Chartered Institute of Taxation
Excellence in Taxation

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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PAPER I

PRINCIPLES OF INTERNATIONAL TAXATION

SUGGESTED SOLUTIONS

QUESTION 1

International tax law is mostly concerned with the taxing rights of states. As with all forms of international law, the norms and principles that guide our understanding of these rights have their foundation in jurisdictional conflict. Such conflict can arise when more than one state claims the right to impose a similar levy on the same arrangement or transaction. Unaddressed, such a situation would result in double taxation, which adversely affects the commerciality of cross-border transactions.

There are two types of double taxation: economic and juridical. Economic double taxation focuses on the continuity of the tax object (i.e. the same property being taxed), whereas juridical double taxation focuses on the continuity of the tax subject (i.e. the same person being taxed). On way of defining juridical double taxation is: two or more taxes, imposed on the same property, in the hands of the same person, during the same period, for the same purpose.

There are over 20 different types of tax treaty, both multilateral and bilateral, most of which focus on just one kind of tax (e.g. air/shipping transport treaties, gift and inheritance tax treaties, and social security totalisation agreements). Tackling juridical double taxation in respect of income and capital gains is the particular concern of one type of tax treaty: the comprehensive double taxation convention on income and capital. These treaties are often referred to as double tax conventions (DTCs), double tax treaties and double tax agreements. DTCs are, for the most part, bilateral, and they apportion the taxing rights of States in relation to income and capital gains. There is a vast worldwide network of these DTCs (well over 2000) and the UK and France currently each have over a hundred of them in force.

It is perhaps worth noting that the official title of US-UK DTC, signed 24 July 2001, is the "Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains". It is evident from its official title that the intention of this DTC is to not only relieve double taxation but also to prevent tax avoidance and evasion. The latter objective is achieved by promoting cooperation between tax administrations through a number of measures including the exchange of information and mutual assistance in recovering tax debts. This is still not the whole story, however, as DTCs are also concerned with preventing double non-taxation (i.e. where neither state levies a tax on a particular transaction) and discrimination (i.e. where nationals of one contracting state are not to be subjected to more burdensome taxation in the other contracting state than a national of that state would be in the same circumstances).

There are a number of Model Tax Conventions upon which many of the extant DTCs are based. The three most studied are the OECD, the UN and the US Model. Each of these model treaties act both as the starting point for treaty negotiations between States and as an interpretative aid for those treaty provisions in force at the time of any dispute. The most significant of these models is unquestionably the OECD Model Tax Convention, not least because the United Nations Model Convention is largely based upon it. The OECD Model has extensive commentaries that aid in the application and interpretation of DTCs. As a result, both the models themselves, and the commentaries, constitute a very important source of international tax law.

The main difference between the UN and OECD model is that the former 'attempts' to accord greater taxing rights to those States where the 'source' of the income is located rather those States where the taxpayer is 'resident'. This division along the lines of source and residence arguably has its origins in the practical difficulties that states have in collecting and enforcing tax claims. As a result, almost all countries have unilaterally restricted their taxing jurisdiction to (i) persons having a certain status vis-à-vis the country (i.e. residence, domicile or nationality) and (ii) income having its source in the country.

The concepts of residence and source were both justified in the writings of Georg von Schanz who, in 1892, proposed the concept of economic allegiance or affiliation. He wrote about persons being economically tied to a community and suggested that every person who

benefited from the obligations of the commune being fulfilled should also share in the responsibilities (i.e. pay tax). He also wrote that "the inhabitants who, by necessity, are provided with internal and external security, roads for transport, sanitation, educational establishments, and are engaged with economic and cultural affairs, need to be taken account of just as much as those who live outside the community, but who depend on the former for the protection of their property and who share in the consumption of the communities efforts in the form of value increases, profit, and safe revenues".

In terms of classification, the constraints imposed by DTCs on the taxing rights of contracting states mainly take one of two forms. First, there are the rules that allocate taxing rights in respect of certain types of income to one or other contracting state. Their underlying rationale is either to eliminate double taxation or to help eliminate double non-taxation. Second, there are those provisions that direct the revenue authorities of the contracting States to cooperate administratively with each other. Their underlying rationale is to eliminate tax avoidance and tax evasion. The key to understanding the perceived need for administrative cooperation between States is the fact that courts have traditionally refused to both enforce foreign tax claims and help collect foreign tax debts (*Government of India v. Taylor* [1955] AC 491).

The treaty provisions most commonly found in DTCs that allocate taxing rights (the "allocative provisions") are concerned with either the type of income or the kind of taxpayer. For example, most DTCs have allocative provisions in relation to: income from immovable property; business profits; shipping, inland waterways transport and air transport; associated enterprises (i.e. connected companies); dividends; interest; royalties; capital gains; income from employment; directors' fees; artistes and sportsmen; pensions; government service; students; and other income.

The allocative provisions have different normative effects depending on the wording used. For example, we see the following phrases commonly used in DTCs: "shall be taxable only in"; "may be taxed in"; and "may be taxed in … but the tax so charged shall not exceed". It is important to note that whichever of these phrases is used, a treaty still only allocates the right to tax. This means that whether to use that right and impose a tax remains the prerogative of the contracting state. It sometimes happens that a State's domestic law does not exercise the right to tax granted by a treaty and in that case there may be no tax levied in either state.

