The Impact of the OECD and UN Model Tax Conventions on Bilateral Tax Treaties

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Last year

⇒ Basics in relations between Model Tax Conventions (MTC) and Bilateral Treaties:

1. The value of OECD MTC and its Commentaries
2. The influence of MTCs on
   a. Distributive clauses contained in bilateral tax treaties
   b. Methods for relieving double taxation
   c. Non-discrimination clauses
   d. Mutual agreement procedures and arbitration clauses
   e. Exchange of information and assistance in collection

This year

⇒**A more technical analysis, with more emphasis on**

I. specific tax treaty clauses and
II. relations OECD with non-OECD countries

Focus on selected tax treaty clauses:

1. Residence
2. Anti-abuse clauses (beneficial ownership, thin capitalization, CFC, limitation-on-benefits clauses, etc.)
3. Permanent establishment and business income
4. Mutual agreement and arbitration
5. Exchange of information and peer-reviewing of Russian tax treaties (2013) – **already addressed in plenary session**

Goal:

⇒ Can Russia lead the BRICS towards a common tax treaty policy?

1. Residence: general (1/3)

- Article 1 (subjective scope) and 4 (residence) determine personal entitlement to treaty benefits
- The 1992 Russian Model joins both in a single article, but has so far only been followed in treaties with Japan and Poland => possible development in this direction expected between 2013 and 2015
  - No major difference

1. Residence of individuals (2/3)

- Individuals:
  - Citizenship and nationality were not synonyms, since the latter meant ethnicity under Russian law, and citizenship is still included in some treaties
  - 2010 Russian Model includes reference to nationality just like most Russian treaties
  - Can we give citizenship an autonomous treaty meaning?
- Partnerships: explicit provisions only included in treaties with Mexico and Poland (transparency). Big uncertainty on treaty entitlement in the absence of specific clauses due to liability to tax for partnerships under Russian tax law
  - Some intervention would be desirable in this field

1. Residence of other persons (3/3)

- Art. 4.1 determines residence of companies in Russian tax treaties by reference to place of incorporation(or rather: of registration) theory
  - Treaty with China: State of head office
- Some Russian tax treaties also include it in Art. 4.3 as tie-breaker rule, other treaties refer to place of effective management in Art. 4.3, others only include mutual agreement procedures, as for the 2010 Russian Model
  - What does place of effective management mean: day-to-day vs. key decisions (as in OECD)
- Number of treaties with mutual agreement procedure as tie-breaker expected to increase in the future (see key policy trends 2013-2015)

2. Anti-abuse Rules (1/5)

How do States react to abusive practices?

1. Abusive practices and tax avoidance
2. Categorization of anti-abuse measures:
   a. Domestic vs. treaty anti-abuse rules
   b. Specific (SAARs) vs. general (GAARs) anti-abuse rules
3. Countering abusive practices in the presence of tax treaties

2. Abusive practices and tax avoidance (2/5)

- Abusive practices arise in tax matters when taxpayers circumvent the application of taxing rules (or unduly benefit from the application of more favourable rules): a problem of friction between form and substance aimed at securing a more favourable tax treatment that should not be available
- No open violation of tax rules, but manoeuvres prevent their application
- Conceptually each country determines the limits within which it tolerates tax avoidance
  - This may lead to asymmetry in countering the phenomenon
  - Some treaties include anti-abuse clauses (e.g. LOB clauses)
- Theory of unreasonable enjoyment of treaty benefits (2006: RF Supreme Court of Arbitrage) as anti-abuse interpretation tool

2. GAARs and SAARs: categories and examples (3/5)

1. Domestic anti-abuse clauses
   1. Anti-thin cap rules
   2. Limited (and non-) deductions
   3. CFC rules
   4. Exit taxes
   5. Trailing taxes
   6. Transfer pricing rules
2. Tax treaties
   1. LOB (limitation-on-benefits) clauses
   2. BO (beneficial ownership) clauses
   3. Various other SAARs included in bilateral tax treaties

