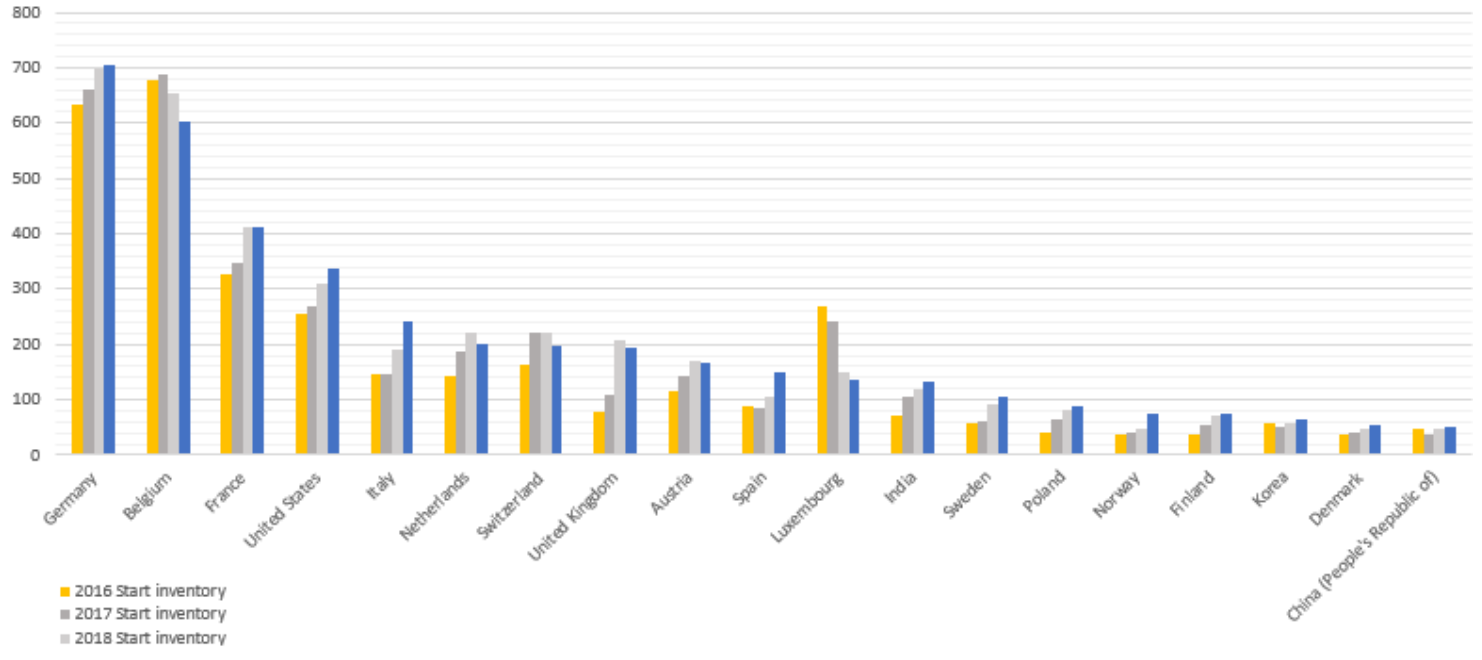
MAP | *Developments*

- MAP Statistics for 2018 – *Transfer Pricing Cases*



MAP | *Developments*

- MAP Statistics for 2018 – *Other Cases*



MAP | *Developments*

- MAP Statistics for 2018

MAP | *Developments*

- MAP Statistics for 2018

Chapter VII/3
Exchange of Information („EOI“)

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ARTICLE 26

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.

- ***Art 26(1) OECD MC*** – The competent authorities of the Contracting States shall exchange such information as is ***foreseeably relevant*** to secure the correct application of the provisions of the ***Convention or of the domestic laws*** of the Contracting States concerning ***taxes of every kind and description***. → *Three ways of exchange: on request, automatically or spontaneously (Art 26 no. 9 OECD MC Comm.) → Borderline to "fishing expeditions"? (→ Art 26 nos 4.4, 5., 5.1, 8 OECD MC Comm.)*
- ***Art 26(2) OECD MC – Confidentiality rules***.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

- ***Art 26(3) OECD MC*** – ***Limitations to the main rule in favor of the requested State*** (e.g., no obligation to go beyond internal laws and administrative practices; to carry out administrative measures that are not permitted under the laws or practice or to supply items of information that are not obtainable under the laws or in the normal course of administration; to disclose certain secret information).
- ***Art 26(4) OECD MC*** – Obligation to exchange information in situations also where the ***requested information is not needed by the requested State for domestic tax purposes***.
- ***Art 26(5) OECD MC*** – Ensures that the limitations of para 3 cannot be used to prevent the ***exchange of information held by banks***, other financial institutions, nominees, agents and fiduciaries as well as ownership information.

Transparency | *Developments*

Document	Issue	EU
Art 26 OECD MC	Basically: Exchange of information on request (EOIR)	Directive 77/799/EC, recast as Directive 2011/16/EU
Tax Information Exchange Agreements (TIEA) (2002)	EOIR + Automatic exchange of informaton (AEOI) (since 2015)	
Multilateral Convention on Mutual Assistance in Tax Matters (1988/2010)	EOIR + AEOI (→ basis for the CRS MCAA and the CbC MCAA) → 137 participating jurisdictions (July 2020)	
Common Reporting Standard (CRS) (2014)	AEOI on financial accounts → CRS MCAA: 108 signatories (as of Dec. 2019) – Implementation Report 2018 and 2019	Directive 2014/107/EU – *US: FATCA*
BEPS Action 5 on Harmful Tax Competition (2015)	Exchange of information on certain rulings → All members of the inclusive framework, 137 jurisdictions (as of Dec. 2019) – Peer review reports 2016, 2017 and 2018	Directive (EU) 2015/2376
BEPS Action 13 on Country-by-Country Reporting (2015)	AEOI of CbC Reports → CbC MCAA: 86 signatories (as of July 2020) – Peer review report 2018 and 2019	Directive (EU) 2016/881

Transparency | *Developments*

- Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures (March 2018) – *Note: EU DAC6!*
- Financial Action Task Force (FATF) Report on Professional Money Laundering (July 2018)
- Publications of the Task Force on Tax Crimes and Other Crimes (TFTC), e.g.,
  - Improving Co-operation between Tax Authorities and Anti-Corruption Authorities in Combating Tax Crime and Corruption (2018)
  - Fighting Tax Crime: The Ten Global Principles (2017)
  - Effective Inter-agency Co-operation in Fighting Tax Crimes and
  - Other Financial Crimes (2017)
  - Improving Co-operation between Tax and Anti-Money Laundering Authorities (2015)
  - Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors (2013)
  - Evading the Net: Tax crime in the fisheries sector (2013)
  - Electronic Sales Suppression: A threat to tax revenues (2013)

Chapter VII/4
Assistance in the Collection of Taxes

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Collection | *Overview*

- **Assistance in the collection of taxes (Art 27 OECD MC)**
  - Territorial limits to jurisdiction and enforcement (PCIJ, 7 September 1927, *The Case of the S. S. „Lotus"*, PCIJ Series A, No. 10 [1927])
  - Assistance in the collection under Art 27 OECD MC or on another legal basis (e.g.,the OECD Multilateral Convention on Mutual Assistance in Tax Matters or Directive 2010/24/EU in the European Union)
  - But: Potential barriers to assistance under national law, policy or based on administrative considerations (see the footnote to Art 27 OECD MC and also Art 27 no. 1 OECD MC Comm.)

Part VII
Treaty Shopping and Tax Avoidance

Overview

- ***Chapter VII/1.1*** – Introduction
- ***Chapter VII/1.2*** – Principle Purposes Test (Article 29(9) OECD MC)
- ***Chapter VII/1.3*** – Third-State PEs (Article 29(8) OECD MC)

Chapter VII/1.1
Introduction

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Improper Use | *Overview*

- **OECD Guidance on treaty shopping and improper use of tax treaties**
  - ***Addressing tax avoidance through tax conventions*** (Art 1 nos 57-65 OECD MC Comm.)
    - (Inherent) guiding principle of anti-abuse (Art 1 no. 61 OECD MC) – *Contra, e.g., Tax Court of Canada, 18 August 2006, MIL (Investments) S A v. The Queen, 2006 TCC 460 (no anti-abuse rule inherent within the treaty itself)*
    - Also: Provisions to counter (certain) abuses, e.g.,
      - Saving clause (Art 1(3) OECD MC)
      - Residency determination, no automatic tie-breaker (Art 4(3) OECD MC)
      - "Beneficial ownership" requirement (in Art 10, 11, and 12 OECD MC)
      - Real-estate companies (Art 13(4) OECD MC)
      - Minimum-holding durations (Art 10(2), 13(4) OECD MC)
      - Look-trough for entertainers and sportspersons (Art 17(2) OECD MC)
      - LoB (Art 29(1)-(7) OECD MC)
      - Third-state PEs (Art 29(8) OECD MC)
      - Principle Purposes Test (Art 29 OECD MC)

Improper Use | *Overview*

- **OECD Guidance on treaty shopping and improper use of tax treaties**
  - ***Addressing tax avoidance through domestic anti-abuse rules and judicial doctrines*** (Art 1 nos 66-80 OECD MC Comm.)
    - Specific legislative anti-abuse rules (Art 1 nos 68-75 OECD MC Comm.)
    - General legislative anti-abuse rule (Art 1 nos 76-77 OECD MC Comm.)
    - Judicial doctrines that are part of domestic law (Art 1 nos 78-80 OECD MC Comm.)
  - ***Special issues (Art 1 nos 81- OECD MC Comm.)***
    - Controlled foreign company provisions (Art 1 no. 81 OECD MC Comm.)
    - Restricting treaty benefits with respect to income that is subject to certain features of another State's tax system (Art 1 nos 82-84 OECD MC Comm.)
    - Provision on special tax regimes (Art 1 nos 85-100 OECD MC Comm.)
    - Provision on subsequent changes to domestic law (Art 1 nos 101-106 OECD MC Comm.)
    - Provision on notional deductions for equity (Art 1 no. 107 OECD MC Comm.)
    - Provision on remittance based taxation (Art 1 no. 108 OECD MC Comm.)