It is important to read the allocation provisions in tandem with the provision on elimination of double taxation. This provision is addressed to the residence state, which is tasked with the job of actually relieving double taxation. The residence state has this job because source states have limited access to information about non-residents and are therefore incapable of determining their 'ability to pay'. The methods for relieving double taxation include: the credit method (ordinary or full); the exemption method (with or without progression); and the deduction method. Only the credit method and the exemption method are accorded dedicated articles in the model conventions. It is, of course, for the contracting states to choose one or other (or perhaps neither) as the basis for their particular agreement. The OECD Model Convention has two alternatives: Article 23A for the exemption method and Article 23B for the credit method.

As well as allocating taxing rights and requiring cooperation, DTCs also have to deal with the following issues:

- which taxpayers are covered (Articles 1 and 4);
- which taxes are covered (Article 2);
- the territorial scope (usually in the definitions article, equivalent to Article 3 of the OECD Model, and Article 29);
- the temporal scope (Articles 30 and 31);
- non-discrimination (Article 24) based on nationality (not residence).

Despite the allocation rules in DTCs, double taxation can still arise because:

- a taxpayer is considered resident in both states under their domestic law. This problem is usually resolved for treaty purposes by Art. 4(2) and (3);

- the two contracting states consider income to have its source in the state. DTCs pay very little attention to this issue;
- the two contracting states attribute income to different persons for tax purposes. DTCs also pay very little attention to this issue;
- the two contracting states classify an item of income differently and wish to apply different treaty articles (often called a qualification conflict). This problem is only partly solved by the definitions in the OECD Model. The commentary to Article 23 (paragraphs 32.1 to 32.7) deals with this issue but the solution given by the OECD is not universally accepted.

QUESTION 2

This question provides students with an opportunity to share their knowledge of exchange of information initiatives, demonstrate that they are up to date with current thinking on information exchange and critically evaluate the likelihood that FATCA style arrangements will become the standard in information exchange across the EU and beyond. It also provides an opportunity to discuss the recent UK/Isle of Man agreement.

Exchange of Information: Overview

Various initiatives: EU, OECD and US.

Exchange of information (EOI) is a key element of international co-operation in tax matters. Information is typically exchanged for one of two purposes: to ascertain the facts in relation to which the rules of a double tax treaty or convention (DTC) are applicable, and to assist one of the CS in administering or enforcing its domestic tax law.

EOI can be based on a number of different exchange mechanisms/agreements. In the context of DTCs, it is often based on article 26 of the OECD model tax convention (MTC). Outside that context, it is often based on: Agreement on Exchange of Information on Tax Matters (MA), which is used as the model for Tax Information and Exchange Agreements (TIEAs) that are entered into between states, and/or certain provisions of the Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters (COEC).

The COEC is a multilateral agreement that was originally open only to the membership of the EU and OECD but as of 1 June 2011 the COEC is open to all countries. TIEAs are bilateral agreements under which territories agree to co-operate in tax matters through exchange of information. The UK has entered a number of TIEAs with non-EU territories such as Jersey, Gibraltar and the Bahamas.

More targeted measures include the European Savings Income Directive (Council Directive 2003/48/EC, entered into force 01/07/2005). This aims to counter cross-border tax evasion by collecting and exchanging information about foreign resident individuals receiving savings income outside their resident state. All Member States are ultimately expected to automatically exchange information on interest payments by paying agents established in their territories. All Member States, except Belgium, Luxembourg and Austria, immediately introduced such a system of information reporting. Those countries were authorized to withhold tax at increasing rates during an interim period (as of 2011 WHT is 35%). Whilst Belgium now exchanges information on an automatic basis, Austria and Luxembourg continue to pay WHT.

As a result of the first 3 year review, the Commission found that it was “relatively easy for individuals to circumvent the rules”, having their savings held by interposed legal persons – such as trusts – or put into innovative financial vehicles, instead of classic savings accounts. In 2012 (second review), the Commission reported significant decline over 2007 to 2009 both in the amount of income reported under the arrangements and the amount of tax deducted by countries applying withholding tax, though part of this trend is probably attributable to the financial crisis in late 2008. It is generally accepted that the EUSD is in urgent need of modification but all amendments are subject to a requirement of unanimity.

A more recent and somewhat controversial measure is that of FATCA (Foreign Account Tax Compliance).

FATCA (Foreign Account Tax Compliance Act)

Students should be able to outline the mechanics of the FATCA legislation. FATCA introduces a new chapter into the US Internal Revenue Code (Chapter 4) and is aimed at addressing perceived tax abuse by US 'persons' through the use of offshore accounts.

Under FATCA, US taxpayers with specified foreign financial assets that exceed certain thresholds (over US $50,000 for natural persons and $250,000 for legal persons) must report those assets to the Internal Revenue Service (IRS). In addition, FATCA requires foreign financial institutions (FFIs) – with some exceptions – to report directly to the IRS information about financial accounts held by US taxpayers, or held by foreign entities in which US taxpayers hold a substantial ownership interest.

