Article 2 – Taxes Covered – Global Tax Treaty Commentaries

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0. Abbreviations and Terms

ACA Athens	Administrative Court of Appeals of Athens
AMT	Alternative minimum tax
BEAT	Base erosion and anti-abuse tax
CE	Conseil d'État (Supreme Administrative Court)
CFC	Controlled foreign company
CGT	Capital gains tax (Australia)
CIDE	Contribuição sobre intervenção do domínio econômico (Brazil)
COFINS	Contribuição para o financiamento da seguridade social (Brazil)
CPI Bruxelles	Cour de Premiére Instance de Bruxelles (Court of First Instance of Brussels)
CSLL	Contribuição social sobre o lucro líquido (Brazil)
DPT	Diverted profits tax (United Kingdom)
DST	Digital services tax
EC	European Commission
ECJ	Court of Justice of the European Union
ESRC	Extraordinary social responsibility contribution (Greece)
FCA	Federal Court of Australia
HCSA	High Court of South Africa
HR	Hoge Raad (Supreme Court)
IAE	Impuesto sobre actividades economicas (Spain)
IEHC	High Court of Ireland
IETU	Impuesto empresarial a tasa unica (Mexico)
ITAT Ahmedabad	Income Tax Appellate Tribunal Ahmedabad
ITAT Kolkata	Income Tax Appellate Tribunal Kolkata
LB	Legfelsőbb Bíróság (Supreme Court)
LBT	Local business tax (Hungary)
NAT	Net asset tax (Belgium)

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NWT	Net wealth tax (France)
OECD	Organisation for Economic Co-operation and Development
OECD/UN Commentary/ies	Commentary/ies on the OECD Model and/or the UN Model
OEEC	Organisation for European Economic Co-operation
ØL	Østre Landsret (Eastern High Court)
PE	Permanent establishment
PIS	Contribuição para os programas de integração social e de formulação do patrimônio do servidor público (Brazil)
RR	Regeringsrätten (Supreme Administrative Court)
RZ	Rechtbank Zutphen (District Court Zutphen)
SARS	South African Revenue Service
SC	Supreme Court
SCI	Supreme Court of India
STC	Secondary tax on companies (South Africa)
TC	Tax Court (United States)
TCC	Tax Court of Canada
TGI Paris	Tribunal de Grand Instance de Paris (High Court of Paris)
TRF2	Tribunal Regional Federal da 2ªRegião (Federal Regional Court of the 2nd Region)
TRF3	Tribunal Regional Federal da 3ªRegião (Federal Regional Court of the 3rd Region)
TSJ Madrid	Tribunal Superior de Justicia de Madrid (High Court of Justice of Madrid)
TTPD	Temporary tax on profit distributions (Sweden)
UN	United Nations
VH	Virgin Holdings
Vwgh	Verwaltungsgerichtshof (Supreme Administrative Court)
VW SA	Volkswagen of South Africa
WP	Working Party

1. Policy and History

1.1. Policy

1.1.1. Summary of article

1.1.1.1. Summary of the paragraphs of article 2 of the OECD Model

The subject matter of article 2 of the OECD[1] and UN[2] Models is the specification of "taxes covered" by these Models and the tax treaties shaped to their example. The language of article 2 is identical in both Models and contains four paragraphs. Paragraph 1 provides that "[t]his Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied". Paragraph 2 explains that "[t]here shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation". Paragraph 3 allows the contracting states to specify a list of particular "existing taxes to which the Convention shall apply". Finally, paragraph 4 extends the coverage of the convention to "any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes". Moreover, "[t]he competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws".

1.1.1.2. The significance of article 2 of the OECD Model

The topic of article 2 hardly seems a matter of details. Instead, it is a foundational aspect of tax treaties. Having a separate article addressing this issue at the beginning of a comprehensive agreement is intended to provide states with a hard-to-miss opportunity to specify the scope of their agreements. The Commentary on Article 2 of the OECD Model claims that the purpose of the article is

> to widen as much as possible the field of application of the Convention by including, as far as possible, and in harmony with the domestic laws of the Contracting States, the taxes imposed by their political subdivisions or local authorities, to avoid the necessity of concluding a new convention whenever the Contracting States' domestic laws are modified, and to ensure for each Contracting State notification of significant changes in the taxation laws of the other State.[3]

In the same spirit, the Commentary on Article 2 of the UN Model notes that, since

> the same income or capital may be subject in the same country to various taxes – either taxes which differ in nature or taxes of the same nature levied by different political subdivisions or local authorities … double taxation cannot be wholly avoided unless the methods for the relief of double taxation applied in each Contracting State take into account all the taxes to which such income or capital is subject. Consequently, the terminology and nomenclature relating to the taxes covered by a treaty must be clear, precise and as comprehensive as possible.[4]

This chapter examines a range of issues in the interpretation of article 2 that have given rise to real-world disputes.[5] A global review of article 2 controversies indicates that they occur with sufficient frequency to justify a separate study. Particularly in light of the above-quoted Commentaries on the OECD and UN Models, disputes that arise under article 2 raise uncomfortable questions about whether the minds of the contracting states failed to meet: disagreements reveal not cracks, but chasms, in the process of international coordination through tax treaties. Moreover, since article 2 addresses the types of taxes covered by a tax treaty, the issues of interpretation that arise are unlikely to depend on specific factual determinations but will almost always be legal in character and of general applicability to taxpayers. One would thus expect that, when disputes do arise, judicial resolutions will only provide a temporary fix. The contracting states must themselves make renewed attempts at reaching consensus about what taxes are intended to be covered by their agreements. However, when a court or the tax administration of one state decides that a particular tax falls (or does not fall) within the scope of a particular tax treaty, it often is not clear at all whether the relevant other contracting state (or states) agrees with (or is even aware of) such decisions.

1. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.
2. *United Nations Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2017), Treaties & Models IBFD.
3. Para. 1 *OECD Model: Commentary on Article 2* .
4. Para. 2 *UN Model: Commentary on Article 2* .
5. For other surveys of country practices in respect of art. 2 *OECD Model* , *see* P. Brandstetter, *Taxes Covered* (IBFD 2010), Books IBFD; and M. Helminen, *General Report* , in *The notion of tax and the elimination of international double taxation or double non-taxation* , International Fiscal Association (IFA), *Cahiers de droit fiscal international* vol. 101b (Sdu Fiscale & Financiële Uitgevers 2016), Books IBFD, and the country reports contained in the same volume.

It should also be emphasized at the outset that the significance of article 2 of the OECD Model should be evaluated not mainly in terms of the judicial and policy disputes to which it has been applied but, more importantly, the policies that are affected by it. Nothing can drive this point home better than the European Commission's (EC's) proposal in March 2018 of two draft directives for taxing the digital economy.[6]At the urging of EU Member States that included France, Germany, Italy and Spain, and supported by similar efforts pursued by the United Kingdom, the EC announced the objective fundamentally to revise the international taxation framework by introducing the concept of "significant digital presence" for corporate income tax purposes. A Member State would be able to tax a company on profits treated as made through a significant digital presence, even if it had no physical presence in that Member State. In the EC's view, this "long-term", "comprehensive" solution cannot be implemented without substantial renegotiations of many tax treaties. States thus face the challenge of making fundamental alterations of the distribution of taxing rights for taxes covered by article 2 while honouring their obligations under existing treaty law. As a strategy for dealing with this challenge, the EC proposed, as an interim solution, a "digital services tax" to be levied on businesses of sufficient size at a rate of 3% on their gross revenues from online advertising, sales of user data or provision of digital platforms enabling user interactions. The digital services tax seems specifically designed not to be an income tax and thus not to be covered under existing tax treaties. While the EC's interim solution drew immediate criticism because of the anticipated distortionary effects of a tax on gross revenue, it seems inevitably to follow from the EC's commitment to honouring existing treaty legal obligations while moving towards fundamental change.[7]

In this sense, article 2 possesses a significance in the post-BEPS world that it never claimed before: its interpretation bears on the capacity and tactics of countries to bring about fundamental changes in international taxation through the enactment of new taxes. This chapter will continue to be updated to examine article 2 in the light of such new taxes; *see* , for example, the discussions of India's equalization levy (section 3.1.3.), the digital services tax (DST) imposed by France and proposed by other countries (section 3.1.4.), the United Kingdom's diverted profit tax (DPT) (section 5.3.1.1.) and the United States' base erosion and anti-abuse tax (BEAT) (section 5.3.1.2.).

1.1.1.3. The structure of article 2 of the OECD Model

Many commentators have noted inherent tensions arising from the structure of article 2 of the OECD Model.[8]Paragraph 1 of the article states that taxes on income and on capital are covered by the convention, and paragraph 2 offers some definitions of such taxes. Paragraph 3 provides a list of the existing taxes to which the convention specifically applies, and paragraph 4 extends the scope of the convention's coverage to identical or substantially similar taxes imposed subsequent to the signing of a tax treaty. The following obvious questions can be raised: what if taxes enumerated in paragraph 3 (and subsequently enacted taxes that are similar) fall outside the definition of income or capital taxes in paragraphs 1 and 2? Conversely, what if the contracting states impose taxes on income and/or capital, whether before or after the signing of the treaty, that are not specifically enumerated in paragraph 3 and are not substantially similar to the enumerated taxes? In other words, it's conceivable for taxes described under paragraphs 1 and 2 not to be described under paragraphs 3 and 4, and vice versa. Do these two sets of descriptions limit each other, or are they disjunctive, so that taxes falling under either set of descriptions are covered under the convention? Neither answer leads to a completely natural reading of the actual language of the article. (These questions are examined in detail in section 5.)

1.1.2. Policy of article

1.1.2.1. Avoiding double taxation

Treaties on the taxation of income and capital coordinate the taxation of contracting states by limiting either source state taxation (e.g. through reduced rates and exemptions) or residence state taxation (e.g. through exemptions or foreign tax credits).[9]The inclusion of a tax within the scope of a treaty means that either or both of these types of coordinated limitations on taxing rights would be applicable.[10]Conversely, the failure to include a tax in the scope of a treaty implies that the tax is free from both of these two types of limitations and, in general, the two states are not engaged in coordination with respect to the imposition of the tax.[11]The fundamental policy issue raised by article 2, therefore, is when and how states should coordinate with respect to a given tax.

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6. *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence* , COM(2018) 147 final (21 Mar. 2018), Primary Sources IBFD; and *Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services* , COM(2018) 148 final (21 Mar. 2018), Primary Sources IBFD.
7. For a similar proposal made by the United Kingdom, *see* HM Treasury, *Corporate tax and the digital economy: Position paper* (Nov. 2017).
8. *See* , for example, Helminen, *supra* n. 5 , at pp 25-27; and M. Lang, *"Taxes Covered" – What is a "Tax" according to Article 2 of the OECD Model?* , 59 Bull. Intl. Taxn. 6, pp. 220-1 (2005), Journal Articles & Papers IBFD.
9. Traditional comprehensive tax treaties also may coordinate the taxing rights of contracting states when they both claim taxing rights as source states or both impose taxes as residence states.
10. There are exceptions to this general statement. *See* sec. 6.2.2.
11. Non-coordination does not immediately imply that adverse double taxation (or unintended double non-taxation) will occur. Unilateral domestic law measures can sometimes achieve the same effect as treaty-based coordination.

The conventional answer to the question of when states should coordinate with respect to the imposition of a tax is that they should do so when there is a significant risk of juridical double taxation, defined as "the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods".[12]Taken as a suggestion of when double taxation is likely to have "harmful effects on the exchange of goods and services and movements of capital, technology and persons",[13]this particular formulation is vulnerable to two fundamental objections.

First, whether juridical double taxation is harmful very much depends on the economic incidence of the taxes in question. Take, for example, a withholding tax imposed by the source state on interest paid to non-residents. Although such a tax may be formally imposed on the non-resident holders of debt claims, it is common for the burden of the tax to be borne by the borrowers in the source state, through higher pre-tax interest rates (or "gross-ups" in favour of the lenders, so that the latter receive the same after-tax interest regardless of the tax imposed by the source state). Where this is the case, if any interest income received is taxed by the lender's residence state, the lender may be no worse off for having "juridically" been subject to tax in both states. In fact, if the residence state offers a foreign tax credit for the tax the lender nominally "paid", but which was in fact borne by the borrower, the result is that the lender bears no burden of tax on its interest income in either state. The attempt to alleviate juridical double taxation directly results in a case of factual double non-taxation.

Second, the same tax can be imposed multiple times on the same tax base, with the same or substantially similar effect (including distortionary or "harmful" effects) on market behaviour, but without juridical double taxation. For example, a withholding tax on interest income imposed on lenders can alternatively be imposed as a tax on borrowers. A tax on wage income imposed on employees can alternatively be levied as an excise tax on employers. Overall, juridical double taxation is neither a necessary nor a sufficient condition for the harmful effects of excess tax burdens to come about.

These two objections to the goal of avoiding juridical double taxation of income have far-reaching implications. For example, they reveal that a supposedly fundamental policy goal of tax treaties may in fact be highly formalistic. Questions of economic (as opposed to mere legal) incidence are critical to evaluating tax policy and, especially, its distributional effects. Ignoring such questions in designing tax treaties may well lead to unsatisfactory policy. Moreover, the artificiality of the concept of juridical double taxation simply invites manipulation by both taxpayers and government authorities. Finally, these problems arguably create insurmountable challenges for legal interpretation. As discussed in section 1.1.2.3., some scholars have argued that article 2 of the OECD Model should be interpreted not formally but more expansively, taking into account not only the meaning of treaty language and domestic law definitions but also the object and purposes of tax treaties. But how far can "contextualism" go if such purported objects and purposes of tax treaties are themselves highly formalistic? Such underlying formalism would also make it very difficult – and controversial – to make claims about the original intent of model tax conventions. The formalistic nature of juridical double taxation implies that such intent is likely to be highly ambiguous.

Some of the article 2 controversies discussed in this chapter directly implicate these theoretical critiques of the norms supposedly guiding the design of tax treaties (*see* section 2.2.2.).[14]Consider a case decided in 2008 by the High Court of South Africa (HCSA) regarding the country's secondary tax on companies (STC).[15]The STC was imposed on companies distributing dividends in respect of the net amount of the dividend. Volkswagen of South Africa (VW SA) paid and declared dividends to its holding company (Volkswagen AG) and, initially, paid the STC on the distributions. It then brought suit to the HCSA for a refund of the STC on the basis that article 7 of the Germany-South Africa Income Tax Treaty (1973)[16]was applicable and that the tax should be reduced from a rate of 12.5% to a rate of 7.5%. Although at the time the treaty was concluded between South Africa and Germany the STC did not exist, VW SA argued that the STC was a tax substantially similar to the tax on dividends that did exist at the time when the treaty became effective.[17]By contrast, the South African Revenue Service (SARS) claimed that the tax treaty did not apply to the STC, because it did not constitute a tax on dividends but a tax on the company. The SARS Commissioner also denied that the STC replaced any earlier tax on dividends.

The HCSA held that the STC was not borne by the recipient of the dividend but was rather a tax imposed on the company declaring the dividend. Therefore, article 7(2) of the tax treaty (which referred to a recipient of dividends and not to a company declaring the dividend) did not apply. In 2013, the STC was abolished and replaced by a withholding tax. It has been suggested that the fact that the STC did not fit comfortably within tax treaties was one of the reasons why it was replaced by the dividends tax. One might even feel emboldened by this subsequent history to criticize the 2008 HCSA decision as overly formalistic. However, this formalism may be rather widely shared, as is suggested by the fact that the HCSA decision and the position of

12. Para. 1 *OECD Model: Introduction to the Commentary* (2017), Treaties & Models IBFD.
13. Id.
14. *See* the discussion of the Brazilian CIDE in sec. 2.2.1. ; *see also* the discussion of the Swedish TTPD in sec. 3.1.
15. SA: HCSA, 21 Apr. 2008, *Volkswagen of South Africa (Pty) Ltd v. Commissioner for the South African Revenue Service* (70 SATC 195), Case Law IBFD.
16. *Ger.-SA Income Tax Treaty* (1973), Treaties & Models IBFD.
17. Specifically, it argued that the STC did not become payable unless and until a dividend was declared and therefore it was not a tax on the income of the company declaring dividends but rather a tax on dividend income distributed by the company. Moreover, VW SA argued that the STC was substantially similar to a withholding tax on dividends, the earlier South African non-resident shareholders tax, which had been abolished in 1995.

the South African government were consistent with a ruling on the STC issued by the Dutch government.[18]More generally, because the norm of preventing all and only juridical double taxation, regardless of the real effect of such taxation, has become an unreflective convention in treaty practice, counter-intuitive results such as the one VW SA suffered can be expected to arise with frequency.

1.1.2.2. Four customary policy considerations regarding the scope of article 2 of the OECD Model

The contour of article 2 of the OECD and UN Models has been shaped historically by a number of customary policy considerations. First, what actual tax treaties tend to uniformly cover are income taxes that the contracting states impose on a worldwide basis, i.e. regardless of whether the income has a domestic source. This makes sense: the initial and main purpose of tax treaties was to avoid international double taxation, when the same economic activity is taxed by more than one state. Income taxation, being perhaps the most widely adopted modern tax around the world, certainly furnishes the most salient example of potential double taxation. To the extent that taxes on capital are also covered by tax treaties (as they are by the OECD and UN Models), the impetus for such coverage is also understood to arise mainly from the fact that some capital taxes, such as net wealth taxes, are imposed on a worldwide basis, giving rise to the risk of double taxation.

Second, notwithstanding the preceding remark, a number of taxes that may also be levied on a worldwide basis are often excluded from the coverage of "comprehensive" tax treaties. These include estate, inheritance and gift taxes, for which the OECD has offered a separate Convention for the Avoidance of Double Taxation with Respect to Taxes on Estates and Inheritances and on Gifts.[19]It is also not uncommon for countries to separately negotiate social security totalization agreements to deal with social security taxes and to carve out such taxes from the scope of income and capital tax treaties.[20]The existence of (or intention to negotiate) separate tax treaties that address certain tax matters does not necessarily dictate that such matters be carved out of income and capital tax conventions. For example, some countries have air transport agreements containing tax provisions that overlap with the scope of income tax treaties. Nonetheless, because the drafters of the OECD Model had a preference for leaving social security taxes for separate agreements, this approach is reflected in a substantial number of tax treaties. In other words, while the coverage of income taxes is typically viewed as sufficient to render income tax treaties more "comprehensive" than other types of tax treaties, "comprehensive" treaties, in light of the discussion in this chapter, are not so comprehensive after all.[21]

Third, it is common to conceive of tax treaties as covering "direct" taxes while leaving out "indirect" taxes, even though what this distinction consists in remains as ambiguous as ever.[22]Among other things, this terminology captures the fact that consumption taxes such as the VAT and consumption excise taxes are usually not included in the scope of income tax treaties (although there are occasional exceptions).[23]The VAT and consumption excises are usually regarded as indirect taxes, but more importantly, whether they are so regarded or not, the risk of double taxation arises for such taxes in very different ways than under income and capital taxes. The VAT, for example, is generally levied on a "destination basis", so that only one state, the state where final consumption takes place, collects VAT revenue from the chain of production that eventuates in the sale of consumable goods and services. Double taxation (or double non-taxation) occurs when this convention fails to hold. Therefore, even if the VAT can give rise to double taxation (or double non-taxation), it has become customary not to address such issues in an income (and capital) tax treaty. However, to explain this as a matter of the exclusion of "indirect taxes" is somewhat misleading, especially given the fact that it has also become customary to exclude many excise taxes that are in certain clear senses "direct" from the scope of tax treaties because they are not income or capital taxes.[24]

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18. A ruling issued by the Dutch Ministry of Finance on 4 April 1996 (Decree IFZ96/94U) affirmed that the South African STC qualified as a tax on profits that would be considered a "substantially similar" tax within the meaning of art. 2(4) *Neth.-SA Income Tax Treaty* (1971), Treaties & Models IBFD. According to the decree, however, the STC does not qualify as a withholding tax on dividends but rather as a "split rate" corporate income tax. Thus, South Africa was allowed to impose the STC without being restricted by the dividend article of the treaty, and the Netherlands was not obliged to grant a credit for the STC. According to the Dutch ruling, the South African tax authorities agreed with this treatment.
19. *OECD Estate, Inheritance and Gift Model Convention* (3 June 1982), Treaties & Models IBFD. Some states have entered into bilateral tax treaties that include in their substantive scope taxes on income, on capital and on inheritances (estates, and on gifts). Examples include France's treaties with its former colonies and Germany's treaties with Denmark and Sweden. *See* J.K. Szczepanski, *The dual system of OECD Model Tax Conventions from the evolutionary perspective* , 46 Intertax 10, pp. 766-793 (2018).
20. For a comprehensive discussion, *see* P.A. Brown, *Articles 18 and 19(2): Pensions – Global Tax Treaty Commentaries* , Global Topics IBFD (accessed 1 Oct. 2019).
21. The long persistence of separate, non-income tax treaties also casts doubt on any claim that the scope of income tax treaties should be interpreted to be as wide as possible. *See* sec. 1.1.2.3.
22. While the terminology of "direct" and "indirect" taxes appears infrequently in tax treaties today, it is still common for international trade and investment agreements to refer matters regarding "direct taxation" to tax treaties. In other words, in the division of labour among different types of treaties, direct taxes are conceived of as falling within the exclusive domain of tax treaties.
23. *See* sec. 5.2.1.
24. *See* I.R.S. Private Letter Ruling 9253049, 6 Oct. 1992, Primary Sources IBFD; and I.R.S. Private Letter Ruling 9143067, 31 July 1991, Primary Sources IBFD (Internal Revenue Code Section 4980A excise taxes on early pension withdrawals are not income taxes and are not covered by tax treaties). *See also* the discussion of excise taxes on the wages of enterprises in sec. 3.5.

