New York University School of Law

Tax Treaties (Tax Conventions) — Syllabus

Spring 2020

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1. **Materials**

The required material for this course is

- *2017 OECD Model Tax Convention on Income and on Capital* and accompanying Commentary developed by the Organisation for Economic Co-operation and Development (OECD) (OECD Model)
- *UN Model Tax Convention Between Developed and Developing Countries (2017)* (UN Model).

You are able to download a PDF copy from the library website.

2. **Lecturer**

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I am available for consultation after class.

3. **Outline**

1. Introduction
2. Relationship between Tax Treaties and Domestic Law and Scope of Tax Treaties
3. Interpretation of Tax Treaties
4. Entitlement to Treaty Benefits
5. Threshold Requirements and Source Rules under Tax Treaties
6. The Concept of Permanent Establishment
7. The Attribution of Profits to Permanent Establishments and Transfer Pricing
8. The Taxation of Income from Services
9. Taxation of Dividends, Interest, Royalties, and Capital Gains
10. Relief of Double Taxation
11. Mutual Agreement Procedure
12. Anti-Tax Avoidance Measures and Tax Treaties
13. Non-discrimination

Please note that we will not consider all the class discussion questions.
1. Introduction

- tax treaty networks
- Structure and role of the OECD
- OECD Model Convention: policy, history, context
- UN Model Convention
- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (called the Multilateral Instrument (MLI))
- other Model Conventions

Questions for Discussion

1. What are the features of the international economy that shape and affect the international tax order today? Consider the areas of trade, investment, capital markets and immigration.
2. What (if any) is the international consensus on international income taxation?
3. What are the driving forces behind a country’s tax treaty network? Compare the US network of tax treaties with those of other countries.
4. Read the Sumner case and identify the domestic tax and treaty issues raised by the case.
5. What is the OECD? What is its current role in international taxation? Why has the OECD Model been so successful?
6. What is the current role in international taxation of other international organisations and institutions (UN, IMF, WTO, EU)?
7. What are the current-day purposes of tax treaties?
8. How are tax treaties made?
9. Why are income tax treaties generally bilateral and not multilateral?

Reading

OECD Model 2017 Introduction

Sumner v The Queen [2000] 2 CTC 2359 (Tax Court of Canada)

Further Reading


Klaus Vogel on Double Taxation Conventions (4th ed, 2015), pp. 12-49


Picciotto, International Business Taxation (Quorum, New York, 1992) chs 1-3, 11

2. The Relationship between Tax Treaties and Domestic Law

- legal nature of tax treaties
- relationship between tax treaties and domestic law
- domestic tax benefit provision
- the scope of tax treaties
  - taxes covered
  - geography
  - time covered by treaties

Questions and Problems for Discussion

1. Under international law, treaties only confer rights and obligations on states (and international organisations). Why and how are tax treaties given effect in relation to taxpayers?

2. What is the relation between tax treaties and domestic tax law? How would a tax treaty operate in the following cases:
   (a) domestic law provides for tax on interest paid by residents to non-residents of alternatively 20% or 0%;
   (b) domestic law contains no rules for making transfer pricing adjustments;
   (c) domestic law has secrecy rules that prohibit the giving of tax information to foreign officials; and
   (d) domestic law provides that tax assessments may only be challenged by appeal under a specific procedure?

3. To what extent are domestic laws incorporated into tax treaties? To what extent, if at all, are treaty rules incorporated into domestic law?

6. Canco is incorporated in Canada but is managed in Australia. Where is Canco considered to be resident for purposes of Australian tax law and for purposes of the treaty? How can this dual-resident status of Canco be exploited from a tax planning perspective?

7. What principles should be applied in determining whether a tax treaty has been overridden by domestic legislation?

8. Is the levy of income tax by a country on the following activities covered by tax treaties with a definition of the kind set out below which is usually added to article 3: an oil well located on the continental shelf; an oil well located on the shelf of the Caspian Sea; fishing activities on the continental shelf; a floating hotel on the continental shelf?

Definition: the term X means the Republic of X and, when used in a geographical sense, includes any area beyond the territorial seas of the Republic of X which, in accordance with international law and the laws of the Republic of
X, is an area within which the Republic of X may exercise rights with respect to the seabed and subsoil and their natural resources.

9. Do China’s tax treaties apply to Hong Kong?

10. What is the purpose of article 29 of the OECD Model on Territorial Extension (as renumbered in 2002)?

11. What are the various stages of a tax treaty coming into effect or going out of effect? How do actual treaties vary from the OECD Model?

12. Assume that in 1996 a country repeals all its current tax laws and enacts a comprehensive tax code containing a combined income tax dealing with individuals and companies, value added tax, excise, a combined tax on the assets of legal persons and physical persons, and provisions on tax procedure. Will a treaty adopting the OECD Model Article 2 apply to such taxes? A treaty adopting only paragraphs 3 and 4 of Article 2? Would you need further information to answer this question?

13. Would tax treaties apply to a digital services tax?

14. Would a tax treaty apply to Diverted Profits Tax?

15. Should a country which has no net wealth tax seek to cover such taxes in its treaties? Does it make a difference if the other treaty party also has no such taxes?