Improper Use | *Overview*

- **OECD Guidance on treaty shopping and improper use of tax treaties**
  - Granting the benefits of treaty provisions would be ***inappropriate*** to the extent that the result would be the avoidance of domestic tax, specifically where it is argued that …
    - … provisions of a tax treaty prevent the application of a domestic GAAR;
    - … Art 24(4) and Art 24(5) prevent the application of domestic thin-capitalization rules;
    - … Art 7 and/or Art 10(5) prevent the application of CFC rules;
    - … Art 13(5) prevents the application of exit or departure taxes;
    - … Art 24(5) prevents the application of domestic rules that restrict tax consolidation to resident entities;
    - … Art 13(5) prevents the application of dividend stripping rules targeted at transactions designed to transform dividends into treaty-exempt capital gains;
    - … Art 13(5) prevents the application of domestic assignment of income rules (such as grantor trust rules).

BEPS | *Action 6*

- BEPS ***Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances***
- Changes to tax treaty law (OECD MC Update 2017 and MLI) include
  - Title and preamble
  - Saving clause (Art 1(3) OECD MC)
  - Dual-resident entities (Art 4(3) OECD MC) (29/84 countries as of Sept. 2018)
  - Splitting-up of contracts (Art 5 OECD MC) (28/84 countries as of Sept. 2018)
  - Minimum holding periods (Art 10(2) and 13(4) OECD MC) (37, 48/84 countries as of Sept. 2018)
  - LoB (Art 29(1)-(7) OECD MC)
  - Third-state PEs (Art 29(8) OECD MC) (23/84 countries as of Sept. 2018)
  - PPT (Art 29(9) OECD MC) (100%)

BEPS | *Action 6*

- BEPS ***Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances***
- MLI and Minimum Standards
  - New preamble statement that the intention of the parties to the treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (e.g., treaty shopping arrangements)
  - Anti-abuse treaty provisions (one of the alternatives):
    - the Principal Purposes Test (PPT);
    - the PPT + a simplified Limitation on Benefits ("SLoB") provision; or
    - a detailed LoB + anti-conduit rules.
- Peer review → Self-assessment and reports 2019 and 2020

Table 3. **MLI and the Implementation of the Action 6 Minimum Standard**

Jurisdictions covered	82
Covered Tax Agreements (CTA)	1 360
Ratification Instruments Deposited	9
Projected % CTA's including new preamble language	100%
Projected % CTA's including PPT	100%
Projected % CTA's including additional S-LOB	3%

Source: OECD/G20 Inclusive Framework on BEPS Progress Report July 2017-June 2018 (2018).

PPT | *Acceptance*

- PPT as (nearly) universally accepted anti-treaty shopping rule → *OECD, Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping (Feb. 2019):*

> 45. For the agreements listed under the MLI, all 80 signatories or parties to the MLI are implementing the preamble statement and the PPT. Twelve jurisdictions have also opted to apply the simplified LOB through the MLI to supplement the PPT when possible. Six additional jurisdictions agreed to accept a simplified LOB in agreements with partners that opted in for the simplified LOB under the MLI.
>
> 46. In total, the PPT will be implemented in around 1 260 agreements to be covered under the MLI. Around 50 of these agreements will also include a simplified LOB provision.
>
> 47. For all 14 agreements subject to a bilateral complying instrument, the minimum standard is implemented through the inclusion of the preamble statement and the PPT. For five of these compliant agreements, the PPT is supplemented by an LOB clause.
>
> 48. Thus, over 80 of the 116 Inclusive Framework jurisdictions have taken meaningful steps towards the implementation of the minimum standard, by signing the MLI or by concluding bilateral amending instruments or by doing both.

PPT | *MLI and Models*

- ***Past:*** **PPT and Mulitlateral Instriument (MLI)**
  - Currently *94 signatories* (as of July 2020; 84 as of 27 September 2018, 87 as of 29 March 2019), more than 50% ratified
  - MLI will modify more than 1.680 treaties
  - Preamble and anti-treaty abuse rule (PPT) in all matched agreements (from the 2018 progress report)
- ***Future:*** **PPT and the OECD/UN Model**
  - Art 29(9) in the 2017 OECD and UN Updates

Table 3. **MLI and the Implementation of the Action 6 Minimum Standard**

Jurisdictions covered	82
Covered Tax Agreements (CTA)	1 360
Ratification Instruments Deposited	9
Projected % CTA's including new preamble language	100%
Projected % CTA's including PPT	100%
Projected % CTA's including additional S-LOB	3%

Source: OECD/G20 Inclusive Framework on BEPS Progress Report July 2017-June 2018 (2018) and Progress Report July 2018 – May 2019 (2019).

Overview | *PPT*

- Inclusion of a general anti-abuse rule based on the ***principal purposes of transactions or arrangements ("PPT")*** – *Art 29(9) OECD MC 2017*

> 9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

Overview | *LoB*

- OECD BEPS Action 6 – Inclusion of a ***Limitation-on-Benefits-Provision ("LoB-Rule")*** *– Article 29(1)-(7) OECD MC 2017*
  - Limitation of substantive treaty benefits to "qualified persons"
  - Series of objective, self-executing tests
  - Derivative benefits clause
  - Subjective Clause (competent authority of source State may grant benefits)

ARTICLE 29

ENTITLEMENT TO BENEFITS[1]

1. [Provision that, subject to paragraphs 3 to 5, restricts treaty benefits to a resident of a Contracting State who is a "qualified person" as defined in paragraph 2].

2. [Definition of situations where a resident is a qualified person, which covers
   — an individual;
   — a Contracting State, its political subdivisions and their agencies and instrumentalities;
   — certain publicly-traded companies and entities;
   — certain affiliates of publicly-listed companies and entities;
   — certain non-profit organisations and recognised pension funds;
   — other entities that meet certain ownership and base erosion requirements;
   — certain collective investment vehicles.]

3. [Provision that provides treaty benefits to certain income derived by a person that is not a qualified person if the person is engaged in the active conduct of a business in its State of residence and the income emanates from, or is incidental to, that business].

4. [Provision that provides treaty benefits to a person that is not a qualified person if at least more than an agreed proportion of that entity is owned by certain persons entitled to equivalent benefits].

5. [Provision that provides treaty benefits to a person that qualifies as a "headquarters company"].

6. [Provision that allows the competent authority of a Contracting State to grant certain treaty benefits to a person where benefits would otherwise be denied under paragraph 1].

7. [Definitions applicable for the purposes of paragraphs 1 to 7].

