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UNDERSTANDING THE OECD MODEL TAX CONVENTION: THE LESSON OF HISTORY

by

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I. INTRODUCTION

An important recent development in international taxation is the publication of the OEEC (the forerunner of the OECD when it was a purely European organization, although representatives from the United States and Canada were also present at the discussions on tax treaties) archives on the development of tax treaties in a website <http://www.taxtreatieshistory.org/> organized by the Institute for Austrian and International Tax Law, Vienna, IBFD, Università Cattolica del Sacro Cuore, Piacenza, Italy, IFA Canadian Branch and the Canadian Tax Foundation. While this may sound like a rarefied topic, the OEEC period from 1956 to 1961 is the story of the making of the current OECD Model. Previously there was a gap in the published sources after the end of the League of Nations Mexico and London Models of 1943 and 1946,¹ which suffered from the wartime domination by the South Americans of the Mexico Model, and the Europeans doing what they could in the London Model to reverse some of the worst excesses. By the time of the OEEC it was accepted that this was not the way of the future.² After the London Model there was previously a complete gap in the history until the publication of the 1963 OECD Draft, which is essentially the OECD Model as we have it today. True there have been many changes in the meantime, particularly to the Commentary, but when compared to the whole edifice these are merely tinkering. The 1963 OECD Draft seemed to have arrived from nowhere and one wondered how this arose. Now, with the

1. The UN Fiscal Commission was dissolved in 1954 without having published anything further.

2. The Secretary-General's note of Nov. 12, 1954 to the Council of the OEEC said:

The I.C.C. Resolution refers to the model agreement produced by the League of Nations in 1946, which is known as the 'London Draft,' but his particular text has not been accepted by all Member and associated countries, and it seems probable that some at least of them would wish to raise fundamental objection to any attempt to make it a standard form of bilateral double taxation convention. In these circumstances, it is not easy to see how the OEEC could intervene to obtain a more rapid conclusion of bilateral agreements than that which is now taking place, nor, in particular, does it seem likely that agreement could be reached in the Council that the 'London Draft' should be the standard form of bilateral convention between Member and associated countries, since the draft itself is not, as it stands at present, fully acceptable to every Member. If an approach of this kind were to be adopted by the OEEC, therefore, it would be necessary for the Organization to set up an expert body charged with the duty of attempting to produce a more acceptable draft. C(54)294 (Nov. 12, 1954) ¶ 8.

publication of the OEEC archives, we know. It was the work of (ultimately) 15 Working Parties (plus another dealing with estate taxes) of the Fiscal Committee each comprising delegates from two countries³ working on a separate article of the Model and reporting to the other countries at regular meetings of the Fiscal Committee.⁴ The results were most impressive and one can trace how the articles developed. The minutes are available as transcribed versions in English and French together with a pdf file of the original minutes so that, for example, alterations can be seen. A few of the current problems can be traced to the technique of working on each article separately with, for example, the definitions article being started late and not being published in any of the Fiscal Committee's four reports. In that respect the League of Nations method of working was superior.⁵ For example, the other income article, which is effectively the general rule that had come first in the original League of Nations drafts,⁶ appears at the end because Working Party 14 started much later. I believe that we still have a mutual agreement provision in the tie-breaker for individuals because that article was drafted before the mutual agreement article. In addition some of the less obvious overlaps were not considered.⁷

The Fiscal Committee was set up by the Council of the OEEC as a result of urging initially by the International Chamber of Commerce⁸ and then by the Dutch delegation. The terms of reference were worked out by an ad hoc committee of experts on taxation under the chairmanship of van den Temple, the Director General of Fiscal Affairs in the Netherlands.⁹ The

3. Working Party 10 on dependent and independent employment had a single delegate from Sweden, *id.* at 14. Before the publication of the minutes it used to be a game to deduce which countries might have been on a particular working party. My co-authors and I once wrote: "We surmise that this part of the Commentary was originally drafted by a German (or Dutch or Swiss) author and approved by the fiscal committee without realizing that permanent agent was a term of art." ("Agents as Permanent Establishments under the OECD Model Tax Convention" [1993] BTR 341 at fn 226). It transpires that the members of Working Party 1 on permanent establishment were from Germany and the UK, confirming our surmise.

4. This met, for example, in 1957 on Jan. 23-25, Jun. 5-7, Oct. 1-7 and Nov. 25-27.

5. This point is made in *Residence of Companies under Tax Treaties and EC Law*, ed G Maisto, IBFD, 2009 by R Vann in chapter 7 at p. 228 in fn.41.

6. 1927 draft Article 10, the first article relating to personal taxes; 1928 draft 1(a) Article 10, (the same as for the 1927 draft), draft 1(b) Article 1.

7. There was joint meeting of Working Parties 8 (royalties), 11 (interest), 12 (dividends) and 15 (avoidance of double taxation), for which there is a document prepared for the meeting, but unfortunately no minutes seem to be available.

8. See *supra* note 2.

9. C(56)1 (Jan. 13, 1956). The Dutch, Swiss and German delegations submitted memoranda, see Report C(56)49.

Fiscal Committee was given the ambitious project of dealing with all the following¹⁰ in the period from March 1956 to July 1958 when it would be determined whether the Fiscal Committee should be continued.¹¹

A. Direct Taxation

The committee should submit concrete proposals as to which taxes on income, capital, estates and inheritances should be included in double taxation agreements, and which methods should apply in such agreement especially as regards apportionment between commercial profits, taxation or investment income, royalties and similar payments.

B. Indirect Taxation

The Committee should make concrete proposals concerning the means of avoiding double taxation on transactions subject to turnover taxes in several member countries and of avoiding double taxation on turnover tax on services.¹²

C. Standardization of Concepts

The Committee should submit concrete proposals as regards the means or standardization of the most important concepts to be found in double taxation agreements.

D. Inequalities in Taxation on Grounds of Nationality

The Committee should make concrete proposals concerning the means of removal of such inequalities.¹³

The Fiscal Committee made an interim report in 1957¹⁴ and a further report in 1958¹⁵ by which time it had prepared draft articles and commentary

10. Note by the Secretary-General, FC(56) 1 (May 16, 1956).

11. C(56)49 (Final) (Mar. 19, 1956).

12. The Swiss delegation were pressing for a multilateral convention on indirect tax, see their notes C(54)331 (Dec. 16, 1954) (in French only); and C(55)88 (Apr. 19, 1955). This was supported by the Netherlands and Germany as well, see C(55)307 (Dec. 9, 1955).

13. This had been identified as a topic by the ad-hoc group of experts, see C(56)49 (Feb. 24, 1956).

14. C(57)145 (Jul. 3, 1957). By that time the following Working Parties were in operation: (1) permanent establishment (Germany, the UK); (2) fiscal domicile (Denmark, Luxembourg); (3) listing of taxes (Italy, Switzerland); (4) discrimination (Netherlands, France); (5) shipping and air transport (Sweden, Belgium). More were then created: (6) inland waterways (France, Germany); (7)

on the definition of taxes, permanent establishment, fiscal domicile, and non-discrimination, which became a recommendation of the Council to be adopted in treaties, which was published.¹⁶ This was a very considerable achievement in such a short period. Further Reports followed in July 1959,¹⁷ August 1960¹⁸ and August 1961.¹⁹ With minor changes the articles included in these reports plus six further articles²⁰ were joined together to become the OECD Draft of 1963.

I shall in the paper explore the origins of some of the more obscure (at least in English) terms used in the definitions in the Model to see whether the history now available sheds any light on their intended meaning. In addition I shall look more generally at the development of one article, the non-discrimination article, in the light of item D of the terms of reference of the Fiscal Committee as it seems surprising today that nationality discrimination should feature so prominently as one of the topics.

II. THE LESSONS OF HISTORY IN RELATION TO SOME DEFINITIONS IN THE MODEL

A. The Definitions of "Person" and "Company"

The definitions of "person" and "company" are crucial to the application of a treaty based on the Model. They originated from OEEC Working Party 14 on definitions (the members of which were from Austria and Sweden) which started late in the development of the articles, being formed in September 1958 and first reporting on March 3, 1959 by which time the OEEC had already published its first report, and work on the

apportionment of profit (UK, Netherlands); (8) royalties (Germany, Luxembourg); (9) immovable property (Italy, Austria); and (10) dependent and independent services (Sweden). By the end, there were also Working Parties (11) interest (France, Belgium); (12) dividends (Germany, Italy, Switzerland); (13) capital (Switzerland); (14) territorial scope, definitions, mutual agreement, exchange of information, diplomatic privileges, entry into force (Austria, Sweden); and (15) avoidance of double taxation (Denmark, Ireland). No.17 dealt with inheritance taxes.

15. C(58)118 (May 28, 1958).

16. C(58)118(Final) (Jul. 15, 1958), published as the Fiscal Committee's First Report in September 1958.

17. Covering shipping and air transport, dependent and independent personal services, immovable property, and capital.

18. Covering allocation of profits to a permanent establishment, other income, personal scope, and territorial extension.

19. Covering dividends, interest, royalties, avoidance of double taxation and mutual agreement procedure.

20. The articles on general definitions, capital gains, exchange of information, diplomatic and consular officials, entry into force, and termination.

dividends article, for which the definition of company was critical, had been going on since March 1958. Indeed all four OEEC Reports were published without the definitions article. The Working Party identified the following three borderline cases of non-corporate bodies of persons:

- a) bodies of persons, which are not treated as taxable units under the taxation laws of any of the Contracting States concerned;
- b) bodies of persons, which are treated as taxable units under the taxation laws of any of the Contracting States and which further are treated by such laws in the same way as legal persons;
- c) bodies of persons which are treated as taxable units under the taxation laws of any of the Contracting States, but are not treated in the same way as legal persons (the taxable treatment of which resembles that of an individual, as for instance happens to be the case with certain partnerships where the Austrian and the German *Gewerbesteuer* is concerned).²¹

The conclusion they drew was that the definition of “person” should be as broad as possible, particularly in view of the agency permanent establishment provision: “where a person...is acting on behalf of an enterprise,” otherwise a transparent partnership acting as an agent would not be included as a permanent establishment if it were not a person.²² In relation to other references to person in the Model they said:

The term “person” is however mainly used within the rules for the allocation of taxation rights and also in the rules for fiscal domicile. Used in this way, the term necessarily has to include all bodies of persons, which might under the taxation laws of any of the Contracting States be treated as a taxable unit.²³

Since a “person” must also be a “resident” for the allocation of taxing rights to be relevant, it was unnecessary to have a wide definition of person for this purpose, but a wide definition did no harm either and was necessary for the agency permanent establishment provision. Their original

21. FC/WP14(61) 2 (Sept. 18, 1961), ¶ 5.

22. Id. at ¶ 7. They considered an alternative of excluding partnerships and replacing the word “person” by “agent” in the agency permanent establishment provision. In fact, this reference started life as agent and employee, after which it was changed to person to make clear that it was the type of authority that mattered, not the nature of the function, see FC/M(57) 3 (Nov. 5, 1957).

23. Ibid. ¶ 8.

definition was: “The term ‘person’ comprises an individual and anybody of persons, corporate or not corporate.”²⁴

This is very similar to the final one adopted by the Fiscal Committee²⁵ that was in the OECD 1963 Draft: “The term ‘person’ comprises²⁶ an individual, a company and any other body of persons.”

The difference is essentially only a drafting change since “company” deals with corporate bodies of persons, leaving non-corporate ones to be covered by “any other body of person.”

The definition of “company” was required mainly for the dividend article for which there was no need to include categories (a) and (c) above although the Working Party recognized that problems could arise if a body was treated as a body corporate in only one of the states, the now-familiar problem of partnerships. The definition therefore had to catch real bodies, corporate and non-corporate bodies, in category (b) above. Their definition was: The term ‘company’ includes anybody corporate and any entity which is treated as a body corporate for tax purposes.²⁷

There was no suggestion that a real body corporate would be anything other than taxable,²⁸ which has since led to difficulties now that this is no longer the case, even apart from the check-the-box Regulations. For example, a recent case in the UK concerned a UK unlimited company with a single shareholder which to the US was a disregarded entity and to the UK was a company taxed as such. From the point of view of each country the treaty entitled the other to tax, giving a source in the other country, and so apparently both had to give relief.²⁹ A better definition today would delete the reference to body corporate and be restricted to entities taxed in the same way as the generality of bodies corporate.

