THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2025

MODULE 1 – PRINCIPLES OF INTERNATIONAL TAXATION

SUGGESTED SOLUTIONS

PART A

Question 1

There is no one way to answer this question and the following provides one possible schematic.

The following is focussed on the OECD MTC 2017. Candidates may note that the UN MDTC 2021 is broadly similar with notable exceptions (it includes a detailed limitation of benefit provision only as this is considered to better protect developing countries and it includes an additional example: Example N).

The PPT is found in Art. 29(9). Art. 29 is the product of the Final Report of BEPS Action 6 (Art. X(7), [26]). The anti-abuse standards (including the PPT) provide a minimum standard such that contracting states (CS) are expected to include such provisions in their DTAs and, in relation to their covered tax agreements (CTAs), they must agree on which single or combined set of anti-abuse rules will modify their CTAs (as per Art. 7 of the MLI). The options available under the OECD MTC are the PPT alone; the PPT and a simplified or detailed limitation of benefits provision; or a detailed limitation of benefits provision with a mechanism that addresses conduit arrangements. While UN MDTC 2021 is broadly similar, it only provides for a detailed limitation of benefits provision as this was considered to better protect developing countries' interests when concluding DTAs (it also adds Example N).

Prior to the PPT, there were various principles relied upon (OECD MTC 2014 Commentary on Art. 1, [9.5], [22], [22.1] and [22.2] and in [9.1] references the guiding principle of denying DTA benefits where a main purpose for entering into certain transactions was to secure a more favourable tax position contrary to the object and purpose of the MTC provisions). Also, various specific DTAs included anti-abuse provisions (e.g. purpose provisions were a feature in certain of the UK's DTAs (see the Burlington Loan Management v HMRC [2024] UKUT 00152 (TCC) on a main purpose test in the interest Art. of the UK-Ireland DTA for which an appeal has been sought by the UK revenue authority). These references sought to ensure that benefits were denied in cases of DTA abuse prior to the publication of the OECD MTC 2017 and are considered to apply where a DTA does not have a PPT following the publication of the OECD MTC 2017 (OECD MTC 2017 Commentary on Art. 29(9), [57] and [61]). While it appears that the OECD considers that the PPT was developed on the same principles as the guiding principle, and in this way confirms the guiding principle, the PPT's formulation may necessitate a somewhat different operation (Buriak, 2019). Some of its operational aspects are considered below.

Operation

At a general level, the PPT can be understood in the context of the object and purpose of the relevant DTA such that where it has been modified it will include the 2017 preamble language (Commentary, Introduction to OECD MTC 2017, [16.2]). On this basis the PPT should at a general level only be engaged when tackling abusive structures (Buriak, 2019).

PPT first sentence

Provides that a benefit shall not be granted if, on an objective review of all relevant facts and circumstances, it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit. This can be described as a standards-based test in that it does not require conclusive proof of subjective intent. Rather it enables the relevant purpose to be inferred from the totality of evidence. It is to be applied on a per item of income or capital basis and, broadly, asks whether an objective observer would, on the basis of the facts, reasonably conclude that securing the DTA benefit was one of a number of principal drivers for the arrangement or transaction. Where the answer is yes, the DTA benefit is denied. However, this denial is subject to the second sentence. This has been described as including a subjective aspect in spite of the fact that Action 6 provided that it was important to ensure that an objective analysis was undertaken of the aims and objects of all persons involved (Lang, 2020).

Any arrangement or transaction

To be interpreted broadly and includes any agreement, understanding, scheme, transaction or series of transactions whether or not legally enforceable (Commentary on Art. 29(9), [177]).

Benefit

The scope of a benefit under the OECD MTC 2017 is broad. In practice it includes rate reductions or exemptions on passive income, limits on source-state taxation, and other DTA-level concessions, that is, all limitations on the source state in Arts. 6 to 22 and the limitation on the resident state in Art. 13 as well as any other limitations in the relevant DTA such as tax sparing provisions (Commentary on Art. 29(9), [175]). It also applies to Art. 23 and Art. 24 but not to Art. 28 (Members of Diplomatic Missions and Consular Posts) as the final privilege results from the general rules of international law or from provisions from special agreements as opposed to the relevant DTA (Lang, 2014 and Rust, 2022).

The relevant benefit may result either directly or indirectly and seeks to include situations where, for example, a loan is entered into for commercial reasons (that is, not for a principal purpose of acquiring a benefit) but is then transferred in order to access a DTA benefit such as reduced withholding tax (Commentary on Art. 29(9), [176]).

