"La visión Europea de los tratados para evitar doble tributación"

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Introduction to tax treaties

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Tax treaties

-- purposes:
  > promotion of cross-border trade and investment without tax obstacles (double taxation)
  > counter-acting international tax evasion

-- concluding tax treaties
  > mutual benefits for the two states:
    o reduction of gross income based withholding taxes
    o coordination between source country taxation and residence country double taxation relief
    o exchange of information & assistance in tax collection
  > tax treaty negotiation

-- OECD & UN Model treaties
  > function of model treaties
  > function of OECD Commentary

Structure of a tax treaty

-- Chapter 3: distributive articles: overview
  > Articles that prohibit source state from taxing: e.g. Art. 18
  > Articles that require residence state to give double taxation relief for (unrestricted) source state taxation: e.g. Art. 6, combined with Art. 23A.1 (exemption) or 23B.1 (credit)
  > Articles that provide for tax sharing: e.g. Art. 11, combined with Art. 23A.2 (exemption) or 23B.1 (credit)

-- Application of Art. 7 (Business profits) combined with definition in Art. 5 (Permanent establishment)
Application of Art. 7 (Business profits)

O main rule: Art. 7.1 s-1,1: only residence state
    exception: Art. 7.1 s-1,2: unless PE in other state:
    > then: limitation to profits attributable to PE under arm's length rules

O notion of `permanent establishment´ (PE) under OECD Model:
    > Art. 5.1: physical PE
    > Art. 5.3: project PE
    > Art. 5.5: agency PE

Art. 4.1 (Residence) OECD Model

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof.

This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Tax terms may have different meanings in internal tax law and in tax treaties

a. `Resident´

Treaty definition of Art. 4.1 is based on internal law definition of `resident´ (provided it gives rise to the most comprehensive form of tax liability available in that country – usually: worldwide tax liability),

>> a permanent establishment of a foreign company is for tax treaty purposes NOT a resident taxpayer.

>> also: a qualifying `internal law´ resident may lose treaty residence under treaty tie-breaker rule (Art. 4.2 & .3) – but will remain for domestic tax purposes a resident taxpayer

(but in UK, Canada and South Africa: will also lose domestic law residence).

b. Classification of an item of income

A profit-sharing interest payment which a resident taxpayer from foreign State S is classified under internal tax law of State S as a dividend and therefore subject to domestic dividend withholding tax of e.g. 20% (State S has no withholding tax on interest). Under the tax treaty with State S the payment is classified as

>> interest (Art. 11: max. rate 10%)

>> and not as dividend (Art. 10: max. rate e.g. 5%).

Result: State S may apply its dividend tax up to a rate of 10%.
Understand the core notions of a tax treaty’s distributive rules correctly

b. ‘Other State’ -- concept of source

Do not get confused by Article 1:

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

It refers only to the recipients of the income, and not to the payors (source).

Example:

I (resident of NL) receive from the US:

-- rent from my brother (a US resident) for his use of an apartment that I own in Amsterdam, for which rent it is assumed that I am subject to US dom. tax;

-- interest from Citibank (a US resident) on the deposit that I maintain with the Amsterdam branch office of Citibank, for which interest I am assumed to be subject to US domestic taxation.
**Example [continued]:**

-- rental income: *Art. 6.1 OECD*:
The `source` of the income is in the State *(not where the debtor of the payment resides [US], but)* where the immovable property concerned is situated [NL].

-- interest income: *Art. 11.1 & .5 OECD*:
The `source` of the income is in State where the debtor of the payment resides [US] *(and not where the deposit is located [NL]).*

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**Understand the core notions of a tax treaty’s distributive rules correctly**

b. `'Other State´ -- concept of source;`

**Example of different source notions applied under different treaties**

NL bank issues a loan to US Corp on behalf of US Corp’s Canadian branch office, for which loan US Corp provides security with a mortgage on immovable property it owns in Israel.

*Source of the interest:*
-- under NL-US treaty (cf. OECD Art. 11.5-1): **US**
-- under NL-CAN treaty (cf. OECD Art. 11.5-2): **CAN**
-- under NL-ISR treaty (Art. 7.2: the term ‘immovable property’ includes loans secured by mortgage on immovable property): **ISR**

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**The scopes of the distributive rules**

**List of the distributive articles:**

6 – income from immovable property
7 – business profits
8 – (income from) shipping, inland waterways transport and air transport
10 – dividends
11 – interest
12 – royalties
13 – capital gains
15 – income from employment
16 – directors’ fees
17 – (income of) artistes and sportsmen
18 – pensions
19 – (income from) government service
20 – (foreign support payments of) students
21 – other income

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**The scopes of the distributive rules**

**a. Geographical scope:**

bilateral vs. worldwide reach

*Art. 6.* Income derived by a resident of a Contracting State from immovable property situated in the other Contracting State.

>> **BILATERAL REACH**

*Art. 7.* The profits of an enterprise [carried on by a resident] of a Contracting State shall be taxable only in that State.

>> **GLOBAL REACH**
The scopes of the distributive rules

a. Geographical scope: bilateral vs. worldwide reach

BILATERAL REACH
Articles 6 10 11 12 16 17

GLOBAL REACH
Articles 7 8 13 15 18 21

Two treaty articles are in between: Articles 19 and 20

b. Scope with regard to the nature of the income -- overlap among articles

The scopes of the distributive rules

a. Geographical scope: bilateral vs. worldwide reach

BILATERAL REACH
(Articles 6 10 11 12 16 17)

If income covered by a bilateral article is derived from a source:
-- in a third state or
-- in the residence state of the recipient,
it falls outside the scope of the article. In such cases, the income is covered by Article 7 (for business income) or Article 21 (nonbusiness income).

ITC Leiden

In 2001, the International Tax Center Leiden was set up to accommodate the rapidly increasing interest in studying and researching international tax law.
If you want to learn more about international tax law, you should consider enrolling in the Leiden Adv LLM Program in International Tax Law. If you cannot go for a full year, you should think about taking only 1 or 2 of the Program’s courses. If you do not have the time for 1 or 2 courses, you may want to treat yourself (or your top associates) to one or two weeks Summer Course in Leiden in July 2009.

**July 2010 Summer Course in International Tax Law**

*coordinated and co-taught by Prof. dr. Kees van Raad*

**first week (Tax treaties)**
- Fundamentals of international taxation
- Introduction to tax treaties & treaty residence
- Business profits taxation under tax treaties
- Dividends, interest & royalties and immovable property income & capital gains under tax treaties
- Income from employment, pensions, etc. under tax treaties

**second week (Advanced subjects)**
- Five fundamental rules on tax treaty application & triangular issues
- Partnerships & double taxation relief
- Beneficial ownership and tax treaty anti-avoidance provisions
- Transfer pricing issues
- Advanced issues of business profits taxation under the 2008 OECD changes

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