2. Anti-abuse clauses and tax treaties (4/5)

- **Critical issue => may domestic rules apply in the presence of tax treaties? And of tax treaties with SAARs?**
- Logical priority of anti-abuse in the characterization for tax treaty purposes raises no problem of compatibility for domestic anti-abuse clauses in the presence of tax treaties
- SAARs included in tax treaties can address specific problems, without preventing the application of domestic clauses to counter or prevent abusive practices
- Inputs from global tax law (source: EU law): reaction to abusive practices should be proportionate and suitable to counter them. Their prevention is possible when not having overkill effects (doubts as to whether presumptions, especially when irrebuttable, should be used)

2. Example of anti-abuse clauses contained in Russian treaties (5/5)

- LOB clauses found in some Russian treaties (Australia, Brazil, Chile, Israel, Singapore, etc.), but expected to increase frequency in Russian treaties based on Art. 29 of 2010 Russian Model (in fact an anti-abuse clause with multiple function and structure)
- Anti offshore clauses (special feature of Russian treaties) in treaties with Iceland, Lithuania, the Netherlands and Norway, etc.)
- Special anti-abuse clauses on passive income (United Kingdom, but now also in 2010 Russian Model), or to preserve application of anti-thin cap rules (Brazil and Portugal)

3 – Permanent establishment and business income (1/2)

1. Permanent establishment
   a. Attribution of profits: as if it were a separate entity vs. alternative methods (full or partial force of attraction). Is there a different way to simplify attribution of profits?
   b. Services permanent establishments: very frequent in bilateral treaties of non-OECD (and even of some OECD) countries, but is it really in the interest of the State of the permanent establishment?
   c. 5.1 and 5.3: connected or disconnected? The time requirement for construction permanent establishments

3 – Permanent establishment and business income (2/2)

2. Business income
   a. Brazil, Mexico and Chile unlikely to include new Art. 7 OECD in their bilateral tax treaties: what is the benchmark for the BRICS?
   b. Brazil - Article 21 may apply instead of Article 7: must profits be income, or are they any different? How should Art. 7, last para. be interpreted?
   c. Business profits vs. fees for technical services: what is best for the BRICS? And for developing countries? Any influence by article on royalties (departing from OECD)?
   d. Article 9 (2) rarely included in bilateral tax treaties
   e. Income from self employment under separate Article 14, sometimes with UN drafting, or with pre-2000 OECD drafting or autonomous. What is best for BRICS?

4. Mutual agreement and arbitration

- Strong influence of some clauses (Art. 24.1 and 24.3)
  - Some treaties include carve-out to discriminate non-nationals
- Intermediate influence of other clauses (Arts. 24.4 and 24.5)
- Weak influence of Art. 24.2

⇒Relations with non-discrimination principle in the EU

⇒Some treaties include right to MFN

⇒Some treaties include an anti-abuse clause

4. Mutual agreement procedure and arbitration (1/2)

- Mutual agreement has many shortcomings, but is important to set up a line of cooperation between tax authorities of two Contracting States
- Interpretative mutual agreements still not included in old treaties (and also in many Russian treaties!)
- Problems of treaty settlement measures with domestic administrative and judicial settlement (especially in presence of res judicata, i.e. final judgments) in both Contracting States
  - Some bilateral treaties exclud mutual agreement procedure when judicial procedure is pending
- More frequent use of mutual agreement procedures possible in Russia in connection with the introduction of mandatory procedure for tax settlement before judicial proceeding

4. Arbitration in tax treaties (2/2)

- Arbitration introduced in Article 25.5 OECD MC, but already existing in several bilateral treaties (standard arbitration vs. baseball arbitration)
- Arbitration has a strong capacity of settling factual disputes, but can raise problems on legal issues, especially by depriving the natural judge in both Contracting States of his jurisdiction to state on a dispute
  - Brazil and Japan are reluctant to include arbitration in tax treaties
  - Australia limits it to factual disputes
- Diffusion of arbitration is growing in bilateral treaties, but is rather exceptional in Russian treaties (Netherlands)