Non-compliance by foreign financial institutions (evidenced by not registering with the IRS within a specified time period) results in 30% WHT when their dividend income, interest income etc. passes through the U.S. There is therefore an imperative for foreign financial institutions to be FATCA compliant. FATCA withholding starts at the earliest on 1 January 2014.

It is unclear at this stage exactly how reciprocity on the part of the U.S. will work.

Likely Impact of FATCA style arrangements and Similarities/Differences with EUSD

Students should demonstrate that they are up-to-date with the state of play regarding FATCA compliance. Countries are already showing their commitment to enter into FATCA agreements by issuing joint statements to that effect (see the UK's Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA 18.09.12). Broadly, there are two types of agreement: Models I and II. In 2012, UK issued a joint statement agreeing to implement FATCA with the US. The inter-governmental deal – that includes Germany, Spain, Italy and France - is an agreement to enter bilateral FATCA agreements with the U.S. (Model Intergovernmental Agreement by the G5, 26. 07. 12)

The agreement envisaged by the aforementioned countries is a Model I agreement meaning that the government of the respective country (as opposed to the FFI) has to collect the data from FFIs and is obliged to report – by way of automatic information exchange – that data to the IRS. This mode of operation is more similar to that of the Savings Income Directive than that of the Model II agreement in which FFIs report directly to the IRS. Such information will be supplemented by direct information exchange by governments where necessary. If national law requires it, FFIs will have to obtain consent from their account holders before transmitting the information to the IRS. Examples of Model II agreements will include those agreed by Switzerland and Japan.

Whilst the above joint statements involve agreements to enter into FATCA arrangements with the U.S., a strong indicator that FATCA's influence is already being felt is the recent announcement that a FATCA style agreement is being finalized between the UK and the Isle of Man (February 2013). The combination of the joint statements regarding FATCA and the recent UK/Isle of Man announcement is considered to demonstrate that the nature of tax cooperation is changing and automatic exchange is becoming the global standard (Chief Minister Bell, Isle of Man, 2013). In August 2012, the International Development Committee called upon the UK to introduce an automatic exchange of information provision relating to all UK citizens and/or corporations. Whilst publicly the proposal was rejected, there is some speculation that the UK will introduce FATCA style legislation on Crown Dependencies and Overseas Territories.

Possible Redundancy of EUSD

The quote in the question references the likely spread of FATCA and the impending redundancy of the proposed amended EUSD. Having already noted the interest in entering FATCA style arrangements above, this is an opportunity for students to consider the

similarities and differences between FATCA and EUSD both in its current form and in the form it would take if the proposals for amendment are eventually agreed to. It is also an opportunity to consider the problems with the implementation of the amendment to the EUSD and the likelihood that Teare's statement (that the FATCA model may replace the amended EUSD) will come to pass.

Possible observations include the following. In terms of similarities both the EU Directive and the FATCA approach are based on exchange of information, enabling the residence jurisdiction to know a taxpayer's personal income and to tax it at an individualized, possibly progressive, rate decided by that residence jurisdiction. However, in terms of the scope of FATCA and EUSD there are some differences. In the case of the EUSD the purpose is for the various EU tax authorities to receive information regarding the income received by their individual tax residents. By contrast, FATCA has a much broader scope in terms of beneficial owner – the provisions do not only focus on individuals but also consider US accounts as the ones held by entities or partnerships incorporated in the US, and the accounts held by 'US owned foreign entities'. US owned foreign entities are non-US corporate entities that are held by specified US persons owning at least 10% (in vote or value) of the corporation. Whilst this 'look through' approach serves the same purpose as the one suggested by the EU commission in the proposed amended Directive, the revised Directive only takes into account payments made to certain low taxed entities established outside the EU and is therefore limited in scope. (Granelli and Gerard 2012). Furthermore, the definition of US accounts subject to reporting under FATCA also includes US persons living outside of the US (e.g. US citizens, persons born in the US and green card holders). This is a specific US tax requirement as US citizens are supposed to file a tax return on their worldwide income.

Problems with Second Savings Income Directive

Proposals for amendment include expanding the concept of interest payment to include payments arising from investment funds, pension funds, innovative instruments and payments made through trusts and foundations (Proposal for a Council Directive amending Directive 2003/48/EC on taxation of savings income in the form of interest payments 6946/11, 4 March 2011). Other proposed amendments include expanding the concept of paying agent and beneficial owner. The amendment currently faces opposition by Austria and Luxembourg and given that the amendments are subject to a unanimous vote, it would appear that the amended version of the EUSD is some way off. Austria and Luxembourg maintain that they will not approve the amendments during a period in which the result of the amended EUSD is to leave Austria and Luxembourg in a worse position than other (non-EU) financial centres such as Switzerland, i.e. they wish to continue being permitted to continue charging WHT and not automatically exchange information until such time as other non-EU financial centres change their practice (ECOFIN Report to the European Council on Tax Issues, 16327/12, 23 November 2012 and Van Thiel, 2012). The inability to achieve unanimity on the proposed amendments to the EUSD coupled with the recent pronouncements of support for FATCA style reporting would appear to lend some weight to Teare's statement regarding the rolling out of FATCA style reporting across the EU and possibly further afield.