Finally, if one considers the question of what types of taxes may give rise to the risk of (juridical)[25]double taxation (or double non-taxation) such that coordination among countries is desirable, the answer is that income and capital taxes may not be the only such taxes. Consumption taxes, excise taxes, social security taxes and gift/inheritance/estate taxes also frequently raise issues of overlapping tax jurisdictions (and failures to exercise such jurisdictions). Moreover, these non-income taxes also often overlap with the income tax in terms of the tax base and thereby create further layers of multiple taxation. Nonetheless, tax treaties have largely limited their scope to income taxes, with only a portion of tax treaties covering capital taxes. Indeed, as discussed throughout this chapter, the range of taxes covered can be further narrowed in several other major ways. For instance, subnational taxes may be excluded. States may also not treat all income and capital taxes as covered but only list a number of existing taxes that does not exhaust the range of relevant taxes. Finally, the question of whether new taxes are substantially similar to existing covered taxes may be shrouded in controversy.

All of this suggests that there may not be a single set of conceptual or normative considerations that explains the inclusion of (some) income and capital taxes in tax treaties and the exclusion of other taxes. Instead, it might be suggested, the inclusion and exclusion of taxes in tax treaties simply represent a convention that countries have converged upon, with income taxation being the most salient element that facilitates (imperfect) coordination among them.

1.1.2.3. Narrow versus expansive readings of the scope of covered taxes

Some scholars have argued that the division of labour between income and capital tax treaties and other tax treaties, and more generally what they perceive to be the under-inclusiveness of article 2 of the OECD Model, are problematic. They claim that the existing treaty framework divides taxes into “silos” (e.g. income, capital, inheritance/estate and consumption taxes), whereas the boundaries among these silos are in reality blurry. Pretending that the boundaries are clear when they are not “trigger[s] ‘treaty dodging practices’”. Some scholars even assert that “under this tangled and conflicting framework, there is more double taxation and less double non-taxation than it appears”. Although it may seem paradoxical, the same scholars suggest that the solution to this problem is to provide even more legal definitions, especially of the basic terms used in article 2, e.g. what is a “tax” and what is “income”.[26]This implies an assertion that legal scholars can delineate better silos than countries have done hitherto.[27]

The issue of whether to read article 2 of the OECD Model broadly or narrowly is related to, but also distinct from, a more esoteric debate about “contextualism” in determining the relationship between paragraphs 1 and 2, on the one hand, and paragraphs 3 and 4, on the other, of the article. That specialized debate is briefly discussed in section 5.1.1. It is worth noting here, though, that there are many reasons to expect treaty context not to provide an abundance of interpretative guidance. First, as noted in section 1.1.2.1. , a purportedly fundamental goal of tax treaties – the avoidance of juridical double taxation – is itself highly formalistic. Not much evidence has been offered that the context and purpose of tax treaties are sufficiently unambiguous to offer clearer guidance as to how to interpret article 2 than treaty language itself.

Second, it is also not clear that countries should be interpreted as putting such great value on the avoidance of double taxation that they are willing to broaden the scope of tax treaties at all costs. Consider the current situation in the post-BEPS world, where some countries wish to tax companies with no physical presence but only a “digital presence” in them. To accomplish this within a treaty framework, fundamental reallocations of taxing right may be required, and to the extent that countries cannot agree on such reallocation for now, a country wishing to tax digital presence may prefer increasing instances of double taxation to accepting an undesirable allocation. After all, tax treaties allow countries to achieve the goal of avoiding double taxation by agreeing on the allocation of taxing rights: tax treaties cannot be said to succeed if they mitigate double taxation but only at the cost of generating allocations that go against countries’ wishes.

Third and finally, the contextual, “broadening” reading of article 2 of the OECD Model can have undesirable effects. This can be illustrated by the current debate about gross-revenue-based taxes on digital companies proposed by the EC, the United Kingdom and other countries. A common view is that these revenue-based taxes are adopted because they could not be easily characterized as income taxes and therefore would not lead to treaty breaches.[28]However, if the scope of tax treaties can be interpreted more narrowly, countries may have wider berth to design other, perhaps less distortionary taxes as alternatives to treaty-covered taxes. Some practitioners have suggested that taxes on net profits (i) allocated according to some unusual formula based on user participation and (ii) imposed alongside the standard corporate income tax should not be viewed as

25. The superficiality of the notion of juridical double taxation is further discussed in sec. 1.1.2.1.
26. *See* R. Garcia, *Summary of discussion: IFA 70th Congress in Madrid, Subject 2: Plenary Session – The notion of tax and the elimination of international double taxation or double non-taxation* (27 Sept. 2016), News IBFD.
27. Other scholars can be read as expressing a contrary view. Helminen writes, for example, “taxation is always based on fictions and the extent to which these fictions are used in different states varies. Basically anything can be defined as income for the purposes of a tax system. Ultimately the definition of income for tax purposes depends on a political decision concerning the items that should be taxed as income”; *see* Helminen, *supra* n. 5 , at p. 35.
28. D. Hohenwarter et al., *Qualification of the Digital Services Tax Under Tax Treaties* , 47 Intertax 2, pp. 140-147 (2019);

sufficiently similar to treaty-covered taxes and therefore can be adopted without breaching tax treaties.[29]The impulse to read article 2 broadly would preclude such possibility, making everyone worse off as a result. To put it differently, to require countries to coordinate on as broad a range of taxes as possible (which is essentially what the contextualists advocate) leaves countries fewer and worse policy instruments when they are unable to coordinate. And if coordination is not the only good, such a requirement is unjustified.

1.2. History

1.2.1. League of Nations

The question of what taxes should be included in the scope of treaties received more attention in the drafting of model tax conventions under the frameworks of the League of Nations and the Organisation for European Economic Co-operation (OEEC) than during the evolution of the OECD Model after 1963. Article 1 of the League of Nations Draft of a Bilateral Convention for the Prevention of Double Taxation of April 1927 stipulated that "[t]he present Convention is designed to avoid double taxation in the sphere of direct impersonal or personal taxes" and further contained two lists of what should be considered to be impersonal and personal taxes.[30]The United States, having already unilaterally implemented a foreign tax credit regime to alleviate double taxation of cross-border economic activities, sought the inclusion of taxes (especially European ones) that were comparable to the US income tax but that took different legal forms.[31]Indeed, the Fiscal Committee of the League of Nations even examined, in 1929, the possibility of extending the material scope of the draft conventions to turnover taxes, record fees etc.[32]However, the perceived imprecision of the terms "direct taxes" and "impersonal/personal taxes" soon led to the consideration of an approach whereby a list of the specific taxes covered was provided, without a general description of the kinds of taxes to be covered. The proposal to bring non-income taxes into the scope of treaties was also short-lived.

The expression "taxation of income" was used for the first time in the title of the League of Nations Model Convention of 1943 (the Mexico Model), but the text of article 1 of the Mexico Model itself only contained a list of taxes covered, as well as an extension clause to future taxes, without referring to the concept of income taxes.[33]Similarly, the term "taxes on income and on capital" first appeared in the title of the London Model of 1946, although article 1 of this draft also merely enumerated specific taxes (and provided for extensions to future taxes).[34]

This early history can be viewed as reflective of the policy issues underlying article 2. On the one hand, the scope of tax treaties should be wide enough that their power to mitigate double taxation would not easily be defeated by legal niceties under different states' tax regimes. (This explains the impulse to include broad descriptions such as direct taxes or income and capital taxes.) On the other hand, it is also not surprising that the scope of tax conventions was determined not by any abstract reflection on all the ways in which the risk of double taxation might arise, but only by the most salient ways in which domestic tax systems converged. By the 1940s, income and capital taxes appeared to be such points of convergence (subject to the carve-outs of social security, gift, estate and inheritance taxes). The legal niceties in the definition of such taxes, however, predictably continued to generate arbitrary boundaries in tax treaty coverage.

1.2.2. OEEC/OECD

In 1956, the Fiscal Committee of the OEEC constituted several Working Parties (WPs) to study the problem of international double taxation and propose solutions to it. Among these, WP 3 focused on the taxes to be covered by tax treaties. In October 1956, WP 3 submitted its first report concerning the listing and definition of taxes on income and capital, based on the study of existing tax treaties at the time. This report proposed that the model convention should avoid using the distinction between direct and indirect taxes, apply to ordinary and extraordinary taxes, include subnational taxes and include an extension

29. There is currently a sufficient divergence of opinion, for example, regarding whether the UK diverted profit tax is substantially similar to corporate and income taxes covered by the United Kingdom's tax treaties. *See* sec. 5.3.1.1. for further discussion.
30. For the 1927 Model, *see* League of Nations, *Double Taxation and Tax Evasion, Report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion* , Geneva, doc. C.216.M.85.1927.II. (Apr. 1927), pp.10-18, available at http://taxtreatieshistory.org/data/html/league_of_nations_1926-04.html . *See also* T. Dubut, *Article 2 from a Historical Perspective: How Old Materials Can Cast New Light on Taxes Covered by Double Tax Conventions* , in *History of Tax Treaties: The Relevance of the OECD Documents for the Interpretation of Tax Treaties* (T. Ecker & G. Ressler eds., Linde 2011).
31. The distinction between personal and impersonal taxes reflected differences that existed at the time between the United States and European countries in their tax practices: the early US income tax was a "personal" tax, while European taxes tended to take "impersonal" forms.
32. *See* League of Nations, *League of Nations Fiscal Committee: Report to the Council on the Work of the First Session of the Committee* ; Geneva, Doc. C516.M.175.1929.II (Oct. 1929) p.4, available at http://taxtreatieshistory.org/data/html/league_of_nations_1929-10.html . *See also* : Dubut, *supra* n. 30 , at p. 130.
33. For the Mexico Model (1943), *see League of Nations, London and Mexico Model Tax Conventions – Commentary and Text* , doc. C.88.M.88.1946.II.A., Geneva (Nov. 1946), available at http://taxtreatieshistory.org/data/html/league_of_nations_1946-11.html .
34. For the London Model (1946), *see League of Nations, London and Mexico Model Tax Conventions – Commentary and Text* , doc. C.88.M.88.1946.II.A., Geneva (Nov. 1946), available at: http://taxtreatieshistory.org/data/html/league_of_nations_1946-11.html .

clause.[35]In 1957, Italian and Swiss delegates to WP 3 submitted drafts of article I, on taxes that should be covered, which introduced legal details such as the inclusion of surcharges, interests, costs and penalties.[36]Upon receiving comments from the Fiscal Committee, WP 3 submitted a common draft article in May 1957, which contained the structure of what was to become article 2 of the OECD Model. That is, the article contained five paragraphs: both taxes on income and on capital imposed on behalf of the state or its political subdivisions or local authorities would be covered (paragraph 1); taxes on total income and capital and on elements of income and capital, including taxes on capital gains and payroll taxes, would be covered (paragraph 2); a (non-exhaustive) list of taxes covered was provided (paragraph 3); and an extension clause to future taxes was provided (paragraph 4). In addition, a mutual consultation procedure was described (paragraph 5).[37]

The OECD succeeded the OEEC in 1961, and the OECD drafting group proposed a draft convention. Article 2 (Taxes covered) of this draft deleted paragraph 5 of the OEEC Draft, on the mutual agreement procedure, since the draft convention now contained a general provision in this respect (article 25). The Council of the OECD adopted the draft convention in July 1963, together with the commentary, which was practically the same as the commentary developed in 1958 by WP 3 of the OEEC.[38]

Notwithstanding the relatively minimal debate within WP 3 of the OEEC and the OECD drafting group regarding article 2, OECD member countries immediately began to express dissenting views about both its general approach and its detailed language.[39]The first analysis of the impact of the OECD Draft (1963), published in 1967, noted that article 2 was rarely perfectly followed by member countries.[40]Nonetheless, unlike most other articles in the OECD Model, article 2 has gone through only very limited revision since its first appearance in the OECD Draft (1963). The changes made in 1976 were merely linguistic, and the more significant changes made in 2000 only concerned the notification requirements in paragraph 4.[41]

1.2.3. Other historical sources

1.2.3.1. US Model

The US Model (1996)[42]did not contain a paragraph similar to article 2(1) and (2) of the OECD Model. It only provided a list of specific taxes covered and a clause dealing with future taxes. The US Model (2006)[43]moved closer to the approach of the OECD Model by including paragraphs that correspond to article 2(1) and (2) of the OECD Model, while at the same time retaining long-standing US treaty policies. For instance, political subdivisions are not mentioned in article 2(1) of the US Model (2006), and US state taxes are not mentioned in article 2(3); moreover, capital taxes are not mentioned in article 2(1), and the list of items of income in article 2(2) is also less extensive.[44]The US Model (2006) also explicitly excludes social security and unemployment taxes (while admitting that they are similar to income taxes).

The recently adopted US Model (2016)[45]contains one significant change in article 2 compared to the US Model (2006) that it replaced. Whereas previous models specifically listed “the Federal excise taxes imposed with respect to private foundations”, this category was narrowed in 2016 to “the Federal taxes imposed on the investment income of foreign private foundations”.

1.2.3.2. Multilateral Andean Community Model (1971) and tax treaty (2004)

The Andean Community Income and Capital Model Tax Treaty (1971)[46]contained a minimalist provision on the “Subject-matter of the Agreement” (article 1), which reads in its entirety:

> The taxes that are the subject-matter of this agreement are:

35. *See* OEEC WP 3, *Report concerning the listing and definition of taxes on income and capital (including taxes on estates and inheritances) which should be covered by double taxation agreements* , doc. FC/WP3(56)1, Paris (16 Oct. 1956), available at http://taxtreatieshistory.org/data/html/FC-WP3(56)1E.html .
36. *See* OEEC WP 3, *On the listing and definition of taxes on income and capital (including taxes on estates and inheritances) which should be covered by double taxation agreements* , doc. FC/WP3(57)1, Paris (10 Jan. 1957), available at http://taxtreatieshistory.org/data/html/FC-WP3(57)1E.html .
37. *See* OEEC WP 3, *Report on the listing and definition of taxes on income and capital (including taxes on estates and inheritances) which should be covered by double taxation agreements* , doc. FC/WP3(57)2, Paris (2 May 1957), available at http://taxtreatieshistory.org/data/html/FC-WP3(57)2E.html .
38. *See* OECD Council, *Report of the Fiscal Committee on the draft convention for the avoidance of double taxation with respect to taxes on income and capital among the member countries of the OECD* , doc. C(63)87, Paris (6 July 1963), available at http://taxtreatieshistory.org/data/html/FC-WP3(57)2E.html .
39. For example, Austria and the United Kingdom suggested deletion of the reference to payroll taxes (para. 2) to prevent social security contributions from being included in the scope of the convention and to alleviate the obligation of notification (para. 4). Canada, the United Kingdom and the United States further proposed deletion of art. 2(1) and (2).
40. *See* OECD Fiscal Committee, *Conformity of bilateral conventions between member countries to the OECD draft convention on income and capital* , doc. TDF/FC/208, Paris (6 Feb. 1967), available at http://taxtreatieshistory.org/data/html/TFD-FC-208E.html .
41. *See* sec. 5.4. for further discussion.
42. *United States Model Income Tax Convention* (20 Sept. 1996), Treaties & Models IBFD.
43. *United States Model Income Tax Convention* (15 Nov. 2006), Treaties & Models IBFD.
44. “There shall be regarded as taxes on income all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of property”.
45. *United States Model Income Tax Convention* (17 Feb. 2016), Treaties & Models IBFD.
46. *Andean Community Income and Capital Model Tax Treaty* (16 Nov. 1971), Treaties & Models IBFD.

- In (State A)....
- In (State B)....

This agreement shall be applicable as well to any changes that may be made in the cited taxes and to any other tax that, because of its tax base, is essentially and economically analogous to those cited above and that any Member Country may establish after the signing of this agreement.

Article 1 of Bolivia-Colombia-Ecuador-Peru Income and Capital Tax Treaty (2004)[47]provides as follows:

> This Decision shall apply to persons who are domiciled in any of the Member Countries of the Andean Community, in respect of taxes on income and on capital. It is mainly applied to the following:
>
> - in Bolivia, the income tax (impuesto a la renta);
> - in Colombia, the income tax (impuesto a la renta);
> - in Ecuador, the income tax (impuesto a la renta);
> - in Peru, the income tax (impuesto a la renta);
> - in Venezuela, the income tax (impuesto sobre la renta) and the business assets tax (impuesto a los activos empresariales).

It further provides that "[the agreement] shall also apply to future amendments to the above-mentioned taxes, and to any other tax introduced by the Member Countries after the publication of this Decision, which, because of its taxable base or subject matter, is substantially and economically similar to any of the above-mentioned taxes".

1.3. Relationship to basic principles of international taxation

Not applicable at present.

2. Article 2(1) of the OECD Model – "This Convention shall apply to taxes"

2.1. What is a "tax"?

The OECD Model does not define the term "tax". Although the question of what makes a levy a tax and a payment a tax payment has raised significant interpretative controversies under the domestic laws of many countries, the volume of controversies surrounding and explicit interpretations of the term in connection with the Taxes Covered article of tax treaties is much smaller.