16. Do tax treaties apply to resource rent taxes, social security levies or fringe benefits taxes levied on employers?

17. Why are the definitions in Article 3(1) applicable subject to the context requiring otherwise?

18. Why is the term “business” defined?

Reading

Vienna Convention (in particular Articles 2, 26-27, and 60)
OECD Model, Article 1 & 2
MLI, Articles 1 & 2

Kinsella v The Revenue Commissioners, [2007] IEHC 250 (2007) (Irish High Court)
Virgin Holdings v Commissioner of Taxation [2008] FCA 1503 (Federal Court of Australia)

Further Reading

Klaus Vogel on Double Taxation Conventions (4th ed, 2015), pp. 65-72
OECD, Tax Treaty Overrides (1989)

Diverted Profits Tax (UK and Australia) Multinational Anti-Avoidance Law (Australia)

Diverted Profits Tax (UK)
3. **Tax Treaty Interpretation**

- interpretation generally and statutory interpretation
- comparison of statutory interpretation and treaty interpretation
- interpretation of tax treaties
- Vienna Convention on the Law of Treaties: articles 31-33
- Article 3(2) of the OECD Model
- approaches to treaty interpretation

**Questions and Problems for Discussion**

1. How are tax statutes interpreted? Are tax treaties interpreted in the same way or differently? Why?

2. What type of interpretive approach is mandated by Article 31 of the Vienna Convention: textual (literal), intentional (the intentions of the parties), or purposive (teleological)?

3. May the OECD Commentaries be relied on in the interpretation of tax treaties and, if so, on what basis? May later Commentaries be used to interpret a treaty already in force (i.e., the Commentary is revised after the treaty entered into force)?

4. What other materials may be relied on in the interpretation of tax treaties, (agreed minutes signed at the same time as the treaty, foreign court decisions and interpretive material produced by one of the treaty parties either at the time of the treaty or later)?

5. How are treaties in different languages interpreted? What if the treaty is in a language which is not the national language of either treaty party, eg, Japanese and Norwegian treaties in the English language only.

6. Are tax treaties generally to be interpreted on a static or ambulatory basis?

7. Should a tax treaty be interpreted the same way in both countries?

8. What is the effect of Article 3(2)? Consider the following cases:

   (a) the commercial laws (alternatively the customs laws, alternatively the income tax laws) of a country define a boat as a water-going vessel of less than 200 tonnes and a ship as a vessel of 200 tonnes and above (see Article 8 and the associated definition of “international traffic” in Article 3);

   (b) the tax laws of a country relating to the withholding system for collecting tax in the building industry define a building site as any activity of a building character carried on by a taxpayer within the bounds of the state;

   (c) the tax laws provide that all activities carried on by a company shall be treated as business activities;
the tax law provides that periodical payments made in relation to the acquisition of a copyright or patent shall be deemed to be for the use of the copyright or patent;

(e) a country changes the tax definition of interest for the purpose of final withholding taxes levied on non-residents to include guarantee fees and the financing element of a finance lease.

9. Article 15(2)(b) of the OECD Model provides an exception if an employee “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.” How should these words be interpreted?

10. X comes to the US holiday for 3 weeks every January. In July 2012 X becomes employed in Australia. Is the 3 weeks of holiday in January counted for purposes of Article 15(2)(b) or not?

Reading
Vienna Convention and Commentary (Articles 31-33)
Article 3(2), OECD Model, Introduction and Commentary on Article 3(2)
Thiel v Commissioner of Taxation [1990] HCA 37 (High Court of Australia)
Commissioner of Taxation v SNF (Australia) Pty Ltd (2011) FCAFC 74 (Full Federal Court of Australia)

Further Reading
*Klaus Vogel on Double Taxation Conventions* (4th ed, 2015), pp. 34-51
Ward et al., *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries in the OECD Model* (IFA/IBFD, 2006)
Avery Jones, Article 3(2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation (1993) 33 *European Taxation* 252-257
Avery Jones et al., The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model [1984] *British Tax Review* 14-54, 90-108
4. **Entitlement to Treaty Benefits**

- Article 1 of the OECD and Commentary on Article 1
- Article 4 of the OECD and Commentary on Article 4
- dual residency of individuals and companies
- saving clause in US tax treaties
- partnerships and other entities

