THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 1

SUGGESTED SOLUTIONS

PART A

Question 1

There is no one way to answer this question but it is expected that candidates' answers include a brief consideration of the nature of a DTA, a discussion of Arts. 31 and 32 OECD MTC 2017 (with more of a focus on Art.32 than Art.31) the Vienna Convention on the Law of Treaties (VCLT) and any relevant case law and/or examples from DTA practice. Answers would then be expected to conclude as to whether the statement can be supported or not. Here is one possible schematic.

VCLT

As DTAs are international treaties, when considering the 'life' of a DTA, reference should be made to the VCLT. Various provisions of the VCLT address when a treaty can be terminated or withdrawn from. These provisions apply to DTAs:

- Consent of the parties. A treaty can be terminated where the treaty itself provides for termination or if all parties to the treaty consent to its termination (Art.54 VCLT). Art.32 OECD MTC 2017 refers to the termination of a DTA
- Denunciation of or withdrawal from a treaty providing no provision regarding termination, withdrawal or denunciation (Art.56 VCLT)
- Suspension of the operation of a treaty under its provisions or by consent of the parties (Art.57 VCLT)
- Termination or suspension of the operation of a treaty implied by conclusion of a later treaty (Art.59)
- Where one CS has breached the treaty: a material breach of a treaty by one of the CS would appear to entitle the other CS to invoke the material breach as a ground for terminating the treaty or suspending its operation in whole or in part (Art.60 VCLT)
- A supervening impossibility of performance. Fulfilment has become impossible due to the permanent disappearance or destruction of an object indispensable for the execution of the treaty (Art.61 VCLT)
- A fundamental change of circumstances. Where the original circumstances have fundamentally changed since the treaty's conclusion and those original circumstances were an essential basis of the CSs' agreement to be bound (Art.62 VCLT)
- Severance of diplomatic relations between CSs does not affect the legal relations between them by the treaty except insofar as the existence of diplomatic or consular relations is indispensable for the application of the treaty (Art.63 VCLT)
- Where a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and terminates (Art.64 VCLT)

The procedure to be followed is contained within Art.65 VCLT (i.e. where a CS wishes to terminate, suspend or withdraw a treaty it must notify the other CS). Art.67 VCLT provides details for the instruments for declaring invalid, terminating, withdrawing from or suspending the operation of the treaty.

OECD MTC 2017

In the OECD MTC 2017, Arts. 31 & 32 specifically address the mechanisms for the entry into force and the termination of DTAs. These articles set out the operational period of the DTAs and provide the conditions under which one of the CSs can terminate the agreement by giving notice. Known as "final provisions," these sections have not seen substantial changes in wording since they were first introduced, underscoring their stability and importance in the framework of DTAs. These provisions fundamentally govern the "timing, effect, and application" of a DTA (Meinert, 2019).

It is necessary to differentiate Arts. 31 and 32 from other provisions within the MTC e.g. Arts. 1 & 2 discuss the personal and substantive scope of DTAs, establishing who and what is covered under DTAs and Art. 26 (exchange of information (EOI) applies as soon as a DTA enters into force, but may also allow for the exchange of information pertaining to the period before the DTA's enforcement, provided that the actual exchange occurs post-enforcement (Dourado 2022 and Art.26(1) Commentary [10.3])). However, once a DTA is terminated, there is no legal framework to support EOI.for periods when the DTA was active, reflecting the critical nature of these final provisions in regulating the life cycle of a DTA. Furthermore, Art.30 OECD MTC 2017 is concerned with scope of territory and enables a CS to extend the application of a DTA to additional territories and so may affect the geographical scope of the DTA (Becker 2022) and is therefore considered separately from Arts. 31 & 32.

Whilst Arts. 31 & 32 are separate within the OECD MTC 2017 and would be expected to feature separately in DTAs, there may be references to the termination of a prior DTA within the relevant entry into force provision in some DTAs. Given this potential overlap, the following considers the entry into force provisions and then the termination provisions. It could be noted that there are no reservations, observations nor positions on Arts. 31 & 32 OECD MTC or the Commentary.

Entry into force/termination

The entry into force process typically involves several steps, which can differ slightly depending on each CS's domestic law and the relevant procedural requirements. Typically, one would expect CSs to adopt the following procedure:

- Negotiation and signing, which indicates intent to be bound by the DTA provisions
- Ratification of the DTA, which may require approval from a legislative body or governmental authority, confirming the DTA's domestic legal status in the relevant CS
- Exchange of documents (instruments of ratification), which verify that each CS has completed the necessary legal steps
- Entry into force will depend upon the relevant provisions within the DTA (the exchange of ratification instruments may trigger it or a specific date may be set)
- DTA provisions may also specify the date from which they start to affect tax matters (e.g. some DTAs specify that provisions relating to withholding taxes may have, for example, effect from the start of the calendar year following its entry into force and provisions relating to other taxes may have effect from a later specified date). Accordingly, there will always be a need to consider the specific DTA provisions at issue (e.g. US/UK DTA 2001, Art.29 Entry into force "in respect of taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date on which this Convention enters into force" then providing different points in time for other taxes, which apply differently for each CS (given their different tax years). These may be referred to as "individual threshold dates"