Conclusion

It is open to students to compare and contrast the work of US, OECD and EU in terms of information exchange. Noting the potential problems with FATCA style reporting may also be relevant here such as the possible burden on business and financial institutions and concerns regarding taxpayer confidentiality (and EU wide data protection rules).

Students may also wish to round up by noting any improvements that could be made to information exchange either across the EU or further afield. EU Member States could, for instance, coordinate the way that they identify taxpayers and introduce one single European wide tax identification number for each individual and company (and real estate and car, etc.). Another practical measure could be to introduce easy ways for using standard formats for automatic exchange. It could also be useful to promote more actual contacts between the different European tax administrations (EU Fiscalis programme; OECD offshore compliance network) and to consider broadening the scope for joint action towards single large taxpayers (Van Tiel 2012).

QUESTION 3

This question requires firstly a description of the arm's length principle as set out in Article 9 of the OECD Model and an analysis of it based on the text of the Model. This should include consideration of the basis for primary and secondary adjustments under Article 9(1) and 9(2).

Candidates should describe the history of the arm's length principle and how it is given effect to in the OECD 2010 Transfer Pricing Guidelines and 2008 Report on Profit Attribution to PEs. This can then form the backdrop to outlining the advantages and disadvantages of the arm's length principle: on the one hand the fact that is regarded as objective and is widely accepted; on the other hand, the difficulties that are often encountered with any given method of applying the principle, for example the absence of comparables (especially in the case of intangibles are involved); the ability of states to choose which method they employ in any particular case; the fact that the method chosen by one state may not be agreed by the other state. Reference should also be made to the practical consequences of adopting the arm's length standard: the need for transfer pricing documentation on a transactional basis or for extensive negotiations to reach Advance Pricing Agreements.

The second part of the question should deal with describing and considering the merits and demerits of unitary taxation. This requires an analysis of what these concepts entail. It should be focused around the chief characteristic of a system of unitary taxation with formulary apportionment: that it involves measuring the income of multinational enterprises as a whole; that the method therefore reflects the functional differences and consequent differences in profitability between integrated businesses and genuinely separate entities; that it avoids – at least to the 'water's edge' of participating states – the administrative burden and uncertainty of transfer pricing and other anti-avoidance approaches based on the arm's length standard, such as thin capitalisation and CFC rules. Credit will be given to candidates who refer to the usefulness of such a system in a federal state or single market and to the experience of states in the USA in employing such a system. The practical disadvantages of unitary taxation that should focus on the problems arising out of its partial adoption: where states or multinational groups are given the opportunity to opt out, all the problems of arm's length pricing are revived between those entities and states adopting unitary taxation and are compounded, from the states' point of view, by the opportunities for arbitraging between them.

Thirdly the question should deal with the likelihood of wider adoption of unitary taxation, noting first of all the difficulties in getting states to agree on a common tax base and apportionment factors. States who consider they will be better off under the current arm's length standard, either in terms of an increased tax take or because of their perception that greater control over the tax base gives increased scope to use tax policy as a tool of social policy, are unlikely to consent to unitary taxation, leading to all the difficulties of partial adoption. Credit will be given for noting the possibility of wider uptake in future among other closely integrated groups of states, particularly in the context of the work by the EU on the draft CCCBT directive and the positive effects this could have in terms of foreign market access for small and medium-sized enterprises. This could be contrasted with countervailing options among closely integrated groups of states for reducing the administrative burdens for multinationals of the arm's length rule through initiatives such as the EU Joint Transfer Pricing Forum and the Code of Conduct relating to the EU Arbitration Convention.

A critical and reasoned conclusion is expected.

QUESTION 4

Candidates should first of all explain the different functioning of the credit and exemption methods, referring to Article 23 of the OECD Model and explaining the various varieties of credit and exemption methods (full and ordinary credit, full exemption and exemption with progression, exemption with a 'subject to tax clause' etc).

Secondly candidates should explain the advantages and disadvantages of credit and exemption methods from a taxpayer's perspective: how the exemption method is generally preferred by taxpayers, not just because of the reduced likelihood of a further tax charge in their residence state, but because of overall reduced administrative burdens. Examples should then be given of situations where the credit method may nevertheless be preferable for taxpayers, such as where foreign losses are incurred. Credit will be given to candidates who point out the how the credit method not only imposes potentially higher tax burdens but also a lack of 'horizontal equity' in the source jurisdiction in terms of access to foreign markets: taxpayers resident in high tax states who operate businesses in other lower-tax states will find themselves competing against local businesses in that state who exposed to the lower level of taxation.