**Questions for Discussion**

1. Is a Government a resident for purposes of its tax treaties?
2. Is a charity created in a country and exempt from income tax under its tax laws a resident of the country under tax treaties?
3. Can a country which adopts a pure territorial system of taxation (that is, taxes only income sourced in the country without reference to income derived outside the country) enter into effective tax treaties in terms of Article 4(1) of the OECD Model?
4. An employee of a foreign company migrates to a country on 1 May 2005 to work in future for a domestic subsidiary of the foreign parent company. She claims that under its tax law she is to be treated as a resident for the whole of 2005 and to be taxed on her worldwide income for the whole year (including her salary and investment income earned in the foreign country from 1 January to 30 April 2005). Assume that under the foreign tax law she is treated as a resident only from 1 January to 30 April 2005 and that the country in question does not permit part year residence and has a 183-day rule. Where is she resident for the purposes of tax treaties from 1 January to 30 April 2005 and from 1 May 2005 to 31 December 2005? What is the result for the taxation of her investment income derived from abroad?
5. Is a US citizen resident in Australia entitled to the benefits of the treaty? Is a US citizen resident in France entitled to the benefits of the Australia-US treaty?
6. A company registered in one country has a branch in another country through which its activities are largely carried out. The head office has no activities. The wife and husband, who own the shares of the company, have a home in the country in which the company is registered; the home is used mainly on weekends. The owners are citizens of this country and have most of their family there. They stay during the working week in the other country where they have a permanent home also and manage the branch. Assume that under the laws of each country, the company and the owners are both resident in each country. For the purpose of tax treaties, where are the company and its owners resident?
7. How do the tie-breakers in the OECD Model and actual treaty variants work in cases other than individuals? What happens if a country adopts a different residence test for companies after a treaty is negotiated (for example, the UK adopted incorporation in 1988 in addition to the central management and control test)? What happens if a treaty omits a tie-breaker for cases other than individuals (as is common in US treaties)?
8. In connection with the Specialty Manufacturing case, consider Articles 25(7) and 25(8) of the Canada-US Treaty. What if the debt:equity ratio was 4:1 and the taxpayer could show that such a ratio is typical for that type of business?

9. Ted is a US citizen and was a resident of the US until March 2007, when he moved to Australia. Until March 2007 Ted was employed in the US by a major US multinational corporation. Ted received stock options as part of his remuneration package. Upon moving to Australia Ted became employed by the Australian subsidiary of the US corporation. Shortly after moving to Australia, in late 2007, Ted exercised the options. Assume that Australia includes in income the gain realized by Ted in respect of the options. Does the Australian-US treaty preclude Australia from taxing the stock option gains?

10. Why does the US include the savings clause in its treaties? How does the clause operate with respect to a US citizen resident in Australia? Should the OECD model include a savings clause?

Reading

OECD Commentary on Articles 1 and 4

MLI Articles 4 (Dual resident entities), 11 (Application of tax agreements to restrict a party’s right to tax its own residents)

Crown Forest Industries v Canada [1995] 2 CTC 64 (Supreme Court of Canada)

Specialty Manufacturing Ltd v The Queen [1999] 3 CTC 82 (Federal Court of Canada)

Federal Commissioner of Taxation v Resource Capital Fund III LP (2014) 225 FCR 290

Conrad Black v The Queen [2014] 3 CTC 2237; 2014 TCC 12

Further Reading

Maisto, ed. Residence of Companies under Tax Treaties and EC Law (IBFD, 2009)

Goldberg et al., Change of Residence, Parts I and II (2000) Tax Notes International 643-59, 741-66

5. Threshold Requirements and Source Rules

- threshold requirements for source country taxation of income
- source-of-income rules or their functional equivalents

Questions and Problems for Discussion

1. What is the threshold requirement for taxing non-residents on their business profits? The threshold requirement in tax treaties for taxing business profits is generally the existence of a PE. Should the threshold requirements in domestic law and tax treaties be the same?

2. Compare the threshold requirements in the UN Model and the OECD Model.

3. The PE is not the only threshold requirement in tax treaties. What other threshold requirements are used and why? Think about the different types of business profits.

4. Is a threshold requirement necessary or appropriate? If it is, what type of threshold is appropriate: fixed place of business, physical presence, level of activity, amount of revenue or income?

5. What, if any, threshold requirement is used in Article 15(2) of the OECD Model?

6. How are dividends, interest, and royalties that constitute business profits taxed under tax treaties? What if the non-resident deriving such profits has a PE in the source country?

7. Identify the different stages involved in determining whether a non-resident is taxable and how much tax is payable of business profits earned in another country under the treaty with that country.

8. What are the functions of source rules in a country’s international tax system? How is the source of business profits generally determined under Australian tax rules?

9. What explicit source rules are found in tax treaties? Consider Articles 6, 7, 10-12, 15 and 21 in particular. For articles that do not refer explicitly to the source of income, is source irrelevant? Is the income that a country can tax under Article 7 restricted to income derived from sources in that country?

10. Is the source of expenses relevant under Article 7? How is the source of an expense determined?

11. How, if at all, are source rules relevant for the elimination of double taxation?

12. How do Australian treaties deal with source of income issues?

Reading

Australia-UK tax treaty Article 21 source of income
Australia-India tax treaty Article 23 source of income
Tech Mahindra Ltd v Federal Commissioner of Taxation (2016) 103 ATR 813
*Satyam Computer Services v Federal Commissioner of Taxation* [2018] FCAFC 172

Treasury Laws Amendment (International Tax Agreements) Bill 2019, Explanatory Memorandum, ch. 2 Australia’s deemed source rule

**Further Reading**

Avery Jones et al., Tax Treaty Problems Relating to Source [1998] no. 3 *British Tax Review* 222-50


6. **The Concept of Permanent Establishment**

- Article 5 of the OECD Model
- fixed place of business
- agency PEs
- services PEs
- BEPS Action 7 Preventing the Artificial Avoidance of Permanent Establishment Status

**Questions and Problems for Discussion**

1. What is a fixed place of business? Can an entire country, city, forest, road, building, office in a building, ship, or equipment (such as a computer) be a fixed place? What is necessary for a fixed place to be a place of business? Is it necessary for the taxpayer to own or rent, or somehow have a legal right to use a place? How long must a fixed place of business continue to be a PE?