Chapter VII/1.2
Principal Purposes Test (PPT)

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PPT | *Overview*

- Inclusion of a **general anti-abuse rule** based on the principle purposes of transactions or arrangements ("PPT")
  - Art 7(1) MLI and Art 29(9) OECD MC 2017

> 9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

  - *Note:* Under Art 31 VCLT, "object and purpose" may be derived, *inter alia*, from the preamble of a tax treaty, which – since the 2017 OECD and UN Updates – addresses non-taxation and treaty shopping

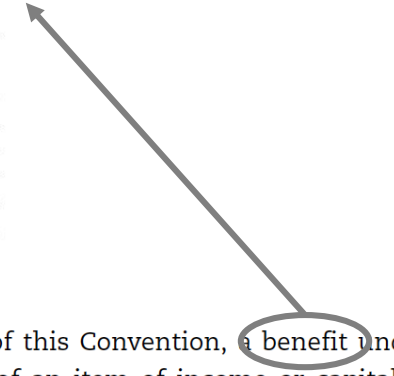
PPT | *Overview*

- Inclusion of a **general anti-abuse rule** based on the principle purposes of transactions or arrangements ("PPT")
- Some preliminary issues
  - PPT versus the "implicit anti-abuse principle" ("guiding principle") (Art 1 no. 61 and Art 29 no. 129 OECD MC Comm.)
  - PPT versus "beneficial ownership" (e.g., Art 10 no. 10.5 OECD MC Comm.)?
  - PPT versus LoB and third-state PE clause (Art 29 nos 171-173 OECD MC Comm.)?
  - PPT versus other specific treaty provisions (e.g., splitting-up of contracts, minimum holding periods etc)? → *PPT applies "[n]otwithstanding other provisions of this Convention" (arguably overrides the lex specialis principle), "circumvention" of specific anti-abuse rules (but see Example E Art 29 no. 182 OECD MC Comm.)*
  - PPT versus specific anti-abuse rules *not* included in a tax treaty? → *E.g., would the PPT apply if the Contracting States decide not to include a minimum holding period in Art 10(2)? (Art 10 no. 16 OECD MC Comm.)*
  - PPT versus domestic law? (Art 1 nos 70 et seq. OECD MC Comm.) → *PPT could apply to deny a benefit under a treaty provision that would otherwise prevail over a domestic anti-avoidance rule (Art 1 nos 75, 78 OECD MC Comm.)*
  - PPT as a "signalling" tool for purposive interpretation?

PPT | *Criteria*

- **"Benefit"** (Art 29 no. 175 OECD MC Comm.)

175. The term "benefit" includes all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of source under Articles 6 through 22 of the Convention, the relief from double taxation provided by Article 23, and the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations. This includes, for example, limitations on the taxing rights of a Contracting State in respect of dividends, interest or royalties arising in that State, and paid to a resident of the other State (who is the beneficial owner) under Article 10, 11 or 12. It also includes limitations on the taxing rights of a Contracting State over a capital gain derived from the alienation of movable property located in that State by a resident of the other State under Article 13. When a tax convention includes other limitations (such as a tax sparing provision), the provisions of this Article also apply to that benefit.



9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

- **"Directly or indirectly"** (Art 29 no. 176 OECD MC Comm.)

176. The phrase "that resulted directly or indirectly in that benefit" is deliberately broad and is intended to include situations where the person who claims the application of the benefits under a tax treaty may do so with respect to a transaction that is not the one that was undertaken for one of the principal purposes of obtaining that treaty benefit. This is illustrated by the following example:

TCO, a company resident of State T, has acquired all the shares and debts of SCO, a company resident of State S, that were previously held by SCO's parent company. These include a loan made to SCO at 4 per cent interest payable on demand. State T does not have a tax convention with State S and, therefore, any interest paid by SCO to TCO is subject to a withholding tax on interest at a rate of 25 per cent in accordance with the domestic law of State S. Under the State R-State S tax convention, however, there is no withholding tax on interest paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State; also, that treaty does not include provisions similar to paragraphs 1 to 7. TCO decides to transfer the loan to RCO, a subsidiary resident of State R, in exchange for three promissory notes payable on demand on which interest is payable at 3.9 per cent.

In this example, whilst RCO is claiming the benefits of the State R-State S treaty with respect to a loan that was entered into for valid commercial reasons, if the facts of the case show that one of the principal purposes of TCO in transferring its loan to RCO was for RCO to obtain the benefit of the State R-State S treaty, then the provision would apply to deny that benefit as that benefit would result indirectly from the transfer of the loan.

9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

- **"Arrangement or transaction"** (Art 29 no. 177 OECD MC Comm.)

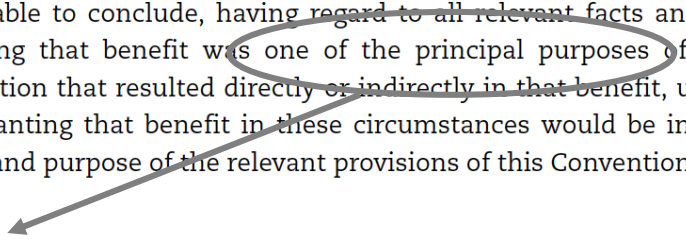
177. The terms "arrangement or transaction" should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable. In particular they include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence. An example of an "arrangement" would be where steps are taken to ensure that meetings of the board of directors of a company are held in a different country in order to claim that the company has changed its residence. One transaction alone may result in a benefit, or it may operate in conjunction with a more elaborate series of transactions that together result in the benefit. In both cases the provisions of paragraph 9 may apply.

9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

PPT | *Criteria*

- **"[O]ne of the principal purposes"** (Art 29 no. 178-181 OECD MC Comm.)

> 9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.



- Objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it.
- Evidence must be weighed to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose.
- Obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction (e.g., move residence before sale of an asset).
- If an arrangement is inextricably linked to a core commercial activity and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit.

PPT | *Examples*

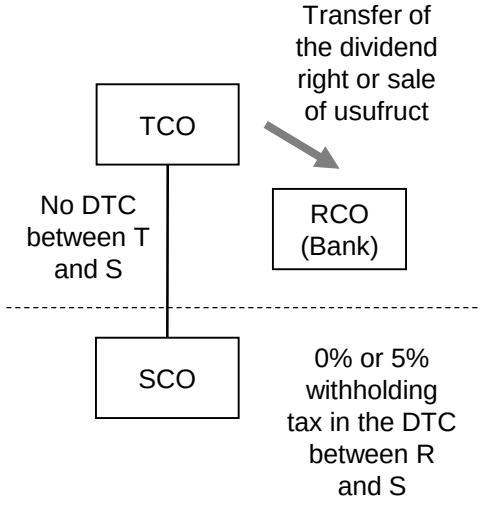
- **Examples in the OECD MC Comm.** (Art. 29 no. 182 OECD MC Comm. 2017)
  - Example A: Withholding tax and assignment of divdends
  - Example B: Withholding tax and usufruct
  - Example C: Choice of location for a PE
  - Example D: Choice of location for portfolio investments
  - Example E: Increase of shareholding to 25%
  - Example F: Acquisition of a family-owned holding company
  - Example G: Choice of location for a regional holding company
  - Example H: Choice of location for a regional active company
  - Example I: Collective management organisations that grant licenses on behalf of neighbouring right and copyright holders
  - Example J: Splitting-up of contracts
  - Example K: Regional investment platform
  - Example L: Securitisation company
  - Example M: Real estate management
- *Note also: Examples for conduit arrangements in Art 29 no. 187 OECD MC Comm.*

PPT | *Examples*

- **Examples A and B → *Withholding tax and assignment of dividends and withholding tax and usufruct***

— Example A: TCO, a company resident of State T, owns shares of SCO, a company listed on the stock exchange of State S. State T does not have a tax convention with State S and, therefore, any dividend paid by SCO to TCO is subject to a withholding tax on dividends of 25 per cent in accordance with the domestic law of State S. Under the State R-State S tax convention, however, there is no withholding tax on dividends paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State. TCO enters into an agreement with RCO, an independent financial institution resident of State R, pursuant to which TCO assigns to RCO the right to the payment of dividends that have been declared but have not yet been paid by SCO.

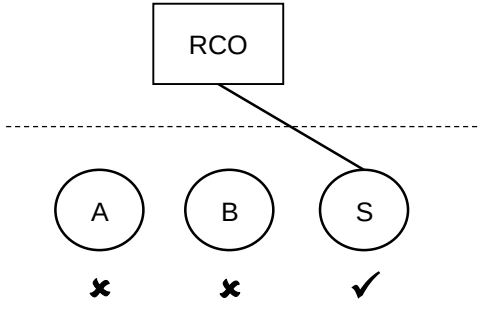
In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the arrangement under which TCO assigned the right to the payment of dividends to RCO was for RCO to obtain the benefit of the exemption from source taxation of dividends provided for by the State R-State S tax convention and it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement.



- **Example C → *Choice of location for a PE***

— Example C: RCO, a company resident of State R, is in the business of producing electronic devices and its business is expanding rapidly. It is now considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs. After a preliminary review, possible locations in three different countries are identified. All three countries provide similar economic and political environments. After considering the fact that State S is the only one of these countries with which State R has a tax convention, the decision is made to build the plant in that State.

In this example, whilst the decision to invest in State S is taken in the light of the benefits provided by the State R-State S tax convention, it is clear that the principal purposes for making that investment and building the plant are related to the expansion of RCO's business and the lower manufacturing costs of that country. In this example, it cannot reasonably be considered that one of the principal purposes for building the plant is to obtain treaty benefits. In addition, given that a general objective of tax conventions is to encourage cross-border investment, obtaining the benefits of the State R-State S convention for the investment in the plant built in State S is in accordance with the object and purpose of the provisions of that convention.



