



Which legal entity is entitled to a treaty protection?

**HARN60 Master Thesis in European and
International Tax Law 2011-2012**

Author: Tamara Bakashvili

Tel: +46 760 947 450

Email: tamara.bakashvili@gmail.com

Tutor: Cécile Brokelind

Examiner: Mats Tjernberg

**Lund University
25 May 2012**

Abbreviations

IFA	International Fiscal Association
OECD	Organization for Economic Co-operation and Development
NAFTA	North American Free Trade Agreement 1992
GATT	General Agreement on Trade Services 1993
MNEs	Multinational Enterprises
LOB	Limitation of benefits
BO	Beneficial owner
EU	European Union
PE	Permanent Establishment
CIT	Corporate income tax
TFEU	Treaty on the Functioning of the European Union
WHT	Withholding tax
OEEC	Organization for European Economic Co-operation

Table of Contents

Table of Contents	3
1. Introduction	4
1.1 Why is it important to focus on the definition of the legal person enjoying treaty benefits?	4
1.2 Why is it difficult to determine the treaty entitlement of legal persons?	5
1.3 Purpose	6
1.4 Delimitation	6
1.5 Disposition	6
1.6 Source and methodology	7
2. Historical Background	7
2.1 The meaning of tax treaties	9
2.2 Problem – the improper use of the treaty	10
2.3 Tax Subject	13
2.4 Tax Object	14
2.5 Beneficial owner	15
3. Main feature, conditions under which the treaty shall apply	16
3.1 Persons covered	16
3.2 Residence of a Contracting States – what does it have to be assumed?	18
4. Taxation of legal persons	
4.1 Subject-to-tax Clauses	21
4.2 Treaty Shopping – where the limit goes?.....	22
4.3 Tax Treaty Case Law	26
5. Is the mutual assistance a solution?	29
5.1 Is the protection for taxpayers and states enough?	31
6. Conclusion	32
Bibliography	34

The ideal tax system is to have plenty of high withholding taxes on nonresidents to make them want treaties, but a good system of relief from double taxation so that the lack of treaties is not too much of a problem for one's own residents.¹

1. Introduction

1.1 Why is it important to focus on the definition of the legal person enjoying treaty benefits?

Every single State has its own rules: legal persons are created based on the domestic laws and States tax them according to their own tax laws. Thus, differences and imperfect legal relationships are inevitable at the international level.² The existence of legal entities formed under diverse domestic laws which are not similar to each other leads to disparities and thus, to difficulties to have a clear understanding of the scope of bilateral tax treaties. A person is generally a spotlight of what happens in daily life. Persons³ are acting, creating, moving, abusing and they are able to take an action as a consequence of their decisions. These are the persons to whom a treaty is dedicated and who could avoid double taxation carrying out economic activity internationally. The OECD Model convention is addressed to a person: this is the person whose residence is determined in the OECD, this is the person whose taxes are covered in the OECD, and this is the person who creates an income, pays and receives it.⁴ Last but not least, this is the person who is taking abusing steps intentionally.

Despite the OECD defines the term “Person”, including individuals, companies, any corporate body and any entity, the list is not complete and has a very broad sense.⁵ Accordingly, when it comes to treaty benefits application, the very first issue is whether the person as such does qualify as a person and is determined as a person under Article 3 of the OECD Model, thus is legally entitled to the treaty application. Obviously, all those answers have farther tax consequences.

Article 1 of the OECD Model states that the treaty shall apply to persons who are residents in one or both of the Contracting States. The statement is already becoming a starting point of the following issue: who are those persons and are they really residents in one of the contracting states? It requires an immediate definition of persons (Article 3 of the OECD) as well as immediate definition of resident (Article 4 of the OECD). However, it is not so easy to give a certain definition at the international level as the diversity of the legal system, particularly the diversity of the legal forms existing in the world, does not tend to have some uniform and clear determination.

¹ The David R., JOHN F. AVERY JONES “Are Tax Treaties Necessary?” Hein Online, Tax Law Review, Vol. 53, Issue 1, 1999, p. 3

² Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 20

³ The “Person” here is also within the meaning of “legal persons” as the latter does not exist without physical persons

⁴ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 171

⁵ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 171

1.2 Why is it difficult to determine the treaty entitlement of the legal person?

Is the legal entity of a contracting state explored as subject to taxation of another contracting state?⁶ It should be noted that frequently it is not, because foreign law is not a binding source of law for domestic State. For instance, according to one contracting State, an entity can be disregarded while is a taxable company according to another contracting State.⁷ It is difficult to suit a foreign entity under domestic law because the recognition of an entity will be done by domestic law of the State where the profit is allocated.⁸ Consequently, it leads to mismatches in the determination of legal persons and the entitlement to the treaty protection. (The problem of being persons concerns many types of structure such as PE, Partnerships, Trusts, Estates, Limited Liability Companies, Associations.⁹) Particularly, a domestic system does not necessarily treat a foreign entity in the same way as a domestic entity for tax purposes. When it comes to the question on how to tax a foreign entity organized according to a foreign law the State tries to fit the foreign entity into the closest category of entities known in the internal law.¹⁰ Obviously, the treatment based on similarity does not lead to the certainty and clarity in definition of an entity and it does not make clear whether the particular legal entity is defined correctly and, consequently, whether the mentioned entity has a legal right to claim treaty entitlement. The correct determination leads to certain treaty benefits and, as a result, to the tax consequences. Thus, it is very important to recognize the right person in order to grant him the treaty benefits and not to a third party. However, the tendency of abusive practice and improper use of the treaty by persons being outside of the scope of the treaty application have been increasing since 40 years ago: these issues have necessarily led to the introduction of beneficial owner¹¹ and limitation of benefits provisions. Thereby, except the definition of legal persons and residence requirements, the person claiming the benefit of the treaty should be also the “beneficial owner” of the particular income, i.e. he should be “subject to tax” in respect for that income¹² and satisfies the requirements of the limitation on benefits article of the treaty.¹³ Despite the limitation of benefits provisions is not present in the OECD Model, apart from paragraph 20 Article 1, it is introduced in bilateral treaties by domestic law according to domestic legislation. For this reason it varies from treaty to treaty. It has been suggested that States willing to include such provisions in tax treaties should first discuss at the OECD level to achieve international consensus, although OECD Model does not have itself such international consensus.¹⁴

⁶ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 90

⁷ Case EWCA Civ 304, 23 March 2011 United Kingdom - Bayfine UK v. Commissioners for H M Revenue and Customs, IBFD

⁸ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 90

⁹ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 92

¹⁰ John F. Avery Jones “Characterization of Other States’ Partnerships for Income Tax” Bulletin-tax treaty monitor, July 2002, p. 305

¹¹ OECD Model Convention 1977, Articles 10, 11, 12

¹² J. David B. Oliver, Deloitte Haskins & Sells, London “Access to tax treaties” Intertax, 1989/8-9, p. 330

¹³ Michael Miller “Accessing U.S. Income Tax Treaties: Current Trends in the Limitation on Benefits Article” International Tax Journal May/June 2007, p.5

¹⁴ Stef van Weeghel, The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States, 1998 p. 259

The provisions will be discussed in the respective sections and will explain why they became as a necessary part in tax treaties.

1.3 The purpose

The purpose of the thesis is to identify and analyze how a legal entity is qualified under a tax treaty taking into account restrictions and limitations related to the treaty shopping. Whether a legal entity is qualified for treaty benefits, beneficial owner and limitation on benefits provisions should be satisfied.

1.4 Delimitation

The complexity of the issue of the treaty entitlement limits a discussion to the scope of the treaty and limitation on benefit provisions. The thesis will be focused mainly on the treaty shopping (improper use) and limitation on benefits provisions because it is directly related to the scope of the treaty application. Other legal instruments protecting a treaty from treaty shopping are not analyzed in the thesis. Dual residence and transparency problem also are out of the scope of the thesis. Only Subject-to-tax clauses in treaties will be considered as they supposed to preclude both double taxation and double non-taxation.

The choice of the provided Tax Treaty Case Law is based on the relevance to the restrictions of the treaty application. Beneficial owner and substance over form rule played its role in deciding the cases¹⁵ although the references to domestic case law and illustrations are only used as supportive materials and do not consist in a detailed investigation of the domestic law in the mentioned States. Also certain treaties among states are not examined in detail.

The thesis will present the scope of the treaty, a general description of the treaty shopping problems in conjunction with transactions that lead to the improper use of treaties; companies with artificial arrangements are an example that might be provided.

1.5 Disposition

The thesis consists of the following six parts. The first part will provide a short but important overview about the definition of the legal persons enjoying treaty benefits and difficulties to determine the legal person's treaty entitlement.

An historical evolution of the term "person," from "undertaking" to qualified persons, will be described in the second part of the thesis. After that, the meaning of tax treaties, the problem description focused on the improper use and "economic allegiance" will follow. The main feature, under which the treaty shall apply, such as the definition of the person and residence of a contracting state, will be examined in the third part.

The following fourth part, which is the core of thesis, is focused on the crucial problem addressed to the treaty shopping performed by a third party and subject to tax clauses.

The next part will provide the examination of the degree of protection to both States and taxpayers. Since both of them are the main players of the OECD Model, it is very reasonable to analyze whether they are equally enjoying possibilities given in the OECD Model and carrying

¹⁵ Case 2 Afs 86/2010-141, 10 June 2011 and Case 09-00064 / SKM No. 2011.57, 22 December 2010 IBFD

out their responsibilities. Finally, the conclusion will analyze which legal entity is entitled to a treaty protection.

1.6 Source and Methodology

The OECD Model Convention with its commentaries is the main material in analyzing the scope of a treaty. However, the remaining applied methodology is based on doctrinal articles, the Tax Treaty Case Law and academic scholars to investigate the purpose of the thesis. There is not a lot of information in the OECD Model to analyze beneficial owner and limitation of benefits provisions. Thereby, the Tax Treaty Case Law has been used as illustrative and supportive part to examine the relevant issue. Academic scholars have been applied to describe the issue, although most of the time they have expressed the authors opinion. The additional OECD working papers that have been used in the thesis are descriptive and show a general situation inside the OECD in taking measures to combat a treaty shopping.

2. Historical background

In this chapter a brief historical background will be given about the development of the terminology which has been employed in respect of a treaty provision. It will also be described a first attempt to define a person using various terminologies about who could be recognized for treaty purposes.

Why is it important to know about the evolution of tax treaty provisions?¹⁶ Many international trade rules and economic activities are based on first timid steps made by our precursors. As Professor David Oliver considers, there are few reasons why the history of tax treaty provisions is important. First of all, the fundamental concepts and the provisions have been developed as part of the “international tax language” and can be understood by knowing the historical development. Second, the problem we might find, by analyzing the current tax treaty issue, is that roots go to the treaty history. And, last but not least, to understand the following question: “what did the negotiators intend the treaty provision to mean and how did they intend it to be applied?”¹⁷

The Double Taxation report, issued by the League of Nations in 1923, was the fundament for the basic model convention of the League of Nations in 1928, which regulates the international allocation of business incomes.¹⁸

Using as a basis the report of 1923 made by four economists, Professors Bruins, Einaudi, Seligman and Josiah Stamp, a group of Technical Experts investigated further issue of double taxation and tax evasion. Thus, two resolutions have been presented about Double Taxation in 1925. These proposals are linked to “undertakings”, “Enterprises”, and “Companies”. However, those terms were not referring neither to the business activity (“business”), nor to the individual or corporate (person operating the activity - “owner of the undertaking”). There is a tendency to

¹⁶ Canadian branch of the IFA, together with the OECD Centre, having had the special seminar in Toronto 2004 “The history of tax treaty provisions”, Richard Vann “Writing Tax Treaty History” Sydney Law School, March 2011, and www.taxtreatieshistory.org

¹⁷ J. David B. Oliver, “The Relevance of Tax Treaty History”, Intertax, Volume 33, Issue 11, p. 484

¹⁸ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 492

believe that the terms were referring to business organizations as such.¹⁹ Later, the draft of prevention of Double Taxation was based on his previous model convention and impersonal and personal taxation (objective and subjective nature) were integrated in one model in 1927.