In order to determine when a DTA benefit arises, one can characterise a benefit with regard to an arrangement or a transaction against a benchmark by which the benefit can be measured (Duff, 2018). One approach is the tax situation under domestic law without the application of a DTA (Lang, 2014 and Duff, 2018). This is considered to be punitive in that it may result in a greater tax liability and does not appear to provide any scope for any benefits to be granted. However, it appears that the OECD prefers this approach in spite of its punitive character (Rust, 2022 and BEPS Action 6, Revised Discussion Draft, 2015, [87]). A second approach is the tax situation that might reasonably have been carried out without a tax-saving purpose (Danon, 2018). This benchmark appears to leave open the possibility that other DTA benefits may be available under a counterfactual approach.

The Commentary on Art. 29(9), [184]–[185], notes that the CS may negotiate a bilateral Art. 29(10) relief clause, under which the CS may treat a taxpayer as entitled to the denied benefit if such benefits would have been granted in the absence of the transaction or arrangement referred to in Art. 29(9) and, before refusing relief, they agree to consider the relevant facts and circumstances and consult the competent authority of the other contracting state. However, the MTC text does not include Art. 29(10), and the Commentary merely notes the option for bilateral adoption. This "in the absence of" wording is considered to lend weight to the benchmark being the benefit that the taxpayer would have received under domestic law without the application of the relevant DTA, as there is no scope for alternative benefits being granted under a counterfactual.

The PPT applies in respect of an item of income or capital, so the analysis is required to be done on a per item basis. Accordingly, the same arrangement may result in denial for some items of income but not for others (Danon, 2016).

There may be a need to consider the overall tax position to assess whether there is a benefit e.g. where the residence state includes the relevant amount of source income in its tax base and then a credit is granted, it may be that the benefit of any lower source state tax rate is neutralised by inclusion in the tax base of the residence state. In such circumstances it may prove difficult to show that obtaining reduced rates of source state taxation was a principal purpose of the transactions (Lang, 2014).

<u>One of the principal purposes</u>

It is sufficient if one of the principal purposes is the obtaining of a DTA benefit rather than that the purpose is the sole or dominant purpose (OECD Commentary on Art. 29(9), [180]). The onus of proof appears to be on the tax authority to establish that one of the principal purposes was the obtaining of a DTA benefit and the taxpayer may then attempt to rebut this position by showing consistency with the DTA's object and purpose. However, a purpose will not be a principal purpose when it is reasonable to conclude that, for example, the transaction is inextricably linked to a core commercial activity and its form has not been driven by considerations of obtaining a DTA benefit. This will always be dependent on the relevant facts and circumstances and the need to consider whether the transaction would have been entered into but for the DTA benefit (OECD Commentary on Art. 29(9), [181]).

It appears that documenting all commercial justifications of relevant transactions will assist in ensuring DTA benefits are not denied under the PPT. This has been described as similar to keeping a master file albeit in a different context (Chand, 2025). There is a view that any dealing that has a substantial non-tax nexus should be legitimate and be protective of a denial of benefits (Rosenbloom, 1994). The Commentary notes that where it is inextricably linked with commercial activity and its form has not been driven by obtaining a benefit then it is unlikely that the principal purpose is obtaining that benefit (Commentary on Art. 29(9), [181]). A further point is that where a CS determines that a domestic anti-avoidance rule has a purpose rule that is breached by the relevant transaction, this does not protect the taxpayer from the transaction having a principal purpose of obtaining a DTA benefit (Commentary on Art. 29(9), [181]). In this way the PPT may operate both independently of and complementary to domestic anti-avoidance tests.

<u>Second sentence</u>

Provides that even if a principal purpose was to obtain a DTA benefit, that DTA benefit may still be granted if it is established that granting the benefit in these circumstances accords with the object and purpose of the relevant DTA provisions.

<u>Unless … in accordance with object and purpose</u>

Enables a taxpayer to demonstrate, so shifting the burden of proof, that even though one of the principal purposes for entering into the transaction was the obtaining of a DTA benefit, granting that benefit is in accordance with the relevant DTA provision(s). This wording is considered by some to be an exception to the first sentence but there is also an argument that it should not be viewed in this way. Rather, it is necessary to consider the context within which this sentence operates: as it sits within Art. 29(9) - which is itself an exception to the position that DTA benefits are available - the wording confirms the general position that DTA benefits must be granted where they are in accordance with the object and purpose of the relevant DTA provisions.

Conclusion

Candidates may conclude by noting that although Art. 29(9) has been described as being superfluous, it may also be argued to add more than a declaratory gloss. Properly applied, the PPT may assist in reducing instances of DTA shopping, unfair competition between CS and, together with disclosure regimes and information about instances of competent authority relief, may start to develop into a shared language of DTA abuse that crystallises standards over time (Cohen, 2025). However, its breadth may also introduce uncertainty. On balance, the PPT seeks to deter abusive arrangements without displacing bona fide cross-border activity where granting the relevant benefit aligns with the relevant DTA’s object and purpose.