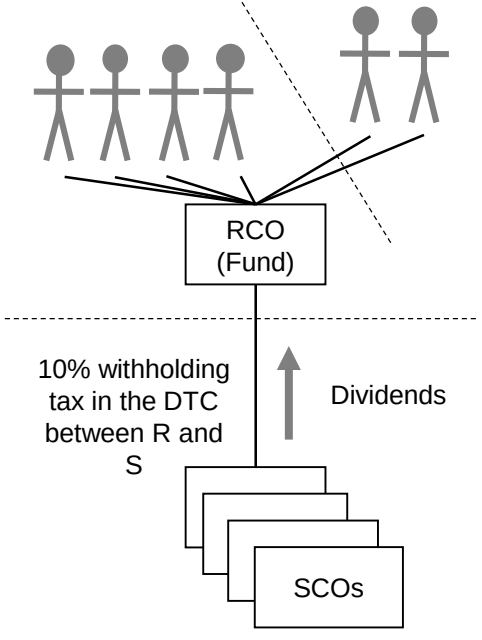
No DTCs with A or B,
but DTC with C

- **Example D → *Choice of location for portfolio investments***

— Example D: RCO, a collective investment vehicle resident of State R, manages a diversified portfolio of investments in the international financial market. RCO currently holds 15 per cent of its portfolio in shares of companies resident of State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30 per cent to 10 per cent.

RCO's investment decisions take into account the existence of tax benefits provided under State R's extensive tax convention network. A majority of investors in RCO are residents of State R, but a number of investors (the minority investors) are residents of States with which State S does not have a tax convention. Investors' decisions to invest in RCO are not driven by any particular investment made by RCO, and RCO's investment strategy is not driven by the tax position of its investors. RCO annually distributes almost all of its income to its investors and pays taxes in State R on income not distributed during the year.

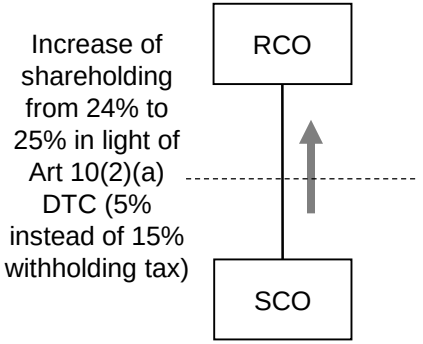
In making its decision to invest in shares of companies resident of State S, RCO considered the existence of a benefit under the State R-State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 9. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 9 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCO's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R-State S tax treaty to RCO.



- **Example E → *Increase of shareholding to 25%***

— Example E: RCO is a company resident of State R and, for the last 5 years, has held 24 per cent of the shares of company SCO, a resident of State S. Following the entry-into-force of a tax treaty between States R and S (Article 10 of which is identical to Article 10 of this Model), RCO decides to increase to 25 per cent its ownership of the shares of SCO. The facts and circumstances reveal that the decision to acquire these additional shares has been made primarily in order to obtain the benefit of the lower rate of tax provided by Article 10(2)*a*) of the treaty.

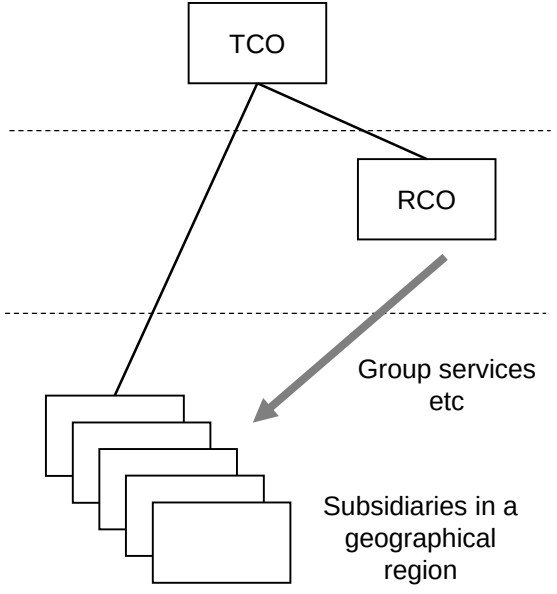
In that case, although one of the principal purposes for the transaction through which the additional shares are acquired is clearly to obtain the benefit of Article 10(2) *a*), paragraph 9 would not apply because it may be established that granting that benefit in these circumstances would be in accordance with the object and purpose of Article 10(2) *a*). That subparagraph uses an arbitrary threshold of 25 per cent for the purposes of determining which shareholders are entitled to the benefit of the lower rate of tax on dividends and it is consistent with this approach to grant the benefits of the subparagraph to a taxpayer who genuinely increases its participation in a company in order to satisfy this requirement.



- **Example G → *Choice of location for a regional holding company***

— Example G: TCO, a company resident of State T, is a publicly-traded company resident of State T. It owns directly or indirectly a number of subsidiaries in different countries. Most of these companies carry on the business activities of the TCO group in local markets. In one region, TCO owns the shares of five such companies, each located in different neighbouring States. TCO is considering establishing a regional company for the purpose of providing group services to these companies, including management services such as accounting, legal advice and human resources; financing and treasury services such as managing currency risks and arranging hedging transactions, as well as some other non-financing related services. After a review of possible locations, TCO decides to the skilled labour force, reliable legal system, business friendly environment, political stability, membership of a regional grouping, sophisticated banking industry and the comprehensive double taxation treaty network of State R, including its tax treaties with the five States in which TCO owns subsidiaries, which all provide low withholding tax rates.

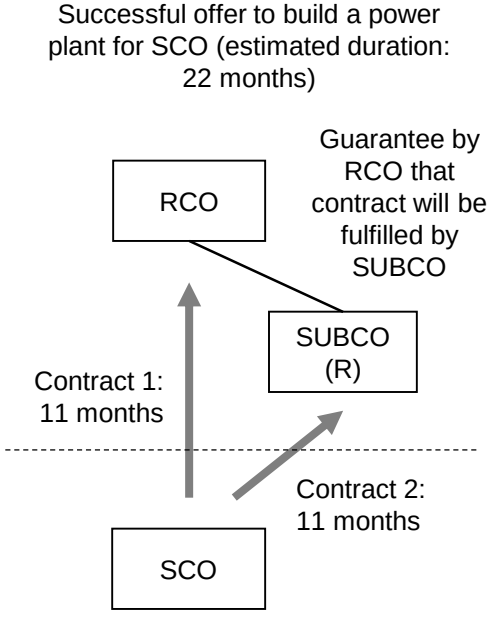
In this example, merely reviewing the effects of the treaties on future payments by the subsidiaries to the regional company would not enable a conclusion to be drawn about the purposes for the establishment of RCO by TCO. Assuming that the intra-group services to be provided by RCO, including the making of decisions necessary for the conduct of its business, constitute a real business through which RCO exercises substantive economic functions, using real assets and assuming real risks, and that business is carried on by RCO through its own personnel located in State R, it would not be reasonable to deny the benefits of the treaties concluded between State R and the five States where the subsidiaries operate unless other facts would indicate that RCO has been established for other tax purposes or unless RCO enters into specific transactions to which paragraph 9 would otherwise apply (see also example F in paragraph 187 below with respect to the interest and other remuneration that RCO might derive from its group financing activities).



- **Example J → *Splitting-up of contracts***

— Example J: RCO is a company resident of State R. It has successfully submitted a bid for the construction of a power plant for SCO, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months. The first contract is concluded with RCO and the second contract is concluded with SUBCO, a recently incorporated wholly-owned subsidiary of RCO resident of State R. At the request of SCO, which wanted to ensure that RCO would be contractually liable for the performance of the two contracts, the contractual arrangements are such that RCO is jointly and severally liable with SUBCO for the performance of SUBCO's contractual obligations under the SUBCO-SCO contract.

In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the conclusion of the separate contract under which SUBCO agreed to perform part of the construction project was for RCO and SUBCO to each obtain the benefit of the rule in paragraph 3 of Article 5 of the State R-State S tax convention. Granting the benefit of that rule in these circumstances would be contrary to the object and purpose of that paragraph as the time limitation of that paragraph would otherwise be meaningless.