Thirdly candidates should explore the wider macroeconomic effects of the credit and exemption methods. This calls for a discussion of the relationship between the methods of relief and capital export and capital import neutrality: how the economic priorities of capital importing and exporting states conflict, and how the credit method applied by capital exporting states effectively negates tax breaks offered by developing/capital importing states unless some form of tax sparing is applied. This is an opportunity to explore the arguments that have been advanced for and against sparing, as well as the wider argument over whether tax breaks attract investment or in most cases merely sweeten investment that would have occurred in any case. Credit will be given for widening this discussion out into the economic efficiency arguments that have been advanced in favour of the credit method in terms of its claimed greater neutrality through attracting capital from credit states to investment opportunities irrespective of the tax treatment in the source state. This should be contrasted with the abovementioned potential unfairness created by the credit method through businesses who operate in a given state being taxed at different rates depending on the tax rates applied by their residence states. Extra credit will be given to candidates who refer to other international tax policy issues at state level: the ability of the credit method in to create 'horizontal equity' between taxpayers in each residence jurisdiction and the greater administrative simplicity of the exemption method in its purest form of exclusive source state taxation.

This question is an opportunity for candidates to show their wider awareness of the interaction of international taxation with economic policy and how the method of double tax relief chosen by any given state is a likely to reflect its (possibly conflicting) priorities of maximising tax revenue and promoting inward or outward investment. Particular credit will be given to candidates who give detailed examples of the use of the different methods by individual states, and come to a reasoned conclusion by relating abstract arguments about the benefits and detriments of each method of relief to particular states' economic and fiscal needs.

QUESTION 5

Overview

There is scope for a lot of information to be contained within students' answers. Whilst an understanding of the operation of the proposed UK GAAR is useful and certainly assists in answering the question, it is not essential. What is essential is an understanding of the reasons why countries seek to introduce GAARs into their tax legislation, the forms these rules may take, the types of scenarios that much domestic anti-avoidance legislation cannot deal with and the interaction between domestic anti-avoidance legislation and international tax law. Knowledge of OECD initiatives to counteract underpayment of tax by multinational companies (MNCs) and individuals as well as an awareness of the media reports regarding low payment of tax by MNCs are also relevant to the discussion.

Introduction

The quoted statement was made recently (December 2012) and references the UK GAAR. The reference to Starbucks, Amazon and Google refers to the recent controversial media

coverage of low payments of tax to HMRC relative to UK sales. As is common knowledge, volume of sales is not a basis of corporate taxation in the UK.

Although knowledge of this is not essential for students answering this question, the background to the discussion referred to is that Starbucks' tax payments have totaled approximately £8.6 million on sales approximately £3 billion. Over the past three years, Starbucks is said to have reported no profit, and therefore paid no corporation tax, on sales of £1.2 billion in the UK. Starbucks is said to have legally reduced its tax liability in the UK by charging its UK unit high royalty fees and then allocating the fees to a low tax jurisdiction; allocating funds generated in the UK to low tax jurisdictions; and charging relatively high rates of interest on inter-company loans.

The quote refers to the fact that there are international tax rules at play that without significant reform will continue to facilitate perceived underpayment of tax irrespective of the introduction of a GAAR in individual countries. In sum, any national GAAR will be limited in scope in that it is provides a unilateral attempt to correct a situation that has a far wider ambit and requires international coordination.

Non-payment or significantly reduced payment of tax by MNCs is said to hurt investment, growth and employment and can leave average citizens footing a larger chunk of the tax bill. There are a number of factors that result in the drive towards ensuring that all MNCs contribute their fair share. These include: (i) austerity measures in many countries (ii) increasingly aggressive tax practices of MNCs and (iii) a growing sense that tax rules and standards have not kept pace with international business practice – especially with regards intangibles and the digital economy.

Unilateral attempts to curb tax avoidance

Unilateral attempts may include: GAARs – wide and narrow; TAARs (targeted anti avoidance provisions within specific laws) as well as other legislation such as domestic CFC rules, thin capitalization rules etc.

An attempt of a definition of a GAAR should be included, as well as an overview of the types of measure that countries may seek to introduce, with examples from country practice where possible. In the case of the proposed UK GAAR, it is a targeted provision and seeks to deny tax benefits to the most "egregious" schemes. Although targeted, the proposed UK GAAR is not a TAAR as it applies to all taxes. In contrast with the proposed UK approach, US approach is much wider and applies an "economic substance" test (codified in 2010).

Reference should be made to the good that can be achieved from adopting a principles based approach to interpreting tax laws as well as the fact that it is difficult for countries to rely upon unilateral measures to increase their tax take from MNCs.

Interaction between unilateral anti-avoidance measures and tax treaties

This is an opportunity for students to note the concern raised by the amendment of the OECD MTC commentary to Article 1 in 2003 where it states that, inter alia, domestic anti-avoidance provisions are consistent with treaty obligations. There are essentially two views: (i) the amendment to the commentary constitutes a fundamental change and so anti-avoidance rules cannot apply to treaties entered into prior to 2003 and (ii) the amendment merely clarifies the OECD's position and so domestic anti-avoidance provisions apply to treaties entered into prior to 2003.

The UK position has been confirmed by HMRC and has support (Baker QC, 2012): domestic anti avoidance provisions will be applied in the spirit of the revised commentaries (introduction to MTC, paras 33-36) and so the UK GAAR will also apply to treaties entered into prior to 2003.