Question 2

There is no single way to answer this question and the following provides one possible schematic.

The question provides an opportunity for candidates to consider the manner in which tax treaties (DTAs) come into being and more specifically whether the modern DTA network is built less on bespoke bargains and more on the repeated use of standard forms. While not required, answers may make reference to specific DTAs and to MTCs other than the OECD MTC and/or the UN MDTC 2021.

The OECD MTC has been described as having "spawned a single multilateral regime, albeit comprised of numerous treaties", with the result that these DTAs look "less like individually negotiated contracts" than manifestations of a common set of norms (Kysar, 2015). On this view, the dominance of model-based drafting may be seen to reduce the space for genuine bargain-making, raising questions about whether bilateral DTAs continue to deserve the legitimacy typically ascribed to agreements between sovereign states.

There is support for the view that the re-use of language in MTCs across a large corpus has resulted in a "clear trend of convergence" of DTA text over time, a priori as regards the OECD MTC (Ash & Marian, 2021). The OECD MTC is described as facilitating bilateral negotiations between OECD member countries and has made possible a desirable harmonisation between their bilateral DTAs for the benefit of both taxpayers and national administrations (Introduction to the OECD MTC 2017, [13]).

The very fact of model-based drafting is considered to impact the interpretation of DTAs; with a wide range of interpretative materials becoming relevant to the interpretation process (Kysar, 2015). In connection with this, both the UN MDTC 2021 and OECD MTC have evolved over time (and the UN MDTC 2021 has evolved in different ways from the OECD MTC). Given these deviations, it is considered good practice for CS to consider MTC provisions side by side (PCT, 2021). It could be argued that the more divergence there is across MTCs the greater the likelihood that agreement is based on informed choice. However, this is always DTA-dependent.

While numerous countries have their own MTC, it appears only a small number of countries publish their MTCs. Evaluating the legitimacy of model-based drafting when countries rely on their own MTC raises different considerations than the reliance placed on MTCs such as the OECD MTC 2017. For example, the US MTC, which provides an example of a published MTC, is stated to have been designed to facilitate negotiations by allowing parties to identify issues quickly and move to key issues that require attention (U.S. Treasury, 1996), and the UN highlights the benefit of countries developing a DTA policy framework and a DTA model before entering negotiations (UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, 2019).

Whether such standardisation undermines legitimacy turns on what features are identified as legitimising a DTA. Under Art. 11 of the Vienna Convention on the Law of Treaties, the consent of a CS to be bound by a treaty may be expressed by signature, exchange of instruments constituting a treaty, ratification, acceptance, approval or accession, or any other means if so agreed. Consent therefore forms the core of DTAs, which raises the question how reliance on model-based drafting may impact the nature of consent by undermining the ability of CS to protect their interests and make informed decisions.

Where the focus is on formal consent and parliamentary approval, model-based uniformity may be seen as doing little to undermine the legitimacy of DTAs based on relevant MTCs. In such cases, CS still sign, ratify, and can (subsequently) deviate from agreed positions by later agreement (e.g. Protocol). Furthermore, while MTCs do provide definitions of some terms, there is still scope for separate consideration such as the MTCs' inbuilt "renvoi clauses"; the scope for CS to cross-refer to both the model conventions when considering their agreed DTA positions; and the fact that MTCs are not static instruments such that the "currency" of DTAs may have more to do with the length of time it takes DTAs to be negotiated rather than their reliance on MTC provisions, which may have evolved since the time the relevant DTA was entered into. There is also the point that over time the UN MDTC 2021 has begun to diverge in meaningful ways from the OECD MTC such that a statement that groups together all MTCs fails to recognise these significant differences (e.g. the Introduction of Art. 12A UN MDTC 2021).

On the other hand, given the minimal levels of transparency around the negotiation process it may be difficult to assess the extent to which genuine consent is achieved. Negotiators have been described as being "universally opaque about their countries' negotiation policies and procedures", which has been stated to deprive courts and the public of the context for the various agreed positions and this may in turn negatively impact any attempts to verify that consent was fully informed (Brauner, 2020). On this view, while numerous countries have their own MTCs (and CS appear to be encouraged to have their own MTC in place prior to negotiation), publication of these MTCs appears to be the exception rather than the rule. More transparent negotiation processes and more extensive (potentially joint) explanatory materials may enhance the ability to assess the context within which MTC provisions were accepted, debated or rejected by one or both CS.