2. What is the function of the PE requirement?

3. Why are preparatory and auxiliary activities excluded from the definition of a PE?

4. Why are dependent agents considered to be PEs?

5. Would it make sense to deem a subsidiary to be a PE of its nonresident parent and vice-versa?

6. How relevant is the permanent establishment concept in an era of globalization, the telecommunications revolution and electronic commerce?

7. What do you understand by the term “enterprise” that is used throughout tax treaties?

8. A Utopian telecommunications company has a satellite over the Atlantic Ocean by which telephone calls are transmitted between Utopia and Ruritania. It has no ground station in Ruritania. Does the company have a permanent establishment in Ruritania? Would it make any difference if there were a ground station in Ruritania owned by the company which operated completely automatically and was repaired when necessary by Ruritanian companies (that is, the Utopian company does not have any employees in Ruritania)?

9. A Nusquam television company transmits via satellite to subscribers in Ruritania. The satellite is in space over Ruritania. Does the Nusquam company have a permanent establishment in Ruritania?

10. Telecom Europa Ltd (“TE”), resident outside Australis, markets telephone calling cards in Australis. TE has rented a toll-free number from Telecom Australis Ltd (“TA”), a telecommunications company operating in Australis. TE pays TA a rental fee for the number. TE does not have any employees in Australis. TE markets its services through advertising in magazines circulated in Australis. A calling card issued to a customer in Australis is connected with the customer’s credit card and billed through that card. A customer in Australis who wishes to acquire a TE calling card fills in the application in the magazine advertisement and posts it to TE’s head office overseas.
Alternatively, a customer may complete an on-line application by accessing TE’s web site the details of which are provided in the advertisement. Applications are approved by TE’s computer at head office according to criteria established by TE and the relevant credit card company. A customer in Australis who is issued with a calling card calls TE’s toll-free number in Australis. The call is then diverted by a computerised operation to TE’s facility at head office which then connects the customer to the number that he or she wishes to call. The number called may be anywhere (including Australis). The connection to the number called is made either through a computerised operation or through a staffed switchboard, both of which are in Australis. Does TE have a PE in Australis?

11. Constructors Ltd, resident outside Australis, has been awarded the contract to construct a housing complex for athletes for the Year 2XXX Olympic Games to be held in Australis. Construction is expected to take 9 months. Constructors engages Engineers Ltd, also resident outside Australis, to supervise the project. Consider the Australis tax liability of Constructors and Engineers. What if construction of the complex takes 13 months due to adverse weather conditions or industrial problems? What if, after completion of the complex within 9 months, Constructors is awarded a contract to construct athletes’ housing at another Olympic site in Australis? It is expected that construction of this complex will also take 9 months. Constructors uses a different firm of consulting engineers for this project. What if the contract for the second complex was awarded shortly after construction commenced on the first complex?

12. Equipment AG is incorporated and managed in Europa. It sells manufacturing equipment to persons in Australis. The equipment comes with a two year warranty. Equipment sets up a repair workshop in Australis. The workshop carries out repairs under warranty on equipment it has sold. No charge is made for these repairs. It also carries out repairs on the equipment outside the warranty period and charges cost plus 20% for such services. Does Equipment have a permanent establishment in Australis?

13. Veuve Cliquot SA is a French company that produces champagne. A significant portion of its sales are made to customers in the US. Veuve Cliquot advertises its products in a variety of US publications. It has wine-tasting showrooms in New York and San Francisco staffed with employees. These employees also travel throughout the US to put on wine tastings and otherwise promote Veuve Cliquot’s wines. The company also has an inventory of wine in a New York warehouse from which US orders are filled. Customers interested in purchasing the wines are invited to fill out order forms, which are sent to Veuve Cliquot’s Paris headquarters for acceptance. US personnel do not have authority to conclude contracts. Does Veuve Cliquot have a PE in the US?

14. What is a commissionaire arrangement? Can such arrangements be successfully structured for inbound investment into common law countries?

Reading

OECD Commentary on Article 5

Knights of Columbus v The Queen [2008] TCJ 307 (Tax Court of Canada)

The Queen v Dudney [2000] 2 CTC 56 (Federal Court of Appeal)
McDermott Industries v Commissioner of Taxation [2005] FCAFC 67 (Full Federal Court of Australia)

Dell Products Case HR-2011-02245-A, 2 December 2011 (Supreme Court of Norway)

G20/OECD BEPS Action 7, Preventing the Artificial Avoidance of Permanent Establishment Status (2016)

Multilateral Instrument, Avoidance of Permanent Establishment Status, Articles 12, 13, 14 & 15

Further Reading

Zimmer (Nos. 304715, 308525, March 31, 2010 – Conseil D’État) (French Supreme Administrative Court)

DIT (International Taxation) v Morgan Stanley 2007 TIOL-125-SC-IT (Supreme Court of India)

CIR v Consolidated Premium Ores, Ltd 265 F.2d 320 (6th Cir. 1959) (US Court of Appeals, Sixth Circuit)


OECD, Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention on Article 5 (2001)


7. Attribution of profits to permanent establishments and transfer pricing

- Former Article 7 of the OECD Model
  - Pre-2008 OECD Commentary
  - 2008 OECD Commentary
- Article 7 of the OECD Model and Commentary
- Article 14 independent personal services article in US tax treaties, repealed in the OECD Model

Questions and Problems for Discussion

1. To what extent does Article 7 provide rules for taxing profits from a business carried on by a non-resident for this purpose? How do Articles 7 and 9 interact? Can the principles established for Article 9 in the OECD Transfer Pricing Guidelines apply to Article 7 without modification?

