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Tax Treaty Interpretation

Some current issues

Mumbai, 5 December 2003

- A. Article 3 (2): „Context“ of DTC
- B. Partnerships and P.E.s
- C. Hiring-Out of Labour
- D. Sportsmen's income from marketing

A. Article 3 (2): „Context“ of DTC

Netherlands

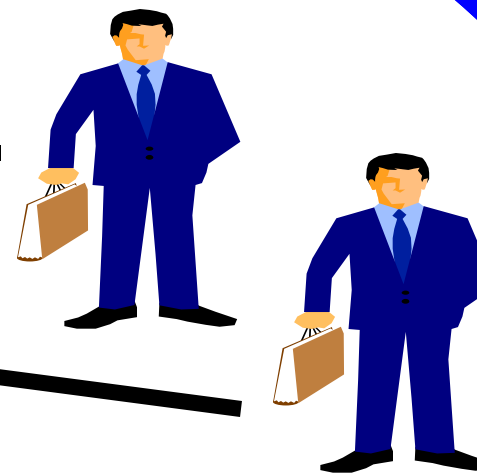
Supreme Court (Hoge Raad), Sept. 5, 2003

- Statute 1997: Manager-shareholders deemed to receive „habitual“ income

Netherlands

Belgium

**Limited Liability
Company**



**Managers
Shareholders**

**Taxable year
1997**

**Tax Inspector:
Deemed Income
150.000 NLG**

Netherlands

Supreme Court (Hoge Raad), Sept. 5, 2003

Statute 1997: Manager-shareholders deemed to receive „habitual“ income

- DTC Belgium-Netherlands of 1970
- Article 15: „wages“ taxable where employment is exercised
- Q.: Does this apply to fictitious wage?

Article 3 (2) OECD and UN-MC:

„As regards the application of the convention [at any time] by a contracting state, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has [at that time] under the law of that State for the purposes of the taxes to which the Convention applies ...“

Hoge Raad reasoned:

- Article 3 (2) refers to domestic law
- Even before amendment to OECD Commentary of 1995: ambulatory
- Under Dutch law in 1997 it was **wage**, though fictitious
 - This would mean: taxation by the Netherlands

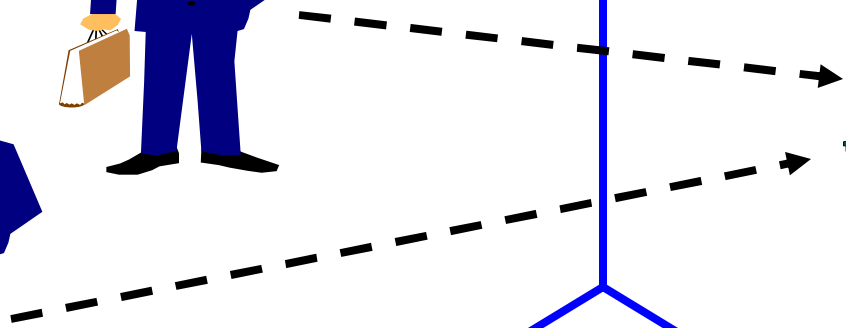
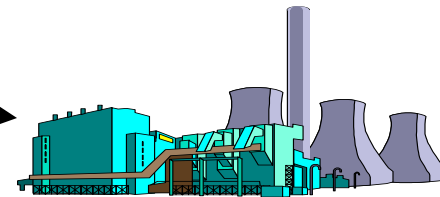
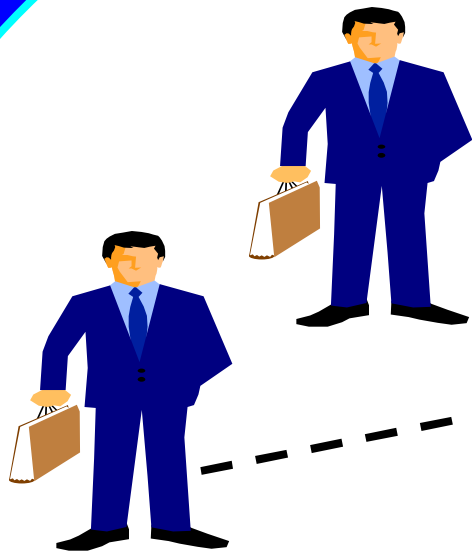
Hoge Raad continued:

