THE NOTION OF TAX AND THE ELIMINATION OF INTERNATIONAL DOUBLE TAXATION OR DOUBLE NON-TAXATION

It is widely accepted that international "double taxation", and increasingly also international "double non-taxation" situations should be eliminated. Tax treaties allocate rights to taxation between treaty partners with a view to providing legal certainty to taxpayers concerning the extent of their tax liabilities, without overlap. The elimination of double taxation, or indeed the preservation of taxation within the reasonable expectations of a treaty, however, goes only as far as the scope of the applicable tax treaty unless domestic law provisions provide for a wider scope. The substantive scope of a tax treaty determines the extent of protection it can provide against international double taxation or double non-taxation.

The substantive scope of a tax treaty depends, fundamentally, on knowing what is "tax" as well as what is "the tax" the taxing rights in respect of which are apportioned between treaty partners. In that regard, it is interesting that most treaty discussions begin with the implicit assumption or expectation that the answers to both of these questions are either self-evident or implicitly have been answered satisfactorily. As countries look to protect their revenue bases, it can be anticipated that more and more cases will arise where these fundamental questions first need to be addressed before trying to apply the distributive treaty rules that are meant to offer certain and predictable outcomes.

This Subject deals with the formative questions, "What is 'tax'?" and "What is 'the tax'?" These are more than questions of definition, because they reach to the essence of each treaty partner's jurisdiction to tax in the first place and then whether the agreements of a treaty have affected that jurisdiction.

The distributive rules and the relief provisions of tax treaties apply only to "taxes covered". Therefore it is important to determine which domestic law levies of the treaty parties qualify as taxes covered by the treaties and which levies fall outside of the scope of the treaties and therefore can be levied irrespective of the treaties and irrespective of double taxation. It is important to analyse whether and to what extent domestic law relief provisions eliminate double taxation caused by such levies not covered by tax treaties.

In doing this analysis, even more basic questions may arise about how the relevant tax base is defined, including what is considered to be "income" or "capital" and how these fundamental notions are expressed in practice. In some cases, treaties assign such meanings to these terms that their natural usage, even for legal purposes, would not sustain. Treaties may, for example, assimilate to payments of a certain character (e.g., "interest") payments that do not have that character. Another example concerns countries that might seek to recover tax base that they have relinquished in their treaties or according to domestic law. In this connection, is a form of transaction tax, such as a "tonnage tax" calculated with reference to a primary input, such as revenue from transporting goods, in the nature of an income tax, a tariff, a commodity tax or some

other charge, even though it is oriented toward some measure of “income”? Are taxpayers disadvantaged by this sort of taxation if it is found to exist outside the scope of a treaty? Do states adopt this tax as a “proxy” to income taxation thinking that any treaty-based renunciation of tax rights would not apply?

Countries worldwide have adopted the text of Art. 2 ("Taxes covered") of the OECD Model Tax Conventions in their bilateral tax treaties. However, the structure and wording of Art. 2 create interpretative issues and uncertainties in practical treaty application. The levies that a state expressly lists in a treaty are surely “taxes covered” for the treaty purposes, but what are the other levies that may qualify as such ”taxes on income and on capital” covered by Art. 2? And what are the “identical or substantially similar taxes” that may come under the scope of Art. 2? Do domestic law definitions of the terms tax, income and capital have relevance in determining the levies covered by tax treaties and to what extent? Yet, even at this stage, interesting questions emerge. A treaty applies in respect of “taxes covered”. But, certain provisions refer to the act of “taxing” or the event of being “taxed”, possibly circumscribed by the “taxes covered” but possibly not. In other words, in addition to the two earlier questions, is “tax” as used in a treaty the same thing as “taxes covered”?

The following are treaty situations in which the questions associated with the meaning of “tax” conceivably would affect the scope of a treaty and its effectiveness to accomplish its primary objectives of relieving duplicated tax while not facilitating a complete avoidance of tax.