2. Do you agree with the results in the following Cudd Pressure (Canada)? Did they depend on any peculiarities of the treaties in question?

3. Manufactures Ltd which is resident in Europa has a branch in Australis. The branch pays a charge to head office covering the following:
   (a) interest at 10% on a “loan” of part of the branch’s capital by head office;
   (b) a foreign exchange loss on profits of the branch repatriated to head office;
   (c) fee for accounting services provided by head office (including a markup on cost);
   (d) prorated share of other head office expenses (including the salary of Manufactures’ CEO);
   (e) $10 per item as cost of goods sold (the cost of manufacture on an absorption cost basis at head office being $7.50).

Manufactures pays a patent royalty of $100,000 to a related company in Ruritania in respect of manufacturing operations carried on by the branch. Manufactures has total external interest costs of $5,000,000 and it allocates in its financial accounts in accordance with Europa tax law a pro rata share of $500,000 of this interest to the branch in Australis based on its worldwide operations. To what extent is deduction of these expenses required, permitted or prohibited under tax treaties? The local tax administration has disallowed the first and second deductions as not being relevant under Australis law and treaties, disallowed the third and fourth deductions on the basis that they are included in the cost of manufacture and reduced the fifth deduction to $7.50. Manufacturers also wishes to know whether it is possible to be taxed on a profit in Australis when overall it makes a loss if the results in Europa and Australis in relation to products sold in Australis are combined.
4. For each question in the previous session concerning the existence of a PE, how would you calculate the profits attributable to the permanent establishment, assuming that there is a permanent establishment?

5. Why do tax treaties often contain special provisions dealing with insurance enterprises (see Article 5(6) of the UN Model)?

6. If a foreign company carries on its business in Australis through an unrelated agent which is not an agent of independent status within the tax treaty meaning and constitutes a permanent establishment of the company, what profits (if any) can be attributable to the permanent establishment? What difference, if any, does it make if the agent is an associate of the foreign company?

7. What obligations, if any, does article 9 impose on a Contracting State? How does it differ from article 7?

Reading
OECD former Article 7 and Article 7
OECD Commentary on Article 7 (2017) paras. 1-43, Annex (Commentary on former Article 7), pp. 199-218

*Cudd Pressure Control Inc. v The Queen* [1995] 2 CTC 2382, [1999] 1 CTC 1 (Federal Court of Appeal) (attribution of profit to a permanent establishment)

Further Reading

*Thiel v Commissioner of Taxation* [1990] HCA 37 (High Court of Australia)
IFA Cahiers 2006
8. The Taxation of Income from Services

- Article 14 of the OECD Model
- income from employment
- income from independent services (former Article 14 of the OECD Model)
- income from entertainment and athletic activities (Article 17 of the OECD Model)

Questions and Problems for Discussion

1. Note the conditions for the exemption of non-resident employees in Article 15(2). Can a non-resident employee of a resident employer qualify for the exemption?

2. When is the salary of an employee borne by a PE?

3. What does “present for a day” mean for purposes of Article 15(2)?

4. How is the distinction between employees and independent contractors made for the purpose of Article 15? What Article of the treaty applies to independent contractors? Does the different treatment of employees and independent contractors make sense?

5. Compare Articles 5(3)(b) and 14(1)(b) of the UN Model.

6. What is a month? Does part of a month count as a month? Does the twelve-month period beginning 15 January 2008 end on 15 January 2009 or 16 November 2008 (the latter being 12 periods of 28 days)?

7. The 2008 Update of the OECD Model contains an alternative provision deeming a PE to exist in certain circumstances where a resident of one country performs services in the other country. Does this provision make sense? The United States is opposed to the provision although it has agreed to include a similar provision in the treaty with Canada, presumably at Canada’s insistence. What is the difference between the two aspects of the OECD provision? Why are both necessary? Compare the OECD provision and Article 5(3)(b) of the UN Model.

8. What is the threshold for taxing income from entertainment and athletic activities under Article 17? Why is there a special provision for such services? What is the reason for Article 17(2)?

9. Are the following persons engaged in entertainment or athletic activities?

- fashion models
- snooker or chess players
- former politicians (eg, Bill Clinton)
- film directors
- TV and radio sports commentators?

Reading
OECD Commentary on Article 15 and 17

**Further Reading**


9. Dividends, Interest, Royalties, Capital Gains and Other Income

- Article 10 (dividends), Article 11 (interest) and Article 12 (royalties) of the OECD Model
  - characterization of income
  - beneficial ownership
  - withholding tax
- Article 13 (capital gains)
  - immovable property
  - shares
  - movable property
- Article 21 Other income

Questions and Problems for Discussion

1. Under what article of tax treaties are the following dealt with: “interest” paid on perpetual debt, participating debt, or convertible bonds; “dividends” on redeemable preference shares; currency and interest rate swap payments (net or gross); distributions on liquidation of a company? What further information do you need to answer these questions? What is the relationship between the classification under domestic law and under tax treaties? To what extent do more recent treaties deal with modern financial instruments?