On the problem of different categorization of an entity treated as a body corporate in each country, the Working Party concluded that no provision was required:

An individual [who] decides to participate in a partnership, which is treated as a body corporate in a certain state, did

24. This was first included in FC/WP14(59) 1 (Mar. 3, 1959) and was repeated in subsequent reports. The customary definition in early UK treaties was almost identical: The term ‘person’ includes anybody of persons, corporate or not corporate.

25. FC/M(62) 1 (Feb. 19, 1962).

26. “Comprises” became “includes” in the 1977 Model. The French remained *comprend* in both.

27. As in the previous footnote, the definition is the same as UK-Germany (1955) except that this said *means* rather than *includes*.

28. “In all the States, companies are taxed on their profits.” FC/WP12(60) 1 (Jan. 8, 1960).

29. Bayfine UK Products v. HMRC [2009] STC (SCD) 43.

initially not mind the fact that the so received corporate income will be liable to tax twice, on the one hand as income of the body corporate and, when distributed, as income of the shareholder. It does not seem necessary to avoid such double taxing which is purposely levied by one of the Contracting States by international agreements for the sole reason that other Contracting States do not take the same view in the treatment of like income.”³⁰

In saying this, either they assumed that the residence state, which treated the entity as transparent, would follow the source state’s categorization of the income as a dividend, in which case they were way ahead of their time,³¹ or they did not consider that the residence state might also tax the partner’s share of the undistributed income of the partnership, perhaps because they were thinking in terms of an exemption system.³² Unsurprisingly, they did not get to the bottom of the problems of partnerships and tax treaties. They did, however, make some progress, as can be seen in an explanation given to the Fiscal Committee when discussing the definition of “person” and “company:”

This might be an incentive for a resident of a third State to establish a partnership in one of the Contracting States with a permanent establishment in the other State, in order to enjoy the advantages of the Convention. Furthermore, a resident of a third State might evade taxation in a Contracting State if the activity in which he engaged through a partnership set up in the other Contracting State was not considered to be an activity of a permanent establishment within the meaning of the Convention, but was considered as such under the law of the former Contracting State. The Working party considered that there would be fewer disadvantages in including partnerships in the definition of ‘persons’ than in including them in the definition of ‘companies.’

30. FC/WP14(61) 2 (Sept. 18, 1961), at ¶ 11; and FC/WP14(62) 1 (Jan. 8, 1962).

31. The Commentary first included a provision to this effect (Article 23 Comm ¶ 32. 1) in the 2000 Update.

32. In a tax credit system the right answer would seem to be for the residence state to give credit for both the withholding tax on the dividend and the share of the underlying tax paid by the entity as a corporation, which I believe is the position in Canada where a US partnership is taxed in the US as a corporation.

Another example of serious thinking about partnerships is that in the Fiscal Committee the Austrian delegate suggested that a transparent partnership with two partners resident in different states should be treated as two separate enterprises for the definition of Enterprise of a Contracting State.³³ This was included by the Working Party in their Commentary:

6. The laws of some Member States do not treat a partnership as a taxable unit and, consequently, a partnership as such cannot be regarded as "a resident of a Contracting State" under Article III on fiscal domicile; where such a Member State is concerned, it could be maintained that an enterprise carried on by a partnership is not strictly "an enterprise carried on by a resident of a Contracting State." In such a case, it may assist towards a clarification of the meaning of the term "an enterprise of a Contracting State" if each participation in a partnership is looked upon as a separate enterprise, the test being whether the partner holding the participation is a resident of the one or the other Contracting State or of a third State. The Member States concerned may consider adopting this line of interpretation in bilateral relations.³⁴

A final example is the following:

[The UK delegate] felt that a State should be able to tax royalties arising in that State and paid to a resident of that State even if he was a member of a partnership which had its effective management in the other State and was taxable in that other State in accordance with the laws currently in force.

33. FC/M(62) 1 (Feb.16, 1962).

34. FC/WP14(62) 2 (Feb. 28, 1962). This became the Commentary to the term Enterprise in Article 3 of the OECD 1963 Draft. The definitions article was not included in the four OEEC Reports. A similar point is now made in more detail in Article 3 Comm ¶ 5 and Article 4 Comm ¶ 8.2. The UK Court of Appeal in *Padmore v. IRC* [1989] STC 493 (discussed in fn. 36) decided that the partnership, not the partner, was the enterprise in circumstances in which the partnership was taxable in Jersey although the total tax was the same as if it had been transparent. The partnership also had a residence. There is evidence in relation to a Guernsey partnership that the UK Revenue thought that there was no enterprise of a Contracting State where not all the partners were resident in that state, Public Record Office document IR40/11917 (although the document relates to Switzerland there are some papers relating to Guernsey).

This situation is found as example 16 in the OECD Partnerships Report³⁵ and now in paragraph 6.1 of the Commentary to Article 1. Later in the same minutes it was reported that:

The Delegate for the United Kingdom thought it necessary to include some overriding provision indicating that nothing in the Convention prevented a State from taxing dividends, interest and royalties arising in that State and paid to one of its residents, or compelled it to give credit for taxes on such income which had been paid in another State.

Unfortunately his good advice was never taken (which shows the wisdom of the US in including the saving clause in treaties), which eventually led to the *Padmore* case³⁶ in the UK in which a UK resident partner in a Jersey partnership successfully claimed exemption for his share of the partnership profits on the ground that the partnership, as a treaty person taxable in Jersey, did not have a permanent establishment in the UK and its profits (and therefore the partner's share of them) were accordingly exempt from UK tax. The law was changed to prevent this. Again this is now considered in examples 16 and 17 of the OECD Partnerships Report, in the latter of which only a minority of states agreed with the UK delegate's point about not giving credit.

B. The Definition of Dividend³⁷

This definition, which depends on the definition of "company," was developed by Working Party 12 (comprising members from Germany, Italy and Switzerland) and went through some interesting changes. It started as:

The term 'dividends' means income from shares in companies limited by shares and limited partnerships with share capital, 'jouissance' shares, mining shares, 'jouissance' bonds, 'founders' shares, debentures participating in profits, and other corporate profit sharing rights represented by paper securities, as well as income

35. The Application of the OECD Model Tax Convention to Partnerships, OECD, 1999.

36. See *supra* note 34.

37. My co-authors and I have discussed this in more detail in "The Definitions of Dividends and Interest in the OECD Model: Something Lost in Translation?" in course of press in the *World Tax Journal* and the *British Tax Review*.

from shares in co-operative societies and limited liability partnerships [*sociétés à responsabilité limitée*].³⁸

The Working Party stated that their definition corresponded to the definition found in a number of treaties. They set out the definitions (of income from movable capital, as they then were; separate dividend and interest articles were only just beginning to be used) contained in four Swiss treaties that in French³⁹ used the same expression adopted by the Working Party (*et autres parts sociales sous forme de papiers-valeurs*) and two Italian treaties⁴⁰ that used a closely-related expression not referring to paper securities: *et d'autres parts sociales analogues*, meaning analogous participations in a company. It is relevant that none of the treaties referred to by the Working Party was in English. This is what my co-authors and I wrote about the origin of the English "other corporate rights," which fully justifies the "Something Lost in Translation?" in the title of the article:⁴¹

The English version of the Working Party's minutes is therefore probably the work of the OEEC translator of the Minutes (or possibly was taken from a collection of treaties translated by the OEEC) who translated the same French expression (*et autres parts sociales sous forme de papiers-valeurs*) in each of the Swiss treaties into English in the following different ways: "or other membership shares in the form of securities;" "or other company shares in the form of securities;" "or other interests in the form of securities issued by bodies corporate;" "or other interests in the form of securities;" and translated the slightly different, but common, French wording in the two Italian treaties (*et d'autres parts sociales analogues*) as "and like participations in companies" and (importantly to the later history) "and all other similar corporate profit sharing rights" respectively.⁴² Therefore the wording "other corporate profit sharing rights represented by paper securities" in the Working Party's

38. FC/WP12(58) 1 (Nov. 28, 1958). This was before Working Party 14 developed the definition of company, the first draft of which is FC/WP14(59) 1 (Mar. 3, 1959).

39. Switzerland-Sweden (1948), Switzerland-Netherlands (1951), Switzerland-Austria (1953), Switzerland-France (1953) (all being in the definition of income from moveable capital).

40. Italy-Sweden (1956), and Italy-France (1958) *et de toutes autres parts sociales analogues* of which the Italian was *ogni altra quota sociale analoga*.

41. See *supra* note 37.

42. The order of these English translations corresponds to the order of the treaties in fn. 39 and 40.

English version of their definition of dividends was not only a translation of the different French wording of the two Italian treaties rather than the French contained in the Swiss treaties that was adopted by the Working Party, but was also possibly the English that was farthest away from the French of all the translator's versions. If this is a translation of the minutes by the OEEC translator rather than a collection of treaties translated at different times by different people, it is remarkable that he or she managed to create so many English variations from essentially the same French in the same document, although it may be said that there is no possible exact English translation.

The Fiscal Committee moved income from debentures participating in profits to the definition of interest.⁴³ The reference only in English to limited partnerships with share capital was also deleted. At the same time "shares participating in profits" was added, and later changed to *rights* participating in profits.⁴⁴ The definition originally specifically included the French Sarl (oddly translated as limited liability partnership) which does not have shares (*actions*) but *parts*, meaning something more like a partnership interest which are not necessarily "paper securities." I believe the US LLC is similar in this respect, although I understand it is allowed to have shares if the other country requires this. Next "income from *parts de sociétés* as the national laws treated as dividends or was taxed as such" (*revenus de parts de sociétés que les législations nationales considèrent comme des dividendes ou qui sont taxés comme tels*) was added,⁴⁵ and in consequence the specific reference to the Sarl was dropped.⁴⁶ The existing "other corporate profit sharing rights represented by paper securities" and the new addition were combined into "income from other corporate profit-sharing rights which are subject to tax on income from shares according to the fiscal laws of the State of which the company paying the dividends is a resident" (*les revenus d'autres parts sociales qui sont imposés comme les revenus d'actions, d'après la législation fiscale de l'Etat dont la société distributrice est un résident*).⁴⁷

43. FC/M(60) 3 (May 28, 1960).

44. FC/M(61) 2 (meeting of Mar. 5-10, 1962) presumably because "shares" was not a correct translation of *parts beneficiaries*.

45. The last words also mirror the second part of the definition of *company* "any entity that is treated as a body corporate for tax purposes" that WP 14 had by then developed since the treatment of the company and its distributions are likely to correspond.

46. The current Commentary (Article 10 Comm ¶ 26) still explains: "The laws of many of the States put participations in a *société à responsabilité limitée* (limited liability company) on the same footing as shares."

47. FC/WP12(60) 3 (Aug. 1960).

Finally, “profit-sharing” was dropped in English, having no equivalent in French.

Thus we ended up with a definition in English that has caused problems ever since.⁴⁸ Fortunately in common law countries most companies have shares and the income from them is covered by the opening phrase, but the rest of the definition has to cater for the US LLC (or limited or general partnership or trust) electing to be treated as a corporation for US tax purposes.⁴⁹ Most of the definitional problems, such as the width of “other corporate rights” are problems of civil law countries, although it is noticeable that the US sensibly avoids using the expression in the US Model and its treaties, and the UK has started to do the same.⁵⁰ An interesting feature is that moving income from debentures participating profits to the definition of interest occurred at the same meeting as the addition of income from corporate rights taxed as income from shares. It seems difficult to argue, as the OECD has since done,⁵¹ that the latter covers income from excessive debt in thin capitalization cases. This is an example where the history is useful to understand the present.