It is possible for CSs to agree for a DTA to have effect before the date of entry into force, which effectively involves a retrospective application of the DTA provisions (see Art.28 VCLT). Whilst it is possible that the new DTA provides for more favourable position for relevant persons, it is also possible that the prior DTA provides for a more favourable outcome than the new DTA. Some DTAs may contain a provision where they permit persons to access the benefits under the prior DTA (where it provides a more favourable position) until the new DTA enters into force, where the new DTA would otherwise apply retrospectively (Nasdala 2015 & US/UK DTA 2001 where it is provided that the prior DTA shall, at the election of such person, continue to have effect in its entirety with respect to that person for a 12-month period from the date on which the provisions of the new DTA would otherwise would have effect).

DTAs will typically remain in force until terminated by one of the CSs (Zembala 2022). Whilst some DTAs may be limited in time (e.g. United Arab Emirates-Germany DTA 2010 has a 10-year duration), they would typically be expected to have a certain minimum duration (e.g. Art.32 OECD MTC 2017 refers to the need to give notice of termination at least six months before the end of a specified calendar year) or to be left open-ended (Commentary on Art.32 [5]). Termination of a DTA is to take place "through diplomatic channels or by giving notice of termination" (Art.32 OECD MTC 2017). Some DTA provisions even refer to the fact that the DTA will remain in force "indefinitely" whilst still providing a termination process (e.g. Art.30 Belgium/India DTA 1993).

Termination by notice involves a unilateral declaration of intent (Zembala 2022). However, other forms of termination are contemplated by the VCLT (e.g. mutual agreement regarding the suspension of the DTA, agreement upon a new DTA as its entry into force will result in the termination of the prior DTA). A new DTA entering into force is considered to be the most common form of termination of a DTA (Tenore 2006). Severance of diplomatic relations has been stated not to justify the termination of DTA (Nasdala 2015). The notice does not need to include the reasons for terminating the DTA. Rather, it needs to comply with diplomatic custom and the relevant notice period (Zembala 2022). Notwithstanding that no reasons are required to be given, termination of a DTA is considered to be a last resort and it is expected that a CS wishing to terminate a DTA would enter into negotiations with the other CS with a view to amending the existing DTA (Vogel 1997).

It is not clear from the OECD MTC 2017 at what point in time the DTA provisions will cease to have effect (Art.32 Commentary [54]) and there is variance across DTAs. Some DTAs may specify when the DTA ceases to have effect (e.g. US-UK DTA 2001, Art.30 – is to remain in force until terminated by a CS.: [e]ither CS may terminate this Convention by giving notice of termination to the other CS through diplomatic channels. In such event, this Convention shall cease to have effect approximately six months after the termination notice is given) and others may specify that, for example, withholding taxes may cease to have effect at a different time to other taxes.

Some suspension/termination examples

The reasons for suspension/termination vary and include concerns regarding base erosion, incongruent tax policies across the relevant CSs, the lapsing of time before the relevant domestic legal processes have been completed by the other CS before a new DTA can come into force, as well as public policy concerns and retaliatory measures. Reported examples include (note some of these terminated DTAs may have been renegotiated):

- US/Netherlands Antilles. Terminated by US in June 1987 as part of its fight against DTA shopping

- US-South Africa 1946. Terminated by the US on 1 July 1987, pursuant to the terms of that DTA and Section 313 of the Comprehensive Anti-Apartheid Act of 1986
- Finland-Portugal. Terminated in June 2018 as Portugal failed to approve a DTA signed by both CSs in 2016 (with a transition period of three years) by the end of November 2018 as required, with the result that as of 1 January 2019 there is no DTA in force between the CSs (PWC Portugal)
- Sweden-Portugal. Sweden initiated discussions with Portugal in 2017 with a view to amending the DTA. An amended protocol was signed during 2019, but it appears Portugal has yet to ratify this
- Sweden-Greece. Sweden initiated a dialogue with Greece to initiate negotiations on a completely new DTA
- US-Hungary. US notified Hungary on 8 July 2022, that it would terminate its DTA with Hungary. In accordance with the DTA's provisions, termination was effective on 8 Jan 2023. However, with respect to taxes withheld at source, the DTA ceased to have effect on 1 Jan 2024 and for other taxes: the DTA ceased to have effect with respect to taxable periods beginning on or after 1 Jan 2024
- Ukraine-Iran. Ukraine terminated the Ukraine-Iran DTA in Aug 2023 over Iran's alleged weapons supply to Russia
- Burkina Faso-France. BF gave notice of termination in Aug 2023 due to France's refusal to renegotiate their DTA despite requests to do so in both 2020 & 2021
- Norway terminated DTAs signed with Barbados, Curacao, Jamaica, Sierra Leone and Trinidad & Tobago in June 2023 (with the termination taking effect as of 1 Jan 2024). According to reports, Norway considered these terminated DTAs to be outdated and seldom used in practice. It is possible that some of these may be renegotiated
- Mongolia unilaterally terminated DTAs signed with Luxembourg, Kuwait, the Netherlands & UAE due to concerns about DTA shopping and tax avoidance (Ulziisaikhan, IMF, 2013)