2. What is the relationship between Articles 7, 11, and 21?

3. A foreign bank has entered into an agreement with a bank resident in Utopia to ensure availability of local currency for payments due by clients of the foreign bank. The foreign bank makes regular transfers of money to the bank in Utopia. This bank is entitled to invest money until it receives payment orders from the foreign bank. If it does invest the money and earns income, then the foreign bank is entitled to a fixed share of the income earned. The foreign bank has no branch or other operations that relate to Utopia. Do tax treaties limit the tax that Utopia can charge the foreign bank on the amounts it receives as a share of the income earned by the Utopian bank?

4. Computers Ltd, incorporated and managed in Europa, is a manufacturer of computer hardware. Computers has appointed Distributor Ltd (an unrelated Australis resident company) as the sole distributor of Computers’ products in Australis. Distributor purchases Computers’ products in its own right and resells to its customers. Computers maintains an office in Australis solely for the purposes of advertising and promoting its products there. Computers has lent money to Distributor to assist it in its business as Computers’ distributor. Negotiations for the loan were conducted at the Australis office of Computers. The loan agreement is executed in Europa and the loan funds advanced there. What are the Australis tax treaty consequences?
5. Advise on the Australis tax treaty consequences in the following situations involving M&M Co which is incorporated and managed in Europa:

(a) M&M has a permanent establishment in Australis which derives interest from a bank in Utopia.

(b) M&M has a permanent establishment in Australis which derives interest from a bank in a country with which neither Australis nor Europa have tax treaties.

(c) M&M has a permanent establishment in Utopia which derives interest from a bank in Australis.

(d) M&M has a permanent establishment in a country with which neither Australis nor Europa have tax treaties which derives interest from a bank in Australis.

6. An Australis subsidiary of a Nusquam company has a licence to use a patent owned by the latter. The royalty is 20% of the sale price of items produced using the patent. There is evidence that the Nusquam company in a comparable transaction has licensed an unrelated company in a third country to use the same patent for 10% of the sale price of items produced. The Nusquam company also has a branch in Australis involved in providing financial services to Nusquam owned companies operating in Australis. Occasionally a technician employed by the Nusquam company who assists the Australis subsidiary in exploiting the patent uses an office in the branch when he visits Australis. How may the royalty payments be taxed under tax treaties in UN Model form?

7. A Utopian resident author of a text on tax law transfers the worldwide copyright to a Utopian publisher in exchange for a payment of 15% of the sale price of copies sold by the publisher. The publisher which does not have an office or agent in Australis sells 1,000 copies of the text to an independent bookseller there for $100 a copy, and pays the author $15,000 as a result. Are any of these amounts taxable in Australis under tax treaties which are in UN Model form?

8. A property investment company resident in Utopia has an office in Nusquam which engages in buying and then renting properties there (financed as to 75% by loans from local financiers). Nusquam levies income tax on rents and gains on sale of immovable property by means of a flat rate gross final withholding tax of 10% (of rent or proceeds of sale). Would tax treaties between the countries affect the application of the domestic law of Nusquam?

9. A land dealer resident in Utopia as part of its business regularly buys and sells real estate in the neighbouring country Australis on the advice of various real estate agents in Australis. The land dealer otherwise has no presence in Australis. Are the profits on sale taxable in Australis?

10. What would be the result on the facts of Thiel and Lamesa Holdings BV under the OECD and UN Models? Would it make any difference in Thiel if the trust and company involved were vehicles for holding real estate?

11. DPF BV is a company incorporated and controlled in Europa. It invests in shares and other securities on a worldwide basis. For investments in Australis, it receives investment advice from Wanker Ltd, uses the broking services of Broke Partners and holds assets through Bank Nominees Ltd, a subsidiary of an Australis bank which is used as a street name for foreign investors and performs custodial functions in relation to scrip etc. Some of the investments are in
startup companies and venture capital companies for which purpose executives of DPF come to Australis every three months to meet with their advisers, meet the owners of the startup and venture capital companies, and generally to superintend the Australis investment operations. While the executives are in Australis, they make decisions on the more risky investments and authorize their agents to proceed with the transactions (or not as the case may be). In the case of start-up companies, DPF usually holds 20-50 per cent of the share capital and plays a part in selecting senior staff. Does DPF have a PE in Australis? Are its income and capital gains on investments otherwise taxable in Australis?

12. McTavish Pastoral Co Ltd. is a company incorporated, and managed and controlled in Europa. It has a wholly-owned subsidiary, McFarmers Ltd., which is also incorporated in Europa. The directors of McFarmers are all Europa residents and directors meetings are held in Europa. The main asset of McFarmers is a large pastoral property in Australis. The property was acquired by McFarmers in 1986. McFarmers has appointed a local manager to run the property. While the local manager has broad powers of management, all major decisions, particularly those involving the acquisition of capital equipment, are made by the directors in meeting in Europa.