Base Erosion and Profit Shifting

This is an opportunity for students to discuss the limits of a GAAR (as a unilateral measure) in combatting low payment of tax by MNCs such as Starbucks and the clear need for multilateral

efforts in this area. It is generally recognized that the cause of base erosion and profit shifting does not rest with any particular country's tax rules but rather it is the way in which a number of country rules interact that provides opportunities for MNCs to eliminate or significantly reduce taxation (OECD, Addressing BEPS, 2013). There is also a view that companies structuring their affairs as they see fit as acceptable commercial practice provided that such structuring falls within the law. Tax is considered to be but one of many considerations when deciding where to (re)locate one's operations.

It is generally acknowledged that the proposed UK GAAR will not affect multinational decision-making but rather targets a small group of people who enter into transactions that have no commercial purpose (Stevens and Dodwell from the CIOT, Judith Freedman and Aaronson QC). This is because the real issue raised by Starbucks etc. is that of allocating taxing rights between countries and perhaps ultimately having some degree of coordination with regards the tax base and tax rates. A recent Spanish case involving Dell's virtual presence in Spain and the finding of a virtual PE illustrates the fact that countries are seeking to rely upon international tax concepts to unilaterally increase their tax take (Ruling of Mar. 15, 2012, R.G. 2107-07).

The manner in which Starbucks etc have sought to reduce their taxation in the UK has been as a result making payments for interest, licenses and royalties to other parts of the company in other jurisdictions. The issue is clearly one that must be addressed at a multilateral level. When considering the issue at the EU level one must of course take into account the implications of any infringement on the freedom of establishment.

Attempts at Tackling Avoidance

Having identified the limits of a narrowly focused GAAR with regards the tax planning of MNCs, students may discuss the steps that are being taken to ensure opportunities for MNCs to reduce or eliminate their taxation are themselves reduced or eliminated.

Making reference to OECD initiatives is useful here. Among those that could be mentioned are those that the OECD (BEPS, 2013) cites – "the key pressure areas" that need addressing in order to reduce the opportunities for multinationals to eliminate or significantly reduce taxation (the references are for illustrative purposes and do not provide an exhaustive list of initiatives):

- International mismatches in entity and instrument characterization (OECD, Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues 2012)
- Application of treaty concepts to profits derived from the delivery of digital goods and services
- Tax treatment of related party debt financing, captive insurance and other intra-group financial transactions
- Transfer pricing especially with regard intangibles and risks (OECD, TP Guidelines for Multinational Enterprises and Tax Administrations, 2010)
- Effectiveness of anti-avoidance rules, GAARs, CFC rules, thin capitalization and anti abuse rules; (e.g. OECD, 2012, "R4 Thin Capitalisation in Model Tax Convention on Income and Capital 2010, Full Version)
- Group Losses (OECD, Corporate Loss Utilisation through Aggressive Tax Planning, 2011)
- The availability of harmful preferential regimes (OECD, Harmful Tax Practice: An Emerging Global Issue (1998) and Progress Report (2004))
- Exchange of Information (OECD, Convention on Mutual Administrative Assistance in Tax Matters, 1988)
- Transparency (OECD, Tackling Aggressive Tax Planning through Improved Transparency and Disclosure, 2011)

Anti-avoidance rules in tax treaties may include:

(i) provisions that limit treaty benefits (US);
(ii) provisions that are aimed at particular types of income;

(iii) provisions that are aimed at preferential regimes introduced after the signature of the treaty (UK/Luxembourg); and
(iv) provisions designed to protect the tax base of countries including treaties with low tax jurisdictions.

EU initiatives such as the Savings Income Directive and exchange of information measures.

Conclusion

Students should summarise the benefits and limits of introducing a GAAR; issues that may arise when introducing a GAAR for a country with a wide treaty network; and the ways in which low or non-payment of tax by MNCs can be best tackled. The conclusion also provides a place where more radical methods of taxing MNCs could be introduced: Formulary Apportionment (Martens-Weiner); Expenditure Tax (Bowler-Smith) and Destination-Based Cash Flow Tax (Devereux).

QUESTION 6

This problem requires candidates to interpret and apply the tie-breaker article for relation to company residence in the OECD Model Article 4(3).

The facts have been chosen consciously so that there is no obviously right answer in terms of that. Instead, this is an opportunity for candidates to demonstrate their familiarity with techniques of treaty interpretation and the ability to come to a judgment on finely balanced facts and arrive at a reasoned conclusion.

Candidates answers should therefore demonstrate knowledge of the interpretative techniques to be applied to treaties as the applicability and interpretation of the OECD Commentary. Credit will be given for referring to the relevant case law on 'place of effective management', the OECD's 2001 discussion document on this concept, and for noting the continued lack of complete international agreement on interpretation of the term. Extra credit will therefore be given for candidates who give examples of differing practice in individual states and that the answer to the question may in practice depend in part on where in the world state states A and B are located, leading to the potential need to invoke the Mutual Agreement Procedure.

In analytical terms, candidates will first need to show their interpretation of the meaning of Article 4(3) and then to apply this provision to the fact pattern. In particular, the relevance of the distinction between the various organs of the company as decision making bodies should be highlighted, and a conceptual delineation drawn between these bodies and the shareholders, while setting out the limited range of circumstances in which the actions of shareholders acting as such can affect the place of effective management.