C. The Definition of Interest

A different Working Party, 11, developed the definition of interest. Their first version was:

For the purpose of this Article, the term ‘interest’ means interest on and all other income (including prizes and redemption premiums) from government securities, bonds or debentures, whether or not secured by mortgage and whether or not carrying a right to participate in profits, debt-claims of every kind, notes of indebtedness, deposits, cash guarantees and other capital assets which can be assimilated to debt-claims or to loans.⁵²

48. See, for example, the OECD Report on Thin Capitalization (Nov. 26, 1986).

49. The only item in the UK is the company limited by guarantee but it is very unusual for this to make distributions.

50. The UK normally leaves it in but adds a reference to anything treated as a distribution in domestic law, thus also effectively avoiding the problem. In three recent treaties, UK-Japan (2006), UK-Libya (2008), UK-Moldova (2007), the UK has followed the US practice of using the OECD definition but without the reference to corporate rights instead of adding a reference to distributions. This seems to be a change of policy.

51. Article 10 Comm ¶ 25.

52. FC/WP11(59) 1 (Jan. 15, 1959).

Interestingly this was before debentures participating in profits were taken out of the definition of dividend so for a time they were in both definitions, an example of the consequences of different working parties working simultaneously. The Fiscal Committee asked the Working Party to try to simplify the definition.⁵³ This, Working Party 11 were reluctant to do, saying that the definition corresponded to domestic law in many countries and was found in treaties, citing France-Switzerland (1953), but they suggested the following:

The term 'interest' employed in this Article means income from government securities, bonds or debentures, whether or not secured by mortgage and whether of not carrying a right to participate in profits, and debt-claims of every kind, as well as all other income assimilated by the taxation law to income from money lent.⁵⁴

The inclusion of a reference to domestic law corresponded in that respect with the definition of dividend. This version found favour with the Fiscal Committee.⁵⁵ The Working Party's Commentary explained:

In any case, the Article does not give a complete and exhaustive list of the various kinds of interest. Such a list might not be fully in harmony with the various States' laws, which may differ among themselves in their interpretation of the concept of interest. It therefore seems preferable to include in a general formula all income which is assimilated by those laws to remuneration on money lent. This applies in particular to interest derived from cash deposits and security lodged in money.⁵⁶

Much later, the OECD 1977 Model deleted the reference to domestic law, thus returning to the OEEC's original concept, saying in the Commentary to Article 11:

19. Moreover, the definition of interest in the first sentence of paragraph 3 is, in principle, exhaustive. It has seemed preferable not to include a subsidiary reference to domestic laws in the text; this is justified by the following considerations:

53. FC/M(60) 3 (May 28, 1960).

54. FC/WP11(60) 2 (Oct. 20, 1960).

55. FC/M(61) 1 (Feb. 17, 1961).

56. FC/WP11(62) 1 (Apr. 10, 1961).

a) the definition covers practically all the kinds of income which are regarded as interest in the various domestic laws;

b) the formula employed offers greater security from the legal point of view and ensures that conventions would be unaffected by future changes in any country's domestic laws;

c) in the Model Convention references to domestic laws should as far as possible be avoided.

It nevertheless remains understood that in a bilateral convention two Contracting States may widen the formula employed so as to include in it any income which is taxed as interest under either of their domestic laws but which is not covered by the definition and in these circumstances may find it preferable to make reference to their domestic laws.

Thus we came to have the odd present position that the definition of dividend contains a reference to domestic law while the definition of interest does not, which makes it virtually impossible to avoid any overlap. Even where both definitions refer to domestic law, which several countries still do in the definition of interest, overlaps are still possible, where, for example, something that is interest within the general wording of the definition of interest is taxed as a dividend, or something that is a dividend within the general wording of the definition of dividend is taxed as interest.

D. Residence

Richard Vann has explained in detail the origin of Article 4(1) and in particular the expression "liable to tax."⁵⁷ In summary, Working Party 2⁵⁸ started from the basis that the treaty applied to persons who were fully liable to tax in one of the states, necessarily under domestic law (i.e. the forerunner of Article 1⁵⁹), to which they added some tie-breaker provisions.⁶⁰ Switzerland, although not on the working party, but who were, as always extremely active,⁶¹ submitted a draft that has considerable similarities to the form of the present article, including "...fully liable to taxation under the internal law, by reason of his or its domicile, head office of residence or by

57. See *supra* note 5, at 224 onwards.

58. Comprising delegates from Denmark and Luxembourg.

59. See the heading Article 1 below.

60. FC/WP2(57) 1 (May, 27 1957).

61. See below on their involvement with the tie-breaker for individuals, and the non-discrimination article.

reason of any other similar criterion.” The Fiscal Committee did not like the concept of “full liability,” and Working Party 2 came back with this proposal:

At any rate the word “full” would presumably have to be dropped. This would mean that in the subsequent articles of the Convention the brief expression: “the State in which he is fully liable to taxation” could not be used, but it would be necessary to say: “the State in which he is liable to taxation by reason of domicile, residence, etc....” For terminological reasons it would be desirable if “a shorthand expression” could be used in all cases where the State of “domicile” is mentioned.... Consequently the Working Party has fixed upon the term “resident,” which is used in Conventions concluded by the United Kingdom and by the United States of America.⁶²

That was the origin of the term “resident” in the Model. The Fiscal Committee completed the drafting:

For the purposes of this convention, the expression “resident” of a State means any person who, under the national law of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other similar criterion.⁶³

Working Party 2 did not view the significance of dual residence in the same way as we do today. Their minutes include the following: The typical cases of conflict are these: (a) between two (or more) domiciles; (b) between domicile and source.

In both cases the conflict arises because, under their internal legislation, one or more States claim that the person concerned has his domicile in their territories. Primarily, the States always apply their own law in so far as it does not conflict with the provisions of a Convention. If it does, the provisions of the Convention must be applied.

The Working Party has pointed out that in the case of a conflict between two domiciles it is not sufficient to refer to the concept of domicile adopted in the internal laws of the State concerned. It is precisely because both States apply their internal laws to the person concerned that the double taxation arises. In these cases special provisions must be established in the

62. FC/WP2(57) 3 (Nov. 5, 1957).

63. FC/M(58) 1 (Jan. 6, 1958).

Convention to determine which of the two concepts of domicile is to be given preference....

In other cases the Working Party's view was that it seemed sufficient to refer to the concept of domicile adopted in the internal laws. The Working Party will revert to this question in paragraph 9 in connection with the discussion of the question of giving a definition of 'domicile.' [The definition was: The term 'resident' of a state means any person who, under the national laws of that State, is subject to tax in that State as a resident.]⁶⁴

The Working Party was intending to give a single meaning of the term "resident" where the taxing right depends on residence only. They did not regard the tie-breaker as having any relevance to source-residence issues as we do now. As the residence article was one of the first set of articles to be completed, along with permanent establishment, taxes covered and non-discrimination, the relationship with other articles was never explored. This is an example where the method of having separate working parties dealing with different articles at different times was unsatisfactory.

E. The Expressions Used in the Residence Tie-breaker for Individuals

Dual residence for individuals goes through a series of tie-breakers: permanent home available to him, centre of vital interests, habitual abode, nationality and finally settling it by mutual agreement. Only the first of these is clear.

The second tie-breaker is interesting because of its development. OEEC Working Party 2 originally proposed "the State with which his *personal* relations are closest (centre of vital interests)."⁶⁵ They had considered whether it should be (1) the stronger economic relations, or (2) the stronger economic and personal relations, or (3) the stronger personal

64. FC/WP2(57) 3 (Nov. 5, 1957). The Fiscal Committee seems to have been content with this: FC/M(57) 2 (Jul. 3, 1957).

65. See John F. Avery Jones et al "The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States" [2006] BTR 695, 718 (for the following earlier use in domestic law). Centre of economic (but not personal) interests is one of the tests for residence in France (Law of Dec. 29, 1976 (Law No.76-1234)), and centre of personal interests is used in case law in Belgium (Mitchell B Carroll, *Taxation of Foreign and National Enterprises* (League of Nations, Geneva, vol. 2 (1933) at 49. R. Zondervan, *Les impôts sur les revenus et l'extranéité*, (Ets. Pauwels, Brussels, 1967), at 92); Netherlands practice used to take into account both factors as one of its tests for residence: "the place where his activities (profit-seeking and other) and recreation are centered" Mitchell B Carroll, *supra*, vol. 2 at 340. An early treaty use is Germany-Sweden (1928) referring to the taxpayer's interests being centered in one place, and also Germany-Sweden (1928), France-Sweden (1936) where the state in which the taxpayer's interests are centered is the first test for resolving dual residence, followed by nationality.

relations.⁶⁶ They decided against (1) and it looked as if they had chosen (3) by adopting this reference to personal relations only. The Fiscal Committee, which seems to have adopted its now familiar preference for changing the Commentary rather than the article even while the article was being drafted, said that the Commentary should state that personal relations covered both family and economic connections.⁶⁷ The Working Party did this and its Commentary was: “this term [personal relations] being understood as the centre of vital interests and covering both family and economic relations.”⁶⁸ The Fiscal Committee then rightly changed the wording of the article to “personal and economic relations,”⁶⁹ and the Commentary became: “the State with which his personal and economic relations are closest, this being understood as the centre of vital interests.”⁷⁰

The third tie-breaker (habitual abode) is the most puzzling in English. The Working Party started by quoting the Netherlands-Switzerland treaty (1951), the original languages of which are Dutch and French, and so the English is a translation:

...in the place where he regularly resides (*où elle séjourne de façon durable*).⁷¹ For the purposes of this provision a person shall be deemed to be regularly resident in the place in which he resides in such manner as to indicate that he does not intend to remain in the place only temporarily. (*Une personne séjourne de façon durable, au sens de cette disposition, là où elle réside d'une manière qui permet de conclure qu'elle a l'intention de ne pas demeurer en cet endroit de façon passagère seulement.*)⁷²

66. FC/WP2(56) 1 (Oct. 2, 1956), at 4.

67. FC/M (58) 1 (Jan. 6, 1958), at 3.

68. FC/WP2(58) 1 (Jan. 10, 1958), at 5.

69. FC/M (58) 2 (Mar. 29, 1958), at 5.

70. FC (58) 2 (1st Revision) Part II Annex C (Feb. 13, 1958), at 18.

71. The IBFD unofficial English translation says “permanently resides.”

72. FC/WP2(56) 1 annex A (Oct. 2, 1956), at 9. An early similar use is Hungary-Sweden (1936) in which treaty residence is defined as the place where the taxpayer has his permanent home, or if there is no permanent home in either state the place where they permanently reside, defined as “residence in any given place in the said State in circumstances which warrant the presumption that such residence is not intended to be temporary only.” Some Italian treaties from the 1920s use similar expressions, including the treaties with Austria (1922), Hungary (1925) (which includes the explanatory sentence), Germany (1925), Croatia (1941): see Avery Jones et al “The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States” [2006] BTR 695 718-19.

At the next meeting the Working Party considered a written observation by the Swiss delegation which put forward the same wording in French as this treaty. This time it came out quite differently in English in the minutes; which must be a translation by the Working Party, or an OECD translator: “the place in which he has his continuing abode.”⁷³ That is not an expression one would ever use in English and it is much less clear than the previous English version “regularly resides,” although this did not matter in view of the explanatory sentence that followed: “a person has his continuing abode in the State in which he resides in such a manner as to warrant the conclusion that he does not intend to live in that State merely temporarily” (*Une personne séjourne de façon durable, au sens de cette disposition, dans l'Etat où elle réside d'une manière qui permet de conclure qu'elle a l'intention de ne pas y demeurer de façon passagère seulement*).