“Undertaking” here is linked to the terms “trade” and “profession.” The term “undertakings” should be understood in the widest sense meaning that the term included wide range of all undertakings, including mines and oilfields, without making any distinction between natural and legal persons.²⁰

Furthermore, in 1930-1931 there was an attempt of drafting a multilateral convention where a directing principle regarding the business taxation has been provided. Thereby the term “undertaking” has been used for “company.”²¹

It has been formulated that “a company operating one or more industrial and commercial enterprises shall be taxable only in the State of its domicile”²². Moreover, the expression “a company operating an enterprise” makes a distinction between “company” and “enterprise” suggesting that a company can operate a several enterprises. Later on, in 1933 the draft underlined the term “enterprise” by including every form of undertaking, whether carried on by an individual, corporation or any other entity. Also the term “subsidiary” has been highlighted by stating that if “an enterprise of one contracting State has a dominant participation in the management or capital of an entity of another contracting State, or when both enterprises are owned or controlled by the same interest” will be taxed as independent enterprise.²³

It has been considered that the abovementioned terms indicated in the drafts confused rather than clarified and suffered of a terminological insufficiency. It seems that confusion and uncertainty have a long history with a successful continuation.

Obviously the tax treaty provisions story had its follow up in a so called “Mexico Draft” in 1943 and again further amendments in “London Model” in 1946.

Protocol 1 defines the terms of “taxpayer of a contracting State” and “enterprise of a contracting State”.²⁴ However, in respect of several vital questions, the draft contained significant dissimilarities and certain gaps.²⁵

¹⁹ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 494

²⁰ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 494

²¹ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 495

²² Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 496

²³ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 497

²⁴ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 497, 498

²⁵ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 2

The history of the terminologies employed in the League of Nations 1925 that was the basis for the first model convention following up to the 1946 London Model, shows that those terminologies have been considered as being inconsistent and unclear.²⁶

Later on in 1959, the Working Party of the OEEC whose members were from Austria and Sweden, defined a company for dividends articles. Non-corporate bodies have been identified as follows:

- 1) bodies of persons not treated as taxable under the law of any of the Contracting States;
- 2) bodies of persons treated as taxable under the law of any of the Contracting State and treated in the same way of legal persons;
- 3) bodies of persons treated as taxable under the law of any of the Contracting States but not considered in the same way of legal persons.²⁷

The consequence of the explanation was that the definition of “persons” should be as broad as possible and has necessarily to include all bodies of persons which can be treated as taxable. Thus, the definition was very similar to the OECD Draft 1963 stating that “The term person comprises an individual and anybody of persons, corporate or not.”²⁸ The expressions “widest sense” and “as broad as possible” are active all the time.

Summing up, the persons who are recognized for treaty purposes are only defined in Article 3(1) of the OECD Model. The following chapters will analyze whether the current definition of persons makes clear which legal entity is qualified for a treaty application.

2.1 The meaning of tax treaties

International flow of capital, trade, workers raise the question about how to tax the foreign income of residents and the income of foreigners. It is up to each State to decide how it prefers to tax the foreign income of its residents and the income of foreigners originating within its border.²⁹ However, the decision can be made only with cooperation with other countries and the international tax treaties are designed to coordinate the question.³⁰

Thus, international treaties serve to secure the avoidance of double taxation and limit the power and the content of the tax law of both the Contracting States.³¹ However, the avoidance of double taxation is probably no longer the dominant meaning of many tax treaties.³²

Overall, the main meaning is allocating taxing rights between the state of the source and the state of the residence, assisting tax authorities to perform tax collections across borders, providing information and dealing with tax avoidance schemes. Another purpose is to assist taxpayers'

²⁶ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 492

²⁷ John F Avery Jones, Understanding the OECD Model Tax Convention: The Lessons of History, Florida tax review, Volume 10/1, 2009, p. 7

²⁸ John F Avery Jones, Understanding the OECD Model Tax Convention: The Lessons of History, Florida tax review, Volume 10/1, 2009, p. 8

²⁹ Richard A. Musgrave, Peggy B. Musgrave, “Public finance in theory and practice” 5th edition, p. 568

³⁰ Richard A. Musgrave, Peggy B. Musgrave, “Public finance in theory and practice” 5th edition, p. 568

³¹ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 20

³² David A. Ward, Access to Tax Treaty Benefits, September 2008, p.3, Available on the Internet at: www.apcsit-gcrfci.ca

economic activities among states, including a setting on a uniform basis for the most common problems which arise in the field on international taxation.³³

Following up, does a treaty comprehensively solve a problem and stop further complication deriving from it? Does a treaty prevent from an improper use of the treaty itself? In the past, the idea of the bilateral treaty was a quite successful solution for double taxation avoidance but the matter is that the success of tax treaties brings problems with it.³⁴ Is it a vicious circle?

2.2 Problem description

Improper use of the treaty

First of all, two very simple questions should be asked to describe the problem: why a treaty protection is given and who is the person supposed to be protected by a tax treaty?

A treaty protection is given to reduce or eliminate double taxation when it is potentially expected. A State concluding a treaty was taking care of its residents who are under State general protection, and have legal rights and capacity to claim State protection.

Tax treaties have been implemented with an original intention to make the international activity easier; however, the problem of the access to tax treaties is very complex.³⁵ Does every legal entity have an access to the treaty protection and how is a single entity qualified under tax treaty to be protected by the treaty itself?

Tax treaties are normally negotiated and due in order to alter the provisions of the domestic tax law in certain cases. The condition to claim the benefit is the scope of tax treaty with beneficial owner and limitation of benefits provisions: a person must qualify as a “person” as required by the definition of “person” in Article 3 of the OECD Model and must be considered to be the resident of a Contracting State as required by Article 4 Of the OECD for treaty purposes.³⁶ Only a qualified person who is a resident of a contracting state is entitled to the treaty protection and able to claim the treaty benefits. It means that resident of a third country is normally not entitled to the treaty protection and benefits.

In other words, if the resident of a contracting state satisfies the mentioned requirements as it is prescribed in a particular treaty, he is entitled to the benefit of the treaty and has access to the tax treaty. This is the standard circumstance of the treaty functioning.

However, it is possible that the person claiming treaty benefits might not be necessarily entitled to the application. In this case it is up to the contracting state to refuse the claim or renegotiate the terms of the treaty.³⁷ Although, most of the contracting states are very severe for the use of treaties by a person to whom it does not address to be entitled for the protection.³⁸

³³ David A. Ward, Access to Tax Treaty Benefits, September 2008, p.3, Available on the Internet at: www.apcsit-gcrfi.ca

³⁴ The David R, John F. Avery Jones “Are Tax Treaties Necessary?” Hein Online , Tax Law Review, Vol. 53, Issue 1, 1999, p.4

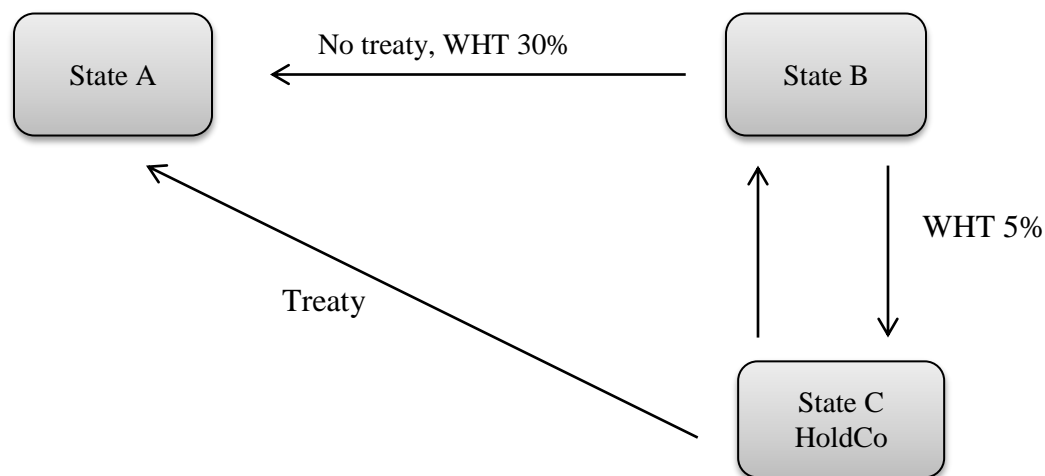
³⁵ J. David B. Oliver, Deloitte Haskins & Sells, London “Access to tax treaties” Intertax, 1989/8-9, p. 330

³⁶ OECD Model Convention, Article 3, 4

³⁷ J. David B. Oliver, Deloitte Hsskins & Sells, London, “Access to tax treaties” Intertax, 1989/8-9, p. 330

³⁸ J. David B. Oliver, Deloitte Hsskins & Sells, London, “Access to tax treaties” Intertax, 1989/8-9, p. 330

In this sense the committee on fiscal Affairs indicated its awareness about the improper use of tax conventions by a person, disregard of being resident or non-resident in a Contracting State. The problem is when a company formed in a treaty state is acting as a conduit for channeling income economically accumulating to a person in another State who is entitled to the treaty and takes the advantage of the treaty benefits “improperly”. This is called “treaty shopping”.³⁹



As shown in the graphic above, no treaty is concluded between states A and B and investment income received from state B is subjected to WHT 30%. In this case, the taxpayer (the treaty shopper) may shop for a treaty with a third state C by incorporating HoldCo to obtain treaty benefits between states A and C. HoldCo invests in state B and receives an investment income. The treaty between states B and C reduced WHT to 5% and state C does not tax the income (or taxes at low rate). The treaty shopping refers to the use of the treaty between states A and C by a taxpayer setting up HoldCo in the state C. Thus, common features of treaty shopping are the following:

- The beneficial owner of the HoldCo does not reside in the state C where the HoldCo is created;
- HoldCo has minimal presence or economic activity in the country C;
- The income is subject to minimal (if any) tax in the country of the HoldCo in the state C.⁴⁰

Consequently, it should be acknowledged whether setting a HoldCo in a State C to benefit from its treaty network is legitimate: is the treaty applicable or is there abusive tax avoidance? Concerning the legitimacy of treaty shopping, states have different views: some states tend to have strict rules in defining qualified persons limiting the accessibility for treaty benefits. Some other ones, which have growing economies, consider treaty shopping as a tool to attract an investment, as long as the loss of revenue is insignificant if compared to other non tax benefits. Thus, the most developed countries ask the other ones to include a full or partial limitation on benefits provisions.⁴¹ If the structure is abusive tax avoidance, the question is: should it be

³⁹ Issue in International Taxation, №1, OECD Paris 1987 “International Tax Avoidance and Evasion—Four Related Studies” p. 88

⁴⁰ Vern Krishna, “Using Beneficial Ownership to Prevent Treaty Shopping” Tax Analysts 2009, p. 539, 540

⁴¹ Michael Lang, Tax Treaties: Building Bridges Between Law and Economics, IBFD 2010 p. 29 and Luc De Broe, Nathalie Goyette, Philippe Martin, Roy Rohatgi, Stef van Weeghel and Phil West, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions, Bulletin for international taxation, July 2011, p. 384

controlled through domestic anti-avoidance provisions in the country of the taxpayer's residence or through specific bilateral anti-treaty-shopping provisions?⁴²

Consequently, the access to treaty benefits is restricted by limitation on benefit provisions in an even more complex way.⁴³ It is up to the State to refuse or renegotiate treaty terms. As it is considered, in treaty negotiation cases, a person's use of a treaty cannot be considered as "improper", disregard if the treaty applies or it does not.⁴⁴

In this regard, analyzing the business purpose and the transaction for tax purpose, domestic tax jurisdictions may apply motive test. As David Oliver suggests, such tests may be based on a general concept of the abuse of rights. Nevertheless, it is not easy to apply these tests because some types of financial transactions are assisted by a treaty for a free flow of funds.