Since the facts do not point unambiguously to a result in favour of either state, credit will be given to candidates who note this and nevertheless put forward cogent arguments that weigh up the elevant factors and arrive at a reasoned conclusion. This should be set in the treaty context of Article 4(3) requiring a choice to be made between the two states. Answers that merely point up the difficulty of making the decision will therefore score less highly than those who undertake the process of assessment and come down in favour of one state or the other.

QUESTION 7

There is a case with a similar fact pattern to that of a case going through the UK courts (*HMRC and CSARS v Ben Nevis (Holdings) Ltd and Another* [2012] EWHC 1807(Ch)). Students are not expected to know this case, but extra marks will be given to those who are aware of it, point up the similarity of fact pattern and issues raised or the fact that the *Ben Nevis* case will be subject to an appeal by HMRC to the UK Court of Appeal in late April/early May 2013.

The issues raised by the question are as follows: the revenue rule; assistance in collection (AIC) provisions; interpretation of tax treaties; and the retrospectivity of law. The relevant principles should be applied to the fact pattern in the question as far as possible and the context within which these principles operate should be noted.

An answer awarded high marks will immediately recognise the above-mentioned issues, be able to apply the above-mentioned principles of international tax law to the fact pattern and discuss the various methods that are relied upon by countries to assist in the collection of tax revenue claims (question 2).

The question can be tackled from a number of perspectives, one of which is outlined below. An alternative approach is to incorporate answers to both questions 1 and 2 in one answer.

Question 1

Question 1 corresponds with the first claim made by HMRC as against Company A in the *Ben Nevis* case at the High Court. The main question is whether assistance in collection by State U for the benefit of State V is permissible (first claim). Whether or not through applying the Ben Nevis case to the fact pattern, the issue that needs to be highlighted centres around the fact that not only the 2006 Protocol but also the 2000 Double Tax Convention (DTC) entered into force after the £300 million tax liability arose (1996-98). Making an argument one way or another requires outlining the reasons why a revenue claim of State V - relating to a period preceding the entering into force of a DTC that has been subsequently amended to include an AIC provision - should or should not be enforced by State U.

In the *Ben Nevis* case Pelling J.'s held that it was immaterial that the AIC provision was included in the relevant DTC only after the period in which the revenue claim arose. It was also held immaterial that the DTC and therefore the AIC provision entered into force after the period in question. Accordingly, the UK was entitled to assist the South African tax authority with collecting an outstanding revenue claim for a period prior to the entry into force of the DTC, its implementing domestic legislation and the Protocol amending the DTC by introducing an AIC provision. A number of the relevant reasons for the HC judgement are mentioned below:

(i) The HC held that there was nothing in the wording of the AIC article to indicate that it was limited by temporal scope. The judge rejected this argument on the basis that if the defendants' argument that the Entry into Force provision (EIF) in the DTC applied to the interpretation of the AIC article of the DTC then there was no need to take into account the fact that the AIC Article did not reference temporal scope.

(ii) According to Pelling J., the application of the Vienna Convention on the Law of Treaties (VCLT) was not relevant in the case because one of the parties to the DTC had not ratified the VCLT. Students would therefore need to consider the relevance of the VCLT as a guide to interpretation of the DTC where (i) both countries are monist (ii) only one country has ratified the VCLT and (iii) both countries have ratified the VCLT. Whilst the HC found that the VCLT was not relevant, the VCLT may be relevant in the context of the fact pattern in the question and should therefore be discussed.

(iii) In terms of supplementary materials, Pelling J. only referred to the OECD Model Tax Convention (OECD MTC) and the OECD Commentary. Pelling J. was influenced by para. 14 of the commentary to Article 27 OECD MTC and noted that the first line was consistent with his view that assistance with the revenue claims of another contracting state (CS) could only be carried out following the entry into force of the Protocol but that the assistance could involve revenue claims for periods prior to said date provided no assistance was given prior to said date:

> "Nothing in the convention prevents the application of the provision to revenue claims that arise before the Convention enters into force, as long as assistance with respect to these claims is provided after the treaty has entered into force and the provisions of the Article have become effective. Contracting states may find it useful, however, to clarify the extent to which the provisions of the Article are applicable to such revenue claims, in particular when the provisions concerning the entry into force of their convention provide that the provisions of that convention will have effect with respect to taxes

arising or levied from a certain time. States wishing to restrict the application of the Article to claims arising after the convention enters into force are also free to do so in the course of bilateral negotiations."

Paragraph 14 of the Commentary was added on 28 January 2003. The DTC relevant to the *Ben Nevis* case (UK/South Africa) was signed and entered into force and before this paragraph was added to the Commentary (respectively 4 July 2002 and 17 December 2002). However, the implementing domestic legislation was effective only after the relevant part of the Commentary had been amended. Accordingly, students should refer to the relevant VCLT articles and discuss the issues surrounding the relevance of commentaries that are amended after the negotiation/entering force of a particular DTC but prior to the Protocol introducing an AIC provision into the DTC (and therefore the domestic legislation that implements the Protocol) to the interpretation of a particular provision or set of provisions. The views of authors such as Sasseville (2004), Wattel and Marres (2003), may also be included here. Pelling J. held that the relevant entry into force provision was that contained within the Protocol and not that contained within the UK/South Africa DTC and as such Sasseville's view could not be used to support the claim that assistance could only be provided for revenue claims that arise after the entry into force of the DTC or its implementing legislation.