The Working Party, however, adopted a different wording: “the country in which he principally resides (*où il a sa résidence principale*)”⁷⁴ and at the same time they dropped the explanatory sentence, no doubt because they thought it unnecessary to such a concept. Their next version returned more closely to the Swiss proposal, with the same English translation of a slightly different French expression: “the State in which he has his continuing abode (*l'Etat sur le territoire duquel elle séjourne d'une façon continue*).”⁷⁵ Unfortunately the explanatory sentence, which would have been useful assuming that the new French expression had a similar meaning to the previous one, was not reintroduced. The Working Party's final thought was a variation on this: “the State in which he has a habitual abode” (*elle séjourne d'une façon habituelle*).⁷⁶

One can see that unfortunately the same unclear English version (continuing abode) of the Swiss proposal, compared to the better English translation of the Netherlands-Swiss treaty (regularly resides) was carried over as a translation of a different French wording *elle séjourne d'une façon continue* (instead of *elle séjourne de façon durable*) and then changed slightly to habitual abode with a corresponding change in the French (*elle séjourne d'une façon habituelle*). The reason why we still have the incomprehensible “a habitual abode” today is therefore the combination of a bad translation of a completely different French expression, probably made by the Working Party whose first language was not English, and the decision

73. FC/WP2(57) 2 Annex 1 (Sep. 19, 1957), at 4; Annex 2 at 9. The original language of these minutes is English and French which suggests that the translation is by the Working Party.

74. FC/WP2(57) 2 Annex 3 (Sep. 19, 1957) at 11.

75. FC/WP2(57) 3 (Nov. 5, 1957), at 2; and TDF/FC/27 (Nov. 26, 1957). The original language of the minutes is English.

76. FC/WP2(58) 1 (Jan. 10, 1958), at 2. The original language of the minutes is English.

to drop the sentence which would have explained its meaning. Incidentally *séjourne* is also currently used in the Model in the 183 day test in Article 15(2)(c): *le bénéficiaire séjourne dans l'autre État pendant une période ou des périodes n'excédant pas au total 183 jours durant toute période de douze mois...* (“the recipient is present in the other state for a period or periods not exceeding in aggregate 183 days in any twelve month period...”). Perhaps an habitual abode really means “is habitually present,” which would be much clearer.

A further, and unconnected, language problem is that in the German version of treaties the expression *gewöhnlicher Aufenthalt* is used as the equivalent to habitual abode, which has been in domestic law since 1934⁷⁷ indicating six months' presence. In German this tends to be interpreted in the same way as domestic law⁷⁸ even though there is no support in the Commentary for the use of any fixed period.

F. Place of Effective Management in the Residence Tie-breaker for Companies

In early OEEC drafts the tie-breaker was not the current “place of effective management” but the UK (and common law) domestic law residence test of “place of management and control” that had consistently been used in early UK treaties.⁷⁹ The reason for the inclusion of this definition in these treaties was not that it was considered to be a good tie-breaker but to prevent the possibility of an alternative domestic law from applying based on the then wrong understanding of the decision in *Swedish*

77. A similar term “habitual and permanent abode” was in use from 1919.

78. Prof Klaus Vogel said: “I have not yet met a German judge who, in this situation, would be prepared to accept an interpretation which differs from German domestic law.” *Bulletin for International Taxation* vol.57, No.5, p. 186. (2003).

79. UK treaties with: US (1945) (as to UK companies only), Canada (1946), Southern Rhodesia (1946), South Africa (1946), New Zealand (1947) with a variation, Palestine (1947), Netherlands (1948, extended to Netherlands Antilles 1957), Sweden (1949) with a variation, Denmark (1950) (this was varied in 1969 to add after stating that a company was resident in Denmark if it was managed and controlled in Denmark “and it is resident in Denmark for the purposes of Danish Tax”), Ceylon (1950), France (1950), Norway (1951), Greece (1953) referring to domiciled or resident in Greece, Germany (1954), and in about 44 arrangements with colonial territories. In UK treaties with France (1945 and 1950) and Belgium (1953) this is used as the definition of fiscal domicile in those countries (which is equated to residence). Uniquely, it was not included in UK-Australia (1946) which had a different statutory definition of residence. The dates in brackets refer to the date of signature which may differ from the date of the statutory instrument giving effect to the treaty.

*Central Railways v. Thompson*⁸⁰ that a company could be UK resident also because it was incorporated in the UK and did some business there. Because of the uncertainties in the meaning of the expression management and control, this was coupled with a mutual agreement provision similar to that still applying to the tie-breaker for individuals (the mutual agreement article had not then been drafted⁸¹).⁸² The Commentary explained: “As the question will hardly be of practical importance, it has been found reasonable and natural to reserve such cases for agreement between the interested parties.”⁸³

The change to the current place of effective management was made to harmonize the test with that in the shipping article, which in turn had been taken from that article in some (but by no means all) existing treaties.⁸⁴ At the same time as this change was made, the mutual agreement provision was dropped on the basis that “it will hardly ever be required.”⁸⁵ It seems strange today that anyone thought that the new expression was that clear in its meaning.⁸⁶ The history seems to show that the meaning of place of effective management was never clear. The unfortunate feature of it is that the expression is sufficiently close to practically every country’s domestic law that they all consider that it means the same as their domestic law expression.⁸⁷ The U.S. is wise not to use the expression in treaties.

80. [1925] 1 AC 495.

81. The first draft of the mutual agreement article is in FC/WP14(59) 1 (Mar. 3, 1959); the final report of Working Party 2 on residence was in FC/WP 2(58)1 (Jan. 10, 1958).

82. Article 4(2)(d) of the OECD Model.

83. FC/WP2(57) 1 (May 27, 1957).

84. It was used in Belgium-Sweden (1953), and Belgium and Sweden were the members of Working Party 5 on shipping, and so its adoption by the Working Party may not be a coincidence.

85. FC/WP2(57) 3 (Nov. 5, 1957).

86. I have explored this in more detail in John F. Avery Jones, 2008 OECD Model: place of effective management – what one can learn from the history 63 Bulletin for International Taxation p. 183. (2009)

87. See, e.g., Residence of Companies under Tax Treaties and EC Law, supra note 5, ch. 9 by J. Sasseville at p. 297-9 where at least six countries see similarities with their domestic law. The same was seen in the discussion of the topic at the 2004 IFA Congress in Vienna in which panelists from three states each argued that place of effective management had the same meaning as their domestic law term with different results. See John F. Avery Jones, “Place of Effective Management as a Residence Tie-breaker,” Bulletin for International Fiscal Documentation 1 (2005), at 20. The last thing one wants of a tie-breaker is for both states to think that it is the same as their domestic law.

G. Article 1

Closely related to the definition of residence is Article 1 of the Model which in its current form says: “This Convention shall apply to persons who are residents of one or both of the Contracting States.” This is puzzling because the point of the tie-breakers is that a person can never be resident in both states for the purposes of the treaty. From the context, even though the definition of resident is not subject to the context otherwise requiring as are the Article 3 definitions, it must mean that the person is resident *in domestic law* in one or both states. The problem cannot be explained by the way the OEEC worked in dealing with each article separately because Article 1, which was drafted by Working Party 14, came after Working Party 2 on residence had finished their definition.⁸⁸ The explanation seems to be that, as already mentioned, originally Working Party 2 proposed the equivalent of Article 1 as part of their definition of residence but were told by the Fiscal Committee to concentrate on the definition itself rather than its field of application.⁸⁹ That article said “This Agreement shall apply in every case where a person is fully liable to taxation in one of the Member countries.”⁹⁰ (This is an indication that the model was then proposed for a multilateral treaty, as we shall see below.⁹¹) In the context this article clearly meant fully liable to tax under domestic law. The draft went on to define in which Member country the right to tax belonged by virtue of the tie-breakers for individuals, companies or other bodies corporate, and also estates of deceased persons. Neither part originally used the expression resident, although by the time Working Party 2 had finished it did. It seems that when Working Party 14 drafted article 1 they were aware of this previous draft and followed the sense of it. Their draft read: “The present convention applies to individuals and legal persons who are residents of the Contracting State A or of Contracting State B or of both states [under the provisions of Article....]”

The draft had become bilateral by then, although a later draft retained a multilateral alternative.⁹² It is strange that the working party should say “individuals and legal persons” when in the same draft they proposed definitions of “person” and “company” in a draft of the whole of

88. The first draft of Article 1 is in FC/WP14(59) 1 (Mar. 3, 1959); the final report of Working Party 2 on residence was in FC/WP2(58) 1 (Jan. 10, 1958).

89. They also proposed a definition of “person” which the Fiscal Committee did not want either: FC/M(57) 2 (Jul. 3, 1957).

90. FC/WP2(57) 1 (May 27, 1957).

91. See the heading Non-discrimination was intended to be dealt with in a multilateral treaty.

92. FC/WP14(60) 1 (Jan. 19, 1960).

what is now Article 3; they corrected this in their next draft.⁹³ It is even stranger that they suggested as a possibility by the passage in square brackets that the definition in the residence article should apply when its purpose was to prevent residence in both states; this was also dropped in the next draft.⁹⁴ Was the reason connected with the dual residence provision not being intended to be applicable to residence-source provisions?⁹⁵ The proposed commentary does not help explain this as it merely states that older treaties applied to citizens but residence was a preferable connection.

H. Permanent Establishment

1. The List of Items That Permanent Establishment Includes Especially

The original definition of “permanent establishment” proposed by Working Party 1,⁹⁶ the members of which were from Germany and the UK, was little different in outline from today, no doubt because of the long history of the use of such a definition in actual treaties.⁹⁷ No guidance was given on why there is a list of items (place of management, branch, office etc) that the term “includes especially.” Is it clear that, for example, an office available for a short time only which is not a permanent establishment by virtue of the general definition is not deemed to be one by virtue of office being included in the list in paragraph 2? The original commentary,⁹⁸ as it still does today,⁹⁹ describes the list as *prima facie* examples, or in another place in the original commentary as examples that can be regarded *a priori* as constituting a permanent establishment, which convey that the list is of items that constitute a permanent establishment at first sight but might not do so when looked into fully. The Working Party explained that the list was one to which all member states would agree with a minimum of discussion, and which closely followed the list in the inclusive definition in the London and Mexico drafts. A place of management was added as it was not necessarily an office, as the Commentary still explains; “head office” and “professional

93. See *supra* note 92.

94. *Id.*

95. See *supra* note 64.

96. This was the first article to be finalized. It was complete by Oct. 2, 1957, see TDF/FC/125.

97. In the League of Nations London and Mexico drafts the list of items that the term “includes especially” was part of an inclusive definition: “includes head offices, branches” etc ending with “and other fixed places of business having a productive character.” The OEEC moved the last item to the beginning as the general principle and at the same time kept the list.

98. FC/WP1(56) 1 (Sep. 17, 1956).

99. OECD Article 5 Comm ¶ 12.

premises,” which were in the London and Mexico drafts, were dropped as unnecessary, being covered by place of management, and office respectively; “installations” was dropped as being meaningless; and “plantations” was dropped because agriculture was not trading income in all states. A “warehouse” was originally included in the list but was deleted because of the potential conflict with the stock of goods exception (“the maintenance of a stock of merchandise, whether in a warehouse or not, merely for convenience of delivery”) with the result that the only example left was that of warehouse for letting facilities for storage to third parties, which was covered by the general wording.¹⁰⁰ In short, unfortunately little can be gained from the history to explain the reason for including the list as well as the general principle; the working party accepted the concept from the Mexico and London drafts.

2. *The Exclusion for a Stock of Goods*

An agent or employee was originally deemed to constitute a permanent establishment of the principal if (as an alternative to having power to contract) he “habitually maintains in the first-mentioned territory a stock of goods or merchandise belonging to the enterprises from which he regularly delivers goods or merchandise on its behalf.”¹⁰¹ At the same time “the maintenance of a stock of merchandise, whether in a warehouse or not, merely for convenience of delivery” was excluded from constituting a permanent establishment except where the agency provision applied.¹⁰² When the Working Party changed the requirement for the agent to have and habitually exercise a “general authority” to conclude contracts to merely having “authority” to negotiate or conclude contracts, the reference to the agent habitually maintaining a stock of goods was deleted.¹⁰³ Storage (originally) and then display and storage, which were originally in a separate exclusion, were added to the delivery exception, thus creating the current storage, display or delivery; and “merely for the convenience of delivery”

100. The Fiscal Committee had asked the Working Party to consider this in FC/M(57) 1 (Feb. 8, 1957), and the Swiss delegate proposed the change (TDF/FC/11 (Jan. 24, 1957) which was discussed in FC/M(57)3 (Nov. 5, 1957); see the explanation in TDF/FC/24 (Oct. 2, 1957).