Chapter VII/1.3
Third-State PEs

WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Third-State PE | *Overview*

- **BEPS Action 6 – Targeted specific treaty anti-abuse rules**
  - Anti-abuse rule for permanent establishments situated in third States – Art 29(8) OECD MC 2017
  - See already before 2017 the 1992 OECD Report on "Triangular Cases" and Art 10 no. 32, Art 11 no. 25, Art 12 no. 21 and Art 24 no. 71 OECD MC Comm. and Art 1(8) US MC

8. *a)* Where

(i) an enterprise of a Contracting State derives income from the other Contracting State and the first-mentioned State treats such income as attributable to a permanent establishment of the enterprise situated in a third jurisdiction, and

(ii) the profits attributable to that permanent establishment are exempt from tax in the first-mentioned State,

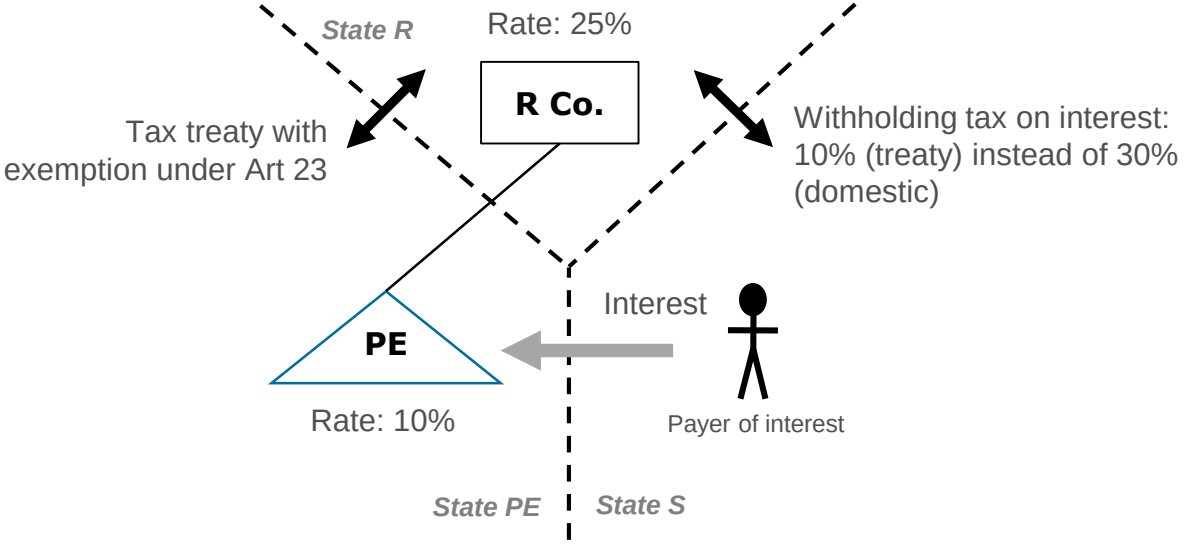
the benefits of this Convention shall not apply to any item of income on which the tax in the third jurisdiction is less than the lower of [rate to be determined bilaterally] of the amount of that item of income and 60 per cent of the tax that would be imposed in the first-mentioned State on that item of income if that permanent establishment were situated in the first-mentioned State. In such a case any income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other State, notwithstanding any other provisions of the Convention.

b) The preceding provisions of this paragraph shall not apply if the income derived from the other State emanates from, or is incidental to, the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).

c) If benefits under this Convention are denied pursuant to the preceding provisions of this paragraph with respect to an item of income derived by a resident of a Contracting State, the competent authority of the other Contracting State may, nevertheless, grant these benefits with respect to that item of income if, in response to a request by such resident, such competent authority determines that granting such benefits is justified in light of the reasons such resident did not satisfy the requirements of this paragraph (such as the existence of losses). The competent authority of the Contracting State to which a request has been made under the preceding sentence shall consult with the competent authority of the other Contracting State before either granting or denying the request

Third-State PE | *Overview*

- **Anti-abuse rule for permanent establishments situated in third States – Art 29(8) OECD MC 2017** – *Example:*



Part VIII
Excursus: Multilateral Instrument (MLI)

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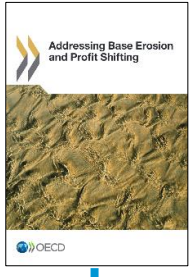
BEPS | *Background*

- ***BEPS ("Base Erosion and Profit Shifting") …***

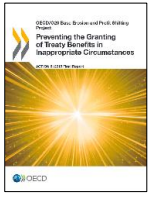
Issues and Action Plan (2013)



Final Reports on 15 Actions (2015) and Follow-up work (since 2016)

#	Topic
1	Addressing the Tax Challenges of the Digital Economy
2	Neutralising the Effects of Hybrid Mismatch Arrangements
3	Designing Effective CFC Rules
4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
5	Countering Harmful Tax Practices More Effectively
6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
7	Preventing the Artificial Avoidance of Permanent Establishment Status
8-10	Aligning Transfer Pricing Outcomes with Value Creation
11	Measuring and Monitoring BEPS
12	Mandatory Disclosure Rules
13	Transfer Pricing Documentation and Country-by-Country Reporting
14	Making Dispute Resolution Mechanisms More Effective
15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Tax Treaty Aspects



Action 2

Action 6

Action 14

Action 7

Action 15

BEPS | *Background*

- *… and the OECD MC and the Multilateral Instrument ("MLI")*

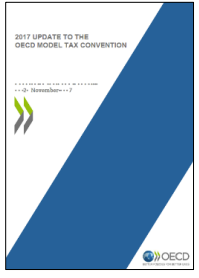
Action 2

Action 6

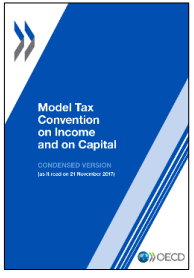
Action 14

Action 7

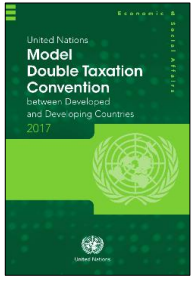
Action 15



2017 Update of the OECD MC and Commentary in November 2017



Condensed Version of the OECD MC and Commentary 2017



BEPS Implementation in the UN MC 2017

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS and Explanatory Memorandum (November 2016; 94 signatories as of July 2020)

BEPS | *Background*

Final Reports on 15 Actions (2015)		*Follow-up work, e.g.,*	
#	**Topic**	**#**	**Topic**
1	Addressing the Tax Challenges of the Digital Economy	1	Tax Challenges Arising from Digitalisation – Interim Report 2018 – Inclusive Framework on BEPS (2018) etc etc
2	Neutralising the Effects of Hybrid Mismatch Arrangements	2	Neutralising the Effects of Branch Mismatch Arrangements, Action 2 – Inclusive Framework on BEPS (2017)
3	Designing Effective CFC Rules		
4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments	4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2016 Update (2016)
5	Countering Harmful Tax Practices More Effectively		
6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances		
7	Preventing the Artificial Avoidance of Permanent Establishment Status	7	Additional Guidance on the Attribution of Profits to Permanent Establishments (March 2018)
8-10	Aligning Transfer Pricing Outcomes with Value Creation	8-10	▪ 2017 OECD Transfer Pricing Guidelines (TPG) ▪ Revised Guidance on the Application of the Transactional Profit Split Method (June 2018) ▪ Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles (June 2018) ▪ Financial Transactions (February 2020)
11	Measuring and Monitoring BEPS		
12	Mandatory Disclosure Rules		
13	Transfer Pricing Documentation and Country-by-Country Reporting		
14	Making Dispute Resolution Mechanisms More Effective		
15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties		

BEPS | *Background*

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Final Reports on 15 Actions (2015)

#	Topic
1	Addressing the Tax Challenges of the Digital Economy
2	Neutralising the Effects of Hybrid Mismatch Arrangements
3	Designing Effective CFC Rules
4	Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
5	Countering Harmful Tax Practices More Effectively
6	Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
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14	Making Dispute Resolution Mechanisms More Effective
15	Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Four Minimum Standards

#	Topic
5	Preferential Regimes, Transparency of Tax Rulings
6	Preventing Tax Treaty Shopping (PPT, PPT + LoB or LoB + Anti Conduit Rule) → Article 29 OECD MC, MLI
13	Country-by-Country Reporting → CbCR MCAA
14	Effectiveness of Cross-Border Dispute Resolution (MAP)

BEPS | *Background*

Four Minimum Standards → Implementation, Peer Reviews

#	Topic
5	Preferential Regimes, Transparency of Tax Rulings
6	Preventing Tax Treaty Shopping (PPT, PPT + LoB or LoB + Anti Conduit Rule) → Article 29 OECD MC, MLI
13	Country-by-Country Reporting → CbCR MCAA
14	Effectiveness of Cross-Border Dispute Resolution (MAP)