<u>Russian DTAs</u>

Russia recently suspended a significant number of material provisions within a significant number of its DTAs e.g. UK-Russia DTA (the UK (and some other countries, 38 "unfriendly states") in response to action taken by other CS. The UK initially suspended exchange of information (EOI) with Russia & Belarus on 17 March 2022). Russa's DTAs with Latvia is reported to have been definitely and unilaterally suspended by Latvia in May 2022 and the Denmark-Russia DTA was terminated by Denmark in June 2023 – it has been reported that the suspended provisions are the distributive rules and the mutual agreement procedure with provisions from relief from double taxation being generally retained.

When considering the Russia-UK DTA, it should be noted that it does not provide for suspension but does contain a termination provision and therefore it is necessary to refer to Art. 60 VCLT when considering suspension. It has been reported that (i) the UK released a statement in August 2023 noting that the UK-Russia DTA does not permit unilateral suspension and asked Russia to reverse the suspension and (ii) the Russian Ministry of Finance issued a press release noting non-compliance with its DTAs, including the suspension of the exchange of tax information (EOI) and cited the VCLT as the legal basis for the suspension of the selected DTA provisions (Schwarz 2023). It is not clear whether the suspension of EOI constitutes a material breach and so a valid justification for the suspension of the relevant DTA(s) under Art.60 VCLT is as yet unclear. There is a view that the UK's noncompliance with Art.26 of the Russia-UK DTA does not necessarily imply a breach of the relevant provision because the obligation to EOI is not absolute. Rather the obligation is subject to the exceptions specified in Art.26(2) Russia-UK DTA 1994, in particular, there is no obligation imposed on the UK to EOI under Art.26(1) where to do so would be contrary to the public policy exception (Art.26(2)(c) UK-Russia DTA 1994) (Goel & Goel, 2023). It has been reported that Switzerland has refused to EOI based on the public policy exception under the Convention on Mutual Administrative Assistance on Tax Matters (Art.26).

Furthermore, even where there is a relevant breach of a DTA provision, according to Art.60(3) VCLT this breach must be "material". The Commentary to the OECD MTC 2017, Introduction [15.6] notes that the administrative provisions within a DTA, whilst important in furthering the goal of reducing tax avoidance/evasion, do not constitute a policy basis for entering into a DTA where there is no actual risk of double taxation as the administrative objectives could be achieved by alternative more targeted means (e.g. Mutual Administrative Assistance on Tax Matters, 2023). Accordingly, there is an argument that it is unclear that a refusal to EOI (an administrative assistance provision) would be sufficient to constitute a material breach (Goel & Goel 2023).

An alternative to Art.60 VCLT is provided by Art.57 VCLT, which provides that the operation of a treaty can only be suspended (i) in conformity with the provisions of the relevant treaty or (ii) through mutual consent of all parties and after consultation with the other contracting state. On this basis, it would appear that Russia's suspension may be unilateral as it has not been effected by way of "mutual consent" and would not appear to be consistent with Art.57 VCLT (Vanhassel & van Doremalen, 2023). Furthermore, as noted above, and at least in the case of the UK-Russia DTA, suspension is not expressly provided for under its provisions.

Conclusion

Candidates may conclude by summarising their evaluation of the statement. It would be expected that candidates would tend to agree with the statement and would support their answers by referring to the VCLT, OECD MTC 2017 (Arts. 31 & 32) and providing examples where CS have sought to terminate their DTAs (e.g. US-Hungary DTA 1979) suspend certain DTA provisions. Candidates may also mention that there are no Reservations, Observations nor Positions on Arts. 31 & 32 OECD MTC nor its Commentary and coupled with the fact that there have been no significant amendments to these Arts. (other than the change in their numerical labelling following the inclusion of Art.29 Entitlement to Benefits in the OECD MTC 2017), it could be concluded that there is general satisfaction with the manner in which they operate.

A consideration of the entry into force and termination provisions of DTAs and the instances of DTA suspension/termination highlight that DTAs are not just technical instruments, rather they can be described as forming part of the international legal infrastructure that both reflects and provides the context for wider international relations. (Schwarz 2023). Arguably, a study of DTA practice combined with the relevant provisions of the OECD MTC, VCLT and DTAs not only supports the statement in the question but also reveals the types of tension that have consistently underpinned DTAs and the conflicting interests (revenue concerns, economic efficiency and the protection of nationals) that different government departments may have (respectively revenue authorities, treasury and the foreign office) when considering terminating a DTA, with these tensions dating back to the first termination of a DTA in 1872 (Jogarajan 2012).

Question 2

Whilst the statement in the question is based on a statement made by Picciotto (Indeterminacy, Complexity. Technocracy and the Reform of International Corporate Taxation 2015) there is no requirement that candidates reference this publication. However, answers would be expected to include supporting evidence for the (dis)agreement with the statement up to and including December 2023 (more recent references are welcomed but not required). Answers would be expected to briefly consider the general rules relating to the interpretation of treaties and address the main issue in the statement: whether there have been increases in both soft and hard law and whether these increases have added to the complexity of the interpretative process when interpreting DTA provisions. Candidates may also consider whether the language of DTAs is or ever has been “plain and simple”. There is no one way to answer this question and the below provides one possible schematic.