101. FC/WP1 (56) 1 (Sep. 17, 1956), at 4. The UK delegate said he was unable to accept this and said it would make a formal reservation if it were approved, FC/M(57)1 (Feb. 8, 1957), correction to the minutes in FC/M(57) 2 (Jul. 3, 1957). This is mysterious since this provision was contained in all UK treaties of the time, and enabling legislation dating from 1930 gave power to enter into agency treaties to exempt agency profits from tax except where this applied (or the agent had power to contract).

102. FC/WP1(56) 1 Appendix 1, at 3. (Sep. 17, 1956).

103. FC/WP1(57) 2 at 12. (Aug. 29, 1957).

became “for the purpose of [display or] delivery, and then solely for the purpose of [storage, display or] delivery.”¹⁰⁴

One can deduce some points from this history. When the agency permanent establishment caused by the agent habitually maintaining a stock of goods was deleted, it seems that the enterprise, through its agent, could make deliveries without there being a permanent establishment so long as the agent did not make the sale. It therefore seems that the delivery exception originally applied to deliveries of goods that were sold from abroad. The combination of storage, display and delivery would have originally have been excluded from being a permanent establishment because storage and delivery were originally in separate paragraphs and the other items were added to both paragraphs. The *or* in storage, display or delivery is unlikely to have been intended to exclude such combinations.

3. How the *Taisei*¹⁰⁵ Problem Arose

Working Party 1’s original commentary to the permanent establishment article contained the following:

10. Agents who may be deemed to be permanent establishment must be strictly limited to those who are dependent, both from the legal and economic points of view, upon the enterprise for which they carry on business dealings (Report of the Fiscal Committee of the League of Nations, 1928, page 12).

The passage referred to in the cross-reference was about independent agents which defined this as “absolute independence, both from the legal and economic point of view.” Applying this to dependent agents logically requires one to change the *and* to *or*, so that a dependent agent is one who is either legally or economically dependent. That passage remained in the Commentary in the 1963 Draft. The 1977 Commentary reverted to defining independent agent by requiring both legal and economic independence. The court in *Taisei* was absolutely right to use the 1977 Commentary to correct the error in the 1963 Commentary:

Generally, we would have reservations about interpreting a convention, ratified in 1971, on the basis of a commentary, adopted in 1977, that contradicts the literal language of the

104. FC/WP1(57) 2 (Aug. 29, 1957) and FC/WP1(57) 3 (Nov. 12, 1957) respectively.

105. *Taisei Fire and Marine Ins. Co., Ltd. v. Commissioner*, 104 T.C. 535 (1995). 105.0 FC/WP1 (56) 1, at 9. (Sep. 17, 1956).

commentary in effect at the time of ratification. However, in light of the extensive analysis by the previously cited commentators and the confirmation of such analysis by our own research, we are persuaded that the criteria in the later commentary reflects the original intention of the commentary to the 1963 Model and that the 1963 Model should be interpreted as having a disjunctive (“or”) meaning.

4. The Priority Rule Now in Article 7(7)

Although not a definition, the current priority rule in Article 7(7) that “where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article” started life as a proposed definition of profits by Working Party 14 which said:

The term ‘profits’ as used in Articles XV and XVI includes income derived from the direct exercise of business as well as income from the letting of the business to others and income from the alienation of the business, but does not include income from the operation of ships or aircraft in international traffic or from the operation of boats engaged in inland waterways transport or income in respect of independent and dependent personal services or income from immovable property, nor does the term include income in the form of dividends, interest, rents or royalties;¹⁰⁶

The Working Party debated whether profits arose on the letting of the whole or part of the enterprise. In the Fiscal Committee some expressed views that a definition of profits was not necessary and others that a priority rule was required, for example for banks receiving interest as part of their profits. They said that profits arising on the alienation of the enterprise should be considered in connection with capital gains.¹⁰⁷ Letting of a permanent establishment gave rise to different views: that it was possible that the permanent establishment ceased to exist when let, and that this was a management arrangement rather than a letting.¹⁰⁸ In the end the definition of profits was dropped in favour of a priority rule that originally referred to seven other articles having priority and eventually ended with the current reference to items of income dealt with by other articles generally.

106. FC/WP14(61) 1, at 1 (Jan. 9, 1961)

107. The capital gains article was not included in the OEEC Reports but first appeared in the OECD 1963 Draft.

108. FC/M(61) 5, (Sep. 29, 1961).

Presumably because the focus started by being in relation to profits a more general consideration of priority between other articles did not take place, and the existence of separate working parties working independently on different articles made this unlikely.

5. *Conclusion on the Definitions*

There is some interesting material here explaining how we arrived at where we are, even though in some respects this is an accident caused by how the OEEC working parties carried out their separate tasks, or even of translation (as with corporate rights, and habitual abode). As a result of the history we have a better understanding of what these definitions were intended to cover, such as the intended width of the definition of “person,” why all bodies corporate were assumed to be taxable, and the purpose of the stock of goods exception to a permanent establishment. The OEEC method of working explains a lot, such as why the main priority rule between articles relates only to profits, why Article 1 seems to ignore Article 4, and why Article 4 has its own mutual agreement provision for individuals but not companies. There were some early thoughts about the treaty problems of partnership. And it is good to have confirmation that the meaning of place of effective management was never clear.

III. NON-DISCRIMINATION

A. *The Nationality Non-discrimination Provision*

As mentioned above, one of the OEEC Fiscal Committee’s terms of reference¹⁰⁹ was:

D - Inequalities in taxation on grounds of nationality

The Committee should make concrete proposals concerning the means of removal of such inequalities.

Clearly, nationality discrimination was assumed to be a major issue by the ad hoc group of experts who wrote the terms of reference of the Fiscal Committee. In spite of this, Working Party 4, comprising members from France and the Netherlands, who were charged with developing the non-discrimination article, did not find widespread nationality discrimination. Indeed the nationality non-discrimination provision was originally intended to deal first with minor differences in personal allowances that existed in France, United Kingdom,¹¹⁰ Ireland, and the Netherlands. Secondly,

109. FC (56) (May, 26, 1956), at 2. For the others, see supra note 13.

110. This was not abolished until 2009.

reference was made to the application of the remittance basis in the UK and Ireland to non-ordinarily resident British/Irish subjects, which was (correctly) described as not very important.¹¹¹ Thirdly, the following further miscellaneous examples of nationality discrimination were mentioned:

The Netherlands exercises discrimination in not allowing foreign nationals domiciled in its territory to avail themselves of the internal measures for double taxation relief unless they maintain their domicile in the Netherlands for at least 3 years or unless the State whose nationality they possess extends reciprocal treatment, while Netherlands nationals who have their fiscal domicile in the Netherlands may claim such relief without exception. In Ireland special exemptions or relief are given to companies registered, managed and controlled in Ireland, so far as concerns profits arising to them from certain mining business. Finally, in Sweden, foreign corporate bodies are subject to a tax on capital invested in Sweden, while Swedish companies and certain other Swedish corporate bodies are not. The Swedish reply states that in principle this does not result in any difference in the tax assessment.¹¹²

It therefore seems that by 1957 examples of nationality discrimination in taxation in Europe were found only on the fringes. Perhaps nationality discrimination has been more important earlier.

The drafting of the OEEC nationality provision generally, including the definition of nationality, was acknowledged to derive from UK treaties of the early 1950s.¹¹³

111. This continued in the UK until 2005 when it was abolished as part of the Tax Law Rewrite in ITTOIA 2005 s.831(4), see Explanatory Notes to the Bill Change 132. Since a non-domiciled person was also entitled to the remittance basis the only discrimination was against UK domiciled foreigners, who were probably few in number.

112. FC/WP4(57) 1, at 2 (Jan. 11, 1957).

113. FC/WP4(57) 1 (Jan. 11, 1957). See UK treaties with: Denmark (1950), France (1950), Norway (1951), Finland (1951), Greece (1953), Belgium (1953), Switzerland (1954), Germany (1954), and Austria (1956). The definition of nationality of legal persons etc is the same as US-UK (1945) but the nationality non-discrimination provision is different in that treaty, being restricted to nationals of one state who are resident in the other state.

B. Non-discrimination was Intended to be Dealt With in a Multilateral Treaty

Interestingly, the non-discrimination article was originally planned as a multilateral treaty between OEEC countries,¹¹⁴ then only European countries, and so it was planned as a forerunner of the far-wider current EC rule. That a multilateral treaty was planned can be seen from the original OEEC Working Party 4 definition of national:

The term 'nationals' means:

- (a) all individuals possessing the nationality of a Member country of the OEEC;
- (b) all legal persons, partnerships and associations deriving their status as such from the law in force in any Member country of the OEEC.¹¹⁵

In relation to paragraph (b) the Commentary explained:

By declaring that all legal persons, partnership and associations deriving their status as such from the law in force in a contracting State are considered to be nationals for the purposes of paragraph 1 of the Article, the provision disposes of a difficulty which often arises in determining the nationality of companies. In defining the nationality of companies, certain States have regard less to the law which governs the company than to the origin of the capital with which the company was formed or the nationality of the

114. The International Chamber of Commerce had put forward this possibility. See C(54)294. (Nov. 12, 1954). By Apr. 19, 1955 the Swiss delegation had accepted that a multilateral treaty on direct tax was not the way forward, although they favoured it for indirect tax. On the former they said: "However, because of the growing complexity of national taxation laws, and of the legal, financial and technical difficulties which make efforts to avoid double taxation problems increasingly arduous, it has not up to now seemed possible to envisage the conclusion of multilateral Conventions in regard to such taxes, and Switzerland has therefore given its preference to the conclusion of bilateral Conventions, that having seemed to be the most suitable procedure." See C(55)88, at 2. The option of a multilateral convention on discrimination and possibly shipping profits was still being considered in 1957: FC/M(57) 3 (Nov. 5, 1957).

115. FC/WP4 (57) 1 (Jan. 11, 1957), at 4. The French version of ¶ (b) was « *toutes les personnes morales, toutes les sociétés et associations constituées conformément à la législation en vigueur dans un Etat-membre de l'O.E.C.E.* »

individuals or legal persons controlling it. No ambiguity need be apprehended, therefore.¹¹⁶

In other words, for legal persons etc, nationality in the Model was equated to governing law, whatever domestic law on nationality might be.

If the above definition had been retained in a bilateral treaty it would have prevented country A from discriminating against nationals of any OEEC country but the OEEC states other than State B with which it was contracting would have made no commitment not to discriminate against State A's nationals. When the article became bilateral the definition was therefore restricted to nationals of a Contracting State, as it had been in the original UK early treaties.

Another indicator of an intended multilateral convention is the stateless persons provision which makes more sense in a multilateral context because such a person has no obvious connection with either state in a bilateral treaty. The original form was:

(4) Stateless persons shall not be subjected in the territory of any Member country to any taxation or any requirement connected therewith, with respect to taxes on income, on capital and on estates and inheritances, which is other, higher or more burdensome than the taxation and connected requirements to which the nationals of that country are or may be subjected.

The immediate cause of a stateless persons' non-discrimination provision was a Convention of September 28, 1954 to improve the conditions of stateless persons¹¹⁷ under Article 29 of which stateless persons were to be given the treatment accorded to nationals. Both Working Party 4 and the Fiscal Committee said that this provision was appropriate only to a multilateral convention,¹¹⁸ but they retained it when the non-discrimination article became bilateral without any explanation for their change of mind. The current Model restricts this provision to stateless persons resident in a Contracting Party (unlike the nationality provision that extends to nationals who are not resident in either state) and provides that they shall not be subjected in either Contracting State to other or more burdensome taxation

116. FC (58)2 (1st Revision) Part II (Apr. 19, 1958), at 26. Similar wording is still contained in the Commentary at Article 3 Comm ¶ 9.

117. This was signed by Belgium, Denmark, Germany, Italy, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom, and France: FC/WP4(57) 1 (Jan. 11, 1957).

118. FC/WP4(57) 3 (Sep. 13, 1957) and Commentary at FC/WP4(58)1 (Feb. 19, 1958); FC/M(57) 1 (11 Jan. 11, 1957), at 4; FC/M(57) 3 (Nov. 5, 1957).