- However: „unless the context otherwise requires“
- Before statute of 1997 it would have been **dividends**, taxation by **Belgium**
- When new legislation would change contracting states' right to tax, context requires static interpretation
- Therefore: no taxation by Netherlands

B. Partnerships and P.E.s

State R

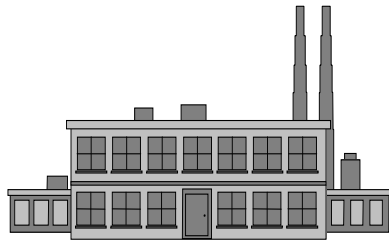
State P



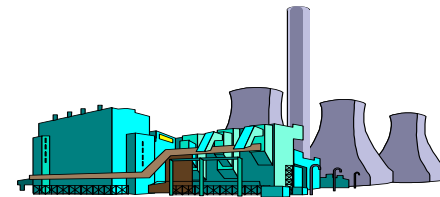
Article 7 (1)?

State R

State P



Corporation



Subsidiary

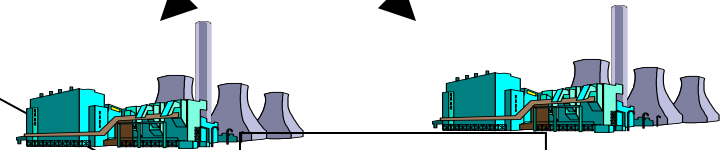
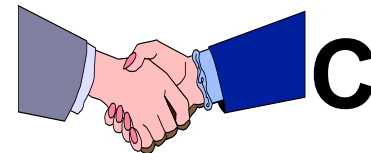
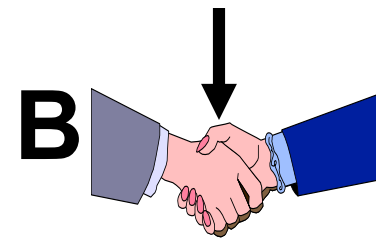
Article 7 (1)?

Subsidiary a P. E.?

- Italy's *Corte Suprema* in *Philip Morris* (March 2002):
 - Subsidiary monitored proper performance of contract between parent and Italian corporation
 - Court: Subsidiary considered to be P. E.
- France's *Conseil d'État* in *Interhome* (June 2003):
 - Only if not independent agent (Art. 5(6))
 - And if it habitually exercises authority to conclude contracts for parent (Art. 5 (5))

Germany

U. S. A.



2 P. E.s

**How will Germany
tax the partners of A?**

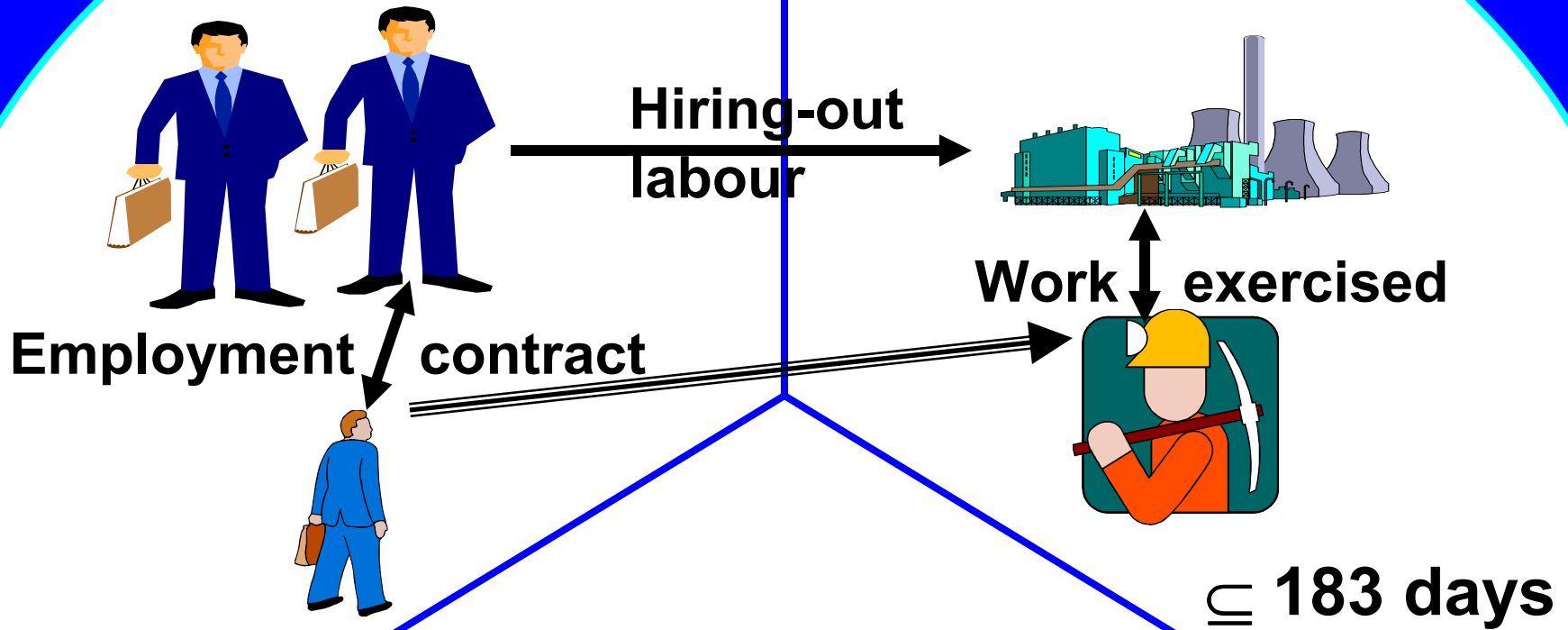
Germany's *Bundesfinanzhof* (Supreme Tax Court)