The huge amount of tax treaties confirms they were successful but it is curious that treaties lead only to more treaties.⁴⁵ Globalization, harmonization, sovereignty – these words are most popular nowadays and most opposite to each other - cannot exist together in a perfect way as it was originally or initially thought by authors of a tax treaty. One day the world is going to reach the most crucial amount of treaties, perhaps. Why does it not lead to the final solution?⁴⁶

Richard J. Vann considers that the problem of the possibility to abuse (to shop) a treaty comes from the tax treaty network itself, because it covers the world incompletely and has a bilateral structure⁴⁷ while MNEs are oriented on a global market. A Treaty solves problem arising between two States, and the case in which there are chain of states it is not considered. Two options of attempt to extend tax treaty coverage, although it has positive and negative aspects, have been presented by Kees Van Raad during a seminar on the future of tax treaties in Amsterdam in 2001⁴⁸

- Series of bilateral treaties should be replaced by multilateral treaty;
- The existing bilateral treaties should be amended to multilateral treaty.⁴⁹

Nowadays, examples of multilateral tax treaties are the Andean Treaty among Latin American countries⁵⁰ and the Nordic Convention on income and capital, entered into by Denmark, Finland,

⁴² Vern Krishna, "Using Beneficial Ownership to Prevent Treaty Shopping" Tax Analysts 2009, p. 539, 540

⁴³ The David R, John F. Avery Jones "Are Tax Treaties Necessary?" Hein Online, Tax Law Review, Vol. 53, Issue 1 1999, p. 4

⁴⁴ J. David B. Oliver, Deloitte Haskins & Sells, London "Access to tax treaties" Intertax, 1989/8-9, p. 330

⁴⁵ The David R, John F. Avery Jones "Are Tax Treaties Necessary?" Hein Online, Tax Law Review, Vol. 53, Issue 1 1999, p. 3

⁴⁶ The David R, John F. Avery Jones "Are Tax Treaties Necessary?" Hein Online, Tax Law Review, Vol. 53, Issue 1 1999, p. 3

⁴⁷ Tax Law Design and Drafting, Volume 2; International Monetary Fund: 1998; Victor Thuronyi, (ed) Richard J. Vann "International Aspects of income tax" Chapter 18, p. 74

⁴⁸ Prof. Michael J. McIntyre "Options for Greater International Coordination and Cooperation in the Tax Treaty Area" International Bureau of Fiscal Documentation 2002, June p.253

⁴⁹ Brian J. Arnold, Jacques Sasseville and Eric M. Zolt, "Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century" International Bureau of Fiscal Documentation June 2002, p. 248

⁵⁰ Raffaello Russo "Fundamentals of International Tax Planning" 2007, p.11

Iceland, Norway and Sweden concluded in 1983.⁵¹ Although supposed that there is no obvious advantage of multilateral treaties in comparison with bilateral ones.⁵²

One more suggestion about why we have circle troubles was made by David Oliver, who states that treaty makers do not understand direct taxes, putting heads in the sand in the case of the TFEU or simply opt out of tax, as in NAFTA and GATS.⁵³

Concluding the analysis about the improper use of the treaty description and before proceeding to the next chapters, it should be asked again: “Whom did the contracting states intend to benefit from the conclusion of their treaty and does the treaty reflect that intention?”⁵⁴ Obviously, it was not planned by the Contracting States, when concluding a double convention, that it can be applicable to a conduit company to gain treaty benefits and the original idea was not a treaty shopping.

2.3 Tax Subject (legal status of a taxpayer)

The following “economic allegiance” is relevant to the research of the issue because it distinguishes taxation of business profit between the taxable subject (the taxpayer – a treaty shall apply to) and the taxable object (an income - a treaty shall apply to). The OECD model is based on the fundamental distinction persons covered and taxes covered. Additionally, in order to determine the entitlement to a treaty benefits the OECD Model refers to the beneficial owner concept⁵⁵. Thus, the abovementioned criteria will be discussed in the chapter.

In order to allocate taxing rights it is necessary to determine the following:

- Tax subject – who is liable to tax;
- Tax object – which article applies;
- The State – where to allocate taxing rights.

Already at the beginning of the treaty history the authors of the Reports on Double Taxation (Professors Bruins, Einaudi, Seligman and Josiah Stamp League of Nations, 1923) have predicted the importance and complexity of determination of the terms of the treaty, stating that “One of the very first preliminary points to make international conventions or agreements on double taxation is to define the terms so that there will be no possibility of misinterpretation.”⁵⁶

Professors Bruins, Einaudi, Seligman and Josiah Stamp have introduced in their famous report four elements of “economic allegiance”⁵⁷, the common principles at that time for attributing to States the right to exercise jurisdiction to tax. Three of these elements are concerned to the object

⁵¹ Andrea Amatucci “International Tax Law” Kluwer Law International, 2006, p. 149, note 2

⁵² David R, John F. Avery Jones “Are Tax Treaties Necessary?” Hein Online , Tax Law Review, Vol. 53, Issue 1, 1999, p.6

⁵³ David R, John F. Avery Jones “Are Tax Treaties Necessary?” Hein Online, Tax Law Review, Vol. 53, Issue 1 1999, p. 7 and Notes 22, 23, 24

⁵⁴ J. David B. Oliver, Deloitte Hsskins & Sells, London, “Access to tax treaties” Intertax, 1989/8-9, p. 330

⁵⁵ OECD Model Tax Convention on Income and on Capital: Condensed Version 2010, Article 10, 11, 12

⁵⁶ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 491

⁵⁷ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 491

of taxation: acquisition (origin), situs and enforceability (legal status). The fourth element concerns the taxpayer: domicile. The distinction in the taxation of business profits between the taxable subject (the taxpayer) and the taxable object (the business profits) is fundamental. The recognition and distinction of these elements is the basis to understand and explain current phenomena.⁵⁸ Although the paper is focused on the fourth element, the taxpayer - taxable subject, a brief overview will be given for the tax object and beneficial ownership.

The personal scope is indicated under the wording “shall apply to”. Since international treaties became domestically applicable, the result can be that the rights can be claimed and the obligations imposed on individual persons too. Entitlements and obligations of a person are accumulated in the treaty and influence a Contracting State. Rights and duties, in connection with the application of a treaty, are normally created by the domestic law. Thus, the treaty shall apply to a person who is entitled to the treaty protection. Under Article 1, “persons who are residents” in a Contracting States and are “treaty subject” are entitled to the treaty protection.⁵⁹ Is this rule really followed? It will be discussed in the chapter “Limitation of benefits”.

2.4 Tax object (contract, the income)

In Article 2 the scope of the treaty application is specified as opposed to its ”personal” scope of Article 1 since the taxation authority to which the treaty applies is determined by Article 2 and not by Article 1.⁶⁰ First, it should be identified under the domestic law of the contracting state whether there is a liability to tax. Then the treaty determines to which contracting state the taxing rights are given. Second, the object identified under the domestic law must be the same as in a treaty but obviously those discrepancies exist.⁶¹

Although the final definition is not provided, a tax treaty normally covers taxes on income and on capital levied on behalf of a contracting State or of its political subdivisions or local authorities, disregarding of the way in which they are applied, i.e. exposes to all the items which may be subject of income tax. Despite all the deviations that exist in the different countries, the broad interpretation of the term “income” is avoided by the basic common understanding. The aim of the term “income” is to cover possibly all the interpreted variations of “profit”, “receipt”, “revenue” or “Einkommen” irrespective of the classification under a domestic law. All payments that are designed to produce revenue are supposed to be covered by a treaty.⁶² Disposal of moveable and immoveable property is also included in the meaning of the term “income”.

Taxes on capital are described as all taxes imposed on total or on elements of capital, taxes on the total amounts of wages or salaries and taxes on capital appreciation.

Repayable levies, dues and duties, as long as they meet the general classification criteria for taxes, are levied for financing purposes. Also charges and penalties for late fulfillment of duties, interests, administrative fines for non-compliance with fiscal requirements and costs, are not left outside the scope. However, a list of taxes, effective at the time of signature of the treaty, should

⁵⁸ Kees van Raad, “The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion” Intertax 1994/11, p. 491

⁵⁹ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 87

⁶⁰ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 141

⁶¹ Stef van Weeghel, The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States, 1998 p. 54, note 57

⁶² Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 147

be provided, although it is not exhaustive.⁶³ Moreover, the model convention provides inclusion of “similar” taxes after the date of signature of the treaty. The list is extended to cover identical or substantially similar taxes to guarantee treaty benefits.⁶⁴ A problem might arise with respect to the determination of the taxes to which the treaty applies.⁶⁵

A treaty covers taxes and not fees: so it is more important for civil law countries than common law countries where taxes and fees are equivalent. Thus, this is one more issue to be reconciled before concluding treaties.

2.5 Beneficial ownership

A Tax Treaty is designed to encourage the international trade by eliminating double taxation but a taxpayer has a possibility to discover the differences in tax law and use the tax advantages among States. However, it is up to the State to counter and prevent such possibilities. Very surprisingly, a tax treaty makes such cases possible using artificial legal arrangements to benefit from the tax advantages under domestic law and the tax relief in tax treaties. The concept of “beneficial owner”⁶⁶ has been introduced in Articles 10, 11 and 12 of the OECD Model to eliminate such artificial arrangements and combat tax avoidance⁶⁷

As Stef van Weeghel has expressed, it seems that only the beneficial owner of the income should be entitled to the treaty protection and recommended to exclude the term “paid to” from the Articles 10, 11 and 12 of the Model and focused on the term beneficial owner.⁶⁸ The reason of the introduction of beneficial owner was to clarify the meaning of that term “paid to a resident”. However, the concept of beneficial owner did not bring clarity and explicitness in the situation because of the different interpretation by courts and tax administrations about who is considered to be the beneficial owner of the income. Such a result is leading to double taxation or double non-taxation causing those differences of interpretation.