Interpretation of DTAs

Various terms are defined within the OECD MTC 2017 and UN MTC 2017 including in Articles 3, 4, 5, 10(3), 11(3) and 12(2) . However, undefined terms are to be afforded their meaning under domestic tax law (with domestic tax law meanings prevailing over non-tax law meanings) of the contracting state applying the DTA at the time unless either (i) the context otherwise requires or (ii) the competent authorities agree to a different meaning pursuant to Art. 25 (Article 3(2) OECD MTC 2017). Article 3(2) has been described as a general rule of interpretation relative to the special rules in the MTCs and DTAs but Art. 3(2) is a special rule relative to the general rules contained within the VCLT (Dourado et al 2022). However, this special rule classification only extends to terms within the DTA and not to general principles of domestic law. It would appear that due to the words “at that time” an ambulatory approach applies in such a case. Where however, a DTA does not contain Art. 3(2) then it would appear that the general rules of treaty interpretation would apply to undefined terms (e.g. Armenia-US 1973, which has a list of definitions but no equivalent to Art. 3(2), (Dourado et al 2022).

The VCLT

Provides the legal framework for the creation, interpretation and application of treaties, including DTAs (which are a form of international treaty, Art. 2 VCLT). Arts. 31 & 32 VCLT detail the general rule of interpretation and supplementary means of interpretation respectively. Art.31(1) establishes that a treaty must be interpreted in good faith in accordance with the ordinary meaning given to its terms in their context and in the light of its object and purpose. Art.31(2) elaborates on the context for interpretation, which includes not only the text, including its preamble and annexes, but also (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty, and (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. Art.31(3) further expands the context for interpretation by including any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions, any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation, and any relevant rules of international law applicable in the relations between the parties. Art.31(4) states that a special meaning shall be given to a term if it is established that the parties so intended. Art.32 provides that supplementary means may be referred to (and this includes the preparatory work of the treaty and the circumstances of its conclusion), may be used to confirm the meaning resulting from the application of Art.31, or to determine the meaning when the interpretation according to Art.31 leaves the meaning ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable.

Increases of soft law and hard law

Whilst there are a number of ways that candidates could explore this aspect of the question, it would be expected that candidates would consider the impact of the BEPS Project in relation to both soft law (BEPS Final Reports and the 2017 changes to the OECD MTC and its Commentary) and hard law (the impact of the MLI where countries have determined that DTAs within their DTA networks are covered tax agreements (CTAs) or more recently negotiated DTAs include terms that are consistent with the minimum standards within the MLI. It is also open to candidates to consider more closely the dividing line between soft/hard law in the context of international tax e.g. when soft law impacts the interpretation of hard law terms. It is also expected there be an acknowledgement that there has recently been an increase in both soft and hard law in the area of international tax. It has also been stated that the OECD laid out three tiers of norms in the form of “minimum standards”, “recommendations” and “best practices” to be operationalised via various soft law (guidance, commentary and reports) and hard law (the MLI) (Christians 2021). It is expected that answers acknowledge that there has been an increase in both soft and hard law in the area of international tax.

Increased complexity in the interpretative process

It is anticipated that this section would include an analysis of the possible interpretative effect of the various documents that together form the BEPS Project (taken here to mean the 15 Final Reports released in 2015 and its relevant outputs including the MLI). When considering the interpretative process, there are a number of points that could be made including: interpretative issues generally (e.g. the VCLT), the role of the OECD commentaries (static v ambulatory approach, etc.), the fairly constant architecture of DTAs in terms of allocating of taxing rights, the impact of the MLI and the relevance of its Explanatory Statement, and the interpretative role of different interest groups (legislators, DTA negotiators, the judiciary, revenue authorities, taxpayers, advisors, etc). Also relevant are the nature of the BEPS Project (noting that there may be different notions of what this includes) and the interpretative impact of its outputs.

Nature and Influence of BEPS Project

In 2013, the OECD & G20 countries adopted a 15-point Action Plan to address BEPS. The final reports were published as a BEPS Package (OECD, BEPS Project: Final Reports 2015). In 2016, the Inclusive Framework (with over 100 members) was established to develop standards and reviewing, monitoring and implementing the BEPS package. Candidates may note that BEPS 2.0 does not appear to form part of the BEPS Project and while it can be referenced it is not expected that BEPS 2.0 would form a significant part of answers.