- P. E.s held by A. are P. E.s of the partners
- P. E.s held by B are P.E.s of A,
– therefore P. E.s of A's partners
- P. E.s held by C are P. E.s of B,
– therefore P. E.s of A's partners, too
- All partnerships being transparent, income of C is income of A's partners, however P.E.-income taxable in U.S.A.

C. Hiring-Out of Labour

U.S.A. +
Canada

Denmark



Article 15 OECD-MC

Article 15 (2) OECD-MC

- Taxable only by state of residence if
 - presence in state of work does not exceed 183 days (a) and
 - remuneration is paid by or on behalf of an **employer** who is not a resident of state of work (b)
 - [„(c)“ is not relevant here]
- **Who is „employer“?**

Who is „employer“?

- Danish „ source tax law“ (*kildeskattelov*) considers recipient of work („user“) to be „employer“
- However DTC's with Canada and U.S.A. were concluded before that law
- *Hoyesterett* (Supreme Court) majority:
 - Article 3 (2) applied ambulatory: recipient is „employer“ under source tax law
 - Two judges dissented, though without reference to „context“

Though both U.S.A. and Denmark are members of OECD, the Court did not read the OECD-Commentary

Commentary to Article 15 Paragraph 8

- Based on a Report submitted by OECD in 1984, paragraph 8 says:
 - *In cases of international hiring-out of labour the functions of employer to a large extent are exercised by user.*
 - *In this context, substance should prevail over form.*
- *The competent authorities should examine each case on its individual merits*
 - *For this purpose six criteria given.*

In contradiction to Commentary German *Bundesfinanzhof* only recently upheld its case law that as a rule lessor is „employer“

Interpretation of treaty prevails over
Commentary

Criteria of para. 8 only „additional“
(„*flankierend*“) to prevent abuse of treaty

Danish Supreme Court did not even discuss
para . 8.

Was it obliged to apply its criteria?

Introduction to OECD Model, para. 29:
Commentaries not legally binding,
nevertheless of assistance in settling disputes

Courts of OECD member states should, in
my view, at least discuss them

What about Courts of non-member states?

In my view they should discuss the Commentaries to the same extent to which they should consider foreign case law and literature

D. Sportsmen's income from marketing

Netherlands

Sweden



Dutch Company



„Holiday on Ice“

- **Sweden's fisc wanted to tax:**
 - **Salaries of artists**
 - **Entrance fees charged by company**

Art. 17 OECD-MA

- Paragraph 1: Artistes may be taxed where activities are exercised
- Paragraph 2: Where income in respect of personal activities of artistes accrues to another person, such income, too, may be taxed where activities are exercised

Sweden's Administrative Supreme Court (Regeringsrätt):

- Artistes taxable under Article 17 (1)
- Article 17 (2) intended to prevent avoidance by way of „artistes' companies“
- Therefore only applies to compensation for artistes' activities, not to additional income for making these activities public

Sweden's Regeringsrätt continued:

- For artistes' activities as such salary paid was deductible, therefore income of company was zero
- To additional income Article 7 applied
- P. e. required, no p. e. in Sweden

Thank you for your attention!