A further potential and related concern is that capacity constraints may skew DTA outcomes. It appears that MTCs may assist lower-capacity CS (in relation to, for example, resourcing, knowledge asymmetries and negotiating experience) but there are also likely to be cases where the interests of a particular CS are not best represented by a particular MTC position and there may be an expectation or pressure for them to adopt that position. For example, developing countries have been stated to have signed “thousands” of DTAs that may restrict their taxing rights in relation to inward investment (Hearson, 2018), prompting the IMF to urge caution in signing new DTAs (IMF, 2014 and Keen et al, 2014). Where there is a material imbalance between the economic positions of the CS, one CS may face informational, institutional, or political pressure to adopt a MTC-based DTA, which may weaken claims that the DTA embodies a genuine agreement. More specifically, it appears that the full implications of adopting certain DTA provisions may not always be widely understood (e.g. Global 120E Pty Ltd v Commissioner of State Revenue; Stott v Commonwealth of Australia [2025] HCA 39) even where they are based on standard MTC provisions, with those involving provisions reducing WHT being an apparent exception and being more “salient” (Hearson, 2018).

However, it is not clear that reliance on MTC provisions necessarily results in minimal negotiation across the board. Many DTAs depart - sometimes significantly - from MTC provisions (for example, on withholding rates, permanent establishment thresholds, services and technical-fee provisions, anti-abuse rules). MTCs may also enhance consent by making choices clearer for the relevant CS as standardised provisions may allow negotiators to focus on policy differences rather than reinventing terminology. Such MTCs may also enable interested parties to rely on a shared body of interpretive resources when, for example, terms are not defined in the DTA. In addition, guidance encouraging side-by-side MTC comparison may support concerns that CS may agree to certain DTA provisions without the capacity to make an informed choice (PCT, 2021). In this sense, and as noted above, the existence of various MTCs may together enhance the legitimacy of model-based drafting, a priori where those MTCs provide for different DTA outcomes (e.g. Art. 12A and 12B of the UN MDTC 2021).

Conclusion

Candidates should form a view as to whether they agree/disagree with the statement in the question. One possible conclusion is that model-based drafting, taken on its own, may not vitiate consent or DTA legitimacy under the VCLT, and therefore does not inherently undermine legitimacy (U.S. Treasury, 1996; UN MDTC 2021; OECD MTC 2017). However, given that MTC dominance may reduce real negotiation - for example, in cases of opacity and capacity asymmetries - the claim that a DTA is a real bilateral bargain may be weakened, even where there is formal legitimacy. Candidates may argue that model-based drafting could be viewed as a supportive framework rather than a substitute for sovereign deliberation, and that DTA legitimacy may be best preserved where negotiating teams have adequate technical depth, (and are supported in this) and choices in relation to contentious areas are explained and recorded, and transparent materials (such as (joint) explanatory statements) are used to demonstrate that MTC provisions agreed upon are the product of informed, bilateral choice. Furthermore, in a post-BEPS world, the MLI’s architecture with Reservations and Options (and possibly also the work towards a UN Framework Tax Convention) can be described as amplifying model-based drafting such that while it is possible the role of MTCs may change over time, the reliance on MTCs and their Commentary may continue for some time to come.

Question 3

There is no single way to answer this question and the following provides one possible schematic.

This question provides candidates with an opportunity to consider the various options available to countries when considering nexus tests under various DTA provisions. There is no requirement to focus on any particular nexus test or set of nexus tests. However, it is expected that answers will include references to either or both MTCs to support points being made. Candidates may note that there is no information provided about the circumstances within which the relevant government finds itself, such that it is not known whether they already have a DTA network or have signed the MLI. This means there is scope to discuss a number of different potential issues and answers are expected to be varied in their discussions.

Nexus

The concept of nexus is a fundamental principle of taxation law and can be understood as the requirement that a qualifying connection exists between the state exercising its taxing power on the one hand and the taxable subject and/or taxable object on the other (Gadžo, 2018). While candidates may note that nexus tests are found in domestic law, customary international law and soft law (such as the OECD MTC and UN MDTC 2021 Commentaries) (Ooi, 2025), answers should be primarily focussed on nexus tests in DTAs (with reference to one or both MTCs). Nexus has been described as taking on an absolute and a relative meaning in that the former considers whether the person has a sufficient link with a state to justify the extension of its taxing power and the latter considers which of two countries has the stronger link (Ooi, 2025). One key feature of DTAs is their regulation of jurisdictional classes in relation to competing nexus claims (Gadžo, 2018).