(or connected requirements) compared to nationals of the state concerned. Something on the lines of the original wording is now contained in the Commentary as a possible alternative.¹¹⁹

During the debates on whether to have a multilateral convention on discrimination there was no great enthusiasm in the Fiscal Committee for a multilateral treaty. Although the delegate from Germany thought it would have favourable psychological effects, the UK delegate said that “a multilateral convention on a question which did not give rise to serious difficulties in practice would give the impression of an academic study.”¹²⁰ The Italian delegate also thought such a multilateral convention would be limited in scope. This is further evidence that nationality discrimination at least was not a serious concern by this time. The debate on whether to have a multilateral treaty generally was still continuing at the time of the OECD 1963 Draft, the Introduction to which left open the possibility of certain groups of countries entering into a multilateral treaty “until it proves possible, after further studies, to conclude a multilateral Convention among all Member countries of the OECD.”¹²¹ I believe that this was the last statement made by the OECD raising the possibility of a Model multilateral treaty.

C. *In the Same Circumstances*

Originally there was no reference to the *same circumstances* in the nationality non-discrimination provision on the basis that this is inherent in the concept of discrimination. It was not included in the early UK treaties that were the source of the drafting of the OEEC provision, but it had been added in the UK-Switzerland treaty (1954) because during the negotiations for that treaty Switzerland had queried whether they were required to treat a UK national resident in the UK in the same way as a Swiss national resident in Switzerland.¹²² The UK suggested the addition of “in the like circumstances” in both the nationality and the ownership non-discrimination provisions. The Belgian and Swiss delegates to the OEEC proposed “in identical/similar circumstances.” Working Party 4 was of the opinion that such an addition was unnecessary but agreed to the addition of “in the like circumstances.”¹²³ It is not clear why “identical circumstances” was not adopted because the comparator, being hypothetical, can always be in

119. Article 24 Comm ¶ 30.

120. FC/M(57) 3 (Nov. 5, 1957), at 9.

121. Introduction ¶ 2.

122. UK National Archives, Public Record Office file IR40/11451 at 283J. The nationality provision was the same as the current Model’s but without these words.

123. FC/WP4(57) 2, at 2 (May 10, 1957).

identical circumstances (unless there is nobody in identical circumstances,¹²⁴ in which case the comparison cannot be made and there can be no discrimination). Unfortunately, use of the like (later, same) circumstances led to the Commentary's odd statement: "The expression 'in the same circumstances' refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation law and regulations, in substantially similar circumstances both in law and in fact."¹²⁵

The reference to similar circumstances in *law* is strange; clearly the discriminatory legal provision must be excluded from the circumstances in law.

D. Other or More Burdensome Taxation or Requirements Connected Therewith

The current "other or more burdensome" was originally "other, higher or more burdensome" in the early UK treaties that were the source of the drafting of the OEEC nationality provision.¹²⁶ One suspects that this was intended to cover, respectively, a different tax, a higher rate of the same tax, and more burdensome connected requirements. The Belgian delegation proposed *more burdensome* only, and Working Party 4 countered with "taxation which is *other* than the taxation"¹²⁷ imposed on its own nationals, on the basis that this would also cover higher taxation.¹²⁸ In the end they compromised on "other or more burdensome" which had in fact been first used in the US-UK treaty of 1945; this makes the reference to "higher" taxation unnecessary. This expression was explained by Working Party 4 in an interpretative comment to

mean that tax may not be in another form (no different tax, no different mode of computing the taxable amount, no different rate, etc.) and that the formalities connected with

124. For example, a non-resident national if nationality is the test for residence, as is common for corporations.

125. Article 24 Comm ¶ 7. Apart from defining same to mean substantially similar, which is unnecessary, the reference to similar circumstances in law is strange as the law will be the cause of the discrimination.

126. The League of Nations London and Mexico drafts used "higher or other" taxes in what was then a residence non-discrimination provision. Early US treaties contained other variations: U.S.-Canada (1942) "more burdensome;" U.S.-France (1939) "higher;" U.S.-Sweden (1939) "higher or other."

127. Connected requirements are not mentioned but presumably were intended to be covered.

128. FC/WP4(57) 2 (May 10, 1957), at 2.

the taxation (returns, payment, prescribed times, etc.) may not be more onerous.¹²⁹

The UK Privy Council later (and without having the benefit of this history) came to the same conclusion in *Woodend Rubber Co. v. Commissioner of Inland Revenue*:¹³⁰

to speak in this context of 'other' taxation must ... at least include some income tax other than the income tax to which resident [in a non-discrimination provision based on residence, rather than nationality] companies are subjected. The Ceylon (as it then was) tax in question was a branch profits tax measured by reference to (rather than charged on) the remittances to the head office made out of the permanent establishment state, amounting to one-third of the remittances up to a maximum of one-third of taxable income. Resident companies, on the other hand, paid an additional tax equal to one-third of the dividends paid, which was deductible from the dividends. This was in form an additional tax on the profits of the company, rather than a withholding tax on the dividends. Since resident companies did not pay tax on remittances abroad, the tax on non-resident companies was an "other" tax, which was prohibited by the residence (in that treaty) non-discrimination provision, even though the charge to tax was all part of income tax. The tax was actually less burdensome since tax on the non-resident company was a maximum of one-third of taxable income when the remittances exceeded one-third of taxable income, while the additional tax on a resident company was one-third of the dividends paid out of the profits, whatever their amount.

E. Public Bodies and Charities

Originally the Commentary's statements that public bodies are not included was contained in the draft article:

(3) The provisions of paragraph 1 of this Article shall not have the effect of requiring a Member country of the OEEC which accords special [taxation] privileges to public bodies or services, or to private institutions not for profit whose

129. FC/WP4(57) 3 (Sep. 13, 1957) at 5.

130 [1971] A.C. 321, 332F.

activities are performed exclusively in the religious, charitable, artistic or scientific field or in any other field of cultural life, or for social or national defense purposes, to extend the same privileges to the like bodies of another Member country.¹³¹

The Fiscal Committee deleted it¹³² in favour of including a comment, and Working Party 4 added the following to the Commentary:

“From this point of view such [public] bodies and services can never be in comparable circumstances to those of the public bodies and services of another State; their position in relation to the State to which they belong is a unique one.”

And in relation to private charities Working Party 4 said:

“Such institution[s] likewise have a unique position in relation to the State to which they belong, since the taxation privileges are accorded them not because they derive their status from the law of that State (although this might be one of the conditions prescribed for the granting of the privileges), but rather because their activities are performed for purposes of public benefit which are specific to that State.

Example: State A gives exemption from tax on estates of deceased persons in respect of legacies to charitable institutions which derive their status as such from its law and whose activities are performed in its territory. Paragraph (1) does not imply that State A must give exemption in respect of legacies received by a charitable institution whose activities are performed in the territory of State B. But State A will be bound to give the exemption to a charitable institution which derives its status as such from the law of State B but whose activities are performed in the territory of State A (although, of course, any other conditions to which the exemption may be subject – e.g. the condition of being established in State A – must be satisfied).¹³³

131. FC/WP4(57) 2 (May 10, 1957), at 10.

132. FC/M(57) 1 (Jan. 11, 1957) at 4.

133. FC/WP4(57) 3 (Sep. 13, 1957), at 9-10. Note the distinction made between governing law and place of establishment, also made in the ownership non-discrimination provision below.

It seems that these statements were intended to be restricted to activities of the state and charities for the benefit of the state concerned, whereas many charities formed in a state benefit persons outside the state, and so it is difficult to see why discrimination against such charities governed by the law of the treaty partner state should not be prevented.

F. The Permanent Establishment Non-discrimination Provision

In spite of the initial focus on nationality discrimination, the permanent establishment provision seems to have been regarded as the most relevant provision in practice. It was described as being “of great importance for the development of commercial and industrial activity across the frontiers.”¹³⁴

The type of discrimination identified was explained as follows:

The replies to the questionnaire show that, in a number of Member countries of the OEEC, non-domiciled persons (individuals and corporate bodies) are in several respects subjected to different treatment from that applied to domiciled persons. The Working Party will confine itself to giving a few examples of this.

It is the case that one State allows persons domiciled in its territory to deduct, in computing their profits, all expenditure incurred in carrying on a business, whereas non-domiciled persons, for the purpose of computing profits from business carried on in its territory, may take into account *no more than the expenditure laid out in its own territory*, so that expenditure incurred out of its territory for the purposes of the same business is unallowed.¹³⁵ Moreover, there are some States which give non-domiciled persons no relief for losses incurred in carrying on a business situated in their territory while they give different treatment to persons domiciled in its territory. Finally, it was found that some legislations prescribe a notional method of computing the taxable profits of foreign transport businesses.¹³⁶

134. FC/WP4(57) 2 (May 10, 1957), at 6. I believe that the state referred to is Belgium.

135. This was also the reason for what is now Article 7(3).

136. FC/WP4(57) 1 (Jan. 11, 1957), at 6.

It is clear that in practice discrimination against permanent establishments were far more widespread than discrimination against nationals.

The Delegate for Switzerland suggested drafting the permanent establishment provision in terms of nationality rather than a residence, making the comparison with an enterprise engaged in the like business and possessing the nationality of that other Contracting Party.¹³⁷ Working Party 4 rightly disagreed saying that it had nothing to do with nationality.¹³⁸ But this debate is the reason for the Commentary still saying what seems to be obvious: Strictly speaking, the type of discrimination which this paragraph is designed to end is discrimination based not on nationality, but on the actual situs of an enterprise.¹³⁹

G. Enterprise

The term enterprise is used in the legal, and consequently the tax, systems of civil law countries, and is a term derived from economics. The Model today uses the word in several different senses. In French, enterprise can mean either the person or the activity depending on the context: this accounts for the use of both meanings in the English version of the Model which makes it difficult to understand as this is not normal English usage.¹⁴⁰ The US Model avoids this problem by referring in Article 7 to the “business profits of an enterprise,” where “enterprise” refers to the taxpayer. There are other difficulties with the English in the definition of permanent establishment in Article 5: “... a fixed place of business through which the business of an enterprise is wholly or partly carried on.” The French version of “...une installation fixe d'affaires par l'intermédiaire de laquelle une entreprise exerce tout ou partie de son activité” (meaning, a fixed place of business through which the enterprise carries on all or part of its activities), is much clearer than the English. Article 7, the business profits article, read with the definition of “enterprise of a Contracting State” is also clearer in French: “*Les bénéfices [d'une entreprise exploitée par un résident d'un Etat contractant] ne sont imposables que dans cet Etat, à moins que l'entreprise*

137. FC/M(57) 3 (Nov. 5, 1957), at 7.

138. FC/WP4(57) 4 (7 Nov. 7, 1957), at 2.

139. Article 24 Comm ¶ 33, originally FC/WP4(57) 3 (Sep. 13, 1957) at 11 in an interpretative note that “Nationality plays no part in this type of discrimination;” original version of the Commentary at FC/WP4(58) 1 (19 Feb. 19, 1958) at 7.