Previous comparative studies have tended to identify the following four essential features of taxes:

(1) taxes are "mandatory", "compulsory" or "involuntary" levies and distinct from "voluntary" payments;[48]

(2) taxes are paid for public purposes, to promote the general interest;[49]

(3) taxes are imposed by an organ of government;[50]and

(4) taxes are paid without anything received specifically in return for the payment.[51]

In relation to factor (4), the OECD has long taken the stance that social security charges are not regarded as taxes. Paragraph 3 of The Commentary on Article 2 of the OECD Model states that "[s]ocial security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received, shall not be regarded as 'taxes on the

47. *Bol.-Colom.-Ecu.-Peru Income and Capital Tax Treaty* (2004), Treaties & Models IBFD.
48. *See* , for example, M. Barassi, *The Notion of Tax and the Different Types of Taxes – Comparative Approach* , in *The Concept of Tax* p. 64 (B. Peters ed., EATLP International Tax Series 2005), Books IBFD; US: TC , 9 Mar. 1995, *Phillips Petroleum Co. et al. v. Commissioner* , 104 T.C. 256, 295 (1995), Case Law IBFD; and Helminen, *supra* n. 5 , at p. 22. Moreover, for foreign tax credit purposes, US Treasury Regulation § 1.901-2(a)(2)(i) provides that a payment to a foreign government is not voluntary only if the taxpayer has exhausted all the effective and practical remedies to reduce its foreign tax liability.
49. *See* , for example, UK: ECJ, 25 Sept. 2003, Case C-58/01 , *Océ Van Der Grinten NV v. Commissioners of Inland Revenue* [2000] All ER (D) 1666, Case Law IBFD; and Helminen, *supra* n. 5 , at p. 22.
50. For instance, art. 2(1) *OECD Model* provides that the convention applies only "to taxes ... imposed on behalf of a Contracting State or of its political subdivisions or local authorities". *See also* Helminen, *supra* n. 5 , at p. 22.
51. *See* , for example, US Treasury Regulation § 1.901-2(a)(2)(i) (for foreign tax credit purposes, a payment to a foreign country is not a tax "to the extent a person subject to the levy receives (or will receive), directly or indirectly, a specific economic benefit ... from the foreign country in exchange for a payment pursuant to the levy"; and Helminen, *supra* n. 5 , at p. 22.

total amount of wages'". Likewise, a report of WP 30 that was prepared in 1967 to examine issues under article 2 of the OECD Draft (1963) argued as follows:

> Without going into detail it could be said that the payer of social security fees (or the person on whose account such payments are made directly or indirectly) receives specific rights against the social insurance in return for these contributions. Therefore the Working Party feels that contributions to social security funds can in principle not be considered to be "taxes" in the meaning of paragraphs 1 and 2.[52]

This has become a conventional position, notwithstanding the fact that the extent of the connection between the levy and the individual benefit under a social security system can be difficult to determine.[53]Similarly, fees charged by governments for services provided, although collected by public bodies and authorized by law, do not qualify as taxes under article 2 of the OECD Model, because there is a direct connection between the levy and the benefit.

In *Niemeijer v. R.* (2009),[54]the Tax Court of Canada (TCC) considered a taxpayer's argument that the premium paid for Dutch health care insurance was in effect a form of tax and therefore should be deductible from the taxpayer's income as a foreign tax paid for the purposes of computing his Canadian income tax liability. The taxpayer argued that the Dutch health care insurance premium was computed directly by reference to the wages of the individual, was compulsory and was not individualized but instead was used for the general public welfare. In reply, counsel for the government cited the *Asscher* decision of the Court of Justice of the European Union (ECJ),[55]which recognized that, although wages tax and national insurance contributions were collected together in the Netherlands, they "belong to fundamentally different categories of levy … The payment of social security contributions forms part of an insurance scheme: it bestows entitlement to specific benefits. The payment of taxes, however, which is unconnected with any insurance transaction, does not give rise to any benefits as such". The TCC concluded that the Dutch health care insurance premium was neither a "wages tax" nor a tax at all under the Canada-Netherlands Income Tax Treaty (1986).[56]

The issue of whether a payment of a particular taxpayer is tied to a benefit to be received by such a taxpayer can be distinguished from the issue of the uses to which tax revenue can be put. In a number of controversies regarding article 2 of the OECD Model discussed elsewhere in this chapter (*see* sections 2.2.1. and 3.1.), courts have used the use of revenue (e.g. the particular uses for which tax revenue is earmarked) to individuate or distinguish among taxes. That is, two levies that are otherwise similar but that are used for different purposes may be seen as two different taxes. Earmarking can thus trigger either the question of whether some levy is a tax or the question of whether two levies are identical or different taxes.[57]

In many countries, the concept of tax has been controversial under domestic tax law because of constitutional or basic legal requirements that any tax must be approved in a statute and all its fundamental elements must also be established by statute.[58]Such controversies are germane to the policy underlying article 2 of the OECD Model, if not so much to the legal interpretation of the article. In many countries, there are trends to meet budgetary needs not with traditional taxes but with earmarked levies and user fees. In other words, "non-tax" revenue has grown (as a percentage of budgets) for domestic political and policy reasons. The increasing significance of such levies has a bearing on cross-border transactions as well. Assuming that the magnitude of non-tax levies is non-negligible, how tax treaties should take them into account – how states should coordinate in respect of them – is a serious question.

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52. Report of WP 30 of the Fiscal Committee of the OECD (Austria-Switzerland) FC/WP30 (69) 1, p.10, Paris (12 June 1969), available at http://taxtreatieshistory.org .
53. Id. (At best, "most systems … have a rule that only individuals who have contributed to the social security system are entitled to specific rights under the system in return for their contributions"; both the proportionality of contributions to benefits and the tracing of use of funds, however, are tenuous.) *See also* Y. Brauner, *The International Tax Regime and Social Security* , in *Double Taxation Conventions and Social Security Conventions* pp. 18-20 (M. Lang ed., Linde 2006); H. Vording, *The Normative Background for a Broad Concept of Tax* , in Peters (ed.), *supra* n. 48 , at p. 47 et seq.; and J. Macón & E.J. Reig, *General Report* , in *Social security contributions as a fiscal burden on enterprises engaged in international activities* p. 104, International Fiscal Association (IFA), *Cahiers de droit fiscal international* vol. 69b (Sdu Fiscale & Financiële Uitgevers 1984), Books IBFD.
54. CA: TCC, 2009, *Niemeijer v. R.* , CarswellNat 4363, 2009 TCC 624, 2010 D.T.C. 1029 (Eng.), [2010] 3 C.T.C. 2368, 2009 CCI 624.
55. NL: ECJ, 27 June 1996, Case C-107/94 , *P.H. Asscher v. Staatssecretaris van Finaciën* , [1996] All ER (EC) 757, Case Law IBFD.
56. *Can.-Neth. Income Tax Treaty* (1986), Treaties & Models IBFD.
57. For discussion, *see* sec. 2.2.1. , regarding the Brazilian *contribuição sobre intervenção do domínio econômico* (CIDE) and the *Unilever* case for a fact pattern that appeared to have led to a conflation of these two issues.
58. *See* H. Ostik, *New Zealand* , in IFA, *supra* n. 5 , at p. 584 et seq. (the New Zealand Court of Appeals, in NZ: NZCA, 15 July 1999, *Haliburton & Ors v. Broadcasting Commission* , [1999] NZCA 110, considered whether a public broadcasting fee contravened the Constitution Act 1986, which provides that it shall not be lawful for the Crown to levy a tax, except by or under an Act of Parliament); and F. Birnbaum & A. Hessdörfer, *Uruguay* , in IFA, *supra* n. 5 , at p. 901 et seq. (the communications regulatory framework control fee was a tax, and the law that created it was declared unconstitutional because the law had not been approved with the special majorities required for approval of taxes).

2.2. "Irrespective of the manner in which they are levied"

2.2.1. Tax on net income by assessment or by final withholding on gross basis

Article 2(1) of the OECD Model provides that the convention applies to taxes on income and capital "irrespective of the manner in which they are levied". The Commentary on Article 2 of the OECD Model states that the method of levying taxes, whether "by direct assessment or by deduction at the source", is immaterial to the question of whether a tax treaty applies to an otherwise covered tax.

Income taxes levied on non-residents by withholding can raise two types of interpretive issues. First, final withholding taxes are typically levied on gross amounts paid. This could be in tension with the conception of the income tax as being imposed on net income, and a tax calculated by reference to gross amounts becomes harder to distinguish from a non-income tax that is imposed on the revenue or turnover of taxpayers. Second, withholding taxes are collected by persons other than the taxpayer that is primarily liable for the tax. An equivalent tax can be imposed as an excise tax on the payer. If this simple shifting of nominal legal liability from one party to another suffices to change an income tax into a non-income tax, that would be another way in which the boundary delineating the scope of tax treaties can appear arbitrary.

The treaty status of the Brazilian *contribuição sobre intervenção do domínio econômico* (CIDE) illustrates this point. For a number of years before 2000, Brazil subjected payments to non-residents for technical services to a 25% withholding tax. Brazilian treaties usually addressed the taxation of technical services in article 12, which typically sets a 15% limitation on the withholding tax. However, in 2000, the CIDE was created to finance federal programmes for new technologies. This new contribution had a 10% rate and was imposed on Brazilian acquirers of foreign technology. The same statute that created the CIDE also provided for the reduction of the regular withholding tax on royalties from 25% to 15%. Thus, neither the overall tax burden on payments for technical services nor even the remittance procedures experienced any change: although the withholding tax was legally a tax imposed on the beneficial owner of income, it was collected by the payer – the acquirer of technology – upon payments of the amounts. Thus, instead of a 25% withholding tax before 2000, there was after 2000 a 15% withholding tax and a 10% CIDE, remitted by the same person at the same time and on the same basis as before 2000.

Nonetheless, the Brazilian government has taken the position that the CIDE falls outside the scope of its tax treaties and that, therefore, the 15% limitation under article 12 does not apply. One reason given is that, while the withholding tax is collected by the acquirer on behalf of the income beneficiary (and therefore is an income tax), the CIDE is paid by the acquirer in its own name. This position has been upheld by the *Tribunal Regional Federal da 3ª Região*(Federal Regional Court of the 3rd Region (TRF3)), which, in a dispute denominated the *Unilever* case,[59]excluded the CIDE from the scope of the Brazil-Netherlands Income Tax Treaty (1990).[60]The court in that particular case also argued that, because the CIDE was a contribution for an intervention in the economic order, its particular use renders it not a tax at all and that therefore it was not identical or substantially similar to the income tax and was not subject to any treaty limitation.[61]

A similar series of decisions by Brazil's *Tribunal Regional Federal da 2ª Região*(Federal Regional Court of the 2nd Region (Rio de Janeiro) (TRF2))[62]also ruled that two other types of Brazilian contributions – the *contribuição para o financiamento da seguridade social* (contribution to the funding of social security (COFINS)) and the *contribuição para os programas de integração social e de formulação do patrimônio do servidor público* (contribution to the employee profit distribution programme (PIS)) – imposed on payments for technical services were not income taxes, because they were levied on the revenues and not on income, and that they thus fell outside the scope of tax treaties. The distinction between these "contributions" and a withholding tax seems artificial.

2.2.2. Surcharges and supplementary levies

A very common manner in which taxes can be imposed is through surcharges. For example, in Belgium, municipalities have the authority to levy taxes in the form of additional surcharges on the federal income tax due. The surcharges are levied as an increase of the personal income tax due based on a pre-set percentage determined by the municipality in which the taxpayer resides and are administered by the federal tax authorities. For Belgian treaty purposes, such surcharges all fall under the

59. *See* T.L. Gama, *Brazil* , in IFA, *supra* n. 5 , at p. 215, citing BR: TRF3 [Federal Regional Court of the 3rd Region], 26 May 2004, Interlocutory Appeal no. 2001.03.00.032586-9, Reporting Appellate Judge Lazarano Neto.
60. *Braz.-Neth. Income Tax Treaty* (1990), Treaties & Models IBFD.
61. The court's decision that any contribution is by definition not a tax is flatly in contradiction with the Brazilian government's own recent position with respect to the social contribution, which, as discussed in sec. 5.1.2.2. , was declared in 2015 (with retrospective effect) to fall within the scope of all of Brazil's tax treaties.
62. BR: TRF2 [Federal Regional Court of the 2nd Region], 22 Feb. 2008, *Compagnie Nationale Air France v. Federal Revenue* , Case Law IBFD. *See also* BR: TRF2 [Federal Regional Court of the 2nd Region], 29 Aug. 2006, Appeal no. 1998.51.01.023848-8, Reporting Appellate Judge Luiz Antonio Soares.

income tax covered by article 2. States may even enter into specific agreements regarding such surcharges.[63]Contracting states have generally recognized the nature of such surcharges as covered under tax treaties.[64]

India is another country where surcharges are a common form of supplementary levy to the income tax. The Constitution of India authorizes the government to increase any duties or taxes by surcharge. Thus, any amount collected towards surcharges should bear the same character as the original levy carried, as it represents an increase in the original levy and not a new or separate levy.[65]In a recent dispute brought to the Income Tax Appellate Tribunal Kolkata (ITAT Kolkata),[66]the taxpayer, a corporation resident in Singapore, earned interest and royalty income, which, pursuant to articles 11 (Interest) and 12 (Royalties) of the India-Singapore Income Tax Treaty (1994),[67]may be taxed in India at rates of up to 15% and 10%, respectively. In excess of these rates, the taxpayer was assessed an "education cess" (at a rate of 2%) and a "higher education cess" (at a rate of 1%) (referred to collectively as the "education cess"). The education cess was introduced by the Finance Act of 2004, according to which "the amount of income tax … shall be further increased by an additional surcharge for purposes of the Union, to be called the 'Education Cess on income tax'". The taxpayer challenged the assessment on the ground that the education cess was covered by the India-Singapore Income Tax Treaty (1994), since article 2(1)(a) explicitly provides that the taxes covered by the tax treaty shall, in the case of India, include "income tax including any surcharge thereon". The ITAT Kolkata ruled in favour of the taxpayer, stating that it is "clear that the education cess … was nothing but in the nature of an additional surcharge".[68]

2.2.3. Interest and penalties

The 2017 revision to the Commentary on Article 2 of the OECD Model asserts as follows:

> Most States … do not consider that interest and penalties accessory to taxes covered by Article 2 are themselves included within the scope of Article 2 and, accordingly, would generally not treat such interest and penalties as payments to which all the provisions concerning the rights to tax of the State of source (or situs) or of the State of residence are applicable, including the limitations of the taxation by the State of source and the obligation for the State of residence to eliminate double taxation.[69]

Consequently, the updated Commentary only urges that "where taxation is withdrawn or reduced in accordance with a mutual agreement under Article 25, interest and administrative penalties accessory to such taxation should be withdrawn or reduced to the extent that they are directly connected to the taxation (i.e. a tax liability) that is relieved under the mutual agreement".

The updated Commentary is interesting, because the inclusion of interest and penalties as elements of tax liabilities under domestic law[70]may result in the presumption of their inclusion in treaty coverage. For example, under Japanese domestic law, interest and penalties are always treated as constituting liabilities under the income tax (or the corporation tax, as the case may be). Therefore, there is no ambiguity that they are elements of the income tax under tax treaties. Likewise, in Spain, since penalties usually depend on the amount of the tax, it is also assumed that penalties (or other obligations, interest, surcharges etc.) are generally included within the scope of tax treaties.[71]

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63. For instance, para. 11 Protocol to the *Bel.-Ger. Income and Capital Tax Treaty* (1967), Treaties & Models IBFD, provides that Belgium is allowed to take into account exempted employment income derived by its residents in Germany for the calculation of the municipal tax and that Germany should reduce the taxes due on that income by an equivalent percentage.
64. In NL: HR [Supreme Court], 5 Mar. 2013, 2010:BL646,8, on Belgian local surcharges (*opcentimes*), the Dutch Supreme Court confirmed a decision of Court of Appeal 's-Hertogenbosch (*Gerechtshof 's-Hertogenbosch*) that this supplementary tax constitutes an income tax because it is called a personal tax, the tax is levied on income, the treaty mentions that it is called an income tax and avoidance of double taxation is granted for this tax.
65. In IN: SCI , 5 Nov. 1971, *Commissioner of Income Tax, Kerala v. K. Srinivasan* , the Indian Supreme Court held that surcharges, special surcharges or additional surcharges on income tax form part of the income tax itself.
66. IN: ITAT Kolkata, 20 June 2012 , DIC Asia Pacific Pte. Ltd. v. Assistant Director of Income Tax (ADIT) , Case Law IBFD.
67. *India-Sing. Income Tax Treaty* (1994), Treaties & Models IBFD.
68. *DIC Asia Pacific* (2012), paras. 8-9. Alternatively, the court also ruled that the education cess, being introduced after the tax treaty was signed and "substantially similar" to an existing surcharge, is covered by reason of article 2(2), which provides that the treaty shall also apply to taxes imposed after the treaty was signed that are "substantially similar" to existing taxes. This is significant, because the reference to surcharges on the income tax is missing from the coverage of tax in some Indian tax treaties. In the absence of specific inclusion, a question arises as to whether such surcharges on income tax would be covered by tax treaties.
69. Para. 4 *OECD Model: Commentary on Article 2* (2017). In contrast, the previous version of the Commentary (2014) stated as follows: "Practice among Member countries varies with respect to the treatment of interest and penalties. Some countries never treat such items as taxes covered by the Article. Others take the opposite approach, especially in cases where the additional charge is computed with reference to the amount of the underlying tax. Countries are free to clarify this point in their bilateral negotiations."
70. Such inclusion may be motivated by the desire, for example, to give tax authorities priority over other creditors in collection from delinquent debtors.
71. There are, however, exceptions; *see* , for example, art. 2(2) *Oman-Spain Income Tax Treaty* (2014), Treaties & Models IBFD.

It is true that a number of states adopt the general practice of excluding interest and penalties from the definition of tax under their tax treaties. Generally, in Australian tax treaties, a tax is defined in article 3 not to include interest and penalties.[72]The United States likewise does not view interest and penalties as taxes.[73]An obvious possible justification for this approach is that, to the extent that tax treaties impose obligations on states – for example, to reduce withholding tax on income paid to non-residents or to provide foreign tax credits to residents – they have the right to preclude such obligations from being triggered by taxpayers' delinquency or non-compliance. Such a view could also be reflected by excluding penalties for late payments from the definition of "interest" in article 11.[74]Nonetheless, states may take slightly different positions under article 11 and article 2 on the treatment of penalties.[75]

But it appears that the most common practice in tax treaties is not making specific provisions regarding whether interest or penalties are covered. For example, among Belgium's tax treaties, only a limited number state that taxes do not include penalties.[76]Among Canada's tax treaties, only the Canada-Papua New Guinea Income Tax Treaty (1987)[77]explicitly excludes interest and penalties from taxes covered. Even states not disposed to treat interest and penalties as covered by tax treaties may not make the effort to make specific exclusions. The 2017 update to the Commentary thus potentially introduces a major change in the interpretation of article 2 in this regard.

2.2.4. Extraordinary taxes

Paragraph 5 of the Commentary on Article 2 of the OECD Model points out that the language of the OECD Model (in paragraphs 1 and 2 of article 2) is silent with respect to any distinction between "ordinary taxes" and "extraordinary taxes".[78]Although the OECD Commentary does not elaborate, "extraordinary taxes" presumably raise two issues. First, they may be considered unanticipated by the contracting states, and therefore one may question whether they are intended to be covered by a pre-existing tax treaty. Second, a new tax may be "extraordinary" in its design, and therefore questions can be raised as to whether it qualifies as a tax on income or on capital, or whether it is substantially similar to taxes that are explicitly covered by a tax treaty.