Tax treaties do not function properly in eliminating double taxation, if it is not clear which is the state of residence of a person for the treaty purposes. The notion of tax is relevant when determining whether a person is a resident of a contracting state for treaty purposes and, therefore, a treaty subject. In accordance with Art. 4 (“Resident”) of the OECD Model a person must be “liable to tax” in a contracting state under the laws of that state by reason of his domicile, residence, place of management or any other criterion of similar nature. Which domestic law levies must a person be liable to in order for the person to qualify as a resident? Should the “losing” state accept the opinion of the other state of the existence of sufficient levies in a dual residence conflict situation? If the “losing” state does not accept the opinion of the other state, double taxation very easily is the consequence. Is there any room for a state not accepting the opinion of the other state, if the relevant tax notion is not defined more specifically in a treaty, it is the other state’s tax liability that is in question, and the tax notion clearly does have significance for the state levying the tax? Is Article 3(2) relevant to this determination? May domestic law anti-avoidance provisions be applied to disregard the tax residence in the other contracting state?

The notion of tax based on Art. 2 is relevant also in determining the extent to which one of the contracting states must eliminate double taxation either on the basis of a distributive article or on the basis of the method article of a tax treaty. When applying the exemption method (Art. 23 A of the OECD Model) a state must exempt the relevant income or capital “from tax”. Are there certain domestic law levies that do not qualify as taxes for treaty purposes and therefore may be levied, even if the country applied the exemption method based on the treaty? Or does the state eliminate

double taxation unilaterally also in relation to these levies not covered by the treaty and exempts certain situation also from these levies?

The notion of tax raises even more issues when international double taxation is eliminated with the credit method (Art. 23 B of the OECD Model). What are the levies of the other state that qualify as such taxes that have to be credited? What are the taxes against which the foreign taxes must be credited on the basis of tax treaties? If certain levies are not credited on the basis of a treaty, may they still be credited on the basis of domestic law provisions? May the levies that do not fall under the credit system still be deducted as a cost deduction for tax purposes?

What if the contracting states do not agree on whether certain levy falls under the treaty or not? Is double taxation eliminated in such conflict situations? Is mutual agreement procedure referred to in such situations? Para. 3 of Art. 25 of the OECD Model allows the contracting states to consult together "for the elimination of double taxation in cases not provided for in the Convention". This reference to mutual agreement procedure seems to cover also double taxation caused by such domestic levies that do not qualify as taxes covered by Art. 2. Are there cases in which the mutual agreement procedure would have been referred to concerning such levies?

The existing tax treaties may not function very well in eliminating double taxation or double non-taxation situations; quite to the contrary they could cause either situation. Most treaties, for example, do not include any subject-to-tax clauses in order to avoid double non-taxation situations caused by tax treaties or the subject-to-tax clauses concern only certain limited situations. Based on the subject-to-tax clauses in certain situations a contracting state is required to apply the exemption method only if the other state taxes the income or capital concerned. The question then is, which are the levies of the other country that are sufficient in order for the exemption to be required, that is what is "tax" and "the tax" that the treaty obligation addresses?

Double non-taxation situations are more and more often also dealt with by domestic law subject-to-tax clauses and other types of anti-avoidance provisions, in some cases incorporating by reference the meanings and results of the application of other countries tax or tax-related notions, by description if not by named country. In some cases, this involves characterising, or re-characterizing, the transactions giving rise to the amounts subject to tax, i.e., "hybrid" entity or instrument situations. Certain tax benefits may be available in cross-border situations only if the other state concerned taxes the income concerned. This is a primary question as part of the OECD's BEPS Action Plan. What are the domestic law examples of these situations and what are the foreign taxes that qualify for this purpose? Does the treatment comply with tax treaties? Certain extra taxes may concern situations in which sufficient foreign taxes are not levied (SAARs e.g. CFC regimes). What are the domestic law situations of this type? Is the domestic law treatment in accordance with tax treaties? General domestic law anti-avoidance provisions (GAARs) may apply in cross-border situations, if a transaction is made in order to avoid taxes. What are the taxes that are avoided; only domestic taxes or also foreign taxes? Is it sufficient to pay foreign taxes in order not to come under the scope of the GAAR? Another question is whether it matters why foreign taxes are paid in order to qualify for treaty relief; in some situations, states may deny access to the "mutual agreement

procedure" for assessments that are based on a GAAR. Does that matter, or is the only relevant consideration the objective fact of taxation including what is a "tax"?