140. See K. van Raad, “The Term ‘Enterprise’ in the Model Double Taxation Conventions—Seventy Years of Confusion” in *Essays in International Taxation*, Festschrift for Sidney I Roberts (Kluwer, Deventer, 1993) at 317; *Intertax*, 1994/11 p. 491. He lists examples of the Model using enterprise in the sense of the person, and in the sense of the business, and those that could mean either.

n'exerce son activité dans l'autre Etat contractant par l'intermédiaire d'un établissement stable qui y est situé" (meaning, the profits of an enterprise [carried on by a resident of a Contracting State] shall be taxable only in that State unless the enterprise carries on its activities in the other state through a permanent establishment), compared to the English "...unless the enterprise carries on *business* in the other State...."¹⁴¹

One can see the seeds of the problem in the discussions on the permanent establishment non-discrimination provision. The draft was originally in terms of an operator (*entrepreneur*):

profits which an operator [in the original French version *les entrepreneurs*] domicile[d] or established in a Member country of the OEEC through a permanent establishment situated therein shall not be less favourably computed by the latter Member country than similar profits obtained by an operator established or domiciled in its own territory.¹⁴²

The Fiscal Committee instructed Working Party 4 to consider whether the word "*entrepreneur*" (operator) should not be replaced by the word "*entreprise*" (enterprise).¹⁴³ They failed to take the hint as it seemed to them that the choice between these two terms should depend on the terminology used in the Convention in which the provision in question will be inserted. They proposed that the word "*entrepreneur*" should be maintained for the time being, and observed that it very frequently happens that it is not the enterprise itself that is taxed but the individual who operates it. The advantage of the word '*entrepreneur*' was that it applies both to individuals and to legal persons and taxpayers assimilated thereto.¹⁴⁴

The Fiscal Committee also wanted the provision to apply to all taxes to which a permanent establishment might be subjected, which resulted in dropping the reference to profits.¹⁴⁵ The Working Party's final version, which still used *entrepreneur* in English, was:

(4) The taxation levied by any Contracting Party on permanent establishments situated in the territory of that Contracting Party and owned by an entrepreneur domiciled or established in the territory of any other Contracting Party

141. See also "Does 'Enterprise' in the OECD Model mean 'Business'?" (2006) 60 Bulletin for International Taxation No.12 p. 476 (OECD/IFA Seminar 2006).

142. FC/WP4(57) 1 (Jan.11, 1957) at 7.

143. FC/M(57) 2 (Jul. 3, 1957), at 4.

144. FC/WP4(57) 3 (Sep.13, 1957), at 12.

145. FC/M(57) 2 (Jul. 3, 1957), at 4.

shall not be less favourable than that levied on an entrepreneur domiciled or established in its own territory and carrying on the same activities.

The original draft of the Commentary stated:

Finally, with regard to the use of the word 'entrepreneur' in the first paragraph of paragraph 4, the question was raised whether it would not be better to use the word 'enterprise' instead. The word 'entrepreneur' has been adopted because it has the merit of designating both.¹⁴⁶

The Fiscal Committee, as might have been expected from their earlier comment, came to the opposite conclusion and changed entrepreneur to enterprise:

Finally, with regard to the use of the word 'enterprise' in the first sub-paragraph of paragraph 4, the question was raised whether it would not be better to use the word 'entrepreneur' instead which had the merit of designating both individuals and legal persons and of thus being applicable where it is not the enterprise itself that is taxed but the individual carrying on the enterprise. The word 'enterprise' was finally selected, it being understood that the choice between the two terms might depend on the terminology used in the Convention in which the provision is to appear.¹⁴⁷

Enterprise fits perfectly well in the permanent establishment non-discrimination provision; it is the other references in the Model that are the problem in English.

H. Not Less Favourably Levied

A Swiss proposal would have harmonized the wording of *taxation which is other, higher or more burdensome* with the nationality provision.¹⁴⁸ Working Party 4 thought that this would have greater repercussions on Member countries' law and preferred a more restricted version that enabled different methods of taxation of a permanent establishment.

The Working Party was also asked to mention in the official comments that to tax, for reasons of practical convenience, non-domiciled

146. FC/WP4(58) 1 (Feb. 19, 1958) at 8.

147. FC(58) 2 (1st Revision) Part II (Apr. 19, 1958), ¶ 17 at 27.

148. FC/WP4 (57) 2 (May 10, 1957), at 6.

persons differently from domiciled persons does not constitute discrimination so long as this does not result in more burdensome taxation on the non-domiciled persons than on the others. The Working Party considers that the words 'shall not be less favourably assessed' give the right to apply such different taxation. But the States should limit their claims in this respect, by endeavouring not to resort to different taxation unless it is in keeping, not only with their own conceptions, but also with generally accepted standards.¹⁴⁹

The different wording of the permanent establishment provision is therefore deliberate.

I. The Ownership Non-discrimination Provision

The ownership provision was originally proposed to Working Party 4 by the Swiss delegation.¹⁵⁰ Such a provision had been contained in its treaty with the UK (1954) and it had been in general use by the UK from the early 1950s in its treaties with countries outside its Dominions and Colonies, although this is not mentioned in the Working Party's minutes.¹⁵¹ The usual form of the ownership provision in these UK treaties was:

The income, profits and capital of an enterprise of one of the territories, the capital of which is wholly or partly owned or controlled, directly or indirectly, by a resident or residents of the other territory, shall not be subjected in the first-mentioned territory to any taxation which is other, higher or more burdensome than the taxation to which other

149. FC/WP4(57) 3 (Sep. 13, 1957), at 12.

150. FC/WP4(57) 2 (May 10, 1957), at 7.

151. See UK treaties with: Denmark (1950), France (1950), Norway (1951), Finland (1951), Greece (1953), Belgium (1953) (which stated that the provision was not to affect a specific treaty provision that profits distributed by a Belgian company to its UK 90% holding company were to be taxed at the lower rate on undistributed profits), Switzerland (1954), Germany (1954), and Austria (1956) (ending "...other enterprises of the first-mentioned territory *similarly carried on* are or may be subjected"); it was not included in US (1946), Netherlands (1948), or Sweden (1949). The Working Party acknowledged the origin of the wording of the nationality provision and the definition of nationality as "based on a provision which is to be found in the Conventions for the avoidance of double taxation concluded between the United Kingdom and most of the countries represented in the Committee." Non-discrimination articles were not included at that time in treaties with the Dominions or Colonies presumably because nationality discrimination was not relevant.

enterprises of that first-mentioned territory are or may be subjected in respect of the like income, profits and capital.¹⁵²

The Swiss proposal was accepted by Working Party 4 on the basis that it was unlikely ever to apply:

It would appear that the discrimination arises only very rarely in the member countries of the OEEC. The Working Party therefore considers that the member countries will find it easy to accept the proposed provision. Nevertheless, such a provision will be of the fullest importance in relations with countries which see no objection in applying such discrimination. Accordingly, the Working Party considers that it should insert this provision in its draft article subject to slight modifications.*

*[Footnote to the original] Indeed it is not easy to see how the Swiss delegation's proposal can have any real significance. The proposal mainly concerns companies under foreign control, as is made clear in the Delegation's commentary. However, although it is true that the company's nationality is sometimes determined by reference to the country of origin of the capital invested in it and of the individuals controlling it, the effect of the Article proposed by the Working Party is that in determining a company's nationality one must look to the law governing companies. Hence, one of two things: assuming that a company established in State A is controlled by persons domiciled in another State B, then either it will derive its status as a company from the law of the latter State and possess in consequence that latter State's nationality, in which case, it should not, by virtue of the equivalent treatment clause, be subjected to treatment different from that which will be applied to a company possessing the nationality of State A; or it will possess the nationality of State A, in which case it is inconceivable that it could be subjected to discriminatory treatment as compared with other companies of State A on the ground that it is controlled by persons domiciled in State B, when, even if it derives its status from the law of State B, it ought in virtue of the equivalent treatment clause to receive the treatment ordinarily applied in State A.

Having defined nationality in terms of governing law for the purpose of the nationality non-discrimination provision, the Working Party's argument was that for a company incorporated in State A and owned by

152. Only UK-Switzerland (1954) added "in similar circumstances" after the last "subjected." In all these UK treaties (except with Belgium) the non-discrimination article applied to all taxes but the opening words effectively restrict the application of the ownership provision to taxes on income, profits and capital.

residents of State B there were two possibilities: (1) if the company is regarded as governed by the law of State B on account of being controlled by residents of that state, as the state of origin of the capital,¹⁵³ it will already be protected by the nationality non-discrimination provision¹⁵⁴ (for which nationality is equated to governing law;¹⁵⁵) or (2) if it is governed by the law of State A on account of its being incorporated in that state, it is highly unlikely that State A would discriminate against it by treating two companies governed by its law differently, particularly when, under the nationality non-discrimination provision, it must not treat a company governed by its law better than one governed by State B's law. In other words, whichever system of defining governing law of a company applied, there was protection against discriminating against it, however, unlikely discrimination might be in the latter case.

The Swiss delegation's original draft, which is the same as the UK-Switzerland treaty (1954) with some minor drafting changes, was:

The income, profits and capital of an enterprise of one of the States, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more persons domiciled in the other State, shall not be subjected in the first-mentioned State to any taxation which is other, higher or more burdensome than the taxation to which other

153. Civil law states ask why should legal relations between members of a company, or as between them and the company, or involving third parties, be determined by a State B court based on the corporate law of State A where the members of the company (and particularly where also the assets) are in State B? In the most fundamental sense, their premise is that incorporation is a legal fiction that provides the members with certain privileges, including in certain cases protection from liability, so they would ask why should those members be able to choose privileges under a foreign law (meaning foreign not just as one that is other than that of State B but one that has little if any connection with the members (and, possibly, the assets)) that are superior to the privileges that State B law has decided to accord? Common law states look only to the country of incorporation for the governing law, perhaps because traditionally they have not had large minimum capital requirements and so there was no incentive to incorporate a company elsewhere to reduce this.

154. Nationality non-discrimination provisions existed in the Mexico and London Models: "A taxpayer having his fiscal domicile in one of the contracting States shall not be subject in the other contracting State, in respect of income he derives from that State, to higher or other taxes than the taxes applicable in respect of the same income to a taxpayer having his fiscal domicile in the latter State, or having the nationality of that State." This is wider than the present Article 24(1), applying to residence as well as nationality, although the residence part may have been intended as a permanent establishment non-discrimination provision, which it later became.

155. See *supra* note 116.

similar¹⁵⁶ enterprises of that first-mentioned State in the like circumstances are or may be subjected in respect of the like income, profits and capital.¹⁵⁷

Working Party 4's first draft, which as already mentioned, was intended to be a multilateral convention on non-discrimination, was:

The income, profits and capital of an enterprise established in a Member country of the OEEC, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more persons domiciled in some other Member country, shall not be subjected in the first-mentioned country to any taxation which is other, higher or more burdensome than the taxation to which other similar enterprises in the like circumstances establishment in that first-mentioned country are or may be subjected in respect or the like income, profits and capital.¹⁵⁸

Although the deletion of this provision was proposed by Italy in the Fiscal Committee¹⁵⁹ Working Party 4 apparently took no notice and their subsequent draft for a bilateral treaty was:

An enterprise established in the territory of one of the Contracting Parties, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more

156. This word was not in the UK-Switzerland treaty (1954) and has remained in the Model.

157. RC/WP4 2 (May 20, 1957), at 8. In French: «*Les revenus, bénéfiques et capitaux d'une entreprise de l'un des deux Etats, dont le capital est en totalité ou en partie, directement ou indirectement détenu ou contrôlé par une ou plus leurs personnes domiciliées dans l'autre Etat, ne doivent être soumis dans le premier Etat à aucune imposition autre, plus élevée ou plus lourde que celle à laquelle sont ou pourront être soumises, pour de semblables revenus, bénéfiques et capitaux, d'autres entreprises analogues de ce premier Etat se trouvant dans une situation semblable.*»

158. FC/WP4(57) 2, at 10. (May 10, 1957). In French: «*Les revenus, bénéfiques et capitaux d'une entreprise établie dans un des Etats-membres de l'O.E.C.E., dont le capital est en totalité ou en partie, directement ou indirectement, détenu ou contrôlé par une ou plusieurs personnes domiciliées dans quelque autre Etat-membre de l'O.E.C.E., ne doivent être soumis dans le premier Etat à aucune imposition autre, plus élevée ou plus lourde que celle à laquelle sont ou pourront être soumises, pour des revenus, bénéfiques et capitaux analogues, d'autres entreprises semblables établies dans ce premier Etat et se trouvant dans la même situation.* »

159. FC/M(57) 2 (Jul. 3, 1957), at 4.

persons domiciled in the territory of another Contracting Party, shall not be subjected in the territory of the first mentioned Contracting Party to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which (other)¹⁶⁰ similar enterprises in the like circumstances established in the territory of the first-mentioned Contracting Party are or may be subjected.¹⁶¹

The modifications were that the provision was no longer limited to income, profits or capital,¹⁶² and the reference to “higher” taxation was deleted, as it had been in the nationality provision. The drafts compared two companies established in State A-one with local control and the other with State B control. The provision prevented discrimination against the one with State B control whichever was their governing law (and therefore nationality in the Model). It was therefore more like an extension of the nationality non-discrimination provision to prevent discrimination purely on account of

160. The reason for “other” being in brackets is found in the French version: «*Une entreprise établie dans le territoire d'une des Parties Contractantes, dont le capital est en totalité ou en partie, directement ou indirectement, détenu ou contrôlé par une ou plusieurs personnes domiciliées dans le territoire d'une autre Partie Contractante, ne sera soumise dans le territoire de la première Partie Contractante à aucune imposition ou obligation y relative, qui serait autre ou plus lourde que celle à laquelle sont ou pourront être assujetties [the next word d'autres was crossed out and changed to les] entreprises semblables établies dans le territoire de la première Partie Contractante et se trouvant dans la même situation.*»

161. FC/WP4(57) 3 (Sep. 13, 1957), at 3. This was adopted by the Fiscal Committee with minor drafting changes in FC/M(58) 2 (Mar. 29, 1958), at 5: the opening words became “Enterprises established” (*Les entreprises établies*), with a consequential plural *ne seront soumises* in the French, and the reference to “other” (*les autres entreprises*) was retained.