The property has not been operating profitably for the last few years and the directors have decided to cease operations in Australis. In recent years, the area has become a popular tourist and retirement destination and this has resulted in a substantial increase in land values. For this reason, it is decided not to sell the pastoral property as a going concern; rather, the assets of the business are to be sold separately. The livestock and capital equipment are sold to unrelated persons in Australis and Republica under contracts of sale executed in the country of residence of the purchaser. Some capital equipment was sold for a price above acquisition cost, while other equipment was sold for prices above the written down value of the property for tax purposes, but below acquisition cost.

The directors are considering three options for the disposal of the land –

(a) The sale of the whole land as is to a single purchaser.

(b) The subdivision of the land into residential lots and the sale of those lots. Under this proposal, the company would engage a local real estate agent to manage the subdivision. The agent would: make application to the local council to have the zoning of the land changed from primary production to residential; engage a firm of surveyors to “peg” out the lots; engage a firm of engineers to advise on a source of water supply for the subdivided lots and the provision of electricity, sewerage, and natural gas; and engage contractors to connect those services to the lots.

(c) As an alternative to (a), the sale by McTavish of its shares in McFarmers.

Advise all concerned on the Australis tax consequences under tax treaties, including the three options for realisation of the land.

Reading
OECD Commentary on Articles 10, 11, 12, 13 and 21
MLI, Article 8 Dividend transfer transactions, Article 9 Capital gains from the alienation of shares or interests of entities deriving their value from immovable property

*Prévost Car Inc v The Queen* [2010] 2 FCR 65


*Deutsche Asia Pacific Finance Inc v Commissioner of Taxation (Cth) (No 2)* (2008) 172 FCR 336

*Tech Mahindra Ltd v Federal Commissioner of Taxation* (2016) 103 ATR 813

*Satyam Computer Services v Federal Commissioner of Taxation* [2018] FCAFC 172

*Thiel v Commissioner of Taxation* [1990] HCA 37 (High Court of Australia)

*FCT v Lamesa Holdings BV* (1997) 35 ATR 239, 36 ATR 589 (Full Federal Court of Australia)


*Virgin Holdings SA v Commissioner of Taxation (Cth)* (2008) 214 FCR 278

**Further Reading**

*Resource Capital Fund III LP v FCT* [2013] FCA (Federal Court of Australia)


10. Relief of double taxation

- Elimination of double taxation
- OECD Model Article 23 A, the exemption method
- OECD Model Article 23 B, the credit method
- tax sparing

Questions and Problems for Discussion

1. What are the differences between the credit and exemption methods? What method does Australia use in its domestic law?

2. Under the foreign tax credit system or alternatively the exemption system operating in a country what provision (if any) is appropriate in double tax treaties in relation to the following matters:
   (a) foreign business income derived by residents of a country;
   (b) foreign dividend income derived by companies resident in a country with an interest in the foreign company in excess of the limit referred to in the equivalent of OECD Model article 10(2)(a) in the country’s tax treaties;
   (c) foreign employment income;
   (d) foreign interest and royalty income?

   To what extent does the answer depend on the domestic tax law of the country?

3. Is it necessary that tax treaties closely mirror the system for relief of double taxation in domestic law? What is the effect of words such as “subject to the provisions of the law of X in relation to the relief of double taxation but not so as to affect the general principle hereof” which appear in the tax treaties of a number of common law countries? Can a country comply with its tax treaty obligations by including a credit relief article and operating an exemption system in practice, or vice versa?

4. Is the Erwin case right or wrong, and why?

5. You have been hired to advise a developing country Nusquam which is currently negotiating tax treaties with five different countries which have the following systems for unilateral relief of double taxation:
   (a) Country A - exemption for all foreign sourced income except investment income that is taxed at reduced rates under tax treaties to which a foreign tax credit is applied;
   (b) Country B - exemption for all foreign sourced business and employment income that is taxed in the country of source and a foreign tax credit for all other income;
   (c) Country C - as for B but with an additional exemption for direct investment dividends (that is, dividends received by a resident company holding 25% or more of the capital in the foreign company);
   (d) Country D - a foreign tax credit (including a tax credit for underlying foreign company tax) using a worldwide foreign tax credit limit; and
(e) Country E - a foreign tax credit without a tax credit for underlying foreign tax and with a country by country and item by item foreign tax credit limit.

Nusquam has the following tax incentives in place for foreign investors: five year tax holidays in the manufacturing and high technology sectors; accelerated depreciation in the tourist and entertainment sectors; and relief from interest and royalty withholding taxes in relation to approved investments. You wish to ensure that the benefit of these tax concessions are preserved for the foreign investors and are not transferred to the treasury of the foreign country through the operation of the tax system of the foreign country. What kinds of provisions would be appropriate for this purpose in Nusquam’s treaties with A, B, C, D and E? Is it possible to achieve better than simple preservation of the incentives by the way the treaty is framed?

6. Explain the type of relief provided in Article 23 of the treaty with Canada as amended by the 2002 Protocol.

7. Is tax sparing an appropriate tax treaty policy?

Reading

OECD Commentary on Article 23 A and 23 B
MLI Article 5 Application of methods for the elimination of double taxation

Further Reading

*Erwin v The Queen* [1998] 2 CTC 2112 (Tax Court of Canada)


11. **Mutual Agreement Procedure**

- Article 25 (mutual agreement procedure) of the OECD Model
- features of mutual agreement procedures
- compulsory arbitration

**Questions and Problems for Discussion**

1. What is the mutual agreement procedure?
2. What obligation is placed on the competent authorities to resolve the double taxation?
3. What is the benefit of arbitration?
4. What are the main double tax disputes resolved through the mutual agreement procedure?

- Article 25 (mutual agreement procedure) of the OECD Model
- features of mutual agreement procedures
- compulsory arbitration

**Reading**

OECD Commentary on Article 25
MLI, Improving Dispute Resolution, Articles 16 & 17

**Further Reading**

BEPS Action 14, Final Report 2015
12. **Anti-Tax Avoidance Measures, Exchange of Information**

- specific anti-avoidance rules in tax treaties
- relationship between domestic anti-avoidance rules and tax treaties (CFC rules, judicial doctrines (substance over form), special anti-avoidance rules)
  - Preamble
  - Principal purpose test
  - Limitation on benefits
- Multilateral instrument, Articles 7
- Inclusive Framework
  - Minimum standards, BEPS Action 6
- Article 26 (exchange of information) of the OECD Model

**Questions and Problems for Discussion**

1. What is “fiscal evasion”? How do tax treaties prevent fiscal evasion?
2. Do tax treaties contain anti-avoidance rules?
3. Can a country apply its general domestic anti-avoidance doctrines/rules to situations covered by tax treaties without being in conflict with the treaties?
4. Why does the US insist on an anti-treaty shopping provision in its tax treaties? How does the provision compare to application of domestic anti-avoidance rules or an abuse of treaties doctrine?
5. Are controlled foreign company and foreign investment fund regimes in conflict with tax treaties? Why has the OECD recommended that its Members adopt such regimes?
6. Is there such a thing as harmful tax competition? Are the measures suggested by the OECD appropriate to deal with the issue? What do those measures suggest about the relevance and future of tax treaties as the pre-eminent mechanism for dealing with international tax problems?
7. What is the purpose of exchange of information?
8. Is fishing for information allowed?
9. What the various types of methods for the exchange of information?

**Reading**

OECD, Introduction and Commentary on Article 1

MLI,
Australia-US Treaty Articles 1, 16, 27

Prévost Car Inc. v The Queen 2009 FCA 57 (Canada: Federal Court of Appeal)

Further Reading
IFA, Limits on the use of low tax regimes by multinational businesses (2001) LXXXVIb cahiers de droit fiscal international pp. 73-88
IFA, Form and Substance in Tax Law (2002) LXXXVIIIa cahiers de droit fiscal international


OECD, Controlled Foreign Company Legislation (Paris, 1996)


13. **Non-discrimination**

- Article 24 of the OECD Model
- importance of principle; extent of treaty protection
- national treatment versus most-favored-nation treatment
- practical application to provisions of domestic law

**Questions and Problems for Discussion**

1. What is the purpose of the nondiscrimination article?
2. Why, until recently, did Australia not include nondiscrimination articles in its treaties? Why was such an article included in the US treaty?
3. What is the major difference between the nondiscrimination articles in the UK and US treaties?
4. Are the following contrary to the non-discrimination article in the OECD Model:
   - a higher rate of tax on non-resident companies compared to resident companies
   - a higher rate of tax on companies incorporated abroad compared to companies incorporated locally
   - a branch profits tax of five percent on the after-tax taxable income of a permanent establishment of a non-resident company
   - a branch profits tax of 30 percent on remittances of profits by a permanent establishment
   - a branch interest tax of 30 percent on the excess of the interest claimed as a deduction by a permanent establishment over the amount of such interest subject to interest withholding in the country of the permanent establishment
   - a 30% withholding tax on gross interest payments to nonresidents
   - a withholding tax on dividends paid to a nonresident corporation if dividends to resident corporations are deductible
   - an exemption for capital gains realized on principal residences that is restricted to residents
   - withholding on payments to nonresidents rendering services
   - a denial of interest deductions for interest paid to non-residents that control or are controlled by the taxpayer
   - tax credits for research and development conducted in your country
   - tax credits for research and development conducted by companies incorporated in your country; or tax credits for research and development conducted by companies controlled by residents of your country
5. A Utopian company with a permanent establishment in Nusquam sells goods manufactured by its factory in Nusquam through a shop in a neighbouring country, Australis. Tax is paid in Australis on one half of the profits arising
from the sale of the goods. How much of the profit, if any, would be taxable in Nusquam under tax treaties? Can the Utopian company claim a foreign tax credit or exemption in Nusquam against its tax liability in respect of the tax paid in Australis?

6. Why does the OECD Model use varying expressions to describe the comparison situations in the non-discrimination article (in the same circumstances, carrying on the same activities, under the same conditions, other similar enterprises)?

7. Why does the OECD Model use varying expressions to describe the level of protection in the non-discrimination article (taxation or any requirement connected therewith, other or more burdensome taxation, taxation not less favorably levied)?

8. Why is the non-discrimination article in the OECD Model extended to all taxes?

Reading
OECD Commentary on Article 24
US-Australia Treaty Article 23
Addy v Commissioner of Taxation [2019] FCA 1768

Further Reading

IFA, Non-discrimination rules in international taxation, (1993) LXXVIIIb cahiers de droit fiscal international pp. 19-71