DTA provisions may often rely on physical presence. Physical presence was traditionally a main nexus test for cross-border claims and there are examples in DTAs that continue to rely on physical presence, but these tests have been complemented by broader notions of nexus to ensure that source states are not restricted from establishing a nexus because of an insufficient physical presence. The OECD MTC 2017 Art. 5 remains central for business profits: a contracting state taxes non-resident business profits only where there is a permanent establishment through which the business is carried on (Art. 7 read with Art. 5). The 2017 text and Commentary extend dependent-agent PE to persons who habitually play the principal role leading to the conclusion of contracts and confine specific-activity exemptions to activities of a preparatory or auxiliary character, with anti-fragmentation and contract-splitting rules, thereby sustaining a presence-based nexus while reducing avoidance (OECD MTC 2017, Art. 5(5), 5(4), 5(4.1)). The UN MDTC 2021 retains these baselines and preserves a services PE: the furnishing of services, including consultancy services, through employees or other personnel for a prescribed period creates a PE even without a fixed place (UN Model 2021, Art. 5(3)(b)).

Classic examples of physical connection include immovable property situated in a contracting state. Where immovable property generates income or gains, the source state taxes. Art. 6 OECD MTC 2017 allocates income from immovable property to the state where the property is situated; Art. 13(1) allocates gains from alienation of such property to that state; and Art. 22 addresses capital. Both MTCs enable land-rich gains from shares deriving their value principally from immovable property (OECD MTC 2017, Art. 13(4); and UN MDTC 2021, Art. 13(4)), and candidates may suggest drafting to ensure indirect disposals are also captured. Time spent by persons in a country is another example of a physical presence-based nexus criterion. OECD MTC 2017 Art. 15 allocates employment income primarily to the state where employment is exercised, subject to the 183-day and employer/PE tests; the UN MDTC retains Art. 14 on independent personal services with a fixed-base/days-in-country nexus, evidencing a more source-forward approach.

Permanent establishment remains the principal business-profits nexus (Arnold, 2013 and Gadžo, 2018). The department should be alerted to the fact that the nexus has been extended to ensure that specific scenarios are captured (dependent-agent language; anti-fragmentation; contract-splitting) and bolstered to ensure that the PE threshold is not circumvented. These PE updates can be introduced via an MLI or bilaterally via protocol, subject to counterparties' reservation positions.

Personal attributes of the taxpayer may also form the basis of nexus tests and in turn allocation. Various provisions focus on residence and allocate taxing rights to the residence state. One example is royalties, which are taxable only in the state of residence of the beneficial owner. The definition adopted in the DTA (including "beneficial owner" and "royalties") directly shapes scope. The UN MDTC 2021 varies the allocation by permitting source-state taxation of royalties and so introduces a source-based nexus for that income stream. Art. 21 "Other income" in the OECD MTC 2017 gives residence-only taxation unless the income is effectively connected with a PE in the source state; the UN Model 2021 adds paragraph 3 allowing the source state also to tax "other income" arising there, a deliberate expansion of source-based nexus.

Two UN MDTC provisions provide DTA source-based jurisdiction nexus tests for cross-border services without physical presence. Art. 12A (Fees for Technical Services) permits the source state to tax fees for managerial, technical or consultancy services arising in that state, generally by way of a capped withholding on the gross amount paid to a resident of the other state; source is determined by the payer's residence or by whether the fee is borne by a permanent establishment or fixed base situated in the taxing state; where the services are effectively connected with a PE or fixed base, allocation reverts to Arts. 7 or 14; ordering and overlap rules coordinate with Arts. 7, 12, 14, 16 and 17; relief of double taxation follows Art. 23; no PE-style minimum presence threshold is required (UN MDTC 2021, Art. 12A). Art. 12B (Income from Automated Digital Services) grants the source state a maximum gross-basis taxing right over income from automated digital services paid to a non-resident, with a taxpayer election to a net-basis calculation of qualified profits computed as 30 per cent of the profitability ratio multiplied by the gross annual ADS revenue sourced to the state; "automated digital services" are services provided over the internet or an electronic network requiring minimal human involvement, with a non-exhaustive list including online advertising, the supply of user data, search engines, intermediation platforms, social media, digital content, online gaming, cloud computing and standardised online teaching; priority and overlap clauses exclude amounts that fall under royalties (Art. 12) or fees for technical services (Art. 12A); effective-connection rules route cases involving a local PE or fixed base to Arts. 7 or 14; source is determined by payer residence or whether the payment is borne by a PE or fixed base; relief of double taxation is provided under Art. 23 (UN MDTC 2021, Art. 12B).

Anti-avoidance is integral to nexus choices. The department should consider whether its anti-avoidance rules align with nexus tests under relevant DTA provisions. For example, controlled foreign company (CFC) rules extend residence-state taxing rights to certain low-taxed foreign income of residents; BEPS Action 3 treats well-designed CFC rules as compatible with DTAs and the OECD MTC 2017 Commentary recognises that such domestic-law measures aimed at residents are not inconsistent with the MTC provisions (see Art. 1(3) OECD MTC and Commentary [81]).