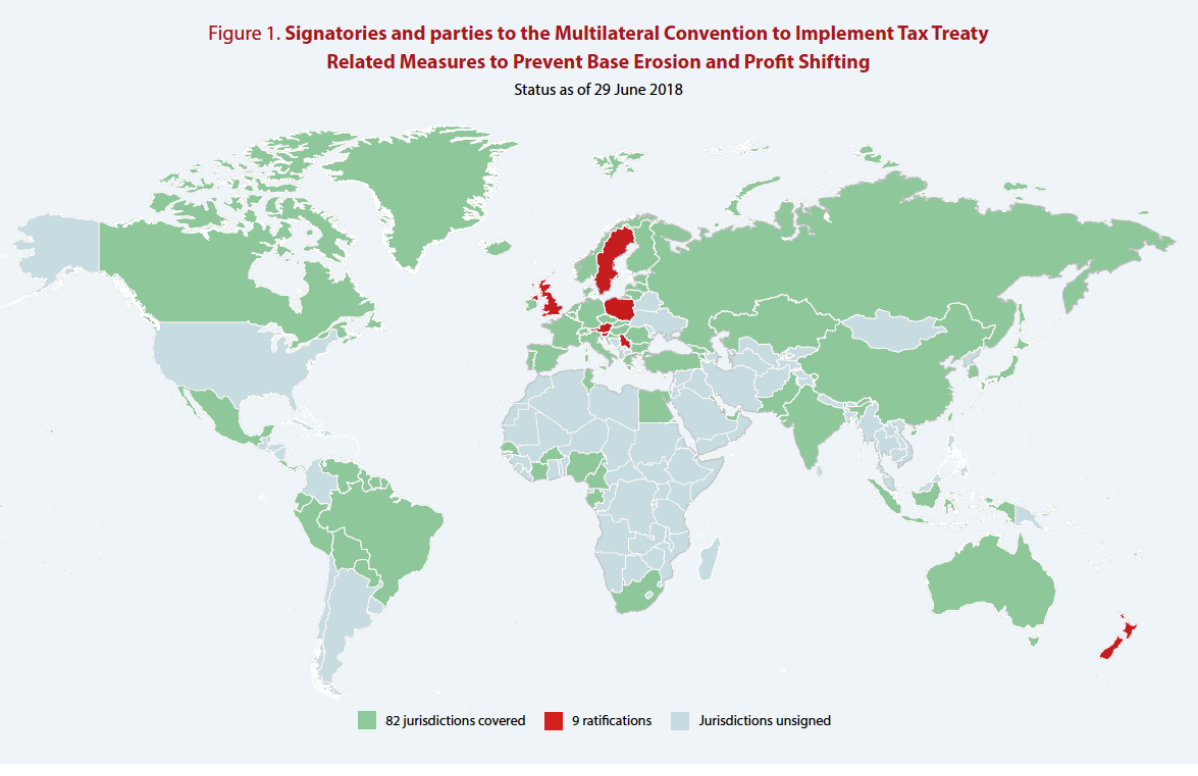
BEPS Inclusive Framework

- Collaboration on the implementation of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Package
- Work Programme
  - Standards on remaining BEPS issues
  - Review the implementation of the four BEPS minimum standards through a peer-review process.
  - Monitor new developments relating to the other BEPS measures and to measure the impact of those measures.
  - Support jurisdictions in the implementation of the BEPS measures
- 137 Member States (as of Dec. 2019)
- OECD/G20 Inclusive Framework on BEPS – Annual Progress Reports:

MLI | *Overview*

- **Tax Treaty Aspects of the BEPS Project: Minimum standards, recommendations**
  - Action 2 on hybrids
  - Action 6 on treaty abuse
  - Action 7 on permanent establishments
  - Action 14 on mutual assistance, dispute resolution
- **Implementation**
  - ***Future treaties*** → US-MC 2016, Update of the OECD MC and the OECD MC Comm. in 2017 and Update of the UN MC and UN MC Comm. in 2017 (2018)
  - ***Existing treaties → Multilateral Instrument („MLI")***
    - Draft and "Explanatory Statement" published in November 2016, signing ceremony in June 2017 → ***Currently 94 signatories*** (as of June 2019), ***amending more than 1.680 (bilateral) tax treaties***
    - Authentic texts in English in French, but a number of "official" translations (Arabic, Chinese, Dutch, German, Italian, Japanese, Serbian, Spanish and Swedish)
    - Many options for states, e.g., by identifying „convered tax agreements", options, non-implementation of rules outside the minimum standard → ***MLI Country Positions***
    - Various open questions (e.g., language, domestic parliamentary proceedings, consolidated versions etc)
    - Extensive OECD webpage (e.g., signatories, country positions, toolkits etc)

MLI | *Signatories*



Source: OECD/G20 Inclusive Framework on BEPS Progress Report July 2017-June 2018 (2018), Progress Report July 2018 – May 2019 (2019) and Progress Report July 2019 – July 2020 (2020)

MLI | *Entry into Force*

- **Entry into force and application**
  - ***Entry into force*** → 3 months after deposit of the 5th instrument of ratification, then 3 months after each subsequent deposit (Art 34 MLI)
    - 1 July 2018 → Austria, Isle of Man, Jersey, Slovenia and Poland
    - Ratifications since then, e.g., Australia, Curaçao, Finland, France, Georgia, Guernsey, Ireland, Israel, Japan, Lithuania, Malta, Monaco, the Netherlands, New Zealand, Serbia, Singapore, Slovak Republic, Slovenia, Sweden and the UK
    - Requires entry into force for both Contracting Jurisdictions!
  - ***Applicability*** → From January 1 of the year after entry into force (for withholding taxes) and for taxable years starting 6 months after entry into force (for all other taxes) *– E.g., into into force on 1 July 2018, applicability for both withholding and all other taxes as from 1 January 2019!*

MLI | *Provisions*

MLI	Topic	OECD MC *Old*	OECD MC 2017	BEPS Action	Minumum Standard?
Art 3	Hybrids	(Art 1, 23)	Art 1(2)	2	×
Art 4	Tie-Breaker-Rule	Art 4(3)	Art 4(3)	6	×
Art 5	Double-Non Taxation	Art 23(4)	*NA*	2	×
Art 6	Preamble	Title, Preamble	Title, Preamble	6	✓
Art 7	Treaty Abuse (PPT, LoB)	—	Art 29(1)-(7), (9)	6	✓
Art 8	Minimum Holding Period	Art 10(2)	Art 10(2)	6	×
Art 9	Real Estate Companies	Art 13(4)	Art 13(4)	6	×
Art 10	Third-Country PEs	—	Art 29(8)	6	×
Art 11	Saving Clause	(Art 1)	Art 1(3)	6	×
Art 12	Agency PEs	Art 5(5), (6)	Art 5(5), (6)	7	×
Art 13	Prepartory and Auxiliary Activities	Art 5(4)	Art 5(4), (4.1)	7	×
Art 14	Splitting-up of Contracts	Art 5(3)	—	7	×
Art 15	Definiton of dependent persons	—	Art 5(8)	7	×
Art 16	Mutual Agreement Proceedings	Art 25	Art 25	14	✓
Art 17	Corresponding Adjustments	Art 9(2)	*NA*	14	×
Art 18-26	Dispute Resolution	(Art 25)	*NA*	14	×

- **Options, elections etc – *Example: Art 12 MLI on agency permanent estblishments …***

Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

1. Notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:

a) in the name of the enterprise; or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that Contracting Jurisdiction in respect of any activities which that person undertakes for the enterprise unless these activities, if they were exercised by the enterprise through a fixed place of business of that enterprise situated in that Contracting Jurisdiction, would not cause that fixed place of business to be deemed to constitute a permanent establishment under the definition of permanent establishment included in the Covered Tax Agreement (as it may be modified by this Convention).

2. Paragraph 1 shall not apply where the person acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise of the other Contracting Jurisdiction carries on business in the first-mentioned Contracting Jurisdiction as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.

3. a) Paragraph 1 shall apply in place of provisions of a Covered Tax Agreement that describe the conditions under which an enterprise shall be deemed to have a permanent establishment in a Contracting Jurisdiction (or a person shall be deemed to be a permanent establishment in a Contracting Jurisdiction) in respect of an activity which a person other than an agent of an independent status undertakes for the enterprise, but only to the extent that such provisions address the situation in which such person has, and habitually exercises, in that Contracting Jurisdiction an authority to conclude contracts in the name of the enterprise.

b) Paragraph 2 shall apply in place of provisions of a Covered Tax Agreement that provide that an enterprise shall not be deemed to have a permanent establishment in a Contracting Jurisdiction in respect of an activity which an agent of an independent status undertakes for the enterprise.

4. A Party may reserve the right for the entirety of this Article not to apply to its Covered Tax Agreements.

5. Each Party that has not made a reservation described in paragraph 4 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in subparagraph a) of paragraph 3, as well as the article and paragraph number of each such provision. Paragraph 1 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision.

6. Each Party that has not made a reservation described in paragraph 4 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in subparagraph b) of paragraph 3, as well as the article and paragraph number of each such provision. Paragraph 2 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made such a notification with respect to that provision.

- **Options, elections etc – *Example: … and part of New Zealand's MLI position:***

Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies

Notification of Existing Provisions in Listed Agreements

Pursuant to Article 12(5) of the Convention, New Zealand considers that the following agreements contain a provision described in Article 12(3)(a). The article and paragraph number of each such provision is identified below.