With respect to the first issue, the Commentary on Article 2 of the OECD Model's position is neutral: "The Contracting States are … free to restrict the convention's field of application to ordinary taxes, to extend it to extraordinary taxes, or even to establish special provisions".[79]On the other hand, in the absence of any such special provisions, the language of the OECD Model "is not intended to exclude extraordinary taxes".[80]It appears that most states, in their tax treaties that contain provisions based on paragraphs 1-2 of article 2 of the OECD Model, do not specifically address extraordinary taxes.[81]Some exceptions are found in a few Swiss tax treaties that explicitly include extraordinary taxes (*see* , for example, the Austria-Switzerland Income and Capital Tax Treaty (1974);[82]the Belgium-Switzerland Income and Capital Tax Treaty (1978);[83]the Denmark-Switzerland Income and Capital Tax Treaty (1973);[84]the France-Switzerland Income and Capital Tax Treaty (1966);[85]the

72. *See* , for example, art. 3(1)(j) *Austrl.-Switz. Income Tax Treaty* (2013), Treaties & Models IBFD; and art. 3(1)(c) *Austrl.-Turk. Income Tax Treaty* (2010), Treaties & Models IBFD. However, the definitions of "tax" in art. 3(1)(c) *Austrl.-Ger. Income and Capital Tax Treaty* (2015), Treaties & Models IBFD; and art.3(2) *Austrl.-Belg. Income Tax Treaty* (1977), Treaties & Models IBFD, do not expressly exclude "interest", but only "any penalty imposed".
73. *See* art. 3 *Austrl.-US Income Tax Treaty* (1982), Treaties & Models IBFD, noting that the term "taxes" did not include "any amount which represents a penalty or interest imposed under the law of either Contracting State".
74. This is the position of art. 11(3) *OECD Model* : "Penalty charges for late payment shall not be regarded as interest for the purpose of this Article."
75. For instance, most Belgian tax treaties provide under art. 11 that the definition of interest in the article does not include penalty charges for late payment, but they do not generally exclude penalties under art. 2.
76. Art. 2(1) *Belg.-India Income Tax Treaty* (1993), Treaties & Models IBFD; and art. 3 *Belg.-Austrl. Income Tax Treaty* (1977), Treaties & Models IBFD: "In this Agreement, the terms 'Australian tax' and 'Belgian tax' do not include any charge imposed as a penalty under the law of either Contracting State relating to the taxes to which this Agreement applies by virtue of Article 2."
77. *Can.-Papua N. Guin.* Income Tax Treaty (1987), Treaties & Models IBFD.
78. Whether extraordinary taxes should be included within the scope of tax treaties was one of the few issues that received discussion during the drafting of the original OECD Model. Whereas one proposed draft in 1957 provided that the convention would not apply to extraordinary non-recurring levies on capital, another proposal covered both ordinary and extraordinary taxes. It was decided to leave the subject to the discretion of the member countries, since no consensus could be found. *See* Dubut, *supra* n. 30 , at pp. 132 et seq. and 138; and Lang, *supra* n. 8 , at p. 217.
79. Lang has highlighted the equivocation in this portion of the commentary: "The position of the Commentary is not completely clear ... The first suggestion [i.e. to 'restrict the convention's field of application to ordinary taxes'] seems to imply that extraordinary taxes are covered by a particular treaty unless the contracting states agree on an explicit exclusion; on the other hand, one could deduce from the second suggestion [i.e. 'to extend it to extraordinary taxes'] that, in the absence of a specific provision, extraordinary taxes do not fall under the treaty"; *see* Lang, *supra* n. 8 , at p. 217.
80. This is certainly a natural interpretation of any treaty provisions based on paras. 1-2 of art. 2 *OECD Model* : as long as a tax can be classified as a tax on income or on capital, it should be covered, regardless of whether it had been specifically anticipated at the time the tax treaty was concluded. As Lang argues, "[f]rom the wording of Art. 2, one does not get the impression that whether a tax is levied regularly or only under specific circumstances should be decisive. Therefore, there is no need to distinguish between 'ordinary' and 'extraordinary taxes'. All types of taxes on income and on capital are covered". Id.
81. Most country experts surveyed by GTTC responded that there is "no country practice" in this regard.
82. *Austria-Switz. Income and Capital Tax Treaty* (1974), Treaties & Models IBFD.
83. *Belg.-Switz. Income and Capital Tax Treaty* (1978), Treaties & Models IBFD.
84. *Den.-Switz. Income and Capital Tax Treaty* (1973), Treaties & Models IBFD.
85. *Fr.-Switz. Income and Capital Tax Treaty* (1966), Treaties & Models IBFD,

Germany-Switzerland Income and Capital Tax Treaty (1971);[86]the Greece-Switzerland Income Tax Treaty (1983);[87]the Iceland-Switzerland Income and Capital Tax Treaty (1988);[88]the Sweden-Switzerland Income and Capital Tax Treaty (1965);[89]and the Switzerland-Turkey Income Tax Treaty(2010)[90]). However, even Swiss tax treaties for the most part do not mention extraordinary taxes.

The more common and important issue raised by "extraordinary taxes", however, is the second one mentioned above, namely, whether a new (unanticipated) tax is classifiable as a tax on income (or capital) or whether it is substantially similar to a covered tax.[91]A spate of "extraordinary taxes" imposed by states around the world in recent years makes this an actively evolving area of treaty law. For instance, Japan introduced add-on taxes to the existing personal income tax and corporate income tax for the purpose of raising funds to recover from the Great East Japan Earthquake of 2011. The special income tax for reconstruction and the special corporation tax for reconstruction are specifically enumerated in Japan's newer treaties. Alternatively, proposal 2 in the exchange of notes appended to the protocol (2013) to the Japan-United States Income Tax Treaty (2003)[92]makes clear that these add-on taxes for reconstruction are "identical or substantially similar taxes within the meaning of paragraph 2 of article 2 of the Convention". Similarly, Hungary introduced a solidarity tax in 2006 on corporations and high-income individuals that is derivative on the pre-existing income tax. The solidarity tax was listed in article 2 as among the "taxes covered" in the tax treaties negotiated by Hungary after its introduction,[93]including in the Azerbaijan-Hungary Income and Capital Tax Treaty (2008),[94]the Hungary-United States Income Tax Treaty (2010, not yet in effect)[95]and the Hungary-Uzbekistan Income and Capital Tax Treaty (2008).[96]It is thus officially considered as an income tax for treaty purposes.[97]

By contrast, in 2010, faced with a financial crisis, Greece introduced a one-time extraordinary social responsibility contribution (ESRC), levied on the total net profits of corporate taxpayers in excess of EUR 100,000 in taxation year 2009.[98]For the purposes of calculating ESRC payable, total net profits were calculated identically as for corporate income tax payable. In fact, taxpayers did not have to file any declaration to be assessed ESRC; they were assessed on the basis of their taxation year 2009 corporate income tax returns. In a case decided by the Administrative Court of Appeals of Athens (ACA Athens) in 2012,[99]an airline company (the taxpayer), resident in the United States, challenged the imposition of the ESRC on the taxpayer's business in Greece carried out through a permanent establishment (PE). Pursuant to article 5(1) (Shipping, inland waterways transport and air transport) of the Greece-United States Income Tax Treaty (1950),[100]the total net profits of a PE are exclusively taxable in the state of registration of the ship or aircraft, which in this case was the United States. In litigation, the taxpayer argued that the ESRC was covered by the tax treaty by reason of article 1(2) (Taxes covered), which provides that the tax treaty "shall also apply to any other taxes of a substantially similar character", and that, therefore, Greece was prohibited from levying it in this case. The Greek tax authority, on the other hand, argued that the ESRC was not of a "substantially similar character" to the existing corporate income tax and was thus not covered by the tax treaty.

The ACA Athens ruled against the taxpayer and argued that the ESRC was not an increase in the corporate income tax but an extraordinary fiscal burden imposed on high-income earners and that, based on the nature and aim of the ESRC, it was not of a "substantially similar character" to the existing Greek corporate income tax. Furthermore, the court asserted that the ESRC was not an income tax, on the grounds that the income or profits on which the calculation of the ESRC is based served as a criterion of the ability of the taxpayer to pay the ESRC, as opposed to the object of the ESRC. For these reasons, the court concluded that the ESRC was not covered by the tax treaty.[101]

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86. *Ger.-Switz. Income and Capital Tax Treaty* (1971), Treaties & Models IBFD.
87. *Greece-Switz. Income Tax Treaty* (1983), Treaties & Models IBFD.
88. *Ice.-Switz. Income and Capital Tax Treaty* (1988), Treaties & Models IBFD.
89. *Swed.-Switz. Income and Capital Tax Treaty* (1965), Treaties & Models IBFD.
90. *Switz.-Turk. Income Tax Treaty* (2010), Treaties & Models IBFD.
91. Since many tax treaties do not even contain provisions that are the counterparts to art. 2(1)-(2) *OECD Model* , the issue of carve-outs for extraordinary taxes may not even directly arise.
92. Protocol (2013) to the *Jap.-US Income Tax Treaty* (2003), Treaties & Models IBFD.
93. It is identified in the tax treaties specifically as "the surtax".
94. *Azer.-Hun. Income and Capital Tax Treaty* (2008), Treaties & Models IBFD.
95. *Hun.-US Income Tax Treaty* (2010), Treaties & Models IBFD.
96. *Hun.-Uzb. Income and Capital Tax Treaty* (2008), Treaties & Models IBFD.
97. For a discussion of the uncertainty regarding whether a similar "solidarity tax increase" introduced in the Czech Republic in 2013 as a temporary measure for the years 2013-2015 is an income tax, *see* L. Fiaková, *Czech Republic* , in IFA, *supra* n. 5 , at p. 291.
98. *See* K. Perrou, *Greece: "Taxes Covered" – Is an extraordinary levy on business profits covered?* , in *Tax Treaty Case Law Around the Globe 2013* (M. Lang et al. eds., IBFD 2013), Books IBFD. According to Perrou, this was the first of "a number of additional fiscal or parafiscal charges have been introduced in Greece, under various names and of various types". The following case summary is based on Perrou's report.
99. GR: ACA Athens, 7 Feb. 2012, *Company, name not disclosed v. Eforia, Dieuthynsi Oikonomikon Ypiresion* , Case Law IBFD
100. *Greece-US Income Tax Treaty* (1950), Treaties & Models IBFD.
101. For another intricate controversy regarding the coverage of an extraordinary tax under tax treaties, *see* SE: RR [Supreme Administrative Court], 3 June 1986, *Corporation, name not disclosed v. TA* , Case Law IBFD, discussed in sec. 3.1.

2.3. "Imposed on behalf of a Contracting State or of its political subdivisions or local authorities"

2.3.1. National taxes and taxes levied by federated states

Many federations (for example Australia, Brazil, Canada and the United States) omit subnational taxes levied by federated states from their tax treaties on the basis of constitutional and political considerations.[102]Australia, for example, made a reservation to the OECD Model from 1977 until 15 July 2005 in respect of the language in article 2 that "the Convention should apply to taxes of political subdivisions or local authorities". This reservation may have its origins in the fact that income tax is only imposed by the Commonwealth Government. Other federations (for example Belgium, Germany, Russia and Switzerland), by contrast, do include subnational taxes.[103]Indeed, some reciprocal treaty provisions specifically address subnational taxes. The Belgium-Germany Income and Capital Tax Treaty (1967), for example, allows Belgium to include its residents' employment income from Germany for the purposes of calculating of the Belgian municipal tax, while requiring Germany to reduce the taxes due on that income by an equivalent percentage.[104]

When states that diverge in this respect negotiate tax treaties, the outcomes vary.[105]Russia, for instance, has approximately 50 tax treaties that cover both income taxes and taxes on capital, where capital taxes, from the Russian perspective, include regional taxes on the property of organizations and local taxes on the property of natural persons.

Yet other states, such as Argentina, do not display clear patterns in their tax treaties, and therefore it might be inferred that their treaty provisions are partially determined by the preferences of the negotiating partner.[106]

The exclusion of subnational taxes from the scope of tax treaties does not, of course, mean that domestic law cannot attempt to alleviate double taxation arising from such taxes. Canada and the United States both grant foreign tax credits for income taxes imposed by foreign subnational governments. In a recent decision, the Income Tax Appellate Tribunal Ahmedabad (ITAT Ahmedabad) in India ruled that Canadian and US state income taxes are creditable in India, despite the fact that such taxes are not covered by India's tax treaties with Canada and the United States.[107]

2.3.2. Subnational taxes in unitary states

With regard to subnational taxes levied at the local level, there is a variety of practices regarding whether to include some or all subnational taxes in treaty coverage. Many states include subnational taxes as a matter of policy. For example, subnational taxes are usually included within the scope of Spain's tax treaties (notable exceptions are the Australia-Spain Income Tax Treaty (1992)[108]and the Spain-United States Income Tax Treaty (1990)[109]).[110]This aspect of Spain's treaty policy has not changed over time, even though its political structure has evolved from a central state when the first tax treaties were negotiated into a quasi-federation today (whose regional entities have even greater powers than those of some states in formally labelled federations).[111]Japan, whose two tiers of subnational governments (prefectures and municipalities) do levy their own taxes on income (the local inhabitants tax), is another example. As of November 2015, 40 of Japan's 53 full-fledged tax treaties include the local inhabitants tax. When the treaty partner has local income taxes, Japan's preferred treaty policy is to include them. Japan was not able to do so in the course of negotiations with some treaty partners with a federal system (*see* , for example, the Australia-Japan Income Tax Treaty (2008),[112]the Brazil-Japan Income Tax Treaty (1967),[113]the Canada-Japan Income Tax Treaty (1986)[114]and the Japan-United States Income Tax Treaty (2003)). In other cases, Japan

102. In addition to making a reservation in the *OECD Model: Commentary on Article 2* similar to Australia's, the United States does not apply art. 2 to political subdivisions and local authorities in its own model convention.
103. It is not clear that the importance of subnational taxes in overall tax revenue in a state is determinative of this position, though it is true that in some states, such as Switzerland, subnational (i.e. cantonal) taxes are dominant sources of revenue.
104. Para. 11 Protocol (2010) to the *Belg.-Ger. Income and Capital Tax Treaty* (1967), Treaties & Models IBFD.
105. Since Australia removed its reservation to art. 2, it included taxes levied by political subdivision in art. 2(1) *Austrl.-Switz. Income Tax Treaty* (2013), Treaties & Models IBFD; and *Austrl.-Ger. Income and Capital Tax Treaty* (2015), Treaties & Models IBFD.
106. Argentina's tax treaties with Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Sweden, and Switzerland apply to the taxes imposed by Argentinian political subdivisions or local authorities; its tax treaties with Australia, Bolivia, Brazil, Canada, Chile, Russia, Spain and the United Kingdom do not.
107. IN: ITAT Ahmedabad, 21 Sept. 2017, case ITA No. 1285 (Ahd.) of 2014, *Dr Rajiv I. Modi v. DCIT* , Case Law IBFD.
108. *Austrl.-Spain Income Tax Treaty* (1992), Treaties & Models IBFD.
109. *Spain-US Income Tax Treaty* (1990), Treaties & Models IBFD.
110. Some Spanish tax treaties do not identify the type of local tax to which the tax treaty applies and simply refer to "local taxes" (for example, the *PRC-Spain Income and Capital Tax Treaty* (1990), Treaties & Models IBFD; and the *Neth.-Spain Income and Capital Tax Treaty* (1971), Treaties & Models IBFD).
111. A similar pattern has been followed in Belgium, a federation, where constitutional reforms have allocated more and more powers to regional entities, but where no correlated change in treaty policy is observed.
112. *Austrl.-Jap. Income Tax Treaty* (2008), Treaties & Models IBFD.
113. *Braz.-Jap. Income Tax Treaty* (1967), Treaties & Models IBFD.
114. *Can.-Jap. Income Tax Treaty* (1986), Treaties & Models IBFD.

was able to cover local taxes in tax treaties with a willing federal-system treaty partner (*see* , for example, the Germany-Japan Income and Capital Tax Treaty (1966)[115]and the Japan-Switzerland Income Tax Treaty (1971)[116]).

By contrast, certain unitary states specifically exclude any type of subnational taxes. Chile, for example, has expressed a reservation in the Commentary on Article 2 of the OECD Model against the inclusion of subnational taxes.[117]

In Spain, ambiguities regarding whether subnational taxes are covered by tax treaties have led to repeated controversies. The Spanish *impuesto sobre actividades economicas* (IAE) is a local tax levied in connection with the economic activity that is carried on by the taxpayer but that is not linked to whether the taxpayer obtains any income. In 1996, the *Tribunal Superior de Justicia de Madrid* (High Court of Justice of Madrid, TSJ Madrid) ruled that the Portugal-Spain Income Tax Treaty (1968)[118]was not applicable to the IAE, notwithstanding the reference in the text of the tax treaty to "local income taxes".[119]The same court ruled in 1998 that the representative office of an Austrian bank was subject to the IAE, even though it did not constitute a PE, because the Austria-Spain Income and Capital Tax Treaty (1966)[120]was not applicable to the IAE (again notwithstanding the fact that "local taxes on income and on capital" were included in article 2).[121]However, an earlier decision admitted the application of the Netherlands-Spain Income and Capital Tax Treaty (1971)[122]to the IAE in respect of a Dutch airline.[123]

3. Article 2(1) and (2) of the OECD Model – "This Convention shall apply to taxes on income"

3.1. What is a "tax on income"?

3.1.1. Relationship to domestic law

Foreign tax creditability under the domestic income tax laws of many countries depends on a foreign tax paid being characterizable as an income tax. The question of what constitutes an income tax, therefore, has been litigated under domestic laws in connection with a wide range of interesting fact patterns.[124]Because the meaning of "taxes on income" in the context of article 2 of the OECD Model must be interpreted at least in part in accordance with domestic law,[125]domestic law jurisprudence on the meaning of the term also indirectly informs the interpretation of the term in the treaty context.

The close connection between the treaty law and domestic law meanings of "taxes on income" is illustrated by a Danish case decided by the *Østre Landsret* (Eastern High Court, ØL) in 1992.[126]The taxpayer in that case had made regular payments under a private pension contract to a Danish insurance company when he had been a Danish resident. In 1980, he became a resident in France and stopped making payments under the pension contract. In 1987, he had the insurance company buy back the pension. In calculating the proceeds, the insurance company assessed the taxpayer an amount of tax pursuant to Danish law, which provided for a 25% tax on the repayment of a private pension. This tax had become effective in 1958 and replaced a former system of taxing the recipient on the repayment of a private pension as on ordinary income (it was described in the legislative history as a "substitute for income taxation"). Before 1970, the Danish tax authority had taken the position that this new tax was not covered by its tax treaties. In 1970, it changed its position to the view that the tax *was* covered by Danish tax treaties. However, in 1977, the Danish tax authority reverted to its original position that the tax was not covered. While the French tax authority was aware of this position, it never made an objection.

115. *Ger.-Jap. Income and Capital Tax Treaty* (1966), Treaties & Models IBFD.
116. *Jap.-Switz. Income Tax Treaty* (1971), Treaties & Models IBFD.
117. Para. 10 *OECD Model: Commentary on Article 2* (2014), Treaties & Models IBFD. The Chilean reservation is seconded by Canada and the United States, but the latter two states are – unlike Chile – federations.
118. *Port.-Spain Income Tax Treaty* (1968), Treaties & Models IBFD.
119. ES: TSJ Madrid [High Court of Justice Madrid], 24 Oct. 1996, rec. 252/1995.
120. *Austria-Spain Income and Capital Tax Treaty* (1966), Treaties & Models IBFD.
121. ES: TSJ Madrid [High Court of Justice Madrid], 3 Feb. 1998, rec. 685/1996.
122. *Neth.-Spain Income and Capital Tax Treaty* (1971), Treaties & Models IBFD.
123. ES: TSJ Madrid [High Court of Justice Madrid], 27 Apr. 1996, rec. 618/1994 , Case Law IBFD.
124. *See* , for example, US: SC , 20 May 2013, *PPL Corp. v. Commissioner of Internal Revenue* , 133 S. Ct. 1897 (2013), rev'g 665 F.3d 60 (3rd. Cir. 2011) (UK windfall profit tax is an excess profit tax and therefore a creditable income tax for US federal income tax purposes); and CA: TRB, 1979, *Lai v. Minister of National Revenue* , CarswellNat 546, [1980] C.T.C. 2073, 80 DTC 1044 (T.R.B.) (Hong Kong property tax computed at a standard rate of 15% on the "net assessable value" of rental properties – equal to the estimated annual rent that would be permitted or authorized under the Landlord and Tenant Ordinance minus an allowance of 20% for repairs and other expenses – found to be a simplified method for taxing rental income and therefore a creditable "income or profits tax" under the Canadian Income Tax Act).
125. *See* sec. 5.1. for further discussion.
126. DK: ØL [Eastern High Court], 5 May 1992, *Individual, name not disclosed v. Ministry of Taxation* , Case Law IBFD.