Also alike of the term “residence” which is defined under domestic law the term “beneficial ownership” is not defined under the domestic law simply because of an historical absence of it. Therefore, it cannot be interpreted referring to domestic law since there is no any domestic law giving precise definition, except in the UK where the term originates from.⁶⁹

In fact, the reason for confusion is that the difference of the concept is used in tax treaties between states with different legal systems and traditions, including different understandings and meanings of ownership. In an international treaty context, the conflict is most often between the civil law and the common law states since it is a familiar term in common law states, while it is

⁶³ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 146 – 148, 152

⁶⁴ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 156

⁶⁵ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 52

⁶⁶ However, the word has different meanings in English common law, civil law, Dutch law, and international law. The OECD model convention does not define the term “beneficial ownership” or “beneficial owner” Vern Krishna, “Using Beneficial Ownership to Prevent Treaty Shopping” Special reports, November 16, 2009, p. 547

⁶⁷ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 111

⁶⁸ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 89

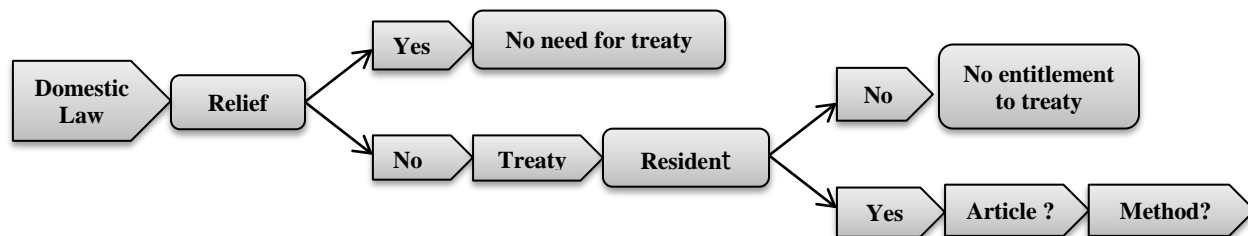
⁶⁹ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 65, note 96

not ordinary term in the domestic law of civil law states. The term was taken from the common law states and incorporated into the OECD Model and it is not yet investigated for international tax language.⁷⁰

Thus, discussions are not limited only to the beneficial owner and are open from time to time to public comments and offers, to be reviewed by all interesting parties, to establish uniformity.⁷¹ It is clear that an urgent help and cooperation is required to make clear provisions because it is really difficult to import a foreign term and implement it into a domestic law which is not made for it.

3. Main feature, conditions under which the treaty shall apply

If the domestic law does not provide a relief to avoid double taxation, the following steps should be taken: firstly, checking if the tax treaty is accessible, secondly, if the taxpayer is resident. Thirdly, which article applies in the treaty? Next, which method is applied for eliminating double taxation?⁷²



3.1 Persons covered

Article 3 (1) of the OECD Model define the term “person” stating that it includes an individual, a company and any other body of persons. Also the definition of “enterprises”, “international traffic” has been given. However, as it has been stated above, the list of the term “person” is not complete and has a very broad sense.⁷³ Consequently, it is a source of confusions and uncertainty. Stef van Weeghel has argued that the meaning of the terms “person” and “company” are not crucial for the application of the treaty. He has considered that the term “residence” for the application of a treaty is the real test.⁷⁴ Nevertheless, contrary to this opinion, the following case will demonstrate the diversity of “persons” that must be determined firstly in order to proceed to the definition of residence. Article 1 of the OECD Model should be understood with relation of Article 3 and Article 4 respectively.

⁷⁰ Charl du Toit The Evolution of the Term “Beneficial Ownership” in Relation to International Taxation over the Past 45 Years” Bulletin for International Taxation, October 2010, p.500, 501

⁷¹ Clarification of the meaning of “Beneficial owner” in the OECD Model Tax Convention. Public Discussion draft 29 April 2011 to 15 July 2011, OECD Centre for tax policy and administration. p. 2

⁷² Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997

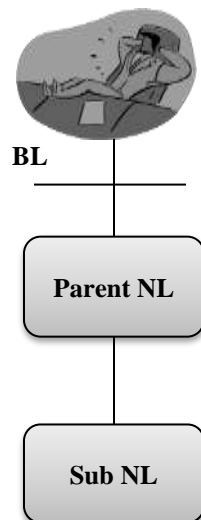
⁷³ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 171

⁷⁴ Stef van Weeghel “The improper Use of Tax Treaties With Particular Reference to the Netherlands and the Untated States” Kluwer Law 1998, p. 39

The new interesting Dutch case - 10/05383; 10/05385; 10/05386, 3 February 2012 on how the place of residence of a parent company and its subsidiary can be defined in a fiscal unity under Netherlands - Belgium Income and Capital Tax Treaty (1970) Articles 4(4), Article 3(1(2) and 1(3)).

The sole owner of the Dutch Parent company was an individual, who was resident in Belgium. The Dutch parent company was founded under the Netherlands law and was the taxpayer in the Netherlands. But the parent company owned all shares of another Dutch subsidiary company also resident in the Netherlands and formed a fiscal unity for Netherlands CIT purposes.

- In 1996 the parent company has transferred place of effective management to the Belgium, home address of the sole shareholder;
- The currency of the shares was changed from Dutch guilders into Belgian franks. (In 1996 before the euro currency was introduced);
- The sole shareholder has become a general manager;
- Since the taxpayer transferred its place of effective management, he had claimed that according to Article 4 (4) of the applicable tax treaty between Belgium and the Netherlands 1970 he became a resident of Belgium and no longer is liable for CIT in the Netherlands, thus the taxpayer was paying CIT in Belgium as resident of the country.



However, the Netherlands tax authorities rejected the interpretation that a transfer of the taxpayer's place of effective management had actually been achieved and had charged CIT as a Netherlands resident. The tax authority especially argued that the residence should be determined for a fiscal unity as a whole and fiscal unity should be regarded as a person for the treaty purposes.

Thereby, the issue at the court was whether for purposes of Article 4(4) of the 1970 tax treaty the effective management of a parent company belonging to a fiscal unity under Netherlands CIT should be determined for that company separately, having regard to the effective management of its subsidiary sharing in the fiscal unity.

The Netherlands Supreme Court considered that, according to the Article 3, the treaty defines a “person” as either an individual or a company and “company” as any body corporate and any unity that is treated as a body corporate. Thus, the court pointed out that, despite a subsidiary is deemed to be part of the parent and constitute a fiscal unity, it does not mean that the parent and the subsidiary would be treated as a single body corporate for purposes of the Article 3 of the treaty.

Furthermore, the Supreme Court does not consider that the contracting states would have intended to deem a fiscal unity a person for the treaty purposes.

Only the place of effective management is relevant when determining the residence of the parent company of a fiscal unity under Article 4 of the treaty. The court took the position that place of effective management of the subsidiary is relevant when determining the residence of that subsidiary itself and not relevant when defining the residence of the parent company of the fiscal unity.

Thus, the court ruled in favor of the taxpayer concluding that a fiscal unity does not qualify as a person and the residence under Article 4 of the treaty should be defined separately for each of the members in the fiscal unity.⁷⁵

The Netherlands tax authorities had established a practice of issuing residence certificates to subsidiaries in fiscal unities (Decree of 20 December 1996, No IFZ96/1529).

Consequently, the taxpayer was taxable in the Netherlands only on the income of its subsidiary, which was attributable to the taxpayer under the terms of the fiscal unity regime. The income of the subsidiary was classified under Netherlands domestic tax law as income from a taxpayer’s permanent establishment in the Netherlands, but under the treaty, as the subsidiary’s own.⁷⁶

Once the right person has been possibly defined, his residence can be considered. What constitutes residence will be discussed in the following chapter.

3.2 Residence of a Contracting States – what does it have to be assumed?

How can we connect an income of a person from the international trade to a particular State to have treaty protection from that State? Residence is a vital criterion in the international trade. The earliest conventions stated that treaty protection applies to “citizens” of a Contracting State. Later on, the term has been changed to “residents” of a contracting State, regardless to the nationality. Many treaties were even confusing because the protection was applicable to “taxpayers” without being resident of the Contracting State. It has been changed for practical reasons to give treaty applicability to “residents” of the Contracting States.⁷⁷ Who is considered being resident and how the term is defined will be discussed in this chapter.

As the first doctrine of the economic allegiance states, mentioned by George Schanz in 1892, some criteria of selecting subject to taxation such as physical presence, residence and nationality were highlighted. Presumably, a person economically tied and benefited from his community who also shared the responsibility, is considered to be a residence of that community. The idea

⁷⁵ Netherlands - Case 10/05383; 10/05385; 10/05386, 3 February 2012 IBFD. Decision published in Vakstudie-Nieuws 2012/9.15 and 2012/12.19 NTFR 2012, 319, english version presented by Hans Mooij, International Tax Consultant, The Hague

⁷⁶ Hans Mooij, International Tax Consultant, The Hague, Case 10/05383; 10/05385; 10/05386, 3 February 2012 IBFD.

⁷⁷ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 85

was developed in the economist's report in 1923 by famous economists proposing four elements of attribution of taxing rights to a particular State.

- Place of the production of the wealth;
- Place where the wealth is owned;
- Place of wealth's rights enforceability;
- Place of the wealth disposition and consumption.

It has been concluded that a State where the greatest economic interest lies and where a person habitually resides or has a property interest is the State with the greatest right to tax a person.⁷⁸

It is assumed that despite the globalization, the increasing mobility and the online network, cardinally in determining the right State of residence, nothing has changed during almost 100 years. The OECD Model has the basis concept taken from the mentioned report and relies on those fundamental criteria of residence. Nowadays, academic scholars also describe that the connecting terms for a person to a particular State in order to benefit from the treaty are "place of incorporation", "real seat" and "control"⁷⁹

Why is it so important to determine the State of residence of a person? Because whether or not a person has a legal capacity, legal rights to claim a particular State protection through the treaty depends on whether or not the person is the resident of the State.

The current OECD Model defines the term "residence" and refers to the domicile principle, place of management or any other criterion of a similar nature. The criteria establish, under the domestic law of a Contracting State, the worldwide tax liability of a person. What is assumed here is that a person resident in a Contracting State entitled to the treaty has specifically the power to claim rights under the double taxation convention.⁸⁰

However, many times the concept of worldwide tax liability for residents for a treaty purposes is subjected to an uncertainty. For example, it is questionable how a person could be "liable to tax" in a state that imposes no tax.⁸¹ On the contrary, "all it requires is that the person has a personal attachment to at least one of the contracting states, which might result in him becoming subject to full tax liability".⁸² Accordingly, it is suggested that if the person has such a personal attachment to one of a contracting state, he should be regarded as resident in that state for treaty purposes.

In order to benefit from a treaty the main point is the tax liability of a person who is a resident in a Contracting State. However, the question of actual payments has been stressed in the following case⁸³ between Frate Lone, Dubai (the taxpayer) and ADIT (the tax authorities). Is a resident qualifies for treaty application though he does not actually pay tax?

⁷⁸ Sarig Shalhav, "The Evolution of Article 4(3) and Its Impact on the Place of Effective Management Tie Breaker Rules" *Intertax*, Volume 32, Issue 10, 2004, p. 462 and note 17

⁷⁹ Guglielmo Maisto (ed) "Residence of Companies under Tax Treaties and EC Law" Amsterdam: IBFD, 2011, Volume 5, p.23

⁸⁰ Andrea Amatucci "International Tax Law" Kluwer Law International, 2006, p. 164

⁸¹ Baker Philip, *Double taxation conventions: a manual on the OECD model tax convention on income and on capital*, London: Sweet & Maxwell, 2001, 4B.07 and Joanna Wheeler, *The Missing Keystone of Income Tax Treaties*, *World Tax Journal* June p. 253

⁸² Klaus Vogel on *Double Taxation Convention*, Third Edition, Kluwer Law International, 1997, p. 229

⁸³ Case ITA No. 2439/Mum/2008, India – Frate Line, Dubai v. ADIT, 29 October 2010, IBFD

The tax authority has denied applicability of the treaty to the taxpayer on the ground that the taxpayer did not pay taxes in the United Arab Emirates although the taxpayer is resident and fiscally domiciled in the United Arab Emirates. He was engaged in the business of shipping and had claimed that Article 8 of India - United Arab Emirates Income and Capital Tax Treaty (1992) applied to its shipping income.

If the taxpayer did not actually pay tax in the United Arab Emirates, would he be regarded as 'resident' of the United Arab Emirates in terms of Article 4(1) of the treaty?