In any case, international double taxation may be required to be eliminated, if levying taxes in a certain situation would mean discrimination forbidden either by a tax treaty or by other provisions (e.g. EU law, constitution etc.). The notion of tax, and in relation to the features of that notion the basis on which is applied – affected by factors that reflect the inherent characteristics of the "tax", are relevant in applying the non-discrimination provisions of tax treaties based on Art. 24 of the OECD Model, which applies notwithstanding the provisions of Art. 2 to "taxes of every kind and description". The question is what are the levies that come under the scope of the non-discrimination article? Are there levies that do not come under the scope of the tax treaty non-discrimination articles and may other provisions forbid these levies?

Cross-border administrative assistance is an important prerequisite for the elimination of double non-taxation situations. The notion of tax is relevant also in determining the scope of exchange of information and assistance in the collection of taxes on the basis of tax treaties. The relevant articles of the tax treaties (Art. 26 of the OECD Model and Art. 27 of the OECD Model) may extend their scope to "taxes of every kind and description" and not only the levies covered by Art. 2. What levies other than the levies covered by Art. 2 come under the scope of tax treaty based administrative co-operation? If there are certain levies that do not come under the scope of tax treaties, are there other instruments that cover these levies?

Provisional outline

I The Notion of Tax

1. Domestic Law Meaning of Tax
    - domestic law levies considered to be taxes
    - foreign levies that fall under the country's unilateral provisions for the elimination of international double taxation
    - determination of whether tax is "payable", i.e., is it a charge that in any sense is "voluntary" if it is disputable, and does it need to be disputed as a requirement for it to be a tax

2. Taxes Covered by Tax Treaties' Distributive Articles
    - is the domestic law definition relevant for treaty purposes?
    - is the reference to "taxed" different than "tax" or "taxes covered", and does this put pressure on a primary determination of whether the tax base falls within the contemplation of a treaty?
    - "taxes covered" (e.g. state v. local taxes; surcharges, interest and tax fines?)
    - "taxes on income and on capital" (e.g. real v. fictious income or income which is assimilated to a character that is different from its natural character)

- "taxes imposed on behalf a contracting state, it political subdivision or local authorities"
- "irrespective of the manner in which they are levied"
- "any identical or substantially similar taxes"
- is the tax subject relevant (payer v. recipient of income)?
- relevance of Article 3(2)

II Relevance of the Notion of Tax in the Elimination of International Double Taxation

1. Tax Treaty Resident Concept
   - "liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature"
   - what are the sufficient levies?
   - who determines the sufficient levies in a dual-resident conflict situation?
   - relevance of domestic law anti-avoidance provisions?

2. The Methods for the Elimination of International Double Taxation
   - are there taxes that are not taxes covered by the applicable tax treaty and are thus levied even though the exemption system is applied?
   - does the domestic law exemption apply also to such levies not covered by the treaty?
   - what are the foreign taxes that should be credited under a treaty?
   - against which domestic taxes foreign taxes must be credited in a treaty situation?
   - does unilateral credit system apply also to levies not covered by treaties?
   - are certain foreign taxes taken into account as a cost deduction?
   - when is a foreign tax considered to be paid for credit purposes? May the tax be still disputable?
   - who determines whether a levy qualifies as a tax under a treaty? Is double taxation eliminated if the states do not agree on the definition?
   - Art. 25(3) of the OECD Model: consultation for the elimination of double taxation caused by taxes not covered by the treaties?

3. Non-discrimination
   - tax treaties: "taxes of every kind and description"
   - do other provisions cover levies not covered by tax treaties?

III Relevance of the Notion of Tax in the Elimination of Double Non-Taxation Situations

1. Tax Treaty Subject-to-Tax Clauses

   - subject-to-tax clauses in tax treaties
- what are the levies that are sufficient in order for certain situation to be subject-to-tax?

- must the tax be already and actually paid (timing issues, liable to tax v. subject to tax)?

3. Domestic Law Anti-avoidance Provisions
   - domestic law subject-to-tax clauses: what foreign taxes are sufficient?
   - domestic law SAARs: what foreign taxes are sufficient?
   - domestic law GAARs: are foreign taxes sufficient? which taxes?
   - must the tax be already and actually paid (timing issues, liable to tax v. subject to tax)?

4. Administrative Assistance
   - tax treaties: “taxes of every kind and description”
   - do other provisions cover levies not covered by tax treaties?