The taxpayer argued that, when the Denmark-France Income and Capital Tax Treaty (1957)[127]was signed, an income tax was imposed on the repayment of a private pension. The tax introduced in 1958 was intended to substitute for this income tax and therefore should be covered by the tax treaty by reasons of article 1(1)(a) (which provided that the tax treaty covered taxes on income) and article 1(2) (which provided that the tax treaty covered taxes introduced after the date of signature of the tax treaty that were "of a similar character" to existing taxes covered by the tax treaty.) Consequently, Denmark was prohibited from levying it on the taxpayer, since article 18 of the tax treaty provided that "[i]ncome not mentioned in the preceding Articles [such as the income at issue] shall be taxable only in the State in which the beneficiary has his fiscal domicile [France]".

However, the court ruled in favour of the Danish tax authority. It argued that, because the tax at issue was calculated independently of income or capital – it was based on the repayment of previously-made payments, as opposed to income – it was a tax neither on income nor on capital. For this same reason, the tax could not be considered "of a similar character" to the existing Danish tax on income and was, therefore, not covered by the tax treaty by reason of article 1(3).

Should coverage under article 2 of the OECD Model depend on the classification of a tax as being on income or on capital, courts may need to analyse the fine details of another state's tax law to determine whether it is covered. In a 2006 decision of the Dutch *Hoge Raad* (Supreme Court, HR),[128]for example, the court had to consider whether French forfeit taxation of income from savings and investments constituted an income tax or a net wealth tax (which had Dutch tax consequences). The HR observed that the forfeit taxation bore characteristics of a net wealth tax but still constituted an income tax, because it was integrated with the taxation of income from other sources, was reducible with personal allowances and was taken into account for the calculation of deductible extraordinary expenses and gifts.

3.1.2. Taxes on income versus taxes on distributions

Another example of where a subtle distinction between taxes on income and other taxes is drawn can be found in a 1985 decision of the Swedish *Regeringsrätten* (Supreme Administrative Court, RR).[129]In 1983, Sweden imposed a one-time temporary tax on profit distributions (TTPD), the base for which was the amount of profits distributed to shareholders. The purpose of the tax was to reduce profits distributions in order to bring about general acceptance of wage restraints during wage negotiations in 1983. One taxpayer, a company resident in Sweden, received dividends from subsidiaries resident in approximately 40 treaty countries and interest and royalty income from subsidiaries resident in Argentina and India. Pursuant to all of the applicable tax treaties, dividend income received by a company resident in Sweden (the taxpayer) from a company resident in the other contracting state is exempt from tax in Sweden (to the extent that such income would be exempt from tax in Sweden under Swedish law if both companies had been resident in Sweden).[130]In addition, pursuant to the applicable tax treaties, interest and royalty income received from Argentina and India was exempt from tax in Sweden by reason of such income being exclusively taxable in the source state. The taxpayer contested the imposition of the TTPD on its distributions. It argued that, although the TTPD was not listed as an existing tax covered under article 2 of the applicable tax treaties, it was covered by reason of article 2(4) of said tax treaties, which provided, in slightly varying terms, that they applied to taxes imposed after the date of signature that were identical or substantially similar to existing taxes covered under them.

The lower administrative court in Sweden found in favour of the taxpayer, holding that the TTPD was substantially similar to the existing Swedish national income tax on the grounds that it was a tax on income (albeit temporary) and that the fact that it was calculated on the basis of the amount of profits distributed to shareholders did not deprive it of its character as a tax on income. However, the RR reversed this decision, holding that the TTPD was not substantially similar to the existing Swedish national income tax: the taxable base of the TTPD was not profits but profits distributed to shareholders; the purpose of the TTPD was unique; the tax applied only to taxation year 1983; revenue collected from the TTPD was transferred to the general pension fund; and the imposition procedure of the TTPD was not the procedure applied to income tax but one applied to selected excise taxes. Therefore, the court held that the TTPD was not covered under article 2(4) of the relevant tax treaties.

Although the Swedish TTPD, like the South African secondary tax on companies (*see* section 1.1.2.1.), is no longer in existence, the type of tax instrument each represents seems to have continuing appeal. For example, in 2013, Belgium introduced a fairness tax, which is a separate corporate tax assessment of 5.15% levied on profits distributed by Belgian companies or Belgian branches of foreign companies.[131]It has been suggested that the fairness tax is "not substantially dissimilar to an income tax … because the revenue raised by the fairness tax is not earmarked, the tax is not (planned

127. *Den.-Fr. Income and Capital Tax Treaty* (1957), Treaties & Models IBFD.
128. NL: HR [Supreme Court], 1 Dec. 2006, Case 42.211, BNB 2007/681, Case Law IBFD. *See also* a press release of the Dutch Ministry of Finance of 4 Apr. 2002, nr. 2002/85, V-N 2002/19.11, in connection with the tax treaty with the United States (the tax regime for investment income (Box 3) constitutes an income rather than net wealth tax).
129. *Corporation, name not disclosed* (3 June 1986). *See also* J. Kesti, *Temporary Tax on Profit Distributions*, 37 Eur. Taxn. 1, p. 30 (1987).
130. *See*, for example, art. 23(2) *Braz.-Swed. Income Tax Treaty* (1975), Treaties & Models IBFD.
131. *See* B. Michel & P. Van Den Berghe, *Fairly Odd: Belgium's New Fairness Tax*, 54 Eur. Taxn. 6, sec. 4.2. (2014), Journal Articles & Papers IBFD. The tax is levied only to the extent that the distributed profits have not been taxed as part of the corporate tax assessment due to the notional interest deduction or a loss carry-forward.

to be) temporary, and [its purpose] is to serve as a correction mechanism for … the corporate income tax".[132]Similarly, in 2012, France introduced an additional contribution to corporate income tax, amounting to 3% of profits distributed by a resident company, as a response to the abolition by the ECJ of the French withholding tax on outbound dividends paid to non-residents.[133]

Since 2000, the tax base of the Estonian corporate tax has not been the net profits of a company, i.e. taxable income minus deductible costs, but rather the sum of distributed profits, particular types of fringe benefits, gifts, and paid representation costs. There is no liability to corporate tax until the moment when assets are taken out of a company or its permanent establishment. The Supreme Administrative Court of Finland had to rule on whether the Estonian corporate tax was a tax that was creditable in Finland under the Estonia-Finland Income and Capital Tax Treaty (1993).[134]In October 2014, the court decided that the Estonian corporate income tax was a covered tax under the tax treaty and was therefore creditable against the Finnish corporate income tax.[135]

3.1.3. The Indian equalization levy (2016)

The government of India introduced an equalization levy of 6% applicable to consideration received by non-residents not having a PE in India for services of online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement.[136]The levy came into effect on 1 June 2016 and is to be deducted by Indian payers from payments to foreign service providers. The levy is distinctive in several ways. First, it is a new tax imposed in parallel both with the service tax under India's indirect tax regime and with the withholding tax under the income tax regime. Second, it is specifically intended to address perceived undertaxation of offshore providers of online advertising. According to the Indian government, "the word 'equalization' represents the objective of ensuring tax neutrality between different businesses conducted through differing business models or residing within or outside the taxing jurisdiction".[137]The lack of neutrality presumably arises from differential taxability under the income tax of residents and PEs, on the one hand, and PE-less non-residents, on the other. Third, the form of the levy was chosen specifically so that India would not need to amend a large number of tax treaties: "The Equalization Levy imposed on the payment for digital transactions, would not be a tax on income, and hence would not be covered by tax treaties."[138]

Like many taxes raising article 2 controversies discussed in this chapter, the Indian equalization levy displays both similarities and dissimilarities to income taxes. In addition to its similarity to withholding taxes under income tax regimes, commentators have also suggested that the "levy is … akin to a presumptive Indian income tax in the form of a turnover tax".[139]There are other ways of implementing presumptive income taxation, and some have argued that such presumptive taxes should be treated as treaty-covered taxes.[140]The response to these perennial questions about whether certain proxies for the income tax should be viewed as similar to the income tax is that what a covered tax is is a question of positive law. In addition to the Indian government's own position that the equalization levy is not a treaty-covered tax, and in the absence of any relevant judicial decision to the contrary, it has been noted that the OECD has itself considered the Indian equalization levy and has not taken the position that it is a treaty-covered tax.[141]Rather, the OECD now promotes a revision of the tax treaty framework so that unilateral measures such as the equalization levy may come to be seen as unnecessary. This strongly implies that the equalization levy is not a covered tax.

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132. Id. The authors argue that these facts should outweigh the consideration that the fairness tax has a separate assessment procedure from the corporate income tax and has a distinct "taxable object".
133. Art. 235 ter ZCA of the General Tax Code.
134. *Est.-Fin. Income and Capital Tax Treaty* (1993), Treaties & Models IBFD.
135. *See* M. Helminen, *Finland: Is the Estonian Corporate Tax Covered by Article 2 and Creditable under Article 23?* , in *Tax Treaty Case Law around the Globe 2015* (M. Lang et al. eds., IBFD 2016), Books IBFD.
136. A.K. Lahiri, G. Ray & D.P. Sengupta, *Equalisation Levy* , Brookings India Working Paper 01 (Jan. 2017), available at https://www.brookings.edu/wp-content/uploads/2017/01/workingpapertax_march2017_final.pdf ; S. Basak, *Equalization Levy: A New Perspective of E-Commerce Taxation* , 44 Intertax 11, p. 845 (2016); and S. Wagh, *The Taxation of Digital Transactions in India: The New Equalization Levy* , 70 Bull. Intl. Taxn. 9, p. 538 (2016), Journal Articles & Papers IBFD.
137. Lahiri, Ray & Sengupta, *supra* n. 136 , at p. 6.
138. Id., at p. 16.
139. Id., at p. 17.
140. For an extended discussion of tonnage tax systems as proxies for corporate income taxation, *see* G. Maisto, *Article 8: International Transport and Other Operations – Global Tax Treaty Commentaries* sec. 1.1.2.4. , Global Topics IBFD (accessed 1 Oct. 2019). For an interesting discussion of a recent Argentinian tax court decision regarding whether the Argentinian minimum presumed income tax is covered by tax treaties, *see* A.A. Verstraeten, *Argentina: Petrobras Case: Is Argentinian Minimum Presumed Income Tax Covered in Tax Treaties?* , in *Tax Treaty Case Law around the Globe 2015* (M. Lang et al. eds., IBFD 2016), Books IBFD.
141. Hohenwarter et al., *supra* n. 28 .

3.1.4. Digital services taxes

On 24 July 2019, French President Emmanuel Macron signed legislation enacting the French DST ,[142]thereby giving real life to a tax policy idea that, though virtually unheard of before 2018, has become perhaps the most controversial subject in international taxation.[143]The French DST is a 3% tax levied on the revenue of large digital platform companies earned from advertising, online intermediation or the transmission of data. It is modelled on a similarly named tax that had been proposed in March 2018 as a European Council directive.[144]The UK government had also staked out its own DST in March 2018, and in July 2019 it released detailed proposed legislative language and draft administrative guidance, as well as further policy explanations.[145]Austria, the Czech Republic, Italy, Spain and Turkey have also introduced DST legislation.

Among academic commentators, there is a strong consensus that the DST is not a tax covered by tax treaties.[146]The reasons are obvious. The DST is a tax imposed on revenue businesses earn from specific types of transactions. No deductions for expenses are allowed, and indeed, as the DST's many critics never tire of pointing out, DST liability could accrue even if the taxpayer reports losses for accounting and income tax purposes.[147]No part of the application of the DST enacted in France or proposed in other countries refers to a taxpayer's taxable income. No government has proposed that the DST be creditable against income taxes under their income tax rules. Moreover, as commentators have pointed out, "compliance with international obligations is an essential aim" of the European Commission' draft directive on the DST, which can also be said of the DSTs enacted or proposed by individual countries.[148]Finally, the OECD's work in 2018 and 2019 on reforming international tax rules, from the March 2018 interim report[149]to the May 2019 Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, all acknowledges countries' consideration of the DST as a unilateral policy instrument. If the DST were a covered tax and thus constrained by the application of tax treaties, surely the OECD would have noticed it.

Aside from these legal arguments, it is useful to note that the DST is closely analogous to the royalties imposed by many national and subnational governments on natural resource extraction.[150]Resource royalties are often calculated on the basis of revenue (i.e. not profit) earned from extraction and are typically collected even before resource extraction firms report accounting profits or have recouped their investments. These deliberate design features render royalties distinct policy alternatives to taxes on resource rent, but royalties can serve the same purpose as rent taxes, i.e. claiming a public share of rent extracted from particular locations. Resource royalties are very common and are generally not affected by tax treaties, the basic reason being that, when location-specific rent is taxed, it is clear which state has the primary taxing right, and there is little need for treaty-based coordination. The analogy between DSTs and resource royalties thus makes it clear why the DST would also not be affected by the application of existing tax treaties.

This is not to deny that unilateral impositions of DSTs raise fundamental issues about how states should coordinate in international taxation when global commerce increasingly features the remote delivery of services involving a low or zero marginal cost of production that is non-rival in usage.[151]Through unilateral instruments like the DST, countries (including small economies) may successfully claim a portion of multinationals' profits, while the technology-exporting countries may not be able credibly to threaten retaliation: the trade in remotely delivered services is likely to be highly asymmetrical.[152]It may thus be rational for countries to impose taxes like the DST even if uncoordinated taxation may harm global technological progress.

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142. FR: LOI no. 2019-759 du 24 juillet 2019 portant création d'une taxe sur les services numériques et modification de la trajectoire de baisse de l'impôt sur les sociétés (1), Journal Officiel de la République Française, no 0171, texte 1, sur 202 (25 July 2019).
143. W. Cui, *The Digital Services Tax: A Conceptual Defense* , Tax Law Review (forthcoming), available at https://ssrn.com/abstract=3273641 .
144. *See supra* n. 6 .
145. UK: HM Revenue and Customs, *Introduction of the New Digital Services Tax* (draft legislation) (2019), available at < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816361/Digital_services_tax.pdf > (accessed 20 Aug. 2019); UK: HM Revenue and Customs, *Digital Services Tax Draft Guidance* (2019), available at < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/817666/20190711_-_Draft_Guidance_vfinal.pdf > (accessed 20 Aug. 2019); and UK: HM Treasury, *Digital Services Tax* (response to the consultation) (2019), available at < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816389/DST_response_document_web.pdf > (accessed 20 Aug. 2019).
146. See W. Cui, *The Superiority of the Digital Services Tax over "Significant Digital Presence" Proposals"* , 72 National Tax Journal 4, pp. 839-856 (2019); Hohenwarter et al., *supra* n. 28 ; G. Kofler & J. Sinnig, *Equalization Taxes and the EU's "Digital Services Tax"* , 47 Intertax 2, pp. 178-200 (2019); R. Ismer & C. Jescheck, *Taxes on Digital Services and the Substantive Scope of Application of Tax Treaties: Pushing the Boundaries of Article 2 of the OECD Model?* , 46 Intertax 6/7, p. 573 (2018); and CFE Fiscal Committee, *Opinion Statement FC 1/2018 on the European Commission Proposal of 21 March 2018 for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services* , 58 Eur. Taxn. 8, p. 371 (2018), Journal Articles & Papers IBFD.
147. The DST also requires remittance by the providers of digital services, and it is not a withholding tax remitted to governments by payers of consideration for services. Thus, it bears no resemblance to gross-revenue-based withholding mechanisms under income taxes.
148. Hohenwarter et al., *supra* n. 28 .
149. OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS* (OECD Publishing 2018), Primary Sources IBFD.
150. W. Cui and N. Hashimzade, *The Digital Services Tax as a Tax on Location-Specific Rent* , CESifo Working Paper no. 7737 (2019), available at https://ssrn.com/abstract=3488812 .
151. Cui, *supra* n. 143 .
152. W. Cui, *The Digital Services Tax on the Verge of Implementation* , 67 Canadian Tax Journal 4, pp. 1-18 (2019).

Clearly, the existing treaty framework is not designed to solve this problem, and efforts to prevent the imposition of DSTs using legal rules under that framework are likely to be futile.

3.2. Taxes imposed on elements of income

Many countries do not have comprehensive income taxes but instead tax income on a source or schedular basis. This is likely the main significance of the OECD Model language stating that taxes on "elements of income" are regarded as taxes on income.[153]There appears to have been little legal elaboration, in any state, of this phrase in article 2(2) of the OECD Model in connection with disputes about whether a tax is imposed on "income". This suggests that, once a government levy is viewed as a "tax", the fact that the tax is imposed only on some types of income is unlikely to preclude the tax from being regarded as a tax on income.

3.3. Taxes on gains derived from the alienation of property

Historically, the United Kingdom and many British Commonwealth nations, such as Canada, did not tax capital gains, treating the gains derived from the alienation of property as something other than income. The OECD Model language that "taxes on gains from the alienation of movable or immovable property" constitute taxes on income[154]should be read as overriding such distinctions and bringing any tax on capital gains into the scope of tax treaties, as is consistent with the distributive rules in article 3. Ironically, the most well-known cases in which a state claimed that a tax on capital gains falls outside the scope of its tax treaties are found in Australia, in the *Virgin Holdings* dispute, resolved in 2008,[155]and the *Undershaft* dispute, resolved in 2009.[156]Because Australia generally has not incorporated article 2(2) of the OECD Model in its tax treaties, the disputes had to be resolved on the basis of whether the tax on capital gains was "substantially similar" to the Australian income tax.

3.4. Taxes on capital appreciation

Paragraph 3 of the Commentary on Article 2 of the OECD Model states that "taxes on income and on capital … include … taxes on capital appreciation".[157]For some states, the reference to taxes on capital appreciation may represent a broadening of the concept of an income tax. For example, many income tax systems adhere to the "realization requirement", so that only the disposition of an asset triggers the recognition of appreciation (or devaluation) of said asset. A tax on mere capital appreciation may not be recognized as a tax on income. By encompassing taxes on capital appreciation within the definition of income taxes, therefore, the OECD Model expands the range of taxes in respect of which the contracting states coordinate: a residence state may need to give credit for a foreign tax paid to a treaty partner, even when the tax would not qualify as an income tax under the residence state's domestic law.[158]

Taxes on "unrealized" capital appreciation may take the form of income tax rules that require taxpayers to "mark to market" their securities holdings. Other examples are the "exit taxes" that a number of states impose on individuals. When the residence of a taxpayer changes on emigration, the taxing rights of the former residence state are reduced to those of a source state. To preserve the right to tax gains accrued while the taxpayer is a resident, an exit tax would deem assets owned by an emigrant to be alienated at market value and reacquired at a cost equal to that value.[159]Coverage under the language of article 2 of the OECD Model (whether under the language of article 2(2) or under the specific enumeration of covered taxes) may allow such tax to be credited in the new residence state, even if there is no corresponding taxable income in the year of "exit".

3.5. Taxes on total wages of enterprises

Article 2(2) of the OECD Model explicitly provides that "taxes on the total amounts of wages or salaries paid by enterprises" are regarded as "taxes on income". The Commentary on Article 2 of the OECD Model elaborates that this includes "payroll

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153. It is unlikely that the breakdown, in economic theories, of income into various components, for example into consumption and accession to wealth, or into risk-free, risky and above-normal investment returns, should be read into this term. Otherwise, any tax on consumption, for example, would be a tax on an element of income.
154. The literal language of art. 2 *OECD Model* leaves it unclear whether "taxes on gains from the alienation of movable or immovable property" could be viewed as taxes on capital.
155. AU: FCA , 10 Oct. 2008, *Virgin Holdings SA v. Commissioner of Taxation* , Case Law IBFD. *See* sec. 5.3.1. for further discussion.
156. AU: FCA, 3 Feb. 2009, *Undershaft (No 1) Ltd v Commissioner of Taxation* and *Undershaft (No 2) BV v. Commissioner of Taxation* , Case Law IBFD. *See* sec. 5.3.2. for further discussion.
157. This leaves it unclear whether taxes on capital appreciation should be conceived as taxes on income or taxes on capital.
158. *See* J.P. Porto, *Peru* , in IFA, *supra* n. 5 , at p. 637.
159. In the case of exit taxes, states that adopt them may negotiate specific provisions to alleviate double taxation, instead of relying on the general coverage of such taxes within the scope of art. 2 *OECD Model* . For example, the new residence state, instead of granting a credit for the exit tax imposed by the old residence state, may allow the taxpayer to use a tax cost for the asset in the new residence state equal to its market value at the time of the change in residence. *See* J. Li & F. Avella, *Article 13: Capital Gains – Global Tax Treaty Commentaries* sec. 2.1.8. , Global Topics IBFD.

taxes", although social security charges – or any other charges paid where there is a direct connection between the levy and the individual benefits to be received – do not qualify. In other words, a tax on an employer/payer could be regarded as an income tax – presumably on the income of the employee/payee. This implication clearly creates a certain dissonance, and a number of states have entered a reservation in respect of this part of article 2 of the OECD Model.[160]It has also been noted that the US Model does not refer to taxes on the total amount of wages, and the words "taxes on the total amounts of wages or salaries paid by enterprises" are missing in many tax treaties.

If the reference to taxes on the total amount of wages is absent from a tax treaty, and if such taxes are not specifically listed, it is likely that they would not be properly viewed as taxes on income.[161]This is consistent with the fact that some states, like the United States, treat such taxes as excise taxes. Moreover, it has been argued that "even if a treaty adopts the same wording as Article 2(2), the reference to 'taxes on the total amounts of wages or salaries paid by enterprises' must be interpreted strictly" and "should not extend to taxes that are paid by employers on the total value of certain non-cash benefits provided to their employees … because the base of these taxes does not generally include the wage component of an employee's compensation".[162]

4. Article 2(1) and (2) of the OECD Model – "This Convention shall apply to taxes on … capital"

Many actual bilateral tax treaties deviate from the OECD Model in not covering taxes on capital. For example, Australia, Japan and Korea have made explicit reservations to the OECD Model "on that part of paragraph 1 which states that the Convention shall apply to taxes on capital". Many other states, such as Singapore, the United Kingdom and the United States, report not including taxes on capital in their tax treaties as a matter of policy. Very often, even if a state has no declared position, and even if it does in fact have taxes on capital, it may choose not to include taxes on capital in treaty coverage. China, for example, has taxes on capital that may be levied on foreign owners in connection with both personal and real property, but only one fifth of China's tax treaties cover capital taxes. Similarly, only half of Russia's tax treaties cover taxes on capital, despite Russia's imposition of capital taxes on personal and real property.[163]

As with income taxes, the question of what taxes should be treated as taxes on capital for the purposes of article 2 of the OECD Model has encountered controversy. One important recent controversy involved the annual tax on collective investment vehicles (net asset tax (NAT)) imposed by Belgium following their registration with the Belgian financial market regulator. When the NAT was introduced, in 1993, it only applied to Belgian collective investment vehicles. In 2003, its scope of application was extended to foreign collective investment vehicles operating in Belgium. In litigation that was decided by the *Cour de Premiére Instance de Bruxelles* (Court of First Instance of Brussels, CPI Bruxelles) in 2011,[164]a collective investment vehicle established in Luxembourg objected to the assessment to the NAT on the grounds that it was a tax on capital and, pursuant to article 22(4) of the Belgium-Luxembourg Income and Capital Tax Treaty (1970),[165]taxes on capital could only be levied in the taxpayer's residence state. On the other side, the Belgian tax authorities argued (perhaps surprisingly) that the NAT could not be regarded as a tax on capital, since it was not a tax on a taxpayer's total capital but rather a specific tax. The court ruled in favour of the taxpayer, pointing out that article 2(2) of the tax treaty defined "taxes on capital" as "all taxes imposed on … total capital, or on elements of … capital". Consequently, the mere fact that the NAT was not a tax on a taxpayer's total capital did not mean that it could not be regarded as a tax on capital for treaty purposes.

The French net wealth tax (NWT) has also been the subject of article 2 controversy. The French tax authority claimed in a 1982 ruling that the NWT, which was levied on non-residents in respect of assets situated in France, was not covered by pre-existing tax treaties.[166]It also adopted this position in litigation before the *Tribunal de Grand Instance de Paris* (High Court of Paris, TGI Paris) in 1985.[167]In this case, involving an individual, resident in Austria, who owned shares in a French company in respect of which he was assessed the NWT,[168]the TGI Paris found in favour of the taxpayer. The court held that, because

160. These include Armenia, Greece (an OECD member country), Latvia, Lithuania, Romania and Tunisia.
161. K. van Raad, *The Concept of Tax in the OECD Model* , in Peters (ed.), *supra* n. 48 , at p. 261.
162. Id. In other words, states that levy a fringe benefit tax would not be able to include such a tax in treaty coverage through the language on "taxes on the total amounts of wages or salaries paid by enterprises". They must specifically include it in tax treaties – which is what Australia and New Zealand do.
163. For a comprehensive treatment of capital taxes under tax treaties, *see* Y. Masui, *Article 22: Capital – Global Tax Treaty Commentaries* , Global Topics IBFD.
164. BE: CPI Bruxelles [Court of First instance Brussels], 23 Nov. 2011, *CIV, name not disclosed v. L'État de Belg SPF Finances* , Case Law IBFD. For discussion, *see* W. Oepen, K. Lievens & T. van den Bruel, *Belgium-Luxembourg Income and Capital Tax Treaty (1970) Resolves Double Taxation on Net Assets of Luxembourg Investment Fund with Belgian Investors* , 67 Bull. Intl. Taxn. 8 (2013), Journal Articles & Papers IBFD.
165. *Belg.-Lux. Income and Capital Tax Treaty* (1970), Treaties & Models IBFD.
166. Ruling 7 R-2-82 (19 May 1982).
167. FR: TGI Paris [Court of Grand Instance Paris], 17 Jan. 1985, *Mr Rohrmoser v. Directeur Générale des Impôts* , Case Law IBFD.
168. The taxpayer argued that France was prohibited from levying NWT on him by reason of art. 3 *Austria-Fr. Income and Capital Tax Treaty* (1993), Treaties & Models IBFD, which provided that "capital shall be taxable only in the State in which the person who derives that income or owns that capital is domiciled [which in this case was Austria]".

article 1(3) of the Austria-France Income and Capital Tax Treaty (1993)[169]provided that the tax treaty shall cover taxes that are identical or substantially similar to existing taxes covered by either contracting state, and because the French NWT was similar – if not identical – to the Austrian capital tax, the French tax authority's position that the NWT is not covered by the tax treaty with Austria must be rejected.[170]

The status of one particular type of tax is likely to remain controversial. Frequently, under the domestic law of various countries, mere control over an asset (or an in rem right other than ownership) may be sufficient to trigger a tax on capital,[171]yet the question of whether such a tax would qualify as a tax on capital for treaty law purposes may be controversial. One recent Dutch court decision considered whether a Dutch municipal commuter tax constituted a tax on capital.[172]The taxpayer was a Swiss resident who owned immovable property in the Netherlands that he temporarily occupied as a home. He was charged a commuter tax, which was based on the fair market value of the home and was levied on individuals maintaining a home in the municipal territory that is not their main residence and that is available for their own use for more than 90 days in a taxable year. The *Rechtbank Zutphen* (District Court Zutphen, RZ) decided that the commuter tax in question was not a tax on capital covered by the tax treaty. The court pointed out that ownership of the property was not required for the tax to be levied. The fact that the tax used as taxable base the fair market value of the abode did not itself make the tax a tax on capital. In fact, Dutch statutory law had carved out the imposition of taxes on capital from municipal powers in the first place.

5. Article 2(3) and (4) of the OECD Model – "Existing taxes" and "Identical or substantially similar taxes … in addition to, or in place of, the existing taxes"

5.1. Place in the structure of article 2 of the OECD Model

5.1.1. Relationship to article 2(1) and (2) of the OECD Model

As anticipated in section 1.1.1.3. , it is conceivable for taxes described under article 2(1) and (2) of the OECD Model not to be described under article 2(3) and (4), and vice versa. If (i) states exhaustively listed the taxes existing at the time of the signing of the tax treaty that fit the descriptions of article 2(1) and (2) of the OECD Model (and only those taxes); and (ii) the question of whether a subsequently enacted tax is substantially similar to an existing tax is determined by the same criteria as used for determining whether a tax is a tax on income (or on capital), then the two sets of descriptions would not conflict. They would, in fact, be redundant. However, one or both of those two premises may fail to be true. In that case, do these two sets of descriptions limit each other or do they amplify each other? Neither answer leads to a completely natural reading of the actual language of article 2 of the OECD Model.

The debate about the relationship between article 2(3) and (4) and article 2(1) and (2) of the OECD Model has been intertwined with a scholarly debate about "contextualism" regarding article 2.[173]Some scholars argue that, because article 2(1) and (2) does not refer to domestic laws at all, it should have a contextual treaty meaning.[174]This is further supported, according to these scholars, by the fact that taxes on the total amounts of wages or salaries paid by undertakings (payroll taxes) are covered as taxes on income, even though the tax base is not actually income and even though they do not qualify as taxes on income under the domestic tax systems of most states.[175]Contextualism in respect of article 2 of the OECD Model implies giving greater weight to article 2(1) and (2) (when included in a tax treaty). However, there are also arguments suggesting that even the interpretation of article 2(1) and (2) has to rely heavily on domestic law. Most importantly, this is because there is no universal definition of the term "tax", even though states seem to agree on a number of essential elements.[176]

169. Id.
170. For a discussion of other cases in which a subsequently enacted tax is treated as covered by a tax treaty because it is substantially similar to a tax imposed by the other contracting state, *see* sec. 5.3.2.
171. *See* Brandstetter, *supra* n. 5 , at sec. 3.2.2.1.
172. NL: RZ [District Court Zutphen], 12 Aug. 2009, 07/1879 , Case Law IBFD.
173. *See* , for example, Helminen, *supra* n. 5 , at pp. 34-6.
174. Lang argues that it would not make sense to include art. 2(3) *OECD Model* , referring to domestic law, in tax treaties, unless art. 2(1) and (2) had autonomous meaning. *See* Lang, *supra* n. 8 , at p. 216.
175. As Helminen points out, however, many actual tax treaties differ from the *OECD Model* in this respect and specifically exclude payroll taxes; *see* Helminen, *supra* n. 5 , at p. 35.
176. *See* sec. 2.1.

5.1.2. Variations in treaty practice

5.1.2.1. The function of article 2(3) of the OECD Model

Examples of internal discrepancies within articles on taxes covered are plentiful when actual tax treaties are examined. For instance, while many tax treaties follow article 2 of the OECD Model and provide, in article 2(1), that subnational taxes on income or capital are covered, such subnational taxes often are not enumerated in article 2(3).[177]Conversely, in some tax treaties, subnational taxes are enumerated in article 2(3) but are not included in article 2(1).[178]Just as commonly, states may choose to enumerate taxes that are not easily classifiable as taxes on either income or on capital, while still accepting the general description in article 2(1) and (2) of the scope of treaty coverage as comprising income (and capital) taxes.

In Belgium, several recent decisions of the CPI Bruxelles have laid out a particular view about the relationship between article 2(2) and (3) of the OECD Model (when both are included in a tax treaty). That court has argued that the purpose of the enumeration in article 2(3) of the OECD Model is not to restrict the scope of application of a tax treaty, since that has already been done by article 2(2); instead, the purpose of article 2(3) is for one contracting state to inform the other contracting state about its own domestic law. Therefore, for a contracting state to interpret article 2(3) as restricting the scope of application of a tax treaty is to interpret that tax treaty in bad faith.[179]It is unlikely, however, that such an understanding of tax treaties' coverage is widely shared.

5.1.2.2. Practice of omitting article 2(1) and 2(2) of the OECD Model

In view of the potential conflicts described in section 5.1.2.1. , many states seem to believe that the better approach is to omit article 2(1) and (2) of the OECD Model from tax treaties. A number of states adopt this practice. For example, most of Australia's tax treaties signed before 2013 do not include paragraphs 1 and 2 in article 2.[180]The same is true for most Swedish tax treaties signed before 2004 and almost all Japanese tax treaties, including the most recently signed ones. Article 2 of these tax treaties generally omits paragraphs 1 and 2 and directly specifies the taxes covered by enumeration.[181]

The US Model (1996) took a similar approach, and it was only in the updated US Model (2006) that the decision was made to "move closer" to the OECD Model by "broadening the scope of taxes covered to include taxes on income imposed on behalf of the Contracting State irrespective of the manner in which they are levied".[182]The Andean Model's article on the scope of taxes covered is also based on a specific enumeration of taxes.[183]This practice is merely acknowledged in the Commentary on Article 2 of the OECD Model, without any further discussion of its merits and drawbacks.[184]

However, the fault lines that may be created by the approach of merely enumerating existing taxes are amply illustrated by the Brazilian experience of reconciling new taxes with treaty coverage. Until 1988, legal entities in Brazil were subject to the income tax. In 1988, a new constitution was enacted, under which the federal government was to share with states and municipalities almost half of its income tax revenues. In the meantime, the constitution created a new category of tax, the *contribuição social sobre o lucro líquido* (social contribution on net profit, CSLL). Different from the previous ordinary taxes (*impostos*), the CSLL has revenues linked to specific social expenses. Under the new tax system, the income tax rate for legal entities was reduced from 33% to 25%, and a new CSLL at an 8% rate was levied on the net profit of legal entities. The CSLL on legal entities' profits, therefore, has substantially the same tax base and the same taxpayers as the income tax. From a taxpayers'

177. *See* the *Hun.-Spain Income and Capital Tax Treaty* (1984), Treaties & Models IBFD; the *Lux.-Spain Income and Capital Tax Treaty* (1986), Treaties & Models IBFD; and the *Mor.-Spain Income and Capital Tax Treaty* (1978), Treaties & Models IBFD.
178. *See* the *Braz.-Spain Income Tax Treaty* (1974), Treaties & Models IBFD; the *Bulg.-Spain Income and Capital Tax Treaty* (1990), Treaties & Models IBFD; and the *Spain-Can. Income and Capital Tax Treaty* (1976), Treaties & Models IBFD. This is sometimes the result of asymmetrical treaty terms: Spain agrees to include some local taxes within the scope of the tax treaty, whereas the other state has not extended the scope of the tax treaty to cover local taxes.
179. *CIV, name not disclosed* (23 Nov. 2011); and BE: CPI Bruxelles [Court of First Instance Brussels], 2 Aug. 2011, *CIV, name not disclosed v. L'État de Belg SPF Finances* , Case Law IBFD. These cases are discussed further in sec. 5.
180. *See* , for example, the *Austrl.-Turk. Income Tax Treaty* (2010), Treaties & Models IBFD; the *Austrl.-Mauritius Income Tax Treaty* (2010), Treaties & Models IBFD; and the *Austrl.-NZ Income Tax Treaty* (2009), Treaties & Models IBFD. Vann notes, however, that while Australia omits art. 2(1) and (2) *OECD Model* , it paradoxically use a generic term like "income tax" rather than specifying the precise statute or source of existing taxes at the time of the conclusion of a tax treaty. This has led to interpretation issues in *Virgin Holdings* (10 Oct. 2008) and *Undershaft* (3 Feb. 2009), discussed in secs. 5.3.1. and 5.3.2. *See* R. Vann, *Commentary on Undershaft (No 1) Ltd. v. Commissioner of Taxation, Undershaft (No 2) Ltd. v. Commissioner of Taxation* , 11 International Tax Law Reports, pp. 653-672 (2009).
181. For examples of Swedish treaties, *see* the *Pol.-Swed. Income Tax Treaty* (2004), Treaties & Models IBFD; the *Malay.-Swed. Income Tax Treaty* (2002), Treaties & Models IBFD; and the *Taiwan-Swed. Income Tax Agreement* (2001), Treaties & Models IBFD. For examples of Japanese treaties, *see* the *Chile-Jap. Income Tax Treaty* (2016) (not yet in force), Treaties & Models IBFD; the *Ger.-Jap. Income Tax Treaty* (2015) (not yet in force), Treaties & Models IBFD; and the *Jap.-Qatar Income Tax Treaty* (2015), Treaties & Models IBFD. According to one Japanese commentator, the policy reason for the omission is the potential difficulty in determining whether a particular tax (such as the business enterprise tax levied by Japanese prefectures) falls into a general definition of "tax on income". *See* Y. Komatsu, *Sozei Joyaku No Kenkyu* [Study on Tax Treaties] p. 23 (Yuhikaku 1982) (in Japanese).
182. US Congress Joint Committee on Taxation Comparison of the 1996 and the 2006 US Models (8 May 2007), JCX-27-07.
183. *See* sec. 1.2.3.2.
184. Para. 6.1 *OECD Model: Commentary on Article 2* .

perspective, the tax burden remained unchanged at 33%. From the government´s perspective, however, a major change occurred, since the 8% contribution revenue would not be shared with states and municipalities.[185]

For Brazilian tax treaties enacted before 1988, a debate immediately ensued regarding whether the CSLL should be included in their scope. Until 2015 (*see* below), the Brazilian tax authority appeared to take the position that the CSLL was not covered, and some courts at least sided with it in litigation.[186]After 1988, some tax treaties (for example, the Brazil-Portugal Income Tax Treaty (2000)[187]) included the CSLL in their scope, but several other post-1988 tax treaties (for example, the Brazil-Netherlands Income Tax Treaty (1990)[188]) did not mention the CSLL in article 2. Because the Brazilian policy on article 2 of its tax treaties is understood to be that the list of taxes is considered exhaustive, it seemed to follow that CSLL was not included in such tax treaties.

However, in December 2015, an “interpretative statute” was enacted, providing that, for the purpose of interpretation, treaties and conventions to avoid double taxation of income signed by the government of the Federal Republic of Brazil cover the CSLL. According to the Brazilian Tax Code, interpretative statutes may be applied retroactively. The 2015 statute thus has implications for tax treaties entered into both after and before 1988: On the one hand, it appears to directly conflict with those tax treaties entered into after 1988 that did not mention the CSLL. (The so-called interpretative rule was thus a de facto treaty override.) For tax treaties entered into before 1988, on the other hand, although it accords with the intuition of many commentators that the CSLL should be covered by prior tax treaties, the interpretive statute raises the question of whether such a change triggered an obligation for Brazil to notify its treaty partners in 1988 about the change.

5.2. Article 2(3) of the OECD Model – Country-specific lists of “existing taxes”

5.2.1. Inclusion of tax (or non-tax) that is not income or capital tax

As discussed in section 1.1. , a main aim of tax treaties is to mitigate the risk of double taxation, and such risks may arise in connection not just with income or capital taxes. Taxes on income and capital may have simply offered the most salient and relevant reference points on which states have converged in forging international agreements. And as discussed in other sections of this chapter, questions such as whether, theoretically, a tax on total wages paid by an enterprise is an income tax, whether social security taxes are income taxes, whether a tax on renters is a tax on capital, and so on, may not ultimately be determinative of whether they should be included in the scope of tax treaties. In light of this, it should not be surprising that some tax treaties cover taxes that all would agree are not taxes on income or capital. In the protocols to the China-Korea Income Tax Treaty (1994)[189]and the China-Singapore Income Tax Treaty (2007),[190]for example, the contracting states undertook to exempt the operation of ships or aircraft in international traffic by an enterprise of a contracting state from the value added tax, the goods and services tax and other similar indirect taxes.