Conclusion

Ultimately, nexus describes whether a taxpayer, property, or activity has sufficient connection with a state to be subject to that state's tax jurisdiction (Mines, 2005). Countries seeking to determine which nexus test(s) best serve their interests in a DTA context will need to consider their economic situation, enforcement capacity and DTA objectives; weigh presence-based baselines (OECD MTC 2017 Arts. 5, 6, 7, 13, 15, 21) against more source-based DTA options (UN MDTC 2021 Arts. 12, 12A, 12B, 21(3)); and remain conscious that DTAs require bilateral agreement such that the likelihood of certain tests being included may be greater with some partners than others. It is also advisable to monitor developments at the UN level to see the extent to which services-focused provisions are useful for particular DTA partners and to track developments in the AI space, where non-physical, user-data-driven value creation may intensify pressure for market-engagement nexus that remains DTA-coherent and ultimately creditable.

PART B

Question 4

There is no single way to answer the question and the following provides one possible schematic.

Option A

Payments under this arrangement may fall within the definition of dividends in Art. 10(3) as they are income from shares or other corporate rights that participate in profits, not being debt-claims, including amounts treated as share income under the payer's domestic law. As NSU is the beneficial owner and holds 50% of NewCo, the maximum WHT rate is 5% provided the 365-day holding period in Art. 10(2)(a) is satisfied and provided NSU's direct holding remains at least 10% throughout that period. If the first dividend is paid within six months, the holding-period requirement will not be met at that time such that the applicable rate will be 15% at the time of payment, with any subsequent reduction to 5% applying to later dividends once the 365-day test is satisfied. However, once the 365-day period is satisfied, it may be possible for NSU to make an application to Bronzia's revenue authority for a refund of the 10% differential in respect of any dividends paid out prior to the holding period being satisfied. On this basis both Auburnium and Bronzia will have taxing rights, with Auburnium granting relief under Art. 23 in accordance with its domestic relief mechanism. CFC rules based on BEPS Action 3 may apply to NSU depending on Auburnium's laws, the level of control, the (effective) tax rate in Bronzia. However, regular distributions and the nature of the activity in Bronzia may reduce the case for CFC inclusion in some regimes. Candidates may note that CFC outcomes are jurisdiction-specific and no details are provided in the facts. BEPS Action 3 may be referenced.

One advantage of Alternative (a) is access to the 5% WHT rate once the holding-period test is met, which represents a significant reduction from Bronzia's 20% domestic rate. Another potential advantage, depending on Auburnium's law (e.g. where various conditions are satisfied), an investor may be able to access the UK's Substantial Shareholding Exemption for certain disposals of at least 10% of ordinary share capital (Taxation of Chargeable Gains Act 1992, Sch. 7AC). Furthermore, where the countries operate participation regimes (e.g. EU participation regimes under the Parent-Subsidiary Directive) there may be scope for further reductions or elimination of taxation. A key disadvantage is that dividends are not deductible for NewCo. A further disadvantage is that the reduced WHT rate under the DTA is linked to, inter alia, the size of NSU's shareholding in NewCo such that NSU would need to may consider the implications of reducing its holding in the future.

Option B

Payments under this alternative may fall within the definition of interest within Art. 11 and may then benefit from reduced WHT as NSU is the beneficial owner. As any payments would arise from a debt-claim made on commercial terms Art. 11 would appear to apply. Given that NSU is the beneficial owner, Bronzia may levy WHT but is limited by the DTA to a maximum of 10% of the gross amount. Auburnium may also tax the interest and then grant relief under Art. 23. It is open to candidates to note that while the facts state that NSU is the beneficial owner, back-to-back on-lending may invite beneficial ownership scrutiny and where this is in doubt, the 20% rate under Bronzia's domestic law may apply.

One advantage of Alternative (b) is that the DTA reduces Bronzia's domestic 20% WHT to a maximum rate of 10%. Another advantage is that interest is generally deductible such that NewCo may be able to deduct the payments to NSU thereby reducing taxable profits in Bronzia. As compared to Alternative (a), the 10% WHT rate under (b) is lower than the WHT rate of 15% under (a) where NSU either reduces its shareholding or fails to meet the holding period requirements. Disadvantages may include the possibility that Bronzia's may have interest-limitation/thin-capitalisation rules based on BEPS Action 4 (such as the UK's Corporate Interest Restriction rules) and these may restrict the deductibility of the interest payments. There may also be transfer pricing considerations re: rates, term, security etc. However, candidates may note the rate is a commercial rate of interest so the transaction appears to be made at arm's length based on the rate. A further consideration is the principal purpose test in Art. 29(9), which can operate to deny access to the maximum 10% rate where a principal purpose of the arrangement is to obtain (in/directly) the reduced WHT rate. It is advisable to document the commercial funding reasons to support the arrangement having a clear commercial purpose.