The court concluded that the actual payment of tax in one of the contracting states was not a prerequisite to benefit from a treaty in the other contracting state. It has been stated that the treaty prevented not only 'current' taxation, but also 'potential' double taxation. Once the taxing right had been allocated to the United Arab Emirates under specific circumstances, the right remained with the United Arab Emirates. It did not matter whether the United Arab Emirates exercised that right.

One more Indian case⁸⁴ (and it is not limited) also confirms that the expression 'liable to tax' appearing in Article 4(1) of the treaty does not necessarily imply that the taxpayer has to be actually liable to tax in the residence state; and it is enough if the residence state has the right to tax such taxpayer, regardless of whether such a right is exercised (this condition was satisfied in the present case).

Crown Capital Limited,⁸⁵ resident of the United Arab Emirates has derived certain long-term and short-term capital gains from India. According to the Income Tax Act 1961, the long-term gains were not subject to tax while short-term capital gains were subject to tax in India. Also according to article 13 of India - United Arab Emirates Income Tax Treaty (1992) capital gains received by a resident of United Arab Emirates were exempt from tax in India. Accordingly, the taxpayer claimed tax exemption from short-term gain as well.

The Tax authority considered that the taxpayer was not entitled to the treaty benefits on the ground that the taxpayer does not have an actual tax liability in the United Arab Emirates.

The issue which has been addressed to the court was whether the taxpayer was entitled to the treaty exemption disregard of the fact that he was not required to pay taxes in the United Arab Emirates.

The Court has considered the following factors:

- The treaty benefits were available on the basis of its place of incorporation in the United Arab Emirates. (prior to an amendment of the treaty effective from 1st April 2008).

- Based on previous cases⁸⁶ where the court had already clarified that regardless of whether the United Arab Emirates actually levied tax on individuals, it is sufficient that a state has the right to tax a taxpayer, disregard of whether such a right is exercised.

⁸⁴ Case ITA No. 2958/M/2009, 4 May 2011, India - United Arab Emirates Income and Capital Tax Treaty (1992), IBFD

⁸⁵ Case ITA No. 8147/ Mum/ 2010, 19 January 2011 India - United Arab Emirates Income Tax Treaty (1992) IBFD

⁸⁶ ADIT vs. Green Emirate Shipping and Travels (286 ITR 60 (AT)), ITO vs. American Express Bank Ltd. (ITAT No. 4650/Mum/2007 dated 09.07.2000), ITO vs. Rameshkumar Goenka (39 SOT 132), ITO vs. Birla Sunlife Management Co. Ltd.

- The company was wholly controlled and managed in the United Arab Emirates to be treated for treaty purposes as resident of the United Arab Emirates. Accordingly, the court noticed that, the actual tax liability in one of the contracting states was not a sine qua non for applicability of the treaty.

- It has been also observed that the taxpayer company holds a valid tax residence certificate which was issued by the tax authorities of the United Arab Emirates.

Finally, the court concluded that the taxpayer was entitled to the treaty benefits. Thus, the taxpayer did not have a tax liability in India in regards of the mentioned gains.

It should be mentioned that, despite having its supporters and opponents, the concept of residence based on unlimited tax liability for treaty purposes became widely accepted.⁸⁷

A residence certificate has been long required to residents of the other Contracting State to be entitled to the treaty benefits.⁸⁸ The India Mauritius case⁸⁹ (Income Tax Treaty 1982, Article 4 (1), decided whether the taxpayer is resident in the Mauritius and consequently entitled to the beneficial provisions of the treaty. One of the listed arguments was that the taxpayer held a residence certificate issued by Mauritius tax authorities. It was referred to the case *Azadi Bachao Andolan* (2003-(263)-ITR-0706-SC, 7 October 2003) stating that a tax residence certificate issued by the tax authorities constituted a valid and sufficient evidence of the residential status for the purposes of the treaty.

4. Taxation of legal persons

4.1 Subject to tax clauses

Tax treaties aimed to avoid the international double taxation, but avoiding the double non-taxation is not automatic in the treaties. Contracting states conclude subject-to-tax clauses in order to avoid double non-taxation. Subject-to-tax clauses are sometimes defined as rules which “make treaty benefits dependent on actual taxation, usually of a specific type of income”.⁹⁰

Treaty benefits in the source State are given in case the respective income is subject to tax in the State of residence.⁹¹

There is double non-taxation that is not precluded by the Model Convention. During the IFA Congress in Vienna, it has been considered that Model convention should prevent double non-

(ITA No. 3734/Mum/ 2008), *Hindustan Petroleum Corporation Ltd. vs. ADIT* (ITA Nos. 5273, 5274, 5761 & 5762/Mum/2004), *Meera Bhatia vs. ITO* (ITA No. 1876/Mum/2006) IBFD

⁸⁷ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 12

⁸⁸ J.David B. Oliver, *Deloitte Haskins&Sells, London, Access to tax treaties*, Intertax, 1989/8-9, p. 330, and <http://www.irs.gov/businesses/small/international/article/0,,id=122559,00.html>, Form 8802, Application for United States Residency Certification

⁸⁹ Case AAR No. 879 of 2010, 28 March 2011, *India - D B Zwirn Mauritius Trading No. 2 v. DIT, India - Mauritius Income Tax Treaty* (1982) Art. 4(1)

⁹⁰ Eva Burgstaller and Michael Schilcher “Subject-to-Tax Clauses in Tax Treaties” *European Taxation*, June 2004, p. 267

⁹¹ Issue in International Taxation, №1, OECD Paris 1987 “International Tax Avoidance and Evasion—Four Related Studies” p. 97

taxation as well.⁹² The problem of the double non-taxation, arising from a proper use, is non-abusive while the double non-taxation, following from an improper use of the treaty, is abusive.⁹³

Thus, it is not a surprise that tax treaties are used for tax planning too; moreover, it is the legal opportunity deriving from tax treaties,⁹⁴ usually on the basis that another country is taxing international transactions and offers opportunities for tax planning or avoidance.⁹⁵

The interaction between a domestic law and a contracted treaty law leads to the international double non-taxation and subject to tax clauses might be included in specific situations. Since this clause is not automatically included in Model those clauses are part of bilateral treaties. Generally the scope of subject to tax clauses is very limited and the clause only applicable to the specific types of income. The application of the subject to tax clause is cause for the vital reason of non-taxation. Most of them apply in case the income is not part of the tax base because there is not any taxable event in the domestic law. If the contracting States would like to avoid the double non-taxation, they have to negotiate on the subject to tax clauses in the treaty since they do not exist automatically in the model. Even upon agreement, not all cases could be covered, due to the limited scope of clauses.⁹⁶

However, the scope of subject-to-tax clauses has been increased and regulates anti-avoidance measures.⁹⁷

Summing up, it should be noted that actually the double non-taxation is the same enemy as the double taxation and specific treaty articles should be included in the Model, although OECD Model does not recommend such provisions.⁹⁸ In fact, the dilemma of the international taxation is to prevent additional (double) taxation of the international trade and prevent a non-taxation of international trade as well. It should be noted that subject-to-tax clauses have an advantage if compared to other anti-avoidance provisions and can be used for the prevention of the double taxation as well.⁹⁹

The international double non-taxation also highlights the imperfection of international agreements, giving many times the possibility for a tax planning. The reason why the topic is not enough stressed is unclear, but it is clear that the topic itself deserves more attention.

4.2 Treaty Shopping – where the limit goes?

The general rule is that a resident person can only benefit from the treaty if it is also a “qualified person”. Nevertheless, a resident that is not a “qualified person” may still benefit from the treaty provisions if it actively carries on business in the residence state.¹⁰⁰ Accordingly to the

⁹² Anna Scapa, Lars A. Henie “Avoidance of Double Non-Taxation under the OECD Model Tax Convention” *Intertax*, Volue 33, Issue 6/7 2005, p. 266

⁹³ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998, p. 258-259

⁹⁴ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 119

⁹⁵ *Tax Law Design and Drafting*, Volume 2; International Monetary Fund: 1998; Victor Thuronyi, (ed) Richard J. Vann “International Aspects of income tax” Chapter 18, p. 3

⁹⁶ Eva Burgstaller and Michael Schilcher “Subject-to-Tax Clauses in Tax Treaties” *European Taxation*, June 2004, p. 276

⁹⁷ Eva Burgstaller, Katharina Haslinger (ed) “Conflicts of Qualification in Tax Treaty Law” 2007, p. 335

⁹⁸ *Issue in International Taxation*, №1, OECD Paris 1987 “International Tax Avoidance and Evasion—Four Related Studies” p. 97

⁹⁹ Eva Burgstaller, Katharina Haslinger (ed) “Conflicts of Qualification in Tax Treaty Law” 2007, p. 347

¹⁰⁰ Perla Gyöngyi Végh, “The 2003 OECD Model” *European Taxation*, July/August 2003, p. 246

abovementioned, limitation on benefits provision provides limited eligibility for treaty benefits to a person who is not otherwise a qualifying person.¹⁰¹

Historically, the availability with “third country treaty network – treaty with the world” has been limited by introducing the concept of “limitation of benefits.”¹⁰² In other words, to restrict a treaty shopping and ensure that only residents can obtain full benefits of the treaty where they meet the criteria to be a qualifying person. By implementing a limitation on benefits clause in a tax treaty, the scope of persons that can access the treaty benefits is reduced.¹⁰³

Beneficial owner which is a special rule for simple cases of abuse¹⁰⁴ and limitation on benefits provisions, are considered to be technical and specific concepts supposed to prevent abusive forms of treaty shopping.¹⁰⁵ The relationship between beneficial owner and limitation on benefits provisions is that limitation on benefit provisions are further on narrowing the type of residence and beneficial owners of the income who are entitled for treaty benefits. First, the beneficial owner test must be applied. Then, if it has been determined that the beneficial owner is a resident, the mechanical tests of the limitation on benefit provisions must be applied to check whether that person is a "bona fide" resident or has a sufficient business purpose.¹⁰⁶

What does treaty shopping do and why it is needed to the shopper? According to Professor Rosenbloom, treaty shopping is an effort to take advantage of the international tax treaty network and careful selection of the most favorable treaty for a specific purpose.¹⁰⁷ It gives a possibility to the shopper to benefit indirectly of the treaty while it is not available directly: for this purpose, an entity is registered in a country that has an advantageous tax treaty.¹⁰⁸ A treaty shopping refers to the use of a treaty by persons who are not normally entitled to the treaty¹⁰⁹ and who are not in line with the personal scope of article of a particular treaty as the personal scope is indicated under wording “shall apply to”, i.e. a company in a treaty State acting as a conduit for channeling income, economically accruing to a person in another State, thus able to take advantage “improperly” of treaty benefits.¹¹⁰ The goal of the treaty shopping is a reduction (in some cases avoidance) from the source taxation.