5.2.2. Omission of tax which is income or capital tax

The failure to enumerate an income or capital tax in article 2(3) in a tax treaty that provides coverage for income or capital taxes in article 2(1) and (2) is not uncommon. There appear to be several systematic reasons for this: First, subnational taxes covered by article 2(1) and (2) are sometimes neglected in article 2(3).[191]Second, small taxes on elements of income or of capital may be neglected. For example, China never lists its vehicle and vessels tax or its real property tax (which may be levied on foreigners) in its tax treaties, even where a tax treaty provides for capital tax coverage. Russia does not list the vehicle tax in its tax treaties and in practice excludes the tax from treaty coverage, in spite of the fact that the tax is very much imposed on owners of property (and therefore elements of capital). Russia also excludes in practice from treaty coverage special tax regimes (e.g. the simplified tax system and the single tax on imputed income for small and medium enterprises), which are not enumerated in the list of taxes covered. Other states, by contrast, may routinely regard similar taxes as taxes on income or on capital. Third, there are taxes the classification of which is definitely a more esoteric matter, and what their relationship to tax treaties is may be the type of issue that one may very reasonably regard as not worthy of ex ante attention.

185. *See* J.F. Bianco & R. Tomazela Santos, *The Social Contribution on Net Profits and the Substantive Scope of Brazilian Tax Treaties – Treaty Override or Legislative Interpretation?* , 70 Bull. Intl. Taxn. 9 (2016), Journal Articles & Papers IBFD.
186. *See* T.L. Gama, *Brazil* , in IFA, *supra* n. 5 , at p. 213, citing (i) a 2014 appellate decision with respect to the *Arg.-Braz. Income Tax Treaty* (1980), Treaties & Models IBFD, that the CSLL, “although somewhat similar to the income tax, has its own tax basis, as well as a different destination, and is not [covered by the treaty]”; (ii) a 2008 administrative announcement in relation to the *Braz.-Den. Income Tax Treaty* (1974), Treaties & Models IBFD, claiming that the CSLL does not fit into art. 2; and (iii) the *Air France* case, discussed in sec. 2.2.2. , in connection with two other Brazilian contributions.
187. *Braz.-Port. Income Tax Treaty* (2000), Treaties & Models IBFD.
188. *Braz.-Neth. Income Tax Treaty* (1990), Treaties & Models IBFD.
189. *PRC-S. Kor. Income Tax Treaty* (1994), Treaties & Models IBFD.
190. *PRC-Sing. Income Tax Treaty* (2007), Treaties & Models IBFD.
191. *See* *supra* n. 177 .

For example, the German *Kernbrennstoffsteuer* (nuclear fuel tax) requires as a taxable event the first use of a fuel assembly or individual fuel rods in a nuclear reactor, starting a self-sustaining chain reaction. The tax was introduced for the purpose of reducing the excess profits of nuclear power companies and is commonly viewed by academic commentators as a disguised special profits tax. Although German legislation claims the tax is an excise duty, the ECJ classifies it as a turnover tax on energy products. Not surprisingly, the tax is not enumerated in any of Germany's tax treaties.

5.3. Article 2(4) of the OECD Model – Future taxes

5.3.1. "Identical or substantially similar"

Article 2(4) of the OECD Model provides that "[t]he Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes". The US Internal Revenue Service stated its understanding of the term "identical or substantially similar" in Revenue Ruling 2002-16:

> In general, the purpose of a Taxes Covered Article is to ensure that tax treaties do not become obsolete due to changes in the tax systems of the parties to a treaty. Thus, if identical or substantially similar taxes are imposed in addition to, or in place of, the taxes that were in force and covered at the time a treaty was signed, it is appropriate to give effect to the intent of the Contracting States, and allow the treaty to continue to apply to the basic income tax structures of Contracting States. There is no definitive test for whether a tax is substantially similar to a covered tax; rather, the outcome rests on the facts and circumstances of each particular case. If it is concluded that a newly enacted tax is substantially similar to a covered tax, it also becomes a covered tax, but remains so only until such time as it is amended. When that occurs, a separate analysis must be made in order to determine whether the amended tax is substantially similar to the taxes in force at the time the treaty was signed.[192]

A leading case on "substantial similarity" is the 2008 *Virgin Holdings* decision in Australia.[193]Virgin Holdings (VH), a Swiss enterprise, sold shares in an Australian company resulting in a capital gain of close to AUD 200 million, which, under Australian law, was subject to capital gains tax (CGT). The CGT was introduced in 1986; the tax treaty between Australia and Switzerland in force at the time was signed in 1980.[194]VH argued that the CGT was covered by the tax treaty and, therefore, that Australia was prohibited from levying it on VH's gain by reason of article 7(1) (on business profits not attributable to a PE in Australia). One of VH's arguments was that the CGT is covered by reason of article 2(2) of the tax treaty, which provides that it shall also cover taxes imposed after it was signed that are identical or substantially similar to existing taxes covered.[195]The Australian Taxation Office countered that the CGT was not substantially similar to the existing Australian income tax, on the grounds that "the introduction of a broad-based capital gains tax regime was monumental" and represented a "novel basis of taxation in Australia, both as to its scope as to its manner of operation". The court ruled in favour of VH, primarily on the ground that "the Australian income tax" was always broad enough to encompass taxes like the CGT. Given this finding, it is not surprising that the CGT was also found to be substantially similar to the Australian income tax as reflected in earlier Australian statutes.[196]

In a dispute adjudicated by the Austrian *Verwaltungsgerichtshof* (Supreme Administrative Court, Vwgh) in 2000,[197]Lufthansa AG, a company resident in Germany, carried on an aircraft enterprise in Austria through a PE and was assessed Austrian municipal tax in respect of the employees working in the PE. Lufthansa argued that it was exempt from the municipal tax because the Austria-Germany Income and Capital Tax Treaty (1954)[198]provided that a company carrying on an aircraft enterprise is only taxable in the state where its effective management is located (which in this case was Germany). The Austrian tax authority argued that the municipal tax, which was not specifically listed as a covered tax in article 2 of the tax treaty, was not covered by the tax treaty. The court found in favour of Lufthansa on the grounds that the municipal tax was imposed after the tax treaty was signed and was substantially similar to the tax on the sum of wages which it had replaced, because the subject matter of the taxes was the same.[199]

192. I.R.S. Rev. Rul. 2002-16, 2002-15 I.R.B. 740 , Primary Sources IBFD.
193. *Virgin Holdings* (10 Oct. 2008).
194. *Austrl.-Switz. Income Tax Treaty* (1980), Treaties & Models IBFD.
195. VH also argued that, under art. 2(1), the existing taxes covered by the tax treaty include "the Australian income tax" and that the CGT was such a tax.
196. For discussion, *see* Vann, *supra* n. 180 .
197. AU: Vwgh [Supreme Administrative Court], 3 Aug. 2000, *Lufthansa AG v. Stadtgemeinde Schwechat* , Case Law IBFD.
198. *Austria-Ger. Income and Capital Tax Treaty* (1954), Treaties & Models IBFD.
199. Though tax on the sum of wages was itself not listed in art. 2(2) of the tax treaty, the court held that it was covered by the reference to tax on industrial and commercial profits listed in art. 2(2). While the reference to tax on industrial and commercial profits explicitly includes tax on the sum of wages in some of Austria's tax treaties (but not its tax treaty with Germany), the court held that this was done only for clarification. The *Austria-Ger. Income and Capital Tax Treaty* (2000), Treaties & Models IBFD, which replaced the 1954 tax treaty applicable in this case, explicitly refers to tax on the sum of wages.

In a 2008 Hungarian Supreme Court case,[200]the taxpayer was a company that was resident in Hungary but that, unusually, carried on all its business in Germany through a PE. The Hungarian tax authority audited the taxpayer and assessed the Hungarian local business tax (LBT) in respect of income derived from its PE situated in Germany. The taxpayer argued that the LBT was covered by the Germany-Hungary Income and Capital Tax Treaty (1977),[201]either by reason of the LBT being an income tax or by reason of the LBT being substantially similar to the local community development contribution, which was listed as an existing tax covered in article 2(3)(b) of the tax treaty. Based on the LBT being covered by the tax treaty and a "non-binding ruling issued by the relevant Hungarian local government's notary", the taxpayer argued that it was under no obligation to pay the LBT to Hungary. The court rejected the taxpayer's argument that the LBT was an income tax: its taxable base was not net income but net turnover corresponding to the goods sold or the services provided less the purchase price of the goods sold, the value of the intermediary services received and the cost of the materials used. Other expenses were not deductible under the LBT. The LBT was also held not to be substantially similar to the existing local community development contribution, because the latter, unlike the LBT, was imposed on individuals on the basis of personal income and privately owned immoveable property.

In a 2018 decision,[202]the French *Conseil d'État* (Supreme Administrative Court, CE) ruled that the tax on network enterprises (*imposition forfaitaire sur les entreprises de réseaux* , IFER) cannot be regarded as identical or similar to the business tax (*contribution des patentes*) referred to in article 1 of the France-Germany Income and Capital Tax Treaty (1959).[203]The court compared the IFER to the business tax, noting that the latter was a tax applicable to any businesses (French or foreign, individual or company) and consisted in a lump-sum tax and a proportional tax based on the rental value of the assets used in the business. In contrast, the IFER only applies to specific assets owned by specific companies and is not based on the rental value of these assets but on fixed values determined by the law. As a consequence, the court concluded that the provisions of article 4 of the tax treaty regarding the business tax do not prevent the application of the IFER.[204]

5.3.1.1. The United Kingdom's diverted profit tax

In March 2015, the United Kingdom adopted the diverted profits tax (DPT),[205]which treats many non-UK companies as having a taxable presence in the UK either by themselves or through affiliates or third parties, even though such presences do not give rise to a PE under tax treaties. To these taxable presences that are not PEs – which the UK DPT law labels "avoided PEs" – "notional PE profits" are attributed. These are the profits that would have been the chargeable profits of the company, attributable to the avoided PE, had the avoided PE been a PE in the United Kingdom through which the foreign company carried on a trade. A foreign company's "taxable diverted profits" are then calculated by reference to such notional profits, and a 25% DPT applies.

The UK government took the position that the DPT is not a "corporation tax" and is thus not covered by the United Kingdom's double tax treaties. The apparent reasons were that the DPT could not be called "substantially similar" to corporation tax: it applies only to diverted profits and only to a particular subset of corporate taxpayers; it is subject to different procedural rules and a different method of charge; and it imposes a different rate on the taxpayer.[206]However, it is also clear that the tax base of the DPT largely followed the profit attribution methods under the corporation tax. Especially notable is the fact that the DPT itself, similar to income taxes, attempts to avoid double taxation: where a foreign company that becomes subject to the DPT is also subject to tax in its home jurisdiction, the DPT permits such credit as is "just and reasonable" against DPT liability. In fact, the United Kingdom developed detailed rules regarding how DPT credits might still be allowed where the party subject to the DPT does not pay tax itself but another company pays tax in respect of the same profits on which the DPT is charged, and where another company pays tax under UK or foreign CFC (controlled foreign company) rules in respect of the profits that are subject to the DPT. By contrast, the more recent EU proposal for a digital services tax only permits the tax to be deducted from a corporation's income, and not credited against its corporate tax liability.

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200. HU: LB [Supreme Court], 4 Sept. 2008, *Corporation, name not disclosed v. Public Administration Office of the Central Transdanubia Region* , Case Law IBFD.
201. *Ger.-Hun. Income and Capital Tax Treaty* (1977), Treaties & Models IBFD.
202. FR: CE [Supreme Administrative Court], 13 June 2018, case no. 415769 , Case Law IBFD.
203. *Fr.-Ger. Income and Capital Tax Treaty* (1959), Treaties & Models IBFD.
204. Contrast with FR: CE [Supreme Administrative Court], 26 Nov. 1975, *Company, name not disclosed v. Ministre de l'Economie et des Finances* , Case Law IBFD. A taxpayer that was a company resident in Canada sold apartment buildings in France not through a PE situated therein, in respect of which it was assessed "advance levy" of an amount equal to 50% of its income therefrom. The taxpayer argued that France was prohibited from the levy by reason of art. 4 *Can.-Fr. Income Tax Treaty* (1951), Treaties & Models IBFD, which provided that France may only tax such income if earned through a PE situated therein. The French tax authority argued that, as the advance levy was introduced after the tax treaty was signed, it was not covered by said tax treaty. The CE found in favour of the taxpayer and held that the advance levy was substantially similar to existing taxes covered.
205. *See* P. Wagman, *The U.K. Diverted Profits Tax: Selected U.S. Tax Considerations* , 147 Tax Notes 1413 (22 June 2015); P. Menon & P. Narasimhan, *United Kingdom* , in IFA, *supra* n. 5 , at pp. 869-70.; and R. Tomazela Santos, *The United Kingdom's Diverted Profits Tax and Tax Treaties: An Evaluation* , 70 Bull. Intl. Taxn. 7 (2016), Journal Articles & Papers IBFD.
206. *See* Wagman, *supra* n. 205 ; and Menon & Narasimhan, *supra* n. 205 .

In any case, from a taxpayer's perspective, the question of whether the DPT is a covered tax may be effectively moot: as a matter of UK law, a tax treaty only creates enforceable rights for taxpayers to the extent it is implemented in domestic law. Even if the DPT is a type of income tax similar to other covered taxes under UK tax treaties, because the United Kingdom neither amended nor intended to amend its domestic law implementing tax treaties to refer to the DPT, UK tax treaties were effectively overridden.[207]

5.3.1.2. The US base erosion and anti-abuse tax (2017)

The Tax Cut and Jobs Act enacted in the United States in December 2017 introduced the BEAT , which is an additional tax imposed on corporations (other than regulated investment companies, real estate investment trusts and S corporations) that make certain "base-eroding" payments to related foreign persons. Specifically, the BEAT imposes a 10% tax (5% for the 2018 calendar year and 12.5% beginning in 2025) on a corporation's "modified taxable income", which is generally the corporation's US taxable income, excluding any deductions for base-eroding payments (such as payments for services, interest, rents and royalties) and deductions for depreciation and amortization of property acquired from related foreign persons. If this amount exceeds the corporation's regular tax liability (i.e. its tax liability calculated without the BEAT), then the amount of the excess is the BEAT payable.[208]

Because no foreign tax credit is allowed against the BEAT, and because the BEAT does not apply to payments made to domestic suppliers, many commentators have question whether the BEAT is in violation of article 23 (Relief from double taxation) and article 24 (Non-discrimination) of US tax treaties.[209]For the article 23 question, a more preliminary issue is whether the BEAT is a covered tax in the first place. One view, laid out by Rosenbloom and Shaheen, is that the BEAT is likely a covered tax, per paragraph 4 of article 2, because it is "substantially similar" to the US alternative minimum tax (AMT), which has been held by US courts to be a covered tax.[210]The two taxes are both "separate tax[es] equal to the difference between a tax at a special rate on a modified income base and the taxpayer's regular tax liability".[211]According to this view, the fact that the income bases for the BEAT and AMT differ does not distinguish the two taxes enough to preclude the BEAT from being substantially similar to the AMT, because "both bases depart from the base of the regular income tax and serve the same broad purpose of assuring imposition of a minimum tax".[212]

Rosenbloom and Shaheen also argue, however, that enactment of the BEAT should not be construed as a treaty override. It follows from their view that the United States' tax treaties severely constrain the applicability of the BEAT. It seems safe to say that this is not the position followed by the US government or most affected taxpayers and tax practitioners. Consequently, whether BEAT is a covered tax may be viewed as a still unsettled question.[213]A detailed look at the differences in the income bases for the BEAT and AMT could possibly result in the conclusion that the two taxes are not substantially similar. The corporate AMT (now repealed) was a 20% tax on a corporation's "alternative minimum taxable income", calculated by adjusting the corporation's taxable income otherwise calculated to reduce the benefits obtained by "tax preference" items such as accelerated depreciation, percentage depletion, intangible drilling costs and non-taxable income. Although both the BEAT and AMT start with a corporation's taxable income otherwise calculated and then reverse the benefits of certain specific items, the benefits that are reversed are quite distinct. More generally, the AMT is designed to set limits on certain tax benefits that are otherwise available, so that subject corporations pay at least a minimum amount of tax each year. The BEAT, by contrast, is designed to reduce the profit-shifting effects of making certain "base-eroding" payments to related foreign persons. These differences in the substantive effects of the BEAT and AMT should arguably be taken into consideration and could result in finding that the two taxes are not substantially similar.

In reality, any interpretation of the BEAT's treaty status would point to the weakness of tax treaties in constraining unilateral actions as a legal matter. The BEAT bears much greater resemblance to the income tax than other recent unilateral tax instruments like the French DST (*see* section 3.1.4.). If the BEAT is not a covered tax, then clear limits to the scope of covered taxes emerge. If the BEAT is a covered tax but the United States has simply overridden its treaties, then it is important to document what quantum of disapprobation follows upon such unilateral action. Finally, if the BEAT is a covered tax but is interpreted to be consistent with US tax treaties,[214]then it is again important to recognize how tax treaties themselves leave ample room for unilateral actions.

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207. *See* Wagman, *supra* n. 205 ; and Clifford Chance Briefing Note, *The UK diverted profits tax: final legislation published* (25 Mar. 2015).
208. C.W. Sanchirico, *Earnings Stripping under the BEAT* , Tax Law Review (forthcoming 2019).
209. *See* , for example, H.D. Rosenbloom & F. Shaheen, *The BEAT and the Treaties* , Tax Notes International (1 Oct. 2018), pp. 53-63; and R.S. Avi-Yonah & B. Wells, *The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen* , Tax Notes International (22 Oct. 2018), pp. 383-391.
210. *See* , for example, US: TC , 8 Feb. 2002, *Kappus v. Commissioner* , T.C. Memo. 2002-36, *aff'd* , 337 F.3d 1053 (D.C. Cir. 2003), Case Law IBFD, where the court ruled that the third Protocol to the *Can.-US Income and Capital Tax Treaty* (1980), Treaties & Models IBFD, specifically took into account the AMT, as amended by the Tax Reform Act of 1986, as a tax to which the convention applies.
211. Rosenbloom & Shaheen, *supra* n. 209 .
212. Id.
213. Avi-Yonah & Wells, *supra* n. 209 .
214. This is the view favoured by Avi-Yonah & Wells, *supra* n. 209 .

5.3.2. Impact of one contracting state's list on the other contracting state

One intriguing technical issue is whether a tax imposed by a contracting state after the tax treaty is signed that is identical or substantially similar to an existing tax imposed by *the other contracting state* can be covered by reason of article 2(4) of the OECD Model. Lang has answered this question in the affirmative, on the following grounds:

> Article 2(4) uses the phrase "identical or substantially similar taxes" and seems to refer to the list of taxes in the bilateral equivalent to Art. 2(3) of the OECD Model. The taxes levied at the time the treaty was signed serve as a benchmark. Art. 2(4) neither distinguishes between the two contracting states nor requires that a newly introduced tax be identical or similar to taxes in *both* contracting states. Thus, even a tax levied only in the *other* contracting state may serve as a benchmark.[215]

Interestingly, this view was endorsed by the Australian Federal Court of Appeals in the *Undershaft* decisions in 2009.[216]The facts of the two *Undershaft* cases, heard together shortly after *Virgin Holdings* , were essentially the same as in *Virgin Holdings* :[217]the taxpayers, resident in the United Kingdom and the Netherlands, respectively, sold shares in their Australian subsidiaries resulting in capital gains of AUD 273 million and AUD 108.585 million, respectively, which gains Australia was prohibited from levying CGT on by reason of the business profits article in the applicable tax treaties. In respect of the UK-resident taxpayer, though the court held that the CGT was covered by the Australia-United Kingdom Income Tax Treaty (1967)[218]on the same grounds as in *Virgin Holdings* , it also noted that, if it was wrong that the CGT is covered by reason of article 1(1), then it was still covered by reason of article 1(2). This is because the CGT is substantially similar to the existing *UK taxes* listed in article 1(1)(a) of the 1967 treaty:

> The inclusion of both the UK capital gains tax and the UK corporations tax as taxes covered by [the tax treaty] suggests that the parties would have regarded an Australian tax imposed on capital gains, whether through the existing income tax or by means of a new tax, on either individuals or corporations, or both, subsequent to the signing of the UK Agreement … as "substantially similar" to either of the UK taxes referred to or to both of them viewed in combination.[219]

Vann has countered that this holding (and Lang's proposition) cannot be correct:

> While it is true that tax treaties are generally symmetrical, the taxes covered list is one case where each country specifies what it wants to be covered on its side. In making up its list presumably the country considers what it does not want to cover as well as what it wants to cover … Consider the implication of this line of argument for the US. The US wishes to cover only its federal income tax in its tax treaties, that is, it wants to exclude state income taxes from coverage. Suppose a treaty [partner's] list in its treaty with the US covers such taxes on its side ... On this line of reasoning, a US state income tax that did not exist at the time of the treaty but was introduced subsequently would be covered by the treaty, a result which would cause significant ructions in the US and is completely contrary to the well-known US treaty position.[220]

5.4. Obligation to notify

5.4.1. From periodical notification to notification of significant changes

The original drafts of article 2 for the OEEC in 1957 and for the OECD in 1961 all contemplated regular exchange among contracting states, through notifications and mutual agreement procedures, to specify and adjust the scope of coverage of tax treaties. The proposed drafts of the OEEC WP 3, for example, provided for a mutual agreement procedure specific to article 2 for clarifying the material scope of the convention.[221]Even though this was dropped by the OECD in 1961 in favour of the general MAP provision in article 25, article 2(4) of the OECD Model still stipulated, prior to its 2000 update, that "[a]t the end of each year, the competent authorities of the Contracting States shall notify each other of changes which have been made in their respective taxation laws".

However, in the 2000 update of the OECD Model, this part of article 2(4) was revised, and the new standard of notification was stated to be that "[t]he competent authorities of the Contracting States shall notify each other of significant changes made to their tax law". As a result, since 2000, the contracting states are no longer expected to agree to a periodical (annual) obligation of notification. Their obligation of notification may also be limited to "significant" changes of domestic legislation only.

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215. Lang, *supra* n. 8 , at p. 221. This proposition is also endorsed in P. Brandstetter, *The Substantive Scope of Double Tax Treaties – A Study of Article 2 of the OECD Model Conventions* p. 39 (ePubWU 2010).
216. A similar conclusion was also endorsed, though not relied on, by the Irish High Court in IE: IEHC , 31 July 2007, *Kinsella v. Revenue Commissioners* , Case Law IBFD.
217. *See* the discussion of *Virgin Holdings* (10 Oct. 2008) in sec. 5.3.1.
218. *Austrl.-UK Income Tax Treaty* (2003), Treaties & Models IBFD.
219. *Virgin Holdings* (10 Oct. 2008), at para. 135. *See also Rohrmoser* (17 Jan. 1985), discussed in sec. 4.
220. Vann, *supra* n. 180 , at p. 662.
221. *See* sec. 1.2.2. ; *see also* Dubut, *supra* n. 30 , at p. 132 et seq.

5.4.2. Treaty practice

There is some variation in treaty practice on this matter among states. Some states simply do not include the notification requirement in their tax treaties.[222]By contrast, in all Australian tax treaties, other than those with Russia and Singapore, there is an obligation on the competent authorities to notify each other of "significant" or "substantial" changes that have been made in their taxation laws. That notification has to be "within a reasonable period of time after those changes" in 21 treaties; "as soon as possible after the end of each calendar year" in 3 treaties; "at end of each calendar year" in 4 treaties; and not subject to any time limit in the other 14 treaties.

Switzerland also has some tax treaties that contain detailed rules on the timing aspect of the notification – either at the end of the year (as, for example, in the Australia-Switzerland Income Tax Treaty (1980),[223]the Denmark-Switzerland Income and Capital Tax Treaty (1973),[224]the Ireland-Switzerland Income and Capital Tax Treaty (1966),[225]the Poland-Switzerland Income and Capital Tax Treaty (1991)[226]and the Sweden-Switzerland Income and Capital Tax Treaty (1965)); at the beginning of the year (the Portugal-Switzerland Income and Capital Tax Treaty (1974)[227]); or within an appropriate or normal deadline (as, for example, in the China-Switzerland Income and Capital Tax Treaty (1990),[228]the Japan-Switzerland Income Tax Treaty (1971)[229]and the Switzerland-Trinidad and Tobago Income Tax Treaty (1973)[230]).

The United States used to set an expectation of a potentially greater amount of exchange than under the OECD Model. The US Model (1996) provided as follows:

> The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their respective taxation laws or other laws affecting their obligations under the Convention, and of any official published material concerning the application of the Convention, including explanations, regulations, rulings, or judicial decisions.

The inclusion of non-tax laws that may affect a contracting state's obligations under a tax treaty clearly goes beyond the OECD Model.[231]This notification obligation is understood to include, for example, "laws affecting bank secrecy".[232]The communication of all "official published material" is also notable. But the expectation of the transmission of such material ceased to be part of the US Model when it was revised in 2006. The US Model (2006) only provided for the notification "of any changes that have been made in their respective taxation or other laws that significantly affect their obligations under this Convention".[233]

5.4.3. Practical relevance of the notification obligation

Even when a notification requirement is incorporated in article 2 of a tax treaty, it is difficult to ascertain the extent to which the obligation to notify is observed in practice.[234]On the one hand, The Commentary on Article 2 of the OECD Model claims that not only are member countries "encouraged to communicate … significant developments … such as new regulations or judicial decisions; many countries already follow this practice".[235]There are also some well-publicized instances of notification. For example, when Mexico adopted the *impuesto empresarial a tasa unica* (single-rate business tax, IETU) in 2007, it notified its treaty partners in advance, in anticipation of possible disagreements regarding whether the tax would be creditable by said partners. Negotiations were entered into during 2007, prior to the enforcement of the law in 2008. As a consequence, most of Mexico's treaty partners, including the United States, allowed the credit of the IETU, at least provisionally.

On the other hand, there are certainly well-publicized instances of non-notification as well. A series of cases in the Netherlands suggests that that state does not routinely notify other states about changes in its domestic law. An important example is the

222. *See* , for example, the *Austria-Switz. Income and Capital Tax Treaty* (1974), Treaties & Models IBFD; the *Ger.-Switz. Income and Capital Tax Treaty* (1971), Treaties & Models IBFD; the *Korea (Rep.)-Switz. Income Tax Treaty* (1980) (as modified through 2010), Treaties & Models IBFD; and the *Nor.-Switz. Income and Capital Tax Treaty* (1987), Treaties & Models IBFD.
223. *Austrl.-Switz. Income Tax Treaty* (1980), Treaties & Models IBFD.
224. *Den.-Switz. Income and Capital Tax Treaty* (1973), Treaties & Models IBFD.
225. *Ir.-Switz. Income and Capital Tax Treaty* (1966), Treaties & Models IBFD.
226. *Pol.-Switz. Income and Capital Tax Treaty* (1991), Treaties & Models IBFD.
227. *Port.-Switz. Income and Capital Tax Treaty* (1974), Treaties & Models IBFD.
228. *PRC-Switz. Income and Capital Tax Treaty* (1990), Treaties & Models IBFD.
229. *Jap.-Switz. Income Tax Treaty* (1971), Treaties & Models IBFD.
230. *Switz.-Trin. & Tob. Income Tax Treaty* (1973), Treaties & Models IBFD.
231. Such practice is suggested in para. 8 *OECD Model: Commentary on Article 2* (2014).
232. *United States Model Income Tax Convention: Technical Explanation* (20 Sept. 1996), Treaties & Models IBFD.
233. The *US Model* (2016) uses yet another variation: "The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws or other laws that relate to the application of this Convention."
234. Country experts surveyed by GTTC generally responded that such notification practice is not public, while giving diverse responses as to whether notification nonetheless occurs (some surmise that it is "unlikely"; others conjecture that exchange is "frequent").
235. Para. 8 *OECD Model: Commentary on Article 2* (2014).

deemed income provision for directors/substantial shareholders. On 5 September 2003, the HR [236]held that this provision could not be applied under the Belgium-Netherlands Income and Capital Tax Treaty (1970),[237]because the change constituted a unilateral amendment of the allocation of taxing rights. Since the change was not discussed with Belgium, the court held that the application of the provision was incompatible with the good-faith principle under the tax treaty. The Dutch tax authority suffered a similar defeat in several other cases before the HR.[238]

Indeed, many of the cases of article 2 litigation around the globe discussed in this chapter provoke a question: was a notification obligation present and followed? In all of these cases, one state imposed a tax, a taxpayer went to court and argued that the tax should be covered by an existing tax treaty and the tax authority claimed the opposite. The disputes raised substantive legal questions that were "significant" in obvious ways. In all of them, therefore, a change in tax law occurred that could significantly affect the contracting states' treaty obligations, and the contracting state other than the state of the defendant tax authority would seem to be an implicit third party involved in the dispute. However, there is rarely any indication from the judicial proceedings of what positions such contracting states might have taken.

6. Relationship to Other Articles

6.1. Express provisions

6.1.1. Article 24 of the OECD Model – Non-discrimination

Article 2 of the OECD Model governs the scope of coverage of a tax treaty primarily insofar as its distributive rules are concerned - when the source and residence states are limited in their taxing powers so as to achieve the desired allocation of taxing rights as well as to coordinate to avoid double taxation. These objectives have been the focus of this chapter so far. Article 2 of the OECD Model may, however, have relevance for other purposes of a tax treaty as well.

Article 24 of the OECD and UN Models articulates certain principles of non-discrimination in tax matters that are to be implemented through a tax treaty. Article 24(6) of the OECD and UN Models states that "[t]he provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description". Where tax treaties adopt such language, the scope of taxes covered by article 24 may be broader than under article 2.[239]However, many states restrict the scope of article 24 of their tax treaties to taxes covered by the tax treaty in question.[240]When a tax treaty does not adopt wording corresponding to article 24(6) of the OECD Model, it is generally believed that the non-discrimination provisions apply only to the taxes covered by article 2 of said tax treaty. The Dutch HR , for example, decided a case in 2000 in which article 24 of the Canada-Netherlands Income Tax Treaty (1986), which does not include the phrase "taxes of every kind and description", was considered to be limited to taxes on income.[241]

Finally, it is worth noting that contracting states sometimes specify in article 2 of their tax treaties the taxes covered for the purposes of the non-discrimination article,[242]as well as taxes covered for the purposes of the exchange of information and mutual assistance in tax collection articles.[243]

6.1.2. Article 26 of the OECD Model – Exchange of information

Since 2000, article 26(1) (Exchange of information) of the OECD Model has provided as follows:

236. In NL: HR [Supreme Court], 5 Sept. 2003, 37.651 , LJN AE8398, BNB 2003/379, Case Law IBFD.
237. *Belg.-Neth. Income and Capital Tax Treaty* (1970), Treaties & Models IBFD.
238. These were NL: HR [Supreme Court], 19 June 2009, 44.050 , Case Law IBFD, with respect to a preserving assessment on annuities under the 1970 tax treaty with Belgium; and NL: HR [Supreme Court], 19 June 2009, 43.978, 07/13267 and 08/02288 , Case Law IBFD, with respect to a preserving assessment on pensions under the tax treaties with France, Korea (Rep.) and the Philippines, respectively.
239. *See generally* A.J. Martín Jiménez, *Defining the Objective Scope of Income Tax Treaties: The Impact of Other Treaties and EC Law on the Concept of Tax in the OECD Model* , 59 Bull. Intl. Taxn. 10 (2005), Journal Articles & Papers IBFD.
240. States that explicitly reserve their right to restrict the scope of art. 24 to the taxes covered by the tax treaty include Chile, Greece, Ireland and the United Kingdom, among OECD member countries; and Albania, Brazil, Bulgaria, Malaysia, the Philippines, Romania, Serbia, Thailand, Tunisia, Vietnam and Ukraine, among non-OECD member countries.
241. NL: HR [Supreme Court], 1 Nov. 2000, 35.398 , Case Law IBFD [Decision BNB 2001/19 of 1 Nov. 2000]. For academic commentaries affirming this understanding, *see* K. Vogel, *Klaus Vogel on Double Tax Conventions* , p. 1338 (Kluwer 1997); K. van Raad, *Nondiscrimination in International Tax Law* , p. 203 (Kluwer 1986); and P. Adonnino, *General Report* , in *Non-discrimination rules in international taxation* p. 38, International Fiscal Association (IFA), *Cahiers de droit fiscal international* vol. 78b (Sdu Fiscale & Financiële Uitgevers 1993), Books IBFD.
242. *See* art. 2(3) *Austrl.-Fin. Income Tax Treaty* (2006), Treaties & Models IBFD; *Austrl.-Nor. Income Tax Treaty* (2006), Treaties & Models IBFD; and *Austrl.-S. Afr. Income Tax Treaty* (1999), Treaties & Models IBFD.
243. *See* the *Austrl.-Fin. Income Tax Treaty* (2006), Treaties & Models IBFD; the *Austrl.-Fr. Income Tax Treaty* (2006), Treaties & Models IBFD; the *Austrl.-Nor. Income Tax Treaty* (2006), Treaties & Models IBFD; the *Austrl.-S. Afr. Income Tax Treaty* (1999), Treaties & Models IBFD; and the *Austrl.-Turk. Income Tax Treaty* (2010), Treaties & Models IBFD.

> The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning *taxes of every kind and description* imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. *The exchange of information is not restricted by Articles 1 and 2.* [Emphasis added.][244]

Before 2000, the paragraph only authorized the exchange of information, and the use of the information exchanged, in relation to the taxes covered by the OECD Model under the general rules of article 2.[245]Because the broader scope of information exchange contemplated by article 26(1) of the OECD Model is of relatively recent vintage, there are still many older tax treaties that do not extend the scope of exchange of information beyond the taxes covered by article 2.[246]However, because of a rapidly growing body of bilateral and multilateral international instruments concerning exchange of tax information, the traditional restrictions of information exchange to article 2 taxes may have diminishing practical relevance.

6.1.3. Article 27 of the OECD Model – Assistance in the collection of taxes

Article 27(1) of the OECD and UN Models provides that the "[t]he Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Articles 1 and 2". Moreover, article 27(2) of the OECD and UN Models defines "revenue claim" as an "amount owed in respect of taxes of every kind and description ... as well as interest, administrative penalties and costs of collection or conservancy related to such amount". Article 27 was added to the OECD Model only in 2003. Prior practice in administrative assistance under the framework of double taxation conventions was limited, and not just in terms of the types of taxes covered. Under the US Model (1996), for example, article 26(4) only provided for assistance in the collection of taxes to the extent necessary to ensure that treaty benefits were enjoyed only by persons entitled to those benefits under the terms of the convention. However, the OECD's Model Convention on Mutual Administrative Assistance in the Recovery of Tax Claims[247]took the position from the outset (in 1981) that its scope was not limited by the scope of taxes covered under double tax conventions. Therefore article 2 of the OECD Model has a minimal role in limiting the extent of mutual assistance in tax collection both before and after 2002.[248]

6.2. Implicit relationships

6.2.1. Distributive rules under articles 5-22 of the OECD Model

Insofar as articles 24, 26 and 27 of the OECD Model apply to taxes other than those described in article 2, this is an exception: the point of article 2 is to delineate the scope of taxes generally covered by a tax treaty. The distributive rules of tax treaties therefore are generally limited by article 2: they create obligations for the contracting states generally only in connection with article 2 taxes.

Nonetheless, there are still instances where a tax relevant to a distributive article is not covered in article 2 of a tax treaty, or a tax enumerated in article 2 is not intended to be relevant for the distributive rules. As an example of the former situation, exemptions from value added tax or goods and services tax are sometimes provided for in article 8 of a tax treaty, in connection with international transportation income, but such taxes would not be enumerated in article 2. As an example of the latter situation, the Netherlands-United Kingdom Income Tax Treaty (2008) states explicitly that "the inclusion of the petroleum revenue tax … in [Article 2] is solely for the purpose of permitting the Netherlands to give relief for these taxes under Article 21".[249]

6.2.2. Relief for double taxation under article 23 of the OECD Model

Article 2 of the OECD Model bears a direction relation to both article 23A and article 23B, the two alternative provisions for the elimination of double taxation. When applying the exemption method under article 23A of the OECD Model, a state must

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244. Art. 26(1) *UN Model* (2011) is similar in substance but stresses that information shall be exchanged that would be helpful to a contracting state in preventing avoidance or evasion of such taxes.
245. Para. 10.1 *OECD Model: Commentary on Article 26* (2014). The *US Model* (1996) also restricted the exchange of information to taxes covered by the convention, while the *US Model* (2006) broadened the scope of coverage in the style of the *OECD Model* (2005).
246. Para. 10.1 *OECD Model: Commentary on Article 26* also suggests that states "not in a position" to exchange information or to use the information obtained from a treaty partner in relation to taxes that are not covered by the convention under the general rules of art. 2 are free to restrict the scope of art. 2(1) to the taxes covered by the convention. In addition, para. 5.5 *OECD Model: Commentary on Article 26* states that, since the exchange of information concerning customs duties has a legal basis in other international instruments, the provisions of these more specialized instruments will generally prevail and the exchange of information concerning custom duties will not, in practice, be governed by art. 26.
247. (OECD), *Model Convention for Mutual Administrative Assistance in the Recovery of Tax Claims: Report of the OECD Committee on Fiscal Affairs* (OECD 1981).
248. Para. 11 *OECD Model: Commentary on Article 27* notes that some contracting states may prefer to limit the application of the article to taxes that are covered by the convention under the general rules of art. 2.
249. Para. I Protocol to the *Neth.-UK Income Tax Treaty* (2008), Treaties & Models IBFD.

exempt the relevant income or capital “from tax” if the tax treaty provides that the income or capital “may be taxed” in the other state. Similarly, article 23B of the OECD Model provides that a “deduction from the tax” of the residence state should be given for the “tax paid in that other State” in accordance with the provisions of the convention. Thus the general structure of article 23 of the OECD Model allows article 2 to limit the scope of double taxation relief.

However, there are many exceptions to this general rule. Many states’ tax treaties provide double taxation relief only subject to the provisions of their domestic laws. For example, because Japan’s treaties provide for credit “subject to the provisions of the laws of Japan”, the listed taxes of the treaty partner must be reviewed in accordance with the “foreign corporation tax” test. As a result, it has been concluded that the church tax (*kirkollisvero*) listed in the Finland-Japan Income Tax Treaty (1972)[250]does not fall within the scope of “foreign corporation tax” and is thus not creditable against the Japanese corporation tax.[251]

In a different vein, article 2(4) of the Norway-United Kingdom Income Tax Treaty (2013)[252]states that, for credit purposes, the UK petroleum revenue tax is covered in addition to the taxes covered mentioned in article 2(3). In other words, the scope of article 2 of the tax treaty is actually anchored in the methods article. The language of article 2(b) of the Italy-United States Income Tax Treaty (1999)[253]expresses this position most explicitly: the “existing taxes to which the Convention shall apply [include a certain Italian tax] but only that portion of such tax that is considered to be an income tax pursuant to paragraph 2(c) of Article 23”. Further, as noted in section 6.2.1. , the Netherlands-United Kingdom Income Tax Treaty (2008) states that “the inclusion of the petroleum revenue tax … in [Article 2] is solely for the purpose of permitting the Netherlands to give relief for these taxes under Article 21”. Thus, the connection between article 2 and the article on the elimination of double taxation is specifically provided, rather than structural.

6.3. Terms defined elsewhere

Article 2(4) of the OECD Model refers to the “competent authorities of the Contracting States” in connection with the obligation to notify the other contracting state of changes in domestic tax law. The term “competent authority” is usually defined in article 3 (General definitions) and article 25 (Mutual agreement procedure) of a tax treaty. *See* section 2. of the GTTC chapter on article 3 and section 6.3. of the GTTC chapter on article 25 .

6.4. Meta topics

To be added.

250. *Fin.-Jap. Income Tax Treaty* (1972), Treaties & Models IBFD.
251. *See* M. Honda, *Japan* , in IFA, *supra* n. 5 , at p. 457.
252. *Nor.-UK Income Tax Treaty* (2013), Treaties & Models IBFD.
253. *It.-US Income Tax Treaty* (1999), Treaties & Models IBFD.