Option C

Payments generated from the certificates need to be classified for DTA purposes. Starting with Art. 10, the question is whether such payments fall within the definition of dividends. The definition refers to income from shares ... or other rights, not being debt-claims participating in profits, as well as income from other corporate rights which is subject to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident. Commentary on Art. 10(3) OECD MTC 2017, [23] provides that as it was not possible to work out a definition of the concept of dividends that would be independent of domestic laws, the term can be interpreted with reference to the domestic law definition "it has at that time under the law of that State for the purposes of the taxes to which the Convention applies … unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25". While Bronzia's domestic definition would be relevant here, no such information is provided. On the basis of the given facts, several features may point towards the payments being dividends (e.g. no payment in loss years (signalling that income is dependent on the success of NewCo), equal ranking with ordinary shares on liquidation, part of share capital, etc).

However, given that the definition of dividends excludes "debt-claims", it is worth exploring whether the payments may constitute debt-claims under Art. 11. Consequently, where the income is not income from a "debt-claim" it may further support classification as "dividends" under Art. 10(2). In contrast to Art. 10, there is no explicit reference to the domestic law of any state in Art. 11. It is open to candidates to explore whether the context requires an autonomous interpretation of the term "debt-claim". Applying the general rules of interpretation in Arts. 31 and 32 of the Vienna Convention on the Law of Treaties (broadly, a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose), when the ordinary meaning of 'debt-claim' is considered, it could be argued that as a debt is 'a documented, binding obligation between two parties in which one party lends funds to another, with the repayment method specified in a contract" the income under (c) is more likely to be classified as dividends because the certificates form part of share capital and do not confer the right to receive repayment of the loan. On this basis, income under (c) is more likely to be classified as dividends, subject to the maximum rates of WHT in Art. 10(2) such that taxing rights are shared.

It is open to candidates to explore the possibility that income from the certificates would not fall within either Art. 10 or Art. 11 (e.g. there may be a situation where the payments are not considered to arise from a debt-claim and Bronzia's domestic definition of dividend excludes payments with the relevant features). In such a scenario, the payments may fall under Art. 21 as other income (and subject to tax in Auburnium under Art. 21(1)).

In terms of (dis)advantages, this depends on the classification of the payments. On the basis that they fall under Art. 10 or Art. 11, there is no obvious advantage for NSU to choose Alternative (c). For example, income arising under (c) would lead to the same tax consequences and tax risks as Alternative (a) or (b). Furthermore, given the potential uncertainty of the nature of the payments and their seemingly "hybrid" qualities, where Auburnium has introduced anti-hybrid rules, the benefits of (c) may be reduced or even eliminated. Should Art. 21(1) apply then the tax consequences would depend on Auburnium's domestic law and Bronzia would not have rights to tax (unless NewCo was a PE of NSU under Art. 21(2)).

Conclusion

While commercial reasons to choose a particular location will generally operate as the driving force behind investment location decisions, tax factors may tip the balance e.g. Alternative (a) provides the potential for a lower WHT rate - as outlined above - than Alternative (b) and given the classification uncertainty of Alternative (c), Alternative (a) might be the most beneficial alternative overall.

PART C

Question 5

There is no single way to answer the question and the following provides one possible schematic.

The question presents two scenarios that provide candidates with an opportunity to demonstrate their understanding of the operation of Art. 8 UN Model Tax Convention 2021 (which candidates may note that Alternative A UN MDTC 2021 is the same as the general rule in Art. 8 OECD MTC 2017) and Art. 15(3) OECD MTC 2017. While there are different issues to consider, both scenarios require consideration of the term "international traffic". Where the relevant activity is not sufficiently connected with international traffic, other DTA provisions may apply and in turn these provisions may provide for a different allocation of taxing rights.

Art. 3(1)(d) and Art. 3(1)(e) OECD MTC 2017 and UN MDTC 2021 define the term as referring to:

"Any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State."

Scenario A

Candidates may note the general position that Art. 8 UN MDTC 2021 has two alternatives and as such it is anticipated that both alternatives will be referenced but given that the relevant profits are generated only from shipping activity Alternative A and Alternative B (as it relates to shipping) need to be applied to the facts. Implicit in this statement is that Alternative B houses two separate allocation rules for aircraft and shipping.

In order to fall within the rule in Art. 8 Alternative A or B, the profits must be derived from the operation of ships in international traffic. Relevantly, traffic does not include the operation of ships solely between places in Country S where the operator is not a resident in Country S and Country T where the operator is not a resident of Country T.

Each of the two profit sources will need to be considered to determine whether they fall within Alternative A of Art. 8 UN MDTC 2021 and Alternative B.