However, it is well known that “any one may so arrange his affairs that his taxes shall be as low as possible.”¹¹¹ Accordingly, taxpayers are free to arrange their economy in the way they consider more beneficial. A tax planning on the domestic and international level is acceptable,

¹⁰¹ Zimka, Kevin, Eastwood, Lisa, Agostini, Massimo, “Canada-US treaty - limitation on benefits” *International Tax Review*, May 2008, Vol. 19, Issue 4, p. 1

¹⁰² William P. Streng, “Treaty shopping: tax treaty “Limitation of Benefits” *Houston Journal of international law*, 1992, volume 15, number 1, p. 10

¹⁰³ Perla Gyöngyi Végh, “The 2003 OECD Model” *European Taxation*, July/August 2003, p. 245, note 6

¹⁰⁴ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 127

¹⁰⁵ Vern Krishna, Using Beneficial Ownership to Prevent Treaty Shopping, *Tax Analysts*, November 16, 2009, p. 540

¹⁰⁶ Luc De Broe, *International Tax Planning and Prevention of Abuse*, Volume 14 in the Doctoral Series, 2008, p. 739

¹⁰⁷ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 96, note 4

¹⁰⁸ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 119

¹⁰⁹ Vern Krishna, “Using Beneficial Ownership to Prevent Treaty Shopping” *Special Report*, November 16, 2009, p. 538

¹¹⁰ Issue in International Taxation №1, OECD Paris 1987 “International Tax Avoidance and Evasion—Four Related Studies” p. 88

¹¹¹ *Helvering v. Gregory and IRC v. Duke of Westminster* (1935), Stefan N. Frommel “United Kingdom tax law and abuse of rights” *Intertax* 54 1991/2, p. 61, 77

but it may reach unacceptable levels, which cannot be within a legal system and the principles of justice. Transactions are performed and entities are established in another State to gain the benefits of a treaty¹¹² without having any other connection with that State. In this sense, it is crucial to know, in absence of anti-abusive provisions, whether there is a possibility to limit the ability of taxpayers to arrange their affairs through base companies, conduit or other structures to gain an advantage of a particular treaty made between states where the taxpayer is not a resident.¹¹³

The original idea of the treaty was to give protection to a resident of a Contracting State: thus the starting point was the residence in a Contracting State as a fact. Nowadays, the international context makes possible for a person to form an artificial resident for himself in whatever State, normally with a favorable treaty network to gain access to that favorable treaty. Thus, the starting point is the opposite: first a favorable treaty is identified and then the residence is adopted in the suitable State by setting up a resident-entity.¹¹⁴

However, it is not obvious that tax authorities are losing the battle;¹¹⁵ governments also keep the answer to such approach of artificial entities to prevent those improper uses of treaties by introducing a different kind of anti-abusive measures, with a particular relation among the tax subject, the tax object and the concept of beneficial ownership. Thus, the treaty shopping can be prevented thanks to the principle of substance over form, domestic law and limitation on benefit provisions in the treaty.¹¹⁶

General principles, for example, substance-over-form and an economic approach to the facts have been introduced. Nevertheless, can the principles be used in any case or are they only applied when it is specified in tax treaties?¹¹⁷ David Ward considers that, despite anti-abusive rules are general legal principles recognized by civilized nations and constitute the sources of international law,¹¹⁸ it is questionable how such an internationally acceptable anti-abuse rules can be formulated and when should they be applied? It has been suggested by David Ward to allow a state to apply its own anti-abusive rules but it would be applicable when dealing with a domestic abuse for internal law purposes. Thereby, it will lead to an imbalance in the application of a treaty by contracting states because internal anti-abusive laws may differ (and it is differed) from another contracting state, or can be the case where one state has such a rule but the other – does not. Thus, universally recognizing anti-abusive rules seems to appear as “an impractical utopian hope,”¹¹⁹ unless the OECD is formulating such rules.¹²⁰ Moreover, it is strongly

¹¹² Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 116

¹¹³ David A. Ward, “Abuse of Tax Treaties”, Intertax, 1995/4, p. 176

¹¹⁴ Stef van Weeghel, The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States, 1998 p. 96, note 3

¹¹⁵ David R, John F. Avery Jones “Are Tax Treaties Necessary?” Hein Online, Tax Law Review, Vol. 53, Issue 1 1999, p. 1

¹¹⁶ Stef van Weeghel, The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States, 1998 p. 165

¹¹⁷ David A. Ward, “Abuse of Tax Treaties”, Intertax, 1995/4, p. 177

¹¹⁸ David A. Ward, “Abuse of Tax Treaties”, Intertax, 1995/4, p. 180, note 31

¹¹⁹ David A. Ward, “Abuse of Tax Treaties”, Intertax, 1995/4, p. 181

¹²⁰ David A. Ward, “Abuse of Tax Treaties”, Intertax, 1995/4, p. 181

recommended that the OECD Model incorporate a specific limitation provisions agreed by member States.¹²¹

However, again, the diversity of the tax system, the different interests and variety of situations that should be considered do not made yet possible to reach the international consensus.¹²²

Meanwhile, the following approaches have been considered by the Committee on Fiscal Affairs to limit the treaty shopping and the improper use of tax treaties, although none of them covers perfectly all the aspect of the treaty shopping:

- Look through approach is supposed to restrict benefits to a company not owned, directly or indirectly, by residents of the State where the company is a resident. Such provisions may limit benefits to companies that have a certain minimum level of local ownership. (IBFD glossary) It means that a resident company may not be entitled to treaty protection if it is owned and controlled by persons who are not residents of a Contracting State. Nevertheless, it is up to treaty negotiators to determine a company status as owned and controlled by non-residents. This approach is normally used by low-tax countries.

- Exclusion approach is considered to deny benefits to company benefiting from a privileged tax regime.

- Subject-to-tax approach is used when a company is not subject to tax in respect of the income: treaty benefits are allowed if the income is subject to tax which represents the aim of tax treaties – avoidance of double taxation. The approach is suitable for developed countries with a complex tax law. The approach is oriented to eliminate companies using special tax arrangements from a treaty entitlement and take the task more suitable since its application is extent to all situations, either based on the law or on special tax ruling.¹²³

- Channel approach is also known as “base erosion rule” when a company pays income in tax-deductible form. An income is received by a non-resident company in a Contracting State, although it is paid by a resident of a Contracting State.

- Bona fide provision is the general rule that denies all treaty benefits to persons who are not bona fide residents of the treaty country.¹²⁴

Although, the definitive text has been left up to treaty negotiators and only recommendations have been suggested.¹²⁵

Concluding this chapter, it can be noted that there is no any international agreement to control treaty shopping and restrict treaty benefits because of the different policies of states towards tax avoidance and treaty shopping.¹²⁶

¹²¹ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 259

¹²² Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 213

¹²³ Stef van Weeghel, *The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States*, 1998 p. 96, note 214

¹²⁴ Vern Krishna, “Using Beneficial Ownership to Prevent Treaty Shopping” *Tax Analysts* 2009, p. 538

¹²⁵ Issue in International Taxation №1, OECD Paris 1987 “International Tax Avoidance and Evasion—Four Related Studies” p.95-100 and Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 111-113

¹²⁶ Vern Krishna, Using Beneficial Ownership to Prevent Treaty Shopping, *Tax Analysts*, November 16, 2009, p. 550 and Luc De Broe, Nathalie Goyette, Philippe Martin, Roy Rohatgi, Stef van Weeghel and Phil West, *Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions*, Bulletin for international taxation, July 2011, p. 389

The domestic case law where beneficial owner and substance over form rules are used in order to determine a treaty application will be presented in the following chapter.

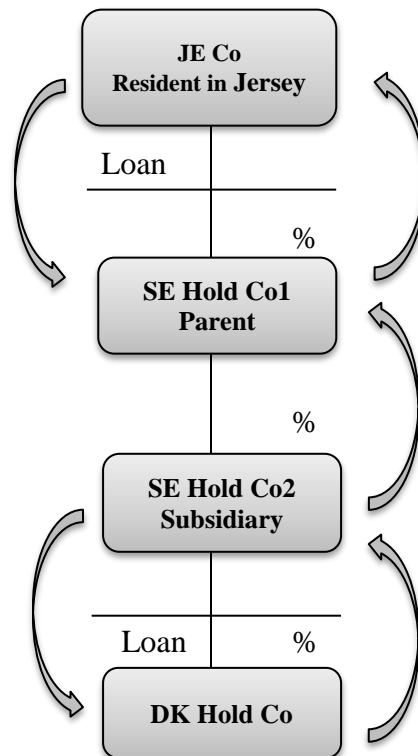
4.3 Tax Treaty Case Law

For example, an entitlement to the treaty protection has been denied by Danish Tax Tribunal in the below case:

A resident company in Jersey (JE Co) holds a Danish holding company (DK Hold Co) through two Swedish parent holding SE HoldCo1 and subsidiary SE HoldCo2. SE Hold Co1 is holding shares of SE HoldCo2 and DK Hold Co without performing a real business activity.

JE Co granted a loan to SE HoldCo1, after SE HoldCo2 granted a loan to DK Hold Co on the day that it acquired DK Hold Co. Notably, those two loans had the same interest rate and face value.

DK Hold Co paid interest to SE HoldCo2 which the latter subsequently transferred to SE HoldCo1 as group contribution. SE HoldCo1 in turn paid interest to JE Co.



The Danish tax authority took the position that the interest paid by DK Hold Co to SE HoldCo2 was subject to withholding tax, since Swedish companies were not beneficial owners of the interest received. As a consequence, DK Hold Co was required to withhold and pay the tax.

The issue which has been addressed to the court was: could Swedish holding company SE HoldCo2 and subsequently SE HoldCo1 be qualified for the treaty entitlement under Article 11(1) of the Nordic Convention and regarded as the beneficial owner of the interest received from a Danish company DK Hold Co?

According to Danish law, withholding tax is not levied if the withholding taxation is reduced or abolished by a tax treaty. Under Article 11(1) of the Nordic Convention, interest paid to a recipient in the other contracting state is taxable in the recipient residence state and the interest is paid to the beneficial owner.

Nevertheless, interests on controlled-debt (i.e. debt to companies that directly or indirectly own more than 50% of the shares or the voting power of the debtor company) paid to non-resident companies are subject to withholding tax.

The National Tax Tribunal has considered the following fact before taking a decision in favor of the tax authority:

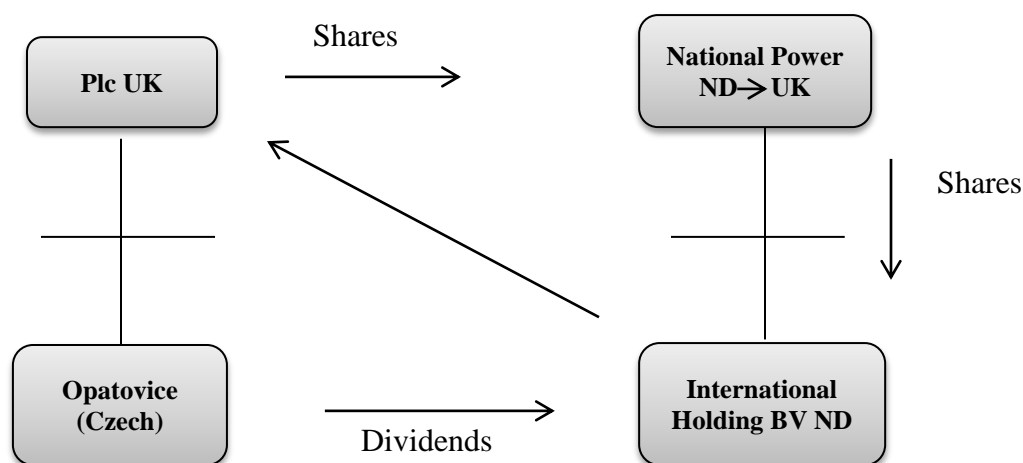
The group contributions between SE HoldCo2 and SE HoldCo1 did not result in taxable income since the contribution is a deductible expense for the payer and taxable income for the recipient. The fact that the payment between two Swedish companies is classified as group contributions, and not as interest, is insignificant. Thus, Swedish companies are regarded as conduit companies since they do not have a real power to act regarding the disposition of the interests received.

Taking into account that SE HoldCo1 and SE HoldCo2 have no business activity except the holding of the shares of DK Hold Co and the identical loans are acquired with a view to escape from the withholding taxes on interest payments made by DK Hold Co.