Listed Agreement Number	Other Contracting Jurisdiction	Provision
1	Australia	Article 5(8)(a)
2	Austria	Article 5(6)
3	Belgium	Article 5(6)
4	Canada	Article 5(8)(a)
5	Chile	Article 5(8)
6	Czech Republic	Article 5(6)
7	Denmark	Article 5(6)
8	Finland	Article 5(6)
9	French Republic	Article 5(6)
10	Germany	Article 5(5)

MLI | *Highlights*

- Highlights from the 2018 Inclusive Framework Report, the 2019 Inclusive Framework Report and the 2020 Inclusive Framework Report
  - Currently *94 signatories* (as of July 2020; 84 as of 27 September 2018, 87 as of 29 March 2019), more than 50% ratified
  - MLI will modify more than 1.680 treaties
  - Preamble and anti-treaty abuse rule (PPT) in all matched agreements:
  - 30 jurisdictions have opted for arbitration (Part V – Art 16 et seq. of the MLI), most of them opting for "baseball arbitration"

Table 3. **MLI and the Implementation of the Action 6 Minimum Standard**

Jurisdictions covered	82
Covered Tax Agreements (CTA)	1 360
Ratification Instruments Deposited	9
Projected % CTA's including new preamble language	100%
Projected % CTA's including PPT	100%
Projected % CTA's including additional S-LOB	3%

Source: OECD/G20 Inclusive Framework on BEPS Progress Report July 2017-June 2018 (2018), Progress Report July 2018 – May 2019 (2019) and Progress Report July 2019 – July 2020 (2020)

MLI | *Highlights*

- Highlights from the 2018 Inclusive Framework Report, the 2019 Inclusive Framework Report and the 2020 Inclusive Framework Report

Box 1. Key Facts on the Multilateral Instrument (MLI)

- The MLI covers 94 jurisdictions, of which 49 have ratified (finally reaching above a 50% ratification rate)
- The MLI is in effect for over 300 treaties and will modify over 1 680 treaties once fully in effect
- Inclusion of the principal purpose test (PPT) in all of those 1 680 modified agreements (Action 6)
- Once all signatories have ratified the MLI, around 65% of all agreements between OECD/G20 Inclusive Framework members will be modified by the MLI to include the Action 6 minimum standard (and other BEPS treaty related provisions)
- 30 covered jurisdictions that opted for mandatory binding arbitration (modifying 211 covered tax agreements to include the MLI mandatory binding arbitration provisions)
- The first meeting of the MLI Conference of the Parties was held on 4 October 2019

IMPLEMENTATION OF ACTION 7 THOUGH THE MLI

Option for the lowering the threshold for a dependent agent PE: **46 jurisdictions**

Option for the overarching preparatory/ auxiliary requirement: **55 jurisdictions**

Option for the anti-fragmentation rule: **54 jurisdictions**

Option for the anti-contract splitting: **34 jurisdictions**

Source: OECD/G20 Inclusive Framework on BEPS Progress Report July 2017-June 2018 (2018), Progress Report July 2018 – May 2019 (2019) and Progress Report July 2019 – July 2020 (2020)

MLI | „Matching“

MLI	Topic	AT	AU	CH	DE	MX	NO	NZ	UK
Covered Treaties		***38***	***43***	***14***	***35***	***61***	***28***	***36***	***109***
Art 3	Hybrids	×	✓	×	×	✓	✓	✓	×
Art 4	Tie-Breaker-Rule	×	✓	×	×	✓/~	✓	✓	✓
Art 5	Double-Non Taxation	✓ (A)	×	✓ (A)	×	×	✓ (C)	×	×
Art 6	Preamble	✓	✓	✓	✓	✓	✓	✓	✓
Art 7	Treaty Abuse	✓ (PPT)	✓ (PPT)	✓ (PPT)	✓ (PPT)	✓ (PPT, LoB)	✓ (PPT, LoB)	✓ (PPT)	✓ (PPT)
Art 8	Minimum Holding Period	×	✓	×	✓	✓	✓	✓	×
Art 9	Real Estate Companies	×	✓	×	✓	✓	×	✓	×
Art 10	Third-Country PEs	✓	×	×	✓	✓	×	✓	×
Art 11	Saving Clause	×	✓	×	×	✓	✓	✓	✓
Art 12	Agency PEs	×	×	×	×	✓	✓	✓	×
Art 13	Prepartory and Auxiliary	✓ (A)	✓ (A)	×	✓ (A)	✓ (A)	✓ (A)	✓ (A)	~
Art 14	Splitting-up of Contracts	×	✓	×	×	×	✓/×	✓	×
Art 15	Dependent persons	×	✓	×	×	✓	✓	✓	✓
Art 16	MAP	✓	✓	✓	✓	✓	✓	✓	✓
Art 17	Corresp. Adjustments	✓	✓	✓	✓	✓	✓	✓	✓
Art 18-26	Dispute Resolution	✓	✓	✓	✓	×	×	✓	✓

MLI | *Tools*

- Note on the functioning of the MLI under public international Law
- MLI Matching Database
- Matrix of options and reservations
- Step-by-Step Overview
- Flowcharts
- Secretariat's note on entry into effect
- Guidance for the development of synthesised texts

MLI Matching Database beta
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Select jurisdictions:	Australia	Mexico	Read the Disclaimer
Status as of 25 February 2019	Australia	Mexico	
Signature MLI	6/7/2017	6/7/2017	
Ratification instrument deposited	9/26/2018		
Status of List	Definitive	Provisional	
Article 2 | Covered Tax Agreement	The agreement would be a 'Covered Tax Agreement'.		
Article 3 | Transparent Entities	Article 3(2) would apply. A.4(3) would be replaced by Article 3(1).		
Article 4 | Dual Resident Entitities	The last sentence of Article 4(1) would be replaced with the text described in Article 4(3)(e). A.4(5) would be replaced by Article 4(1).		
Article 5 | Application for methods for Elimination of Double Taxation	Article 5 would not apply.		
Article 6 | Purpose of a Covered Tax Agreement	The preamble language would be replaced by the text described in Article 6(1). The preamble text described in Article 6(3) would be included in the agreement.		
Article 7 | Prevention of Treaty Abuse	A.11(8),12(8) would be replaced by Article 7(1). Article 7(4) would not apply. The Simplified Limitation on Benefits Provision would not apply.		
Article 8 | Dividend Transfer Transactions	Article 8(1) would apply with respect to A.10(2)(a).		
Article 9 | Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property	Article 9(1)(b) would not apply. Article 9(1)(a) would apply with respect to A.13(2). Article 9(4) would not apply.		
Article 10 | Anti-abuse Rule for Permanent Establishments Situated in Third Jurisdictions	Article 10 would not apply.		
Article 11 | Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents	Article 11(1) would apply and supersede the provisions of the agreement to the extent of incompatibility.		
Article 12 | Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies	Article 12 would not apply.		

Models | *Updates 2017*

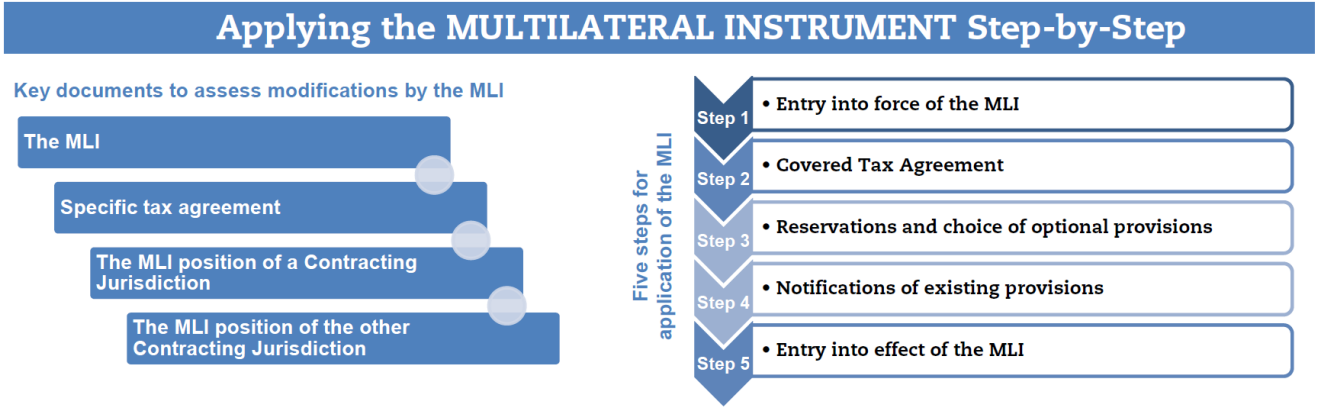
Topic	MLI	OECD MC 2017	UN MC 2017
Preamble	Art 6	Title, Preamble	Title, Preamble
Hybrids	Art 3	Art 1(2)	Art 1(2)
Saving Clause	Art 11	Art 1(3)	Art 1(3)
Recognised pension fund	—	Art 3(1)(i), 4(1)	—
Tie-Breaker-Rule	Art 4	Art 4(3)	Art 4(3)
Prepartory and auxiliary activities	Art 13	Art 5(4), (4.1)	Art 5(4), (4.1)
Agency PEs	Art 12	Art 5(5), (6)	Art 5(5), (7)
Splitting-up of contracts	Art 14	—	
Definiton of dependent persons	Art 15	Art 5(8)	Art 5(9)
International shipping and air transport	—	Art 8 (and 3(1)(e), 13(3), 15(3), 22(3))	Art 8 Option A, B (and 3(1)(d), 13(3), 15(3), 22(3))