Alternative A

Profits arising from the transportation of foreign freight from Country S to Country T

Any profits arising from the transportation of foreign freight by sea from Country S to Country T and back again would appear to fall within Alternative A of Art. 8 UN MDTC 2021. This seems to be a fairly straightforward case of relevant profits being derived from the operation of international traffic and as such Country S is likely to be allocated exclusive taxing rights.

Profits arising from occasional delivery by road of freight delivered into other Country T locations

It is possible that any amounts derived from these services, notwithstanding that they are delivered by road transportation, may fall within the scope of Art. 8 as being ancillary to the operation of ships in international traffic. While the Commentary on Alternative A of Art. 8 UN MDTC 2021 does not provide an example that completely captures this situation it does refer to a situation where an airline provides a bus service from an airport to a town within the same country to primarily connect passengers of its international flights with the airport (UN MDTC 2021 Commentary on Art. 8, [13] and OECD Commentary, [6]). There is a further example that may also lend support to this outcome. In that example any amounts derived by a company for arranging the pick-up/delivery of cargo by a third company would also fall within Alternative A of Art. 8 UN MDTC provided that the company making the arrangement was the company that operated the relevant ships or aircraft in international traffic. By analogy it may then be possible that the road transportation of freight within Country T may fall within Alternative A of Art. 8 UN MDTC 2021. On this basis, any profits from this delivery service are also likely to be allocated to Country S only.

Alternative B

Profits arising from the transportation of foreign freight from Country S to Country T

Only the second paragraph is relevant here as the first paragraph for Alternative B applies only to aircraft.

Under Alternative B it is necessary to ascertain whether Country T may be allocated taxing rights in respect of any profits derived by SC from its transportation of freight into and out of Country T. The relevant threshold for Country T to have taxing rights is that operations in Country T are "more than casual." According to the Commentary on Alternative B, "more than casual" refers to a scheduled or planned visit of a trip to pick up freight or passengers

(Commentary on Alternative B, [16]). This wording has been described as rather vague and suggestive of virtually all "contractual passenger and cargo shipping" being more than casual and therefore potentially subject to tax in Country T (Kofler, 2022). On this basis it appears that Country T would be allocated taxing rights over some of these profits but the precise manner in which an apportionment would operate is not provided in the facts and would, in practice, be expected to have been negotiated by Country S and Country T. The Commentary on Alternative B, [17] provides that Country S (as the resident state) would generally be expected to determine the allocation based on overall net profits, but ultimately the "final conditions of the determination" might be decided in bilateral negotiations between Country S and Country T. Other details are also provided in the same paragraph of the Commentary but there is no requirement to speculate as to which conditions might be included.

Profits arising from occasional delivery by road of freight delivered

Profits arising from the occasional delivery of freight to Country T customers may also fall within Art. 8 UN MDTC 2021 under Alternative B as these profits appear to have a sufficient connection with the operation of ships in international traffic and as such they can fall under the "international traffic" umbrella. On this basis, these profits would also appear to be "more than casual" in the sense that they are more than isolated and are planned rather than "merely fortuitous" (UN MDTC 2021 Commentary on Art. 8, Alternative B, [16]). On this basis, profits derived from such activity would then also be subject in Country T as per the profits arising from the transportation of freight into and out of Country T.

<u>Scenario B</u>

Art. 15(3) provides that:

"Notwithstanding [Art. 15(1) and (2)), remuneration derived by a resident of a CS in respect of an employment, as a member of a regular complement of ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the other CS, shall be taxable only in that State."

Both Art. 15(3) and Art. 3(1)(e) were amended in the 2017 version of the OECD MTC in ways that are relevant to the facts in Scenario B. Art. 15(3) seeks to ensure that the remuneration of an employee of an aircraft (or ship) operated in international traffic will have their salary subject only to tax in their state of residence (Commentary on Art. 15(3), [9], OECD MTC 2017) and the definition of international traffic was amended so that it applies to an employee under Art. 15(3) who exercises their employment on board an aircraft (or ship) that is operated by an enterprise of a third state (Commentary on Art. 15(3), [9] OECD MTC 2017).

It appears that Leila's remuneration will fall under Art. 15(3) OECD MTC 2017 and so only Country L (as the resident state) would have taxing rights. This is because, as an employee (salaried pilot) of a company that is resident in Country N that operates aircraft between Country L and Country M, Leila will derive her salary from employment exercised aboard an aircraft that is operated in international traffic and it matters not that the operator of the aircraft is resident in a country (Country N) that is neither Country L nor Country M. For completeness, her salary is also sufficiently connected with the operation of the aircraft in international traffic as she exercises her employment in the course "of the usual operation of the aircraft" (Commentary on Art. 15(3), [9.3]).