As a result, it has been decided that DK Hold Co interest liability is in fact paid to JE Co through SE HoldCo1 and SE HoldCo2; and SE Hold Co 2 or SE HoldCo1 were held not to be the beneficial owner of the interests under the Nordic Convention.¹²⁷

Another interesting case about intermediary companies, substance over form rule and beneficial owners has been decided by Czech Supreme Administrative Court.

International power plc (UK) was a shareholder of the International Power Opatovice (Czech) – operator of brown coal power plant in the East Bohemia. The UK plc transferred shares to Dutch National Power International Holdings B.V which later became a tax resident of the UK. Shares have been transferred again from National Power International Holdings B.V (UK) to International Power Holdings B.V (ND)



¹²⁷ Case 09-00064 / SKM No. 2011.57, 22 December 2010, IBFD English summary is presented by Katja Joo Dyppele, Ph.D. scholar, Corit, Copenhagen Business School and Deloitte

International Power Opatovice, (Czech) paid dividends (around euro 25 ml) to International Power Holdings B.V (ND) which afterwards has remitted the amount directly to the bank account of International power plc UK in 2003. On this action, International Power Holdings B.V. stated that, through this payment, it discharged its obligation to pay declared (but not yet paid) interim dividends to its parent, National Power International Holdings B.V., which, in turn, discharged its obligation to pay declared (but not yet paid) interim dividends to its parent.

However, Czech tax authority argued that double transfer of shares from International Power plc (UK) to National Power International Holdings B.V. and, eventually, to International Power Holdings B.V. was a formal transaction and relied on the general substance-over-form rule. Except this, the Czech tax authorities, using the possibility of the mutual assistance, received documents about the group structure from the Netherlands and the United Kingdom, mentioning the fact that, “the dividends from International Power Opatovice, (Czech) to International Power, plc. (UK) are not subject to withholding tax as they flow through International Power Holdings B.V.”

The Czech tax authorities argued that the only reason why the International Power Holdings B.V. (ND) was established was the purpose to avoid withholding tax on dividends before the Czech Republic joined the European Union on 1 May 2004.

The question which has been addressed to the court was: could the Dutch International Power BV - intermediary company be regarded as the beneficial owner of the dividends received from the International Power Opatovice - Czech subsidiary under Article 10(3) of the 1974 treaty between Czech Republic - Netherlands if beneficial ownership requirement is not directly mentioned in the treaty?

The issue is that tax treaties concluded in the 1970s and early 1980s (including the tax treaties with the Netherlands, Japan, Sri Lanka, Sweden, Greece and Germany) followed the 1963 OECD Model and did not refer to the beneficial owner when setting out tax treaty benefits for recipients of dividends, interest and royalties. However, later treaties concluded by the Czech Republic include the concept of beneficial ownership. Also, after joining the EU in 2004, Czech Republic incorporated the Interest and Royalties Directive into the Czech Income Taxes Act, limiting its benefits to beneficial owner, i.e. if a person receives those payments for its own benefit and not as an intermediary, such as an agent or authorized signatory, for some other person.

According to the Czech Supreme Court the fact that the dividends were actually paid out to International Power, plc (UK) does not automatically entail that International Power Holdings B.V. was not the beneficial owner of the shares. It has been concluded that a beneficial owner can instruct the paying agent to pay out the dividend to a third party. The documents received through mutual assistance procedure were considered not sufficient to make conclusion that the parties clearly did not qualify for the benefits of the tax treaty. It has been stated that such documents cannot be used because the taxpayer did not have a chance to review and comment them during the tax proceedings at the administrative level as they were obtained after the decision and were not disclosed.

Nevertheless, it has been noted that if the recipient did not exercise its shareholder rights and the dividends only “flowed through” to it in order to avoid withholding tax it would have not been possible to apply the benefits of the 1974 treaty.¹²⁸

It should be stated that the terms used in tax treaties, which has been signed many years ago, should be revised and updated according to the current reality. Otherwise the expression “limitation of benefits” becomes useless. This case also demonstrates the importance of mutual assistance, although in the particular case, did not help.

It has been indirectly indicated that if the Czech tax authorities had collected documents regarding the recipient before taking the final decision at the administrative level and these documents had clearly indicated that the dividends only “flowed through” to recipient, the decision would have been opposite: the tax treaty benefits would not have been allowed despite the particular tax treaty was based on the 1963 OECD Model and did not refer to the beneficial owner directly.¹²⁹

After considering two cases it is clear that the treaty abuse exists because persons and entities are abusing (irrespective of resident or not). If a legal entity is not entitled to a treaty, he uses any suitable possibilities to receive the treaty entitlement.

Generally, whatever are circumstances, contracting States expect that an income will be taxed either in one of the contracting state or partly in both.¹³⁰

5. Is the mutual assistance a solution?

“The prevention of the fiscal evasion primarily refers to cases where taxpayers fraudulently conceal incomes in an international setting and rely on the inability of tax administrators to obtain information abroad”.¹³¹ Thus, the articles of the exchange of information in tax treaties are very important since they are dealing with this problem. The exchange of information is important, but in practice, there are some considerable hurdles to reach a successful exchange, for many different reasons.¹³²

Mutual assistance, exchange of information and administrative cooperation play a vital role in helping to detect and combat international tax abusive practices because the cooperation makes the battle more efficient. However, in practice, the mutual cooperation works very slowly in favor of an abusive behavior. It is not easy to obtain information behind the national borders,

¹²⁸ Case 2 Afs 86/2010-141, 10 June 2011, IBFD and Pavel Fekar “Czech Supreme Administrative Court on Beneficial Ownership” European Taxation, September/October 2011

¹²⁹ Pavel Fekar “Czech Supreme Administrative Court on Beneficial Ownership” European Taxation, September/October 2011, p. 420

¹³⁰ Stef van Weeghel “The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States” 1998, p. 257

¹³¹ Tax Law Design and Drafting, Volume 2; International Monetary Fund: 1998; Victor Thuronyi, (ed) Richard J. Vann “International Aspects of income tax” Chapter 18, p. 8

¹³² Tax Law Design and Drafting, Volume 2; International Monetary Fund: 1998; Victor Thuronyi, (ed) Richard J. Vann “International Aspects of income tax” Chapter 18, p. 8

where the competence of the State is limited; apart from any kind of barriers, even the problem of the language plays its role in the difficulty to obtain information.¹³³

States are developing already existing rules in the administrative cooperation since they aimed extremely challenging task to keep balance among sovereignties in taxation, to exercise revenue collection right and not hinder movement at the international level with the issue of a taxpayer's fundamental rights.

Even the mutual assistance could not escape from the problem of the diversity of the legal systems since States have different understanding on the level of exchange information and certain limits. This is the reason why cooperation is important. As it is known, the cooperation among tax authorities in the field of mutual assistance in tax matters is performed through the European Union (EU), the Organization of Economic Cooperation and Development (OECD), the United Nations (UN), the Inter-American Center of Tax Administrations (CIAT), Asociación Latinoamericana de Integración (ALADI), and between the Nordic States.¹³⁴ All those organizations have developed methods such as, for example, OECD Model Article 25, 26 Mutual agreement procedure and exchange of information respectively. Based on this articles contracting States are entitled to claim, under international law,¹³⁵ a treaty partner to provide information for the purpose of administrative assistance and provisions on mutual agreement procedure for resolving treaty disputes. However, according to article 26(2) a treaty partner may refuse to provide information if it led to the violation of the law or to the administrative practice of a treaty partner. Moreover, requesting information cannot be necessarily obtainable and providing information leads to disclose trade or business secrets which are contraries to public policy.¹³⁶ It should be noted that in tax matter everything is important. Even the exchange of information could lead to the dispute as can be seen in the tax treaty case law.

Except listed organizations, there is a Global Forum on Transparency and Exchange of Information for Tax Purposes whose work has been performing by both OECD and non-OECD economies since 2000.¹³⁷ As its report states, the Global Forum is authorized to ensure that all jurisdictions (more than 90 countries) follow the same high standard of international cooperation in tax matters.¹³⁸ It should be noted that a permanent works are going on and one of them is the "Good governance in tax matters" issued by the European Commission on 28 April 2009. Tasks of the project include greater transparency, exchange of information, fair tax competition and more international cooperation in the fight against tax evasion, "to take action against non-cooperative tax jurisdictions, including tax havens".¹³⁹ It has been held that request of information can no longer be refused on the ground that the information is held by certain

¹³³ Tax Law Design and Drafting, Volume 2; International Monetary Fund: 1998; Victor Thuronyi, (ed) Richard J. Vann "International Aspects of income tax" Chapter 18, p. 8

¹³⁴ Ulrika Gustafsson Myslinski, "Mutual assistance in tax affairs" Swedish national report to the conference of the European association of Tax Law professors in Santiago Di Compestela, June, 2009, p.3

¹³⁵ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 1402

¹³⁶ Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997, p. 1393 and Richard L. Doernberg, "International Taxation in a nutshell", 6th edition, Thomson west, 2004, p. 150-152

¹³⁷ WWW.OECD.ORG/TAX/TRANSPARENCY and WWW.EOI-TAX.ORG

¹³⁸ Report of "The Global Forum on transparency and exchange of information for tax purposes" OECD, 05 April 2012, p. 2, 4-6

¹³⁹ EU Tax News, "Major developments-Stepping up efforts to promote good governance in tax", Issue 31 May/June 2009, p. 1

financial institutions, or on the ground that the requested state has no domestic interest in such information.¹⁴⁰

It has been already admitted by almost all States that the need of international assistance is highly important. However, a taxpayer also admitted that it is necessary to overcome the existing rules and is considering a new way. As the history of the treaty evolution shows, any new provision has been implemented in a treaty, every time with more inventive approach, because it was dictated by a taxpayer's abusive behavior. Accordingly, do these new taken steps really help to combat the illegal behavior? It is assumed that no and can be proven by the case law on the matter. It should be suggested that opposition exist continuously and will remain, as long as the concept of the state and taxpayer will be existing.

As a conclusion of this chapter, I would have liked to answer that the mutual assistance is a solution but after analyzing the case law it does not appear to be so.

5.1 Is protection for taxpayers and states enough?

It is well known that a legal certainty and the taxpayers' rights should be balanced with the necessity for states to protect their tax revenues from the misuse of treaty provisions. Thereby, states affect the balance between the need to protect their tax revenues and the need to provide legal certainty to taxpayers who often invest many resources in developing countries.¹⁴¹

Thus, the lack of legal certainty and clarity continues to remain for taxpayers as well as some confusing factors at the international level, while States are still keeping track on mobility in globalization to detect abusive practice.

For States, among other provisions, the limitation on benefits has been supposed to help to avoid treaty shopping. We all have admitted that those problems exist and we need to cope all the time with some arising new ones. The Model Tax Convention of the OECD, on which virtually all bilateral treaties are based, is continuously revised to meet the current needs of a particular time issue.¹⁴² The seminar, concerning Tax Treaties in the 21st Century, in 2002, and the upcoming seminar in Mumbai in 2014 are the evidence of revising needs of all time. However, a fundamental revision of the existing tax treaties is necessary because the requirements are becoming more challenging as the time goes by.