162. UK-Switzerland (1954) and the other UK treaties (except with Belgium) applied to all taxes but limited the ownership provision to income, profits or capital, presumably on the basis that it would not apply to other types of taxes (although there could be such taxes that were not within the treaty, such as local taxes). The Swiss proposal that the non-discrimination article should apply to all taxes, see the heading Taxes of every kind and description below was made at the same time and so they had deliberately limited this provision to taxes on income, profits and capital. It is interesting that the OECD Model Estate Tax Treaty has a non-discrimination rule applying to all taxes but only the equivalent of ¶¶ 1 and 2 of the OECD Model on income and capital. Its Commentary says “It was decided not to include ¶¶ 4 to 6 [now 3 to 5 after 1992 renumbering] of Article 24 of the 1977 Income Tax Model since the provisions of those paragraphs relate, more or less exclusively, to taxes on income and capital and are not appropriate in the concept of this Model.”

foreign ownership where this did not give rise to different nationality, as defined to mean governing law.¹⁶³ It seeks to treat in the same way discrimination based on the governing law (nationality) of the company and that based on the residence of the shareholders.¹⁶⁴

The following example was given of the type of circumstance covered by the ownership provision:

Example: State A subjects companies established in its territory to special profits tax if the majority of the shares in them are owned by persons not domiciled in it. The result is that a company established in the territory of State A, all the shares in which are owned by persons domiciled in that State, is not subject to the special tax, while another company which is also established in the territory of State A, but all the shares in which are owned by persons not domiciled in that State, has to pay the tax. The purpose of paragraph (5) is to prohibit such difference in treatment of taxpayers who are equal to one another from all points of view. As a result of paragraph (5), therefore, State A will no longer be able to subject the last-mentioned company to the special tax.¹⁶⁵

The reference to enterprises *established* in a state was later changed by the Fiscal Committee to “enterprises of a Contracting State,” defined to mean *resident* of the contracting state concerned.¹⁶⁶ This was not intended to be a change of substance because it had previously been assumed that a company established in a state was a resident of that state, as can be seen from the Commentary’s reference to ensuring “equal treatment for taxpayers

163. It is interesting that the scope of the ownership provision corresponds exactly to the nationality provision by covering taxation that is other or more burdensome, and connected requirements that are other or more burdensome than those suffered by the object of comparison. By contrast the permanent establishment provision applies only to taxation that is less favourably levied.

164. It is interesting that Canada splits the issues and treats them differently. Canada generally grants non-discrimination protection to foreign nationals (along the lines of 24(1)), and to non-residents in respect of their Canadian PEs (along the lines of 24(3)), but reserves the right to discriminate against Canadian companies that have foreign ownership or control by making the comparison with third country controlled companies in the ownership provision (a most-favoured nation test).

165. FC/WP4(57) 3 (Sep. 13, 1957), at 13. It is not known whether there was an actual example of this at the time. Canada does this today.

166. FC(58) 2(1st Revision) Part I (Apr. 19, 1958), at 24.

residing in the same State.” That was not true of the UK and many other common law countries in which residence was not connected to incorporation until later.¹⁶⁷ The ownership provision now compared two *resident* companies, whatever the governing law of the companies, one controlled by residents of the other state and the other with domestic control.

The words “in the like circumstances,”¹⁶⁸ near the end of the draft, which were included only in the UK treaty with Switzerland (1954) out of the 1950s UK treaties containing an ownership provision,¹⁶⁹ were subsequently deleted in the Working Party’s final report for the following reasons: “First, they might lead to misunderstanding; secondly, they add nothing to the meaning of the provision, the purpose of which is to subject enterprises situated in a given State and under foreign control to the same treatment as similar enterprises likewise established in the same State.”¹⁷⁰ Logically, the words should have been deleted from the nationality provision for the same reason, but they still remain there.

The early UK treaties did not say other *similar* enterprises, but just “other enterprises.” The Fiscal Committee’s minutes stated: “It was agreed that the expression ‘other similar enterprises established in the territory of that first-mentioned Contracting Party’ referred to enterprises not under foreign control.”¹⁷¹ This was implicit in the Working Party’s original proposal, but unfortunately this statement was never included in the commentary (and nor was the provision redrafted accordingly). If it had been, it would have avoided the disagreements that have subsequently developed about the meaning of this phrase. For example, the UK Revenue’s long-standing interpretation¹⁷² and their original argument in *NEC Semi-Conductors Ltd. and other Test Claimants v. IRC*¹⁷³ was that the comparison

167. One by one the common law countries adopted incorporation as an additional test for residence (Australia 1930, Canada 1961, South Africa 1962 (at the same time replacing the common law test by place of effective management), UK 1988). Management and control still applies to companies not incorporated in the state.

168. FC/WP4(57) 4, at 5. (Nov. 7, 1957). Originally the nationality provision did not refer to the same circumstances either (FC/WP4(57) 1 (Jan. 11, 1957)) on the basis that it was implied but “in the like circumstances” was added at the suggestion of the Belgian and Swiss delegates (FC/WP4(57) 2 (May 10, 1957)).

169. See *supra* note 152.

170. FC/WP4(58) 1 (Feb. 19, 1958) at 4.

171. FC/M(58) 2 (Mar. 29, 1958), at 5.

172. See [1978] BTR 198. Although in a memorandum to the Select Committee on Statutory Instruments (Oct. 25, 1994, HC 20-xi) the Revenue gave an example where the comparison was with a company owned by residents of the same state.

173. [2007] STC 1265. The case is also known as *Boake Allen, Ltd. v. IRC*, [2007] 1 W.L.R. 1386.

should be with an enterprise owned by third-state residents. It was, however, accepted by all the UK courts¹⁷⁴ that the comparison is with domestic-owned enterprises. The OECD Discussion Draft of May 3, 2007 considered that this interpretation was clear and that there was no need to change the Commentary.¹⁷⁵ The history shows that the Discussion Draft was correct on this point.

Does *similar* add anything? It is not a substitute for the deleted reference to “in the same circumstances” as they were both contained in the original Swiss proposal. It is suggested not, because sameness is inherent in the concept of discrimination. Indeed it is unfortunate that the word “similar” was used. All the other references in the article are to *same*: “same circumstances” in Article 24(1)¹⁷⁶ and (2), “same activities” in Article 24(3), and as a later addition, “same conditions” in Article 24(4). The OECD Discussion Draft, in a passage that is not repeated in the 2008 Update, raised an argument that the ownership provision had no relevance to domestic grouping provisions. It argued that “similar enterprises” referred to the company concerned as a separate enterprise only, so that transactions with other members of the group should be ignored since in respect of such transactions similarity could not be achieved between subsidiaries with domestic and non-resident parent companies:

11. These questions [relating to groups of companies] are linked to the meaning of the term “similar enterprises” in paragraph 5. Contrary to paragraph 1, paragraph 5 does not explicitly require that the enterprises must be in the same circumstances. However, the term “similar enterprises” might imply that they should be comparable and that this is not always the case. The term “similar enterprises” might suggest that paragraph 5 is dealing with companies as separate entities only and that as far as transactions between the subsidiary and the parent are concerned, the subsidiary of a domestic parent might not be a similar enterprise. Also, the question has been raised whether or not an enterprise is

174. Park J in the High Court lists four possible interpretations: UK subsidiaries of (i) other parent companies in the treaty-partner state (which he described as the most correct grammatical reading but obviously not intended); (ii) third-state parent companies (which was the Revenue’s contention; the amendment that Canada makes in its treaties is to this effect: see note 164); (iii) UK parent companies (which he accepted as being the correct interpretation); (iv) that there are no similar enterprises, [2004] STC 489 at [27].

175. OECD Discussion Draft ¶ 88.

176. But *supra* note 125 for the Commentary’s interpretation of the same circumstances to mean substantially similar circumstances.

“similar” if the foreign parent company is not necessarily subject to national taxes on a worldwide basis.

The history shows that this passage is extremely doubtful. First, nothing can be deduced from the absence of a reference to same circumstances, which was deleted as being unnecessary. Secondly, there is nothing to suggest that similar has anything to do with looking at the company as a separate enterprise. Thirdly, treating the subsidiary of a domestic enterprise as a similar enterprise as a comparator to the actual subsidiary of a foreign enterprise is the whole purpose of the ownership provision. Lastly, having said that the provision deals with the subsidiary as a separate enterprise, why is the taxability of the parent company relevant at all?

J. The Deduction Non-discrimination Provision

There are no discussions in the OEEC about this provision, which was only added to the Model in 1977.

K. Taxes of Every Kind and Description

It was the Swiss delegation that proposed the inclusion of this paragraph, which on the face of it is rather dangerous; UK treaties, for example, do not include it, and indeed the provision under which treaties are given effect in domestic law does not enable them to do so. Working Party 4 approved the proposal in principle and the Fiscal Committee minutes do not record any disagreement.¹⁷⁷

L. Conclusion on Non-discrimination

While it is interesting to see how the non-discrimination article evolved, it is sad that nobody stopped to ask what the article was trying to achieve, which would have been helpful to those coming after in trying to construe it. The OEEC set out to deal with discrimination on grounds of nationality as one of their four major topics, but found little. They included a nationality provision for good measure largely because this was found in 19th century non-tax treaties, such as consular or establishment conventions, and treaties of friendship or commerce, as the Commentary still explains. A stateless persons' provision was designed solely for inclusion in a multilateral treaty on tax discrimination to mirror a then-recent multilateral non-tax law European Convention, and it was retained without any explanation in a model for bilateral treaties. The important topic turned out to

177. FC/WP4(57) 2 (May 10, 1957), at 1.

be discrimination against permanent establishments, the prevention of which they identified as being “of great importance for the development of commercial and industrial activity across the frontiers.” But even that was drafted in a more restrictive form than the nationality provision, not covering “other” taxation, since to do so “would have greater repercussions on Member countries’ law and [the Working Party] preferred a more restricted version that enabled different methods of taxation of a permanent establishment.” Discrimination on grounds of foreign ownership was included essentially as a back-up to the nationality provision for those states who took a different view of nationality, as defined to mean the governing law. It was adopted because “it would appear that the discrimination arises only very rarely in the member countries of the OEEC. The working party therefore considers that the member countries will find it easy to accept the proposed provision.” The history of the ownership provision is relevant to the current debate about the effect on provisions relating to groups of companies.

There was therefore no overview of the policy of a non-discrimination article and because of the method of working parties operating independently there was no thought given to how it related to the rest of the Model, such as the suggestion which has been made later that its purpose was that double taxation relief would be given only for non-discriminatory taxes. That is why the non-discrimination article is, as Mary Bennett has said, “A Concept in Search of a Principle.”¹⁷⁸

178. *Non-discrimination in International Tax Law: A Concept in Search of a Principle* (2005) republished in Mason, ed., *The Tillinghast Lecture 1996-2005* (New York, 2007, NYU School of Law) p. 411.