Models | *Updates 2017*

Topic	MLI	OECD MC 2017	UN MC 2017
Corresponding Adjustments	Art 17	*(Art 9(2))*	*(Art 9(2))*
Minimum Holding Period	Art 8	Art 10(2)	Art 10(2)
Fees for technical services	—	—	Art 12A
Real Estate Companies	Art 9	Art 13(4)	Art 13(4)
No relief for residence taxation	—	Art 23A, 23B	Art 23A, 23B
Double-Non Taxation	Art 5	*(Art 23A(4))*	Art 23A(4)
Mutual Agreement Proceedings	Art 16	Art 25	—
Treaty Abuse (PPT, LoB)	Art 7	Art 29(1)-(7), (9)	Art 29(1)-(7), (9)
Third-Country PEs	Art 10	Art 29(8)	Art 29(8)
Dispute Resolution	Art 18-26	—	—

Step-by-Step | *5 Steps*

- **Applying the MLI:** *Step-by-step*



Source: http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

Step-by-Step | *Entry into Force*

- **Applying the MLI:** *Step-by-step*

Step 1 • **Entry into force of the MLI: Verify if the MLI has entered into force**

(i) Is the MLI itself in force? (Have five jurisdictions deposited the instrument of ratification, acceptance or approval?)	☐ YES: *Go to (ii)* ☐ NO: *The MLI does not apply.*	More information:
(ii) Is the MLI in force for both Contracting Jurisdictions to the tax agreement? (Are both Contracting Jurisdictions Parties to the MLI?)	☐ YES: *The MLI could apply to the tax agreement. Go to* ***Step 2*** ☐ NO: *The MLI does not apply.*	▪ Article 34 ▪ Explanatory Statement, para. 320-323

Source: http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

Step-by-Step | *Covered Agreement*

- **Applying the MLI:** *Step-by-step*

Step 2 • **Covered Tax Agreement: Verify if the tax agreement is a Covered Tax Agreement**

(i) Do both Contracting Jurisdictions list the tax agreement in their MLI positions as an agreement to be covered by the MLI?	☐ YES: *Go to (ii)* ☐ NO: *The MLI does not apply to the tax agreement.*	More information:
(ii) Is the tax agreement in force?	☐ YES: *The MLI can apply to the tax agreement (The tax agreement is a Covered Tax Agreement). Go to **Step 3*** ☐ NO: *The tax agreement will be a Covered Tax Agreement after entry into force.*	▪ Article 2(1)(a) ▪ Explanatory Statement, para. 25-33 ▪ Flowchart on Article 2

Source: http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

Step-by-Step | *Reservations*

- **Applying the MLI:** *Step-by-step*

Step 3 • **Reservations and choice of optional provisions: Identify which MLI provisions apply**

This step must generally be followed to identify which MLI provisions apply to a Covered Tax Agreement.
For detailed information and specificities of each Article, please see the MLI flowcharts.

Reservations: Does either Contracting Jurisdiction to the Covered Tax Agreement make a reservation on the application of a provision of the MLI?	☐ YES: *The MLI provision for which the reservation is made does not apply and does not modify the Covered Tax Agreement.* ☐ NO: *The MLI Article could apply and modify the Covered Tax Agreement.*	More information: ▪ Each MLI provision and its Explanatory Statement ▪ Flowchart on each Article

Note: Each Contracting Jurisdiction is allowed to make a reservation unilaterally, while the effect of reservation applies symmetrically (see Article 28(3)). Accordingly, a reservation made by a Contracting Jurisdiction with respect to a provision generally blocks the application of the provision, whether or not the other Contracting Jurisdiction has also made the reservation.

Optional provisions: Do both Contracting Jurisdictions to the Covered Tax Agreement choose to apply an optional provision of the MLI?	☐ YES: *The optional provision chosen could apply and modify the Covered Tax Agreement.* ☐ NO: *The optional provision does not apply.*	More information: ▪ Each MLI provision and its Explanatory Statement ▪ Flowchart on each Article

Note: Contrary to reservations, both Contracting Jurisdictions are required to choose to apply the same optional provision in order to apply the provision (except for Article 5 and 23(5)).

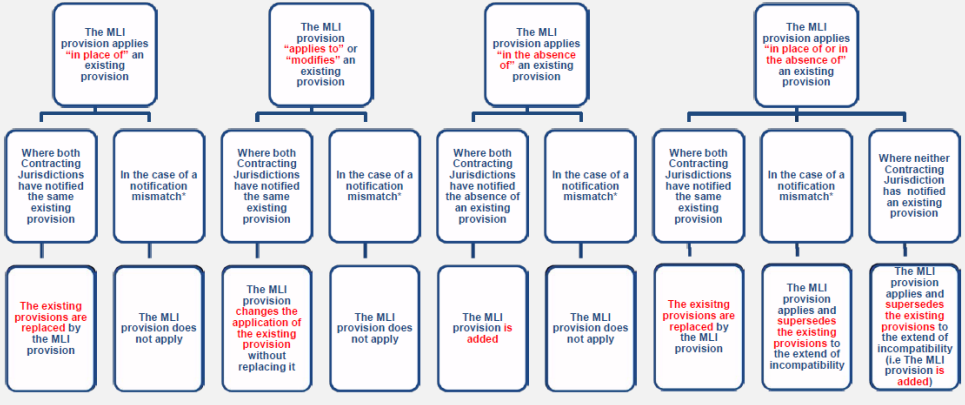
Source: http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

Step-by-Step | *Notification*

- **Applying the MLI:** *Step-by-step*

Step 4 • **Notifications of exsiting provisions: Identify which existing provisions are modified**

To ensure clarity and transparency about the application, the MLI requires Parties to notify existing provisions to be modified by the MLI provision. In addition, each Article contains provisions describing details on how the applicable MLI provisions modify a Covered Tax Agreement (compatibility clauses). The effect of notificaitons depends on the type of compatibility clause which could provide that the MLI provision applies "in place of", "applies to" or "modifies", "in the absence of", or "in place of or in the absence of" (see also the Explanatory Statement, para. 15-18).

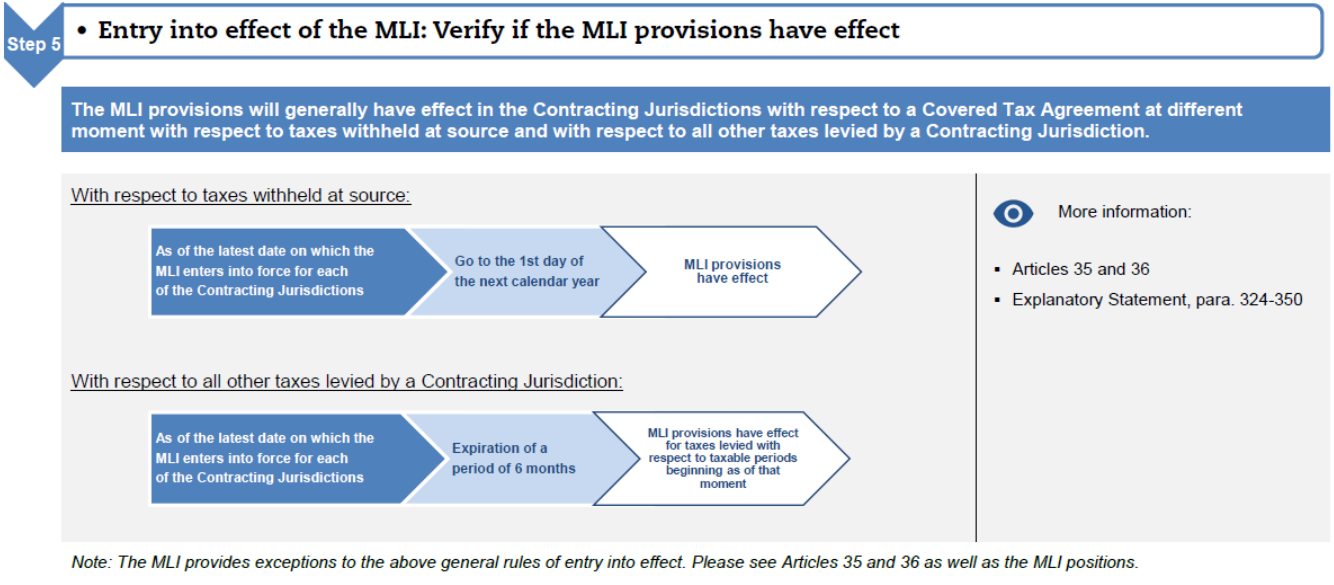


** Notification mismatches are cases where one Contracting Jurisdiction has notified an existing provision but the other has not, or where the Contracting Jurisdictions have made a different notification with respect to existing provisions in their MLI positions (except for minor differences).*

Source: http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

Step-by-Step | *Entry into Effect*

- **Applying the MLI:** *Step-by-step*



Note: The MLI provides exceptions to the above general rules of entry into effect. Please see Articles 35 and 36 as well as the MLI positions.

Source: http://www.oecd.org/tax/treaties/step-by-step-tool-on-the-application-of-the-MLI.pdf

Thank you!

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