Considering that article 26(2) OECD Model consists in a limitation of exchange information (three exceptions); it can be assumed that opportunities for protection are given to both States and taxpayers. However, the protection is left to the discretion of the tax authorities.¹⁴³ On the paper, the rules are precisely written, but as we know, practice deviates from the theory especially in tax matter when the confrontation is becoming a real war. The pressure from tax

¹⁴⁰ 2012 Ben Terra/Julie Kajus, EVD News 15 Jun 2009 - Good governance in tax matters, clause 5

¹⁴¹ Luc De Broe, Nathalie Goyette, Philippe Martin, Roy Rohatgi, Stef van Weeghel and Phil West, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions, Bulletin for international taxation, July 2011, p. 376, 377

¹⁴² Brian J. Arnold, Jacques Sasseville and Eric M. Zolt, "Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century" International Bureau of Fiscal Documentation June 2002, p. 233

¹⁴³ Perla Gyöngyi Végh "Towards a Better Exchange of Information" European Taxation, September 2002, p. 398

authorities to comply with their requirements is highly intensive and huge number of rule changes leads to difficulties to keep tracking and follow them, and makes difficult to work in a global environment that can be called hyper-regulatory environment.¹⁴⁴ Tax authorities have been fighting to take over tax avoidance to protect their revenue. The effort includes the renovation of bilateral treaties in sections of the exchange of information to increase transparency and reduce the cases of tax avoidance, evasion with a lot of anti-avoidance regulations. Having reached very complex level in anti-avoidance regulations some countries simply call to moral righteousness.¹⁴⁵

6. Conclusion

The scope of the treaty entitlement is becoming narrow for legal entities because restrictions and limitations that limit treaty benefits have been developed to deal with treaty shopping in order to make sure that benefits of a treaty are available only to qualified persons, who are residents of a contracting state. Thus, it is strongly recommended to take them into account when planning cross-border investments.¹⁴⁶

However, no efficient solution has been yet presented, as the thesis shows. The issue of the treaty entitlement consists in many single subjects which interact with each other. They are with their open questions and uncertainty: for example, the definition of the person, differences in the interpretation at the international level of the term “beneficial owner”¹⁴⁷ and the absence of limitation on benefits provisions at the OECD level¹⁴⁸. All the single issues should be resolved step by step and separately to present a clear picture of persons who are entitled to the treaty protection.

Meanwhile, legal entities are qualified for a treaty protection if they meet the criteria of a qualified person. Those criteria vary from treaty to treaty. Some treaties contain very complex limitations on benefits provisions¹⁴⁹ that are limiting even more persons who are qualified for treaty purposes. It should also be mentioned that not all the States will necessarily aim to include provisions strictly limiting the access to their tax treaties because of the differences of tax policy objectives among countries and the economic reality. Thus, in some cases the treaty entitlement would not necessarily require that the resident satisfies limitation on benefits provisions¹⁵⁰.

The disparity between domestic taxes and legal systems does not allow to uniform the definition of legal person, which is entitled to a treaty protection. Moreover, in absence of an agreement either because of different legal system, tax policy or economic interest, on how to control treaty shopping and restrict treaty benefits, those factors differentiates even more persons qualified for

¹⁴⁴ Chris Walsh, “How you can manage taxes in a hyper-regulatory world”, Tax management, HeinOnline 21 Int'l Tax Rev. 60 2010-2011, May 2010, p. 60

¹⁴⁵ Chris Walsh, “How you can manage taxes in a hyper-regulatory world”, Tax management, HeinOnline 21 Int'l Tax Rev. 60 2010-2011, May 2010, p. 61

¹⁴⁶ Michael Miller “Accessing U.S. Income Tax Treaties: Current Trends in the Limitation on Benefits Article” International Tax Journal May/June 2007, p. 9

¹⁴⁷ Stef van Weeghel “The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States” 1998, p. 64, note 94

¹⁴⁸ Stef van Weeghel “The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States” 1998, p. 259

¹⁴⁹ Netherlands - United States Income Tax Treaty 1992, as amended 2004, Article 26, IBFD

¹⁵⁰ Vern Krishna, Using Beneficial Ownership to Prevent Treaty Shopping, Tax Analysts, November 16, 2009, p. 540

treaty benefits, according to every single treaty. Thus, an entity which satisfies all criteria of a specific treaty is entitled to that treaty protection.

Bibliography

Official documents

OECD Model Tax Convention on income and capital, Organization for Economic Co-operation and Development 2010

Issue in International Taxation, №1, OECD Paris 1987 “International Tax Avoidance and Evasion—Four Related Studies”

Tax Treaty Case Law

EWCA Civ 304, 23 March 2011 United Kingdom - Bayfine UK v. Commissioners for HM Revenue and Customs, IBFD

ITA No. 2439/Mum/2008, India - Frate Line, Dubai v. ADIT, 29 October 2010

10/05383; 10/05385; 10/05386, 3 February 2012 Netherlands - IBFD. Decision published in Vakstudie-Nieuws 2012/9.15 and 2012/12.19 NTFR 2012, 319, English version presented by Hans Mooij, International Tax Consultant, The Hague

SKM No. 2011.57, 09-00064 / 22 December 2010, IBFD English summary is presented by Katja Joo Dyppel, PhD scholar, Corit, Copenhagen Business School and Deloitte

Afs 2 86/2010-141, 10 June 2011, IBFD Czech Supreme Administrative Court, IBFD

ITA No. 2958/M/2009, 4 May 2011, India - United Arab Emirates Income and Capital Tax Treaty (1992), IBFD

ITA No. 8147/ Mum/ 2010, 19 January 2011 India - United Arab Emirates Income Tax Treaty (1992) IBFD

AAR No. 879 of 2010, 28 March 2011, India - D B Zwirn Mauritius Trading No. 2 v. DIT, India - Mauritius Income Tax Treaty (1982) Art. 4(1) IBFD

Academic scholars

Klaus Vogel on Double Taxation Convention, Third Edition, Kluwer Law International, 1997

Stef van Weeghel, The Improper Use of Tax Treaties: with particular reference to the Netherlands and the United States, 1998

Andrea Amatucci, International Tax Law, Kluwer Law International, 2006

Richard A. Musgrave, Peggy B. Musgrave, Public finance in theory and practice, 5th edition

Eva Burgstaller, Katharina Haslinger (ed), *Conflicts of Qualification in Tax Treaty Law*, 2007

Richard L. Doernberg, *International Taxation in a nutshell*, 6th edition, Thomson west, 2004

Michael Lang, *Tax Treaties: Building Bridges between Law and Economics*, IBFD 2010

Luc De Broe, *International Tax Planning and Prevention of Abuse*, Volume 14 in the Doctoral Series, 2008

Raffaello Russo “Fundamentals of International Tax Planning” 2007

Philip, *Double taxation conventions: a manual on the OECD model tax convention on income and on capital*, London: Sweet & Maxwell, 2001

Doctrinal Articles

The David R, John F. Avery Jones, *Are Tax Treaties Necessary?* Hein Online, *Tax Law Review*, Vol. 53, Issue 1, 1999

John F. Avery Jones, *Characterization of Other States’ Partnerships for Income Tax*, *Bulletin-tax treaty monitor*, July 2002

J. David B. Oliver, *Deloitte Haskins & Sells, London, Access to tax treaties*, *Intertax*, 1989/8-9

Michael Miller, *Assessing U.S. Income Tax Treaties: Current Trends in the Limitation on Benefits Article*, *International Tax Journal* May/June 2007

Stefan N. Frommel “United Kingdom tax law and abuse of rights” *Intertax* 54 1991/2

J. David B. Oliver, *The Relevance of Tax Treaty History*, *Intertax*, Volume 33, Issue 11

Kees van Raad, *The Term “Enterprise” in the Model Double Taxation Conventions – Seventy Years of Confusion*, *Intertax* 1994/11

Brian J. Arnold, Jacques Sasseville and Eric M. Zolt, *Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century*, *International Bureau of Fiscal Documentation* June 2002

Tax Law Design and Drafting, Volume 2; *International Monetary Fund: 1998*; Victor Thuronyi, (ed) Richard J. Vann, *International Aspects of income tax*, Chapter 18

Prof. Michael J. McIntyre, *Options for Greater International Coordination and Cooperation in the Tax Treaty Area*, *International Bureau of Fiscal Documentation* 2002

Vern Krishna, *Using Beneficial Ownership to Prevent Treaty Shopping*, *Special reports*, November 16, 2009

Charl du Toit, The Evolution of the Term “Beneficial Ownership” in Relation to International Taxation over the Past 45 Years, Bulletin for International Taxation, October 2010

Guglielmo Maisto (ed), Residence of Companies under Tax Treaties and EC Law, Amsterdam: IBFD, 2011, Volume 5

Stef van Weeghel, The Tie-Breaker Revised: Towards a Formal Criterion? in Liber Amicorum F. Vanistendael “A vision of Taxes Within and Outside the European Borders” Kluwer 2008

Brian J. Arnold, Tax Treaty News, Bulletin for International Taxation, October 2008

Eva Burgstaller and Michael Schilcher, Subject-to-Tax Clauses in Tax Treaties, European Taxation, June 2004

Anna Scapa, Lars A. Henie, Avoidance of Double Non-Taxation under the OECD Model Tax Convention, Intertax, Volue 33, Issue 6/7 2005

David A. Ward, Abuse of Tax Treaties, Intertax, 1995/4

William P. Streng, Treaty shopping: tax treaty “Limitation of Benefits” issue, Houston Journal of international law, 1992, volume 15, number 1

Zimka, Kevin, Eastwood, Lisa, Agostini, Massimo, Canada-US treaty - limitation on benefits, International Tax Review, May 2008, Vol. 19, Issue 4

Perla Gyöngyi Vég, The 2003 OECD Model, European Taxation, July/August 2003

Pavel Fekar, Czech Supreme Administrative Court on Beneficial Ownership, European Taxation, September/October 2011

Ulrika Gustafsson Myslinski, Mutual assistance in tax affairs, Swedish national report to the conference of the European association of Tax Law professors in Santiago Di Compestela, June, 2009

John F Avery Jones, Understanding the OECD Model Tax Convention: The Lessons of History, Florida tax review, Volume 10/1, 2009

Perla Gyöngyi Vég, Towards a Better Exchange of Information, European Taxation, September 2002

Chris Walsh, How can you manage taxes in a hyper-regulatory world, Tax management, HeinOnline 21 Int'l Tax Rev. 60 2010-2011, May 2010

Vern Krishna, Using Beneficial Ownership to Prevent Treaty Shopping, Tax Analysts 2009

Richard Vann “Writing Tax Treaty History” Sydney Law School, Legal Studies Research Paper No. 10/19 March 2011

Sarig Shalhav, “The Evolution of Article 4(3) and Its Impact on the Place of Effective Management Tie Breaker Rules” Intertax, Volume 32, Issue 10, 2004

Luc De Broe, Nathalie Goyette, Philippe Martin, Roy Rohatgi, Stef van Weeghel and Phil West, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions, Bulletin for international taxation, July 2011

Joanna Wheeler, The Missing Keystone of Income Tax Treaties, World Tax Journal June 2011

Online publications

Clarification of the meaning of “Beneficial owner” in the OECD Model Tax Convention. Public Discussion draft 29 April 2011 to 15 July 2011, OECD Centre for tax policy and administration

WWW.OECD.ORG/TAX/TRANSPARENCY

WWW.EOI-TAX.ORG

www.taxtreatieshistory.org

<http://www.irs.gov/businesses/small/international/article/0,,id=122559,00.html>

Netherlands - United States Income Tax Treaty 1992, as amended 2004, Article 26, IBFD

Report of “The Global Forum on transparency and exchange of information for tax purposes” OECD, 05 April 2012

EU Tax News, “Major developments-Stepping up efforts to promote good governance in tax”, Issue 31 May/June 2009

2012 Ben Terra/Julie Kajus, EVD News 15 Jun 2009 - Good governance in tax matters

David A. Ward, Access to Tax Treaty Benefits, September 2008, p.3, Available on the Internet at: www.apcsit-gercfi.ca