Also, and not mentioned in the *Ben Nevis* HC judgment, is the OECD's 2007 Manual on the Implementation of Assistance in Tax Collection. This document provides an example of a CS restricting the application of Article 27 OECD MTC to have effect on revenue claims that are finally determined by the applicant state after the date that is 10 years before the date on which the convention enters into force (para. 35).

Reference could also be made to both Article 27(5) of the OECD MTC (and paras. 23-24 of the Commentary to Article 27), and Article 14 (1) of the Joint Council of Europe /Organisation for Economic Co-operation and Development Convention on Mutual Administrative Assistance in Tax Matters (COEC), in which it is provided that questions concerning time limits shall be governed solely by the laws of the applicant state (State V in the fact pattern). The main reason for this rule is that the requested state (State U in the fact pattern) is providing assistance in the collection of a claim that has arisen under a different legal system, which governs the creation and the extinction of that claim. Therefore, as long as the right to recover the claim has not expired under the laws of the applicant state, the claim remains in existence and can be recovered. The validity of the claim may not be affected by the fact that the time limit of the requested state has expired, since only the law of the applicant state is to be applied concerning time limits. The Commentary clarifies that it is open to the CS to agree that a certain time period the obligation to assist no longer exists (para. 24). Paras. 23-24 of the Commentary were added in 2003 so again after the signing and entering of force of the relevant DTC in the Ben Nevis case and the fact pattern.

(iv) According to Pelling J. in *Ben Nevis*, the AIC article applies to all revenue claims as defined subject only to the qualifications that:

1. are listed in the article itself (i.e. that it applies to revenue claims as defined in AIC), is enforceable under the laws referred to within the AIC article itself and the revenue claim is owed by a person who cannot prevent collection according to the laws of the CS; and
2. the request for assistance was made on or after the date when the Protocol entered into force.

Whether or not they refer to the *Ben Nevis* case, students need to consider whether this is a correct interpretation of AIC provisions that follow the OECD MTC and or whether they would apply different reasoning to the fact pattern.

(v) Pelling J. also rejected the defendants' claim that the Article 1 of the First Protocol to the European Convention of Human Rights applied. Pelling J. distinguished the *Ben Nevis* situation from that in *R (HMRC) v Huitson* [2010] EWHC 97 (Admin) [2011] QB

174 and did not accept that the AIC provision had an "objectionable retrospective effect" (as described by Bennion 2008).

As it is not clear where either State U or State V are situated students are also free to discuss assistance of collection initiatives that were not mentioned in the *Ben Nevis* case. Marks will be awarded for including country practice, case law etc.

Question 2

This part of the question involves considering the revenue rule and the various initiatives that have been eroding and continue to erode this principle. Countries wishing to seek assistance from another country or set of countries in the collection of revenue claims may rely upon a number of different initiatives. Within the EU, reference should be made to the Mutual Assistance in the Recovery of Debts Directive (MARD and its various amendments) and to COEC outside the EU.

The history of Article 27 of the OECD MTC as a basis for debt recovery provisions in DTCs should also be mentioned. Again, examples of country practice are encouraged in this section. For example, Article 27 OECD MTC is increasingly being adopted by the UK in new and existing DTCs. To date, the UK has entered into such agreements with the Faroes, Mexico, New Zealand, the Netherlands, Oman, Liechtenstein and very recently Norway (has been signed but has not yet entered into force). Although, DTCs based on the OECD model tend to relate to just income and capital gains (and not, for example, inheritance or estate taxes), Article 27 (in its unamended form) is not restricted to those taxes.

An overview of the MARD 2010 imposes an obligation on the UK to, inter alia, assist any Member State of the EU in the recovery of tax debts. Many of the key features of MARD 2010 were already present in the predecessor directive (EU Council Directive 2008/55/EC (MARD 2008), and were enacted into UK law in 2008. MARD 2010 broadened the scope of taxes so that, essentially, all taxes are covered (including inheritance/estate duty type taxes) as well as all penal charges arising in respect of those taxes.

COEC was formed in 1998 and amended in 2010 (entering into force on 1 June 2011). Whilst initially it was only open to the membership of the Council of Europe and OECD, it has been amended to allow all countries to be signatories. In the case of the UK, COEC was enacted into UK law in its original form on 1 May 2008 and subsequently (with the 2010 amending protocol) in October 2011.

Other multilateral initiatives such as the Nordic Convention on Mutual Assistance in Tax Matters and The Benelux Convention could also be noted here.

Conclusion

The erosion of the revenue rule and the increasing reliance on AIC provisions, especially as budgets tighten and tax authorities seek to raise more revenue. Issues raised by AIC provisions could also be noted here. These include: confidentiality of taxpayer information; timely and adequate notice of claims against the taxpayer; the right to appeal; the right to be heard and present argument and evidence; the right to be assisted by a counsel of the taxpayer's choice; and the right to a fair trial.