OECD MTC 2017 and its Commentary

The Final Reports of the BEPS Actions, to varying extents, have influenced the 2017 version of the OECD MTC and its Commentary. The BEPS reports were not attached to the MTC but rather aspects of the reports were incorporated into the provisions and/or included in the Commentary. The MTC included changes to the following text based on different BEPS Actions: Preamble (Action 6); Art.1(2) & (3) (Action 2); Art.3(1)(e) (Action 2 & 2013 Discussion Draft); Art.3(1)(f) (Action 6 & 2016 Discussion Draft); Art.3(2) interpretation by competent authorities (possibly Action 14 but it has been stated that this was developed after the publication of the Final Reports in 2015); Art.5(4)(f), (5), (6) & (8) (Action 7); Art.8 (BEPS Action 6); Art.10(2)(a) (Action 6); Art.13(3) (indirectly Action 2 & 2013 Discussion Draft); Art.13(4) (Action 6); Art.23A (Action 6): Art.23B(1) (Action 6); Art.25(1) & (5) (Action 14); & Art.29 (Action 6). In addition, there were a large number of amendments made to the Commentary that accompany the relevant aforementioned changes to the text of the OECD MTC.

The MLI

Candidates are expected to provide examples of hard law, e.g. new DTAs entered into by countries and the MLI (examples can also be provided of domestic law changes to support points being made but this is not required). As a hard law BEPS output, it is necessary to consider the MLI's impact on the interpretation of DTAs (and its . Explanatory Statement (ES)). DTAs modified by the MLI are covered tax agreements (CTAs). The MLI is the product of Action 15 where it was acknowledged that the implementation of the BEPS recommendations required changes to the operation of the actual text of DTAs (in addition to domestic law changes). Where countries sign on to the MLI and determine that a particular DTA may be modified by certain MLI provisions (in addition to the minimum standards) a modification will generally take place where there is a MLI match in position. This process was thought preferable to the alternative of separately negotiating changes to all DTAs that countries wished to amend. It is also open to candidates to briefly refer to examples of hard law domestic changes brought about by BEPS Actions that may affect the interpretation of DTA provisions (e.g. changes to CFC rules, rules restricting interest deductibility, anti-hybrid rules etc.) but this is not required.

When considering the extent to which the MLI may affect the interpretation and implementation of DTAs, it is necessary to be clear about the nature of the MLI. Whilst the MLI (i) is a treaty in that it is 'a binding formal agreement, contract, or other written instrument that establishes obligations between two or more subjects of international law (primarily states and international organizations) (Henriksen 2019) and is a multilateral treaty in that it is concluded among a number of countries, establishing rights and obligations between each party and every other party Convention on Mutual Administrative Assistance in Tax Matters, there appears to be disagreement about the precise nature of the MLI e.g. it may be viewed as an (i) autonomous treaty that must be read alongside the relevant CTA provisions (Bravo, 2020 and Avery Jones 2019), which appears to be the more supported view (Manzi, 2020) but (ii) it is also considered by some to operate as a protocol of sorts that applies so as to implement the relevant BEPS measures (Bravo, 2020). This disagreement as to nature of MLI may be considered to have a knock-one effect for the interpretation of DTAs e.g. where the MLI is not viewed as a self-sustaining DTA (as it based on the relevant CTAs) and without these CTAs the MLI would have no reason to exist) as under this approach only the CTAs remain the only agreements in force between the relevant contracting jurisdictions (CJs) (Bravo 2020).

The main interpretative guide for the MLI is the ES, which was drafted by an ad hoc group. Both the text of the MLI and the ES were adopted by member countries in 2016. The ES, at [11], is stated to "provide clarification of the approach to be taken in the MLI and how each provision is intended to affect tax agreements covered by the MLI [and] reflects the agreed understanding of the negotiators with respect to the MLI." There is a discussion around whether only those countries that formed the ad hoc group are bound by the ES or whether all those signing on to the MLI have implicitly accepted the ES as an interpretative aid (Manzi 2020). The legal status of the ES is controversial as it does not form part of the MLI and the MLI does not expressly refer to the ES for interpretational purposes. There are numerous views as to the ES' status, which include that:

a) It is binding on members of the ad hoc group per section 31(2)(a) of the VCLT as it qualifies as an agreement relating to a treaty that was made between the parties in connection with the conclusion of the treaty' (Manzi 2020);
b) It can be viewed as a supplementary means of interpretation under Art.32 VCLT;
c) Art.31(4) VCLT special meaning applies;
d) It may also influence those countries who had the option to join the ad hoc group but chose not to do so as these countries may be seen to have freely adopted the terms of the MLI as drafted by the ad hoc group and as a consequence indirectly agreed to be bound by the ES per Art.31(2)(b) VCLT (Manzi 2020): and
e) It should be distinguished from the OECD MTC / UN MTC and relevant Commentary as it is not possible for countries signing on to the MLI to change the terms within the MLI (Manzi 2020).

Other points that could be made include:

- That the MLI specifically provides for a mechanism by which parties can determine questions of interpretation and implementation for provisions of CTAs as modified by the MLI (Art.32(1) MLI), which are to make use of the mutual agreement procedure to determine how the MLI has modified a specific agreement where such an agreement is consistent with the MLI provisions and provisions of the MLI itself. (Art.32(2)) (Opinion of the Conference of the Parties of the MLI, MLI Interpretation and Implementation Questions, May 2021). Implicit is that increased issues relating to interpretation are anticipated. The impact of the MLI may impact different provisions in different DTAs differently e.g. the MLI may significantly affect the interpretation of CTAs that have had their provisions modified in line with specific MLI provisions as it is clear that there CJs are legally bound to comply with the relevant modifications. There is also scope for countries who have reservations on certain MLI provisions to remove those reservations in the future such that the MLI may further influence the interpretation of CTAs moving forward where, for example, the other CJ was (and has remained) open to modifying the relevant CTA in line with the relevant MLI provision. As noted above, the role of the ES is less clear. Whilst it does not appear to constitute hard law, it can be expected to influence the interpretation of provisions within CTAs that have been MLI modified.
- There is also the question of whether the MLI may affect the interpretation of DTAs that are not CTAs. Whilst the MLI provisions are clearly not binding in such a case, it is possible that MLI provisions (and interpretative material associated with the MLI such as the ES) may influence the interpretation of provisions within DTAs that are not CTAs where these provisions are identical or very similar to the relevant MLI provisions (e.g. DTAs that have been entered into between countries that have chosen not to include their DTA as a CTA but have included provisions that implement the minimum standard with the same or similar wording to the relevant MLI provisions. Revenue authority guidance on MLI provisions, may also affect the interpretation of provisions contained within DTAs that are identical or substantially similar to those contained within the MLI. A further point in relation to DTAs that are not CTAs, is that it has been stated that Reservations on the MLI in relation to optional MLI provisions should not be relied as an indication of the intended meaning to give to DTAs that are not CTAs as the reservations to the optional MLI provisions are made for a variety of reasons (including disagreement with a DTA related BEPS measure to the desire to implement the relevant measure only in certain specified DTAs and not others) (De Bravo 2020).

<u>Soft law</u>

OECD & UN MTC 2017 (and their Commentaries). Candidates may briefly refer to the fact that the OECD and UNMTC 2017 (and their Commentaries) are not hard law and so can be considered under this heading where they are accepted as soft law. This section considers the changes made in the OECD MTC 2017 Commentary at a high level – it is open to candidates to provide examples in this section. Whilst the focus here is on the work of the OECD more generally, it is also open to candidates to mention the UNMTC 2021 (e.g. the introduction Art.12B, which introduced a source state taxing right for income derived from automated digital services into the UNMTC). To avoid duplication there is no discussion of the ES to the MLI in this section. It has been stated that the Commentary on the OECD MTC 2017 contains 150 pages of new Commentary introduced into the 2017 version (Hattingh, 2018).

In relation to the influence of the OECD MTC Commentary, it is possible to consider this in a number of different ways, including:

- CTAs. There is an argument that the Commentary to the OECD MTC 2017 may be relevant to the interpretation of the MLI modified provisions within a CTA where relevant OECD MTC provisions are the same as the relevant CTA modified provisions. Where this is the case, there is an argument that the boundary between soft law (Commentary) and hard law (CTA provisions) may be less than clear. When considering the extent to which the Commentary to the OECD MTC 2017 may influence the interpretation of provisions that have not been modified but sit within a CTA (because, for there is no match in the CJs' MLI position), then arguably the argument that the 2017 Commentary is relevant is weakened by the fact that the original DTA wording remains "unmodified" and for those DTAs that were entered into pre-BEPS there appears to be evidence of an "opt-out" by either one or both CJs in relation to a specific MLI provision in relation to a provision that has been incorporated into the MTC / its Commentary.

- Non-CTAs. DTAs that are not CTAs may be broadly categorised as BEPS compliant or not e.g. some DTAs entered into in the post-BEPS era, like the Australia-Germany DTA 2015, incorporate key aspects of the BEPS project, meeting the minimum standard even though they are not CTAs. Other pre-BEPS DTAs, such as those with the USA that include limitation of benefit provisions, may also be considered “BEPS compliant”. If such DTAs contain provisions that align with the terms of the OECD MTC 2017, there is an argument that the MTC Commentary could influence their interpretation. However, for non-CTAs with terms not aligned with BEPS standards, the 2017 updates to the OECD MTC and its Commentary arguably have limited relevance in interpreting these provisions.

Conclusion

BEPS has been characterised as ushering in a new era where individuals and organizations outside the usual tax policy circles have recognised the societal importance of tax, cross-border tax regimes and their associated institutions. This recognition has led numerous organizations to express opinions on the meaning and significance of DTAs, extending well beyond the traditional scope of government officials, tax practitioners, academics or judicial officers (Hattingh 2020). Thus, it can be said that the landscape for DTA interpretation in the post-BEPS era is more plural than before (Schon 2020). When considering the impact of hard and soft law changes to DTA interpretation, the interpretation of the MLI is clearly relevant and it could be noted that the MLI can be viewed differently to the other BEPS outputs (which as soft law may not constitute “context” per Art.31(2) VCLT) as they were not adopted in connection with the conclusion of the MLI and were agreed by a group smaller than the ad hoc group (Hattingh 2020)).

The relevance of the BEPS Project has been described as “controversial” (Manzi 2020) as these are “not binding tools per se but at the same time represent the substance of the MLI”. Where the ES to the MLI is viewed as a binding interpretation tool then to the extent that the ES refers to paragraphs within the BEPS Project (e.g. ES [39]-[40] refers to BEPS Action 2: Manzi 2020) the BEPS Project could be considered to play a role in the interpretational process of MLI provisions under Article 31(2) VCLT and potentially relevant provisions in DTAs. However, it could also be noted that (i) the MLI’s impact on DTAs generally may be viewed as still being rather limited in that it has been stated that as at 2018 it has only affected directly approximately 1,246 DTAs (Hattingh, 2018) and (ii) concerns have been raised that if BEPS outputs are seen as influencing the interpretation of DTAs, this approach could be perceived as introducing BEPS measures "through the backdoor" (Brauner 2018), a priori given that there are significant questions as to whether non-OECD member countries and even some OECD member countries regard the BEPS project as legitimate (Elliffe 2019).

Candidates might also note that MLI provisions, a key BEPS output, are now part of the OECD MTC 2017 and may impact certain DTAs, particularly CTAs, in various ways. This can be said to contrast with pre-BEPS strategies, where approaches to address profit shifting and DTA shopping were added to the MTC Commentary, influencing the interpretation of existing DTA terms (Hattingh 2020) and this has been said to have elevated the status of certain key aspects of the BEPS project to OECD MTC provisions or as part of the Commentary (Hattingh 2020). Accordingly, it can be argued that the BEPS Project has impacted the interpretation of DTAs more generally than just impacting those DTAs that are CTAs and it is arguable that whilst DTA provisions may not typically ever have been described as “plain and simple”, arguably they may now be considered to be relatively less simple to apply than previously (Bossuyt, 2020 referencing the MLI’s spillover effect on the bilateral DTA network which has strongly increased complexity in the interpretation of DTA rules).

Question 3

This question asks candidates to evaluate whether adopting a multilateral tax agreement (MTA) by some or all countries would be preferable to maintaining the existing bilateral network of over 3,000 DTAs. Candidates should address several key aspects in their responses, which may include:

1) Current Situation. Provide a brief overview of the existing landscape, which includes numerous bilateral DTAs, many of which have been modified by the Multilateral Instrument (MLI).
2) Challenges with the Current System. Discuss the perceived issues and challenges associated with the current predominance of bilateral DTAs.
3) Nature of Multilateral Treaties. Outline what constitutes a multilateral treaty and how it differs from bilateral agreements in structure and scope.
4) Pros and Cons of MTAs. Analyse the potential benefits and drawbacks of shifting towards a single or a greater number of MTAs over the existing system of bilateral DTAs.

Candidates are expected to incorporate at least some of these points into their answers, providing a well-rounded argument for or against the move towards more generalised multilateral agreements in tax policy. There is no one way to answer this question and the following provides one possible schematic.

Current situation and concerns

Bilateral DTAs: the current situation involves over 3,000 individually negotiated bilateral DTAs that are to varying extents like the relevant OECD MTC in existence at the time the DTA was entered.

MTAs: existing MTAs can be categorised based on their focus: some address substantive international tax law issues, such as the relief of international double taxation, while others are dedicated to administrative cooperation (Baker 2021). Further, these MTAs can be classified into regional instruments, designed for members of specific regional groups, and global instruments, which are open to all countries. Unique among these is the MLI, which may prove transformative for the future development of MTAs. There is a long list of regional instruments, although it has been stated that relatively few of them are particularly significant in practice (e.g. there is a view that the Nordic Convention is a hybrid international arrangement that consists of a series of bilateral DTAs held together by common principles and provisions: Orow 2005)).

In terms of administrative cooperation between revenue authorities, there are both regional instruments and a global, multilateral instrument of significance Multilateral Convention on Administrative Assistance (MCAA)). The growth in acceptance of the MCAA has undoubtedly been assisted by developments arising out of the OECD's Harmful Tax Competition project in the late 1990s, with its emphasis on exchange of information and administrative cooperation to identify cooperative and non-cooperative jurisdictions (Baker 2021).

Concerns: it has been said that pre-BEPS international tax involved a series of unrelieved collective action problems related to the issues of tax competition and tax arbitrage, particular in respect of the taxation of multinational enterprises (Christians 2007). The large number of bilateral DTAs can be described as exacerbating these problems and whilst the MLI seeks to reduce these concerns there is an argument that it may not (fully) meet its objectives (Parts I-V) and adds complexity to an already somewhat fractured regime.

Examples of concerns include:

- Complexity. The Full Version of the OECD MTC 2017 on which many DTAs are based is over 2,500 pages in length (including a Commentary that is approximately 550 pages) (Hynes 2022); whilst the MLI may provide a mechanism for the swift implementation of certain of the BEPS recommendations, there is a view that it creates considerable complexity by providing a multitude of options for jurisdictions to opt in or out of various provisions (Hynes 2022).
- Ineffective. There is no definitive evidence that the BEPS project has effectively curtailed tax avoidance. However, some reports indicate that compliance and administrative costs have generally increased, partly due to BEPS initiatives. For instance, the cost of complying with tax laws in Australia reportedly rose from $40 billion in 2010 to $50 billion per year by 2021. This figure has been reported to be approximately 14 times higher than the cost of running the relevant country's revenue authority (Mills 2021). Additionally, factors such as accelerating globalisation, digitalisation and the rise of borderless entities highlight the growing challenges faced by a bilateral tax regime in maintaining control. Furthermore, the MLI might introduce uncertainty and confusion, potentially creating new gaps or frictions in DTAs, which could inadvertently open up new avenues for BEPS.
- Uncertainty. There is a concern that the past decade has witnessed constant changes in the international tax space, which has had a knock-on effect on certainty due to increased complexity, compliance and administrative costs. Furthermore, it appears that further changes are now being implemented or an on the horizon (e.g. BEPS 2.0).

- Unprincipled. The MLI does not address the underlying cause of BEPS (i.e. the bilateral DTA regime per se and the variously framed domestic tax laws that have developed as a result). There is a view that the MLI may not meet the objectives of neutrality, complexity nor efficiency (Hynes 2022). Plus, there are those who consider that in the main the changes being made by the MLI are trivial, often to the point of total irrelevance (Cooper 2019).

Benefits

Some possible benefits of an MTA include (note: some are inter-related):

- Reducing overall complexity by decreasing the total number of DTAs) from approximately 3,500 to one MTA (or to a subject specific set of MTAs)
- Removal of opportunities for tax competition through the terms of bilateral DTAs (Baker 2021)
- Provides an opportunity to address international tax issues that concern more than two countries e.g. triangular cases (Baker 2021)
- Standardising regulations — companies can more easily navigate tax laws between CSs to an MTA rather than via a multitude of bilateral DTAs, thousands of pages of commentaries, the MLI, and the need to investigate the current MLI elections of each trading partner
- Reducing competition for mobile capital and maintaining tax rates
- Reducing compliance costs for taxpayers and administrative costs for tax collectors
- Encouraging tax havens to become signatories of the MTA
- Leveling the playing field for all tax jurisdictions with an MTA – as there may be an imbalance in power when a bilateral DTA is negotiated (Baker 2021)
- Encouraging and producing cooperation among all tax jurisdictions
- A more effective instrument for the development of a global approach to the taxation of cryptocurrency-related activities and the future manifestations of both digitalization and globalization (Hynes 2022)
- Amended more easily once the decision to amend has been reached (Baker 2021)
- A need for a world tax organization/court to address MTA issues (this could be viewed as a disadvantage depending on one's perspective) (Tanzi 1999)
- It may be easier for some countries, a priori smaller countries that either have not entered DTAs with other countries or have only entered into a small number of DTAs to enter into fiscal relations with a larger number of countries rather than separately negotiating individual DTAs (Baker 2021)
- Possibility of a common interpretation of the MTA's provisions and ultimately develop new international tax principles (Baker 2021)
- Practical benefit that there would be a need only to access a single document rather than potentially thousands of bilateral DTAs (Baker 2021)

Disadvantages

Many of the possible arguments that may be raised against a MTA relate to multilateral treaties generally and include:

- Ceding of Sovereign Rights: adopting an MTA may require countries to relinquish a certain degree of sovereignty, especially concerning their tax imposition and collection practices. This could pose a challenging political stance for jurisdictions participating in an MTA, as it directly impacts their autonomy over tax policies.
- Difficulty in reaching a consensus (Baker 2021)
- Likelihood that in order to achieve consensus multiple options would need to be included, which would add to the complexity of the document (Baker 2021)
- There is no or minimal opportunity for tailored bespoke solutions (Baker 2021)
- It is possible that the structure of an MTA may give undue influence to a small number of countries or only one country (Baker 2021)
- Reduced Competitive Advantage: an MTA might limit individual countries' ability to use tax incentives to attract capital and corporations, impacting their competitive edge in the global market
- Lengthy Negotiation Process: Establishing the terms of an MTA could involve prolonged and complex negotiations, given the need to accommodate the diverse interests and tax policies of all participating countries
- Increased Mistrust: confidential negotiations for an MTA could lead to heightened mistrust between governments and taxpayers, potentially eroding confidence in the tax system
- Complexity in Drafting Provisions: creating an MTA that fairly represents the interests of all or most participating countries can be extremely complex, given the vast differences in national tax systems and policies
- Challenges in Gaining support from Larger Economies: securing the buy-in of larger economies for an MTA can be particularly difficult, as these countries might have more to lose from ceding tax policy sovereignty and may prefer to maintain their bilateral agreements

Conclusion

In concluding, candidates might determine that either expanding the use of MTAs, whether regional or topic-specific, or continuing to rely on a vast network of bilateral DTAs is preferable. Their conclusions could involve a critical analysis of the arguments for and against adopting a more extensive MTA framework. It is also notable that increased multilateralism in tax is likely, and this trend may be more pervasive than initially recognised. For instance, there is a perspective that Part VI of the MLI might apply to all DTAs—not only to those modified by Parts I-V of the MLI—and could function as an effective standalone MTA focused on mandatory arbitration of tax disