General report

PASQUALE PISTONE

Introduction

Tax treaties have developed considerably throughout the twentieth century, based on the assumption that states need an agreed legal instrument to coordinate the exercise of taxing powers and thus minimize overlaps and the negative influence of taxation on cross-border economic activities. In particular, the impetus for international tax coordination grew steadily in the second half of the twentieth century under the auspices of international organizations, such as, in particular, the OECD and the UN. The OECD and the UN continued the technical activity undertaken in the framework of the League of Nations and drafted their Model Tax Conventions, which are currently the main source of tax treaty clauses around the world. Such Models are the outcome of technical activities carried out in working parties, which include representatives from the tax authorities and from business, and are usually regarded as the set of tax treaty rules that most consistently reflects the international tax policy of the member countries. Accordingly, the Models are generally regarded as the best available tax treaty practice. This reputation has enhanced their implementation in bilateral tax treaties over the past decades, showing that international tax law in fact shares a common substance to a much greater extent than it may appear in the absence of a proper international customary tax law. This structural peculiarity makes such Model Tax Conventions the soft source of international tax rules, which then find their normative dimension in the bilateral tax treaties that include them.

Over the past decades this structural peculiarity has gradually expanded to a global dimension. The era of global law and worldwide free trade with decreasing tax barriers for cross-border activities makes states very concerned about the need to have a global tax system which is able to compete with best practices and offers an attractive legal environment to internationally mobile capital. This is even more the case since harmful tax regimes started being dismantled and global fiscal transparency picked up.

This process is beginning to take on the features and substance of a multilateralization of tax treaties, in particular when it comes to clauses that do not affect the allocation of taxing powers, where the OECD has succeeded in achieving an effective worldwide consensus, as recent developments on arbitration in taxation and, even more evidently, on global fiscal transparency show.[1]

As the national reports indicate, the influence of the OECD Model Tax Convention on Income and on Capital (OECD Model) on the general structure and clauses of bilateral tax treaties has gradually gained in importance so that it now affects those concluded with or even between non-OECD Member countries. Meanwhile, the overall influence of the United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model) has gradually declined, with its residual role confined only to a limited number of bilateral tax treaties or to some specific clauses. In particular, UN Model clauses can still be found in the treaties between some non-OECD countries that wish to preserve a stronger taxing sovereignty of the state of source or of some OECD countries, that maintain a separate tax treaty policy for their relations with some net capital-importing countries, in order to foster the economic development of such countries.[2] Several reasons exist for this phenomenon, including in particular the stronger negotiating powers of OECD countries, which pursue the defence of allocation rules patterned on the OECD tax treaty policy, but also the more proactive attitude of the OECD, which is constantly refining its Commentaries through the activity of its working parties.[3] The following analysis is therefore in principle centred on the influence of the OECD Model on bilateral tax treaties and occasionally includes some specific remarks that are also relevant for the UN Model.

The tax literature has accompanied this development by initiating a worldwide technical debate on legal issues raised by the interpretation of tax treaties, focusing particular attention on the clauses included in the Models. By contrast, the technical debate did not reach the same degree of intensity on two issues, which are central from the perspective of our analysis.

[1] See further on this section VIII of this General Report and of the country reports, in particular on the standards for exchanging information set by Article 26 of the OECD Model.

[2] A very good example of this can be found in the shared allocation of taxing powers provided for by Article 12 on royalties, which is perhaps the UN provision exercising the strongest influence on bilateral tax treaties.

[3] Nevertheless, there are several clauses of the OECD Model that are either seldom or never included in bilateral tax treaties. This is the case, for instance, for Articles 9(2), 12(1), 24(2) and 27, as well as to a minor extent for the reference to the place of incorporation as a tie-breaker rule under Articles 4(3), 18 and 23A(4). Furthermore, peculiar issues arise as to Article 14, which was deleted in 2000 from the OECD Model and is instead often kept in post-2000 bilateral tax treaties, in several cases with the wording of the pre-2000 version of the OECD Model. This gives rise to technical uncertainties as to the scope of Articles 7 and 14, as well as to the full relevance of the corresponding OECD Commentaries to such articles, only one of which keeps being updated. For more information on this, see section III of this General Report.

First, clauses not patterned along the schemes of the Models are often relegated to a regional debate or are only analysed from the perspective of their consistency with the national tax treaty practice of the states.[4] Second, the determination of the actual boundaries of the influence of (each of the) Models is still significantly underexposed in international tax law. This often leads to an incorrect *a priori* general conclusion that tax treaties are what the Models say they are. Despite the undoubted growing importance of the Models, one may not ignore the still large grey areas where legal uncertainty rules and international tax planning is often used as a solution to overcome the mismatches and overlaps that otherwise generate economic distortions and double taxation.

The approach to such problems requires a detailed analysis of tax treaties based on a common pattern in order to facilitate an immediate comparison among the various tax treaty options available in the various countries.[5] This chapter will guide the readers through the technical maze of the bilateral tax treaty provisions analysed in this book and will highlight critical issues, common points and differences contained in Models and bilateral tax treaties around the world.[6] Together with the opinions and technical information concerning the bilateral tax treaties covered by the national reports included in this book, this General Report will include the views of the author, also based on a comparison among the country reports or of relevant technical elements put forward by the tax literature.

The articles of the OECD and UN Models constituted the starting point for the drafting scheme of this book, which was then further refined by using the subdivisions that have become commonly used in tax literature.[7] In particular, this resulted in a structure in which all chapters are divided into eight sections, which focus on: 1. the relevance of the OECD and UN Models

[4] The author believes instead that in several cases the international tax literature should reconsider the debate on such clauses, especially taking into account their very wide diffusion in bilateral tax treaties. For instance, this is the case for tax sparing clauses, the entitlement of entities other than individuals and companies to treaty benefits, the tax treatment of cross-border income from services, and also of the rules for relieving the double taxation in cases not covered by the Model Tax Conventions (such as economic double taxation), the use of most-favoured nation clauses, the boundaries of mutual agreement procedures and types of arbitration in bilateral tax treaties.

[5] All chapters were drafted on the basis of a common questionnaire.

[6] Accordingly, all tax treaty clauses and specific areas not giving rise to critical issues or major discrepancies at a global level will be hereby either superficially mentioned or omitted.

[7] For this reason, distributive rules contained in tax treaties were grouped under the two main umbrella provisions of Articles 7 and 15 dealing with business income and income from employment, respectively. Likewise, rules contained in the final chapter of the OECD and UN Model Tax Conventions have been separated into two chapters, focusing on the non-discrimination principle and the provisions on mutual agreement procedures and international mutual assistance in tax matters.

and their Commentaries for the interpretation of tax treaties; 2. the personal and material scope of tax treaties; 3. business profits and income from other independent activities; 4. passive income; 5. income from employment and other dependent activities; 6. methods for relieving double taxation; 7. non-discrimination; and 8. mutual agreement and international mutual assistance in tax matters.

I The relevance of the OECD and UN Model Conventions and their Commentaries for the interpretation of tax treaties

Before analysing whether tax treaty clauses contained in bilateral and multilateral tax treaties follow or depart from the Models, this section will preliminarily ascertain the relevance of such Models for the interpretation of clauses that follow their structure and/or wording. Although the differences in understanding the scope of Article 3(2) of the OECD and UN Models are acknowledged, this section will not specifically address them.

The influence of the Models on the interpretation of tax treaties is perhaps one of the most controversial issues in international tax literature, leading to a significant volume of judicial decisions around the world, and is based on the assumption that one of the Models influenced the drafting of a bilateral treaty. Unless specified otherwise, we will assume that the wording of tax treaty clauses matching those of either Model is the intentional outcome of tax treaty negotiations that took the Model into account.[8] Accordingly, the technically correct interpretation of the Model should be relevant in order to determine the interpretation of such bilateral and multilateral treaties.

A good way to approach the influence of the Models on the interpretation of tax treaties is to look at whether legal elements external to a tax system can affect the interpretation of its rules. An IFA seminar analysed this issue in international taxation,[9] comparing the influence of the Models with that of foreign court decisions on the interpretation of tax treaties. Enormous differences could be seen around the world, ranging from countries that consider the interpretation of OECD-like tax treaty clauses to be technically correct only when complying with the criteria provided by the OECD to those that instead regard the OECD interpretation as one of the many relevant elements to be taken into account when interpreting tax treaties.

The national reports confirm this, in particular as to the differences between the influence of the Models and that of clarifications contained in

[8] The author acknowledges that only in some countries is this explicitly acknowledged. However, the empirical approach of this report to the problem suggests that even in the countries that do not specifically accept this, a perfect match with the Model clauses is almost never a mere coincidence.

[9] IFA, 2008 Congress, Seminar F, 'The Use of Foreign Court Rulings for Tax Treaty Interpretation Purposes', unpublished.

their Commentaries, dynamic and static interpretation of tax treaties,[10] the value of reservations and observations, often including, on a more nuanced basis, the positions held by the administrative and judicial practice. Some general trends can be detected and are now briefly reported, together with some relevant elements arising from the national reports.

Countries like Canada,[11] the Netherlands[12] and the UK[13] give the OECD Model and its Commentaries an almost binding value. Other countries, such as Australia,[14] the Czech Republic[15] and Germany,[16] do so to a lesser extent,

[10] The importance of this dichotomy has exponentially grown since the time that the OECD significantly increased the frequency of amendments to the Commentaries on the Model Tax Convention. The author believes, however, that the key issue in such difference is not just finding out which one is technically more in line with the obligations undertaken by a state, since technical arguments duly back up both theories. The issue is rather whether OECD Commentaries actually interpret or, by contrast, revise the substance of clauses contained in the Model.

[11] As the Canadian report indicates, in the *Crown Forest Industries* case the Supreme Court of Canada acknowledged the high persuasive value not only of the OECD Model but also of its Commentaries when interpreting the definition of residence under the tax treaty with the USA (p. 206). More recently, the Federal Court of Appeal, in the *Prévost Car* case, defined the OECD Model and its Commentaries as a widely accepted guide to the notion of beneficial ownership in tax treaties (p. 207). Further Canadian decisions also compare the wording of the OECD and UN Models to empirically show that in general the former does not have the same influence on Canadian tax treaties (p. 208).

[12] Since 1992 the Netherlands Supreme Court considers the OECD Model and its Commentaries of significant relevance for the interpretation of tax treaties based upon them, generally acknowledging the dynamic theory of interpretation. This view was expanded in 2003 to treaties with non-OECD countries (Brazil and Nigeria), as well as *a fortiori* to more recent tax treaties (such as that concluded in 2006 with Barbados) that specifically indicate that both contracting states are bound to follow the OECD Commentary. The same type of clause is included in the protocol to the tax treaty between Austria and New Zealand, as the New Zealand report indicates (p. 736).

[13] The UK national report indicates that this is in particular the position of the HMRC on the OECD Model (reaching the opposite conclusion for the UN Model and its Commentaries), whereby courts and academics have taken a more nuanced view on the matter, but affirming in general the reliance from 1984 onwards (p. 1102). The Hong Kong report suggests that judicial decisions of common law countries, in particular the UK, may also indirectly affect the position that Hong Kong courts will take in the future on the matter (p. 502).

[14] As the Australian reporters indicate, in the *Thiel* case the High Court of Australia concluded that the OECD Model provides a guide to the current usage of terms used by the parties in the tax treaty with Switzerland and, in the *Lamesa Holdings* case, the Federal Court of Australia reached a similar conclusion on that with the Netherlands (p. 69).

[15] See further the report from the Czech Republic (p. 325).

[16] Nevertheless, this judicial view is criticized by tax literature, which supports a stronger relevance of the OECD Model and its Commentaries, as the German report indicates (p. 468).

often regarding both rather as a supplementary means of interpretation.[17] Other countries, such as France,[18] Italy[19] and Slovenia,[20] ascribe a more limited importance to the OECD interpretation, in some judgments even considering it to have a similar value to that of authoritative tax academics. It should also be noted that in a growing number of countries, including a likewise growing number of non-OECD countries such as Brazil, Colombia, Peru, Russia and Serbia among those covered in this book, there is a general awareness of the technical interpretation based on the Model(s) (in particular that of the OECD), which permits their use among the arguments discussed in court, though without a decisive influence. A stronger technical consideration of the OECD Model can instead be noted in a limited number of non-OECD countries, in particular India. Besides such differences, the author sees a growing trend to use the OECD Model as a vehicle to aggregate the rules of all tax treaties around some consolidated and homogeneous legal standards, thus facilitating a voluntary building-up of internationally accepted standards. This approach minimizes the relevance of domestic law to mismatches in tax treaty interpretation, achieving in fact consistency across bilateral tax treaties, and it secures legal certainty while preventing interpretative disputes. The author positively regards the fact that OECD Member countries put reservations on the articles or observations on the interpretation given by the Commentaries when they do not agree with the content, since this achieves some transparency as to how such states will carry out their own tax treaty practice at the bilateral level.[21]

All such desirable results should, however, remain subject to an effective correspondence between the text of bilateral tax treaties and that of the Models, as interpreted in their Commentaries. National reports confirm that this problem is traditionally approached by the tax literature within the dichotomy between dynamic and static interpretation. However, the author believes that it should more properly presuppose the truly interpretative

[17] For the signatory countries of the Vienna Convention on the Law of Treaties (Vienna Convention), this means relevance within the framework of the conditions listed in Article 32 of the Vienna Convention.

[18] See further on this the report from France (p. 425).

[19] The Italian report also suggests that a different position has been put forward in Italian tax literature, more inclined to support a technical value of the Models and their Commentaries, in particular of the OECD.

[20] See further the report from Slovenia (p. 1000).

[21] The author does not consider such reservations in their strict meaning under public international law, since the Models are not international treaties but mere non-binding models used to coordinate the exercise of tax treaty practice, whose clauses only obtain their proper legal and binding dimension once transposed into the actual treaties signed by the states. However, in the author's view, this should not prevent the use of the Vienna Convention for interpreting the two-tier system of Models and bilateral treaties patterned on their clauses.

function of the Commentaries, thus carving out all cases in which the Commentaries in fact do not clarify the meaning of a provision contained in the Model, but rather make innovations to it. Although no clear general trend can be regarded around the world, tax authorities are often keener in supporting a dynamic interpretation, with a view to securing that tax treaties are always fine-tuned to the development of international taxation and technically up to best-practice standards. However, some countries[22] accept this theory only in general and, by contrast, others[23] are stronger supporters of the static interpretation. The foundations of the dynamic interpretation are often criticized by the tax literature,[24] based on various arguments, including the need to make the interpretation correspond to the intended meaning of the contracting state at the time when the treaty was signed. However, considering the technical relevance of the Model on the interpretation of tax treaties patterned along its clauses, the author feels that later versions of the Commentaries cannot be completely ignored when interpreting clauses of previously signed bilateral treaties, provided that they do not in fact change the plain wording of the clause. The reports confirm that this corresponds to the current evolution worldwide. Whether this relevance is equivalent to or weaker than that of versions of the Commentaries predating the bilateral tax treaty is a matter that depends on the way in which a given country interprets tax treaties and how it applies the provisions of Articles 31 and 32 of the Vienna Convention to them. However, from such a perspective, it also seems appropriate not to ignore the fact that even a clause with the same wording as the OECD Model can have different implications if framed in a different context. This is also often a reason why the author suggests that despite the OECD Model and its Commentaries being the most important indicators of the internationally accepted tax treaty standards, they should have a very limited indirect influence on treaties that are not patterned on the schemes provided by the OECD.[25]

[22] See in particular the reports from the Netherlands (p. 670), Peru (p. 798) and Spain (p. 1029).

[23] See in particular the reports from Argentina (p. 42), Italy (p. 602) and Liechtenstein (p. 650).

[24] See M. Lang, *Introduction to the Law of Double Taxation Conventions* (Vienna: Linde, 2010), pp. 45 *et seq.*; M. Lang and F. Brugger, 'The Role of the OECD Commentary in Tax Treaty Interpretation', *Australian Tax Forum* 23 (2008), 95–108 (at 101 *et seq.*); M. Lang, 'Die Bedeutung des Musterabkommens und des Kommentars des OECD-Steuerausschusses für die Auslegung von Doppelbesteuerungsabkommen', in W. Gassner, M. Lang and E. Lechner (eds.), *Aktuelle Entwicklungen im Internationalen Steuerrecht* (Vienna: Linde, 1994), pp. 11–41 (at pp. 24 *et seq.*); J. F. Avery Jones, 'The Effect of Changes in the OECD Commentary after a Treaty is Concluded', 56 *Bulletin for International Fiscal Documentation* 3 (2002), 102–9 (at 103 *et seq.*).

[25] However, the European Court of Justice (ECJ), when interpreting cases involving tax treaty issues, sometimes regards the OECD Model as almost an equivalent source to international customary law in tax treaty matters.

Observations on the Commentaries and reservations on the Models can raise more critical issues in their practical application than in their general value and effects.

Observations on the Commentaries are used to reject an interpretation accepted by all other Member countries. Accordingly, they are an instrument to narrow down in advance the scope of interpretation of tax treaty clauses patterned on the Model. However, this should not necessarily imply that in the absence of an observation, a state should be bound by the interpretation contained in the Commentaries. Even in the countries that more closely follow the technical indications of the Commentaries, other instruments can be used to achieve the same result. Furthermore, a different conclusion would deprive non-Member countries of the possibility of achieving a similar limitation in the scope of a clause included in a bilateral tax treaty and patterned along the lines of the Model.[26]

Reservations on the Models generally achieve an equivalent result to the one they have in a binding multilateral tax treaty, since they are almost always reflected in a different wording of clauses (or in different clauses) included in the bilateral tax treaties of such a country. The existence of a reservation, however, should also affect the interpretation of all other clauses included in the treaty, which must comply with the different context created by such a reservation. However, reservations on the Model have no legal value when the state includes in its bilateral treaties clauses that correspond to those on which the reservation was made.

A separate issue arises for the positions of non-Member countries that have been included as annexes to the Commentaries on the OECD Model since 2000. Their function being that of enhancing transparency in the interpretation and application of tax treaties, they are to be equated neither with observations nor with reservations and have a mere informative function as to the current tax treaty practice of a country.

II The personal and material scope of the tax treaties

II.1 Personal scope

The OECD and UN Models do not present major differences as to their personal scope, which is defined by Articles 1 and 4. Some old bilateral treaties still in force do not include an equivalent clause to Article 1 of the OECD and UN Models,[27] whereas others still follow the 1963 version of

[26] See further on this the UK report (p. 1107).
[27] See for instance the Brazil–Japan treaty (p. 173) and the reports from India (p. 556) and the Netherlands (p. 671).

the OECD Model and do not provide for a limitation to liable-to-tax persons in either contracting state.[28] Save for the specific issues related to the USA taxing on the basis of citizenship and Russia distinguishing between citizenship and nationality, similar criteria are used to determine the personal entitlement to treaty benefits, taking into account the residence of individuals[29] and basically using the same tie-breaker rules contained in both Models.[30]

Perhaps the most relevant difference between the UN and the OECD Models as to the personal scope is the reference to the place of incorporation of companies, which is among the criteria used by the UN Model to determine the residence of companies, but which can also be relevant for the OECD Model under the other criteria of a similar nature to the place of management. A rather high number of bilateral tax treaties around the world[31] currently include the place of incorporation, which, in several treaties, unlike in the UN Model, is also used as a tie-breaker rule.[32] Another relevant difference concerning the tie-breaker rules can often be noted with respect to the fact that several treaties include mutual agreement procedures for persons other than individuals[33] and further treaties

28 A classic example of this category is Serbia (p. 952). However, see also the reports from Australia (p. 71), Canada (p. 209), the Netherlands (p. 675) and the USA (p. 1154). Belgian treaties with countries not levying taxes contain special clauses in this respect (p. 147). Special clauses are also contained in the Hong Kong treaties (p. 504). Lebanese (p. 636) and Ugandan (p. 1086) treaties include the requirement but also consider it met in case of fully exempted entities.

29 The reports from Canada (p. 209) and India (p. 556) illustrate the relevance of the concept of ordinary residence under the tax treaties of such countries. The Chinese report addresses special problems of residence under Chinese domestic law that also affect the personal entitlement to tax treaties (p. 264). The French treaty with Monaco contains a special presumption of residence (p. 432).

30 The report from Australia indicates the more limited use of habitual abode as a tie-breaker rule (p. 71).

31 See the reports from Argentina (p. 44), Brazil (p. 174), Canada (p. 210), Chile (p. 235), Croatia (p. 313), Estonia (p. 358), Finland (p. 390), France (p. 433), India (p. 556), Lebanon (p. 636), Liechtenstein (p. 651), Norway (p. 776), Peru (p. 800), Portugal (p. 859), Russia (p. 920), Serbia (p. 951), Slovenia (p. 1002), Sweden (p. 1060) and the USA (p. 1154). The UK report (p. 1117) suggests that the increasing use of this criterion is not related to the importance of the UN Model, but rather is to be seen as a consequence of domestic law.

32 See the reports from Chile (p. 235), Croatia (p. 313), Russia (p. 921) and Spain (p. 1031).

33 See the reports from Argentina (p. 44), Belgium (p. 146), Brazil (p. 174), Chile (which in some cases can even lead to denial of treaty benefits) (p. 235), Croatia (p. 313), Hong Kong (p. 506), the Netherlands (p. 676), Slovakia (p. 976), Spain (p. 1031), Sweden (p. 1060), the UK (which indicates that mutual agreement procedure is gradually replacing the place of effective management as tie-breaker rule for persons other than individuals) (p. 1117) and the USA (p. 1155).

do not include reference to the place of effective management at all.[34] In some cases additional criteria are used to determine the residence of companies.[35]

Several more recent bilateral treaties contain specific rules on the entitlement to treaty benefits for entities other than companies and individuals, such as in the case of pension funds,[36] trusts,[37] investment vehicles,[38] partnerships,[39] dormant inheritance[40] and non-profit organizations.[41]

Unlike in the OECD and UN Models, the personal entitlement to the benefits of several bilateral treaties is often limited for the purpose of countering abusive practices. The USA has supported the introduction of the so-called limitation on benefits (LOB) clauses, which restrict the personal entitlement for residents of the contracting states in the absence of a sufficient genuine link with their taxing jurisdiction.[42] However, other types of clauses affecting the personal entitlement to treaty benefits are also included in tax treaties to counter abusive practices.[43]

[34] See the reports from Australia (which refers to domestic law instead) (p. 71), Brazil (p. 174), Colombia (which indicates that the place of effective management has no meaning in the domestic tax system) (p. 296), Estonia (p. 358) and Spain (p. 1031). There seems to be a diffused awareness among the national reports of the uncertainties related to the use of this criterion, which is losing importance in bilateral treaties or requires a further specification of its meaning. The latter option is followed by Croatia in its treaty with Armenia (p. 314) or is linked to domestic law, as in the New Zealand treaties (p. 739). For the purpose of countering such problems, Estonia uses it instead only within the framework of mutual agreement procedures (p. 359).

[35] Australian tax treaties refer to domestic law (p. 70). German treaties include reference to the place of the statutory seat (p. 471), which is in substance equivalent to the place of registration under the Hong Kong treaty with Indonesia (p. 504) and some UK treaties (p. 1117). The Hungarian treaty with Japan refers to the location of the head office (p. 535).

[36] See the reports from Argentina (p. 44), Belgium (p. 147), the Netherlands (p. 675) and Portugal (p. 860).

[37] See the reports from Hong Kong (p. 502) and Portugal (p. 860).

[38] See the Liechtenstein treaty with Uruguay (p. 652).

[39] This type of clause is not necessarily needed in countries that treat partnerships as opaque for tax purposes. For clauses specifically mentioning the entitlement of partnerships to treaty benefits, see the reports from France (p. 435), Hong Kong (p. 503), Portugal (p. 860), Russia (p. 922) and Sweden (p. 1060).

[40] See the report from Liechtenstein (p. 651).

[41] See the reports from Liechtenstein (p. 652) and the Netherlands (p. 675). Estonia makes the entitlement to treaty benefits contingent on the submission of a certificate of residence (p. 359).

[42] However, LOB clauses have spread well beyond the US treaties (p. 1156). See further on this the reports from Colombia (p. 297), the Czech Republic (p. 328), Estonia (p. 361), Finland (p. 391), France (p. 434), Norway (p. 777) and Russia (p. 923).

[43] See the reports from Belgium (p. 148), Chile (p. 236), Colombia (p. 297), the Czech Republic (which uses beneficial ownership as a general anti-treaty shopping clause) (p. 329), Portugal (p. 860) and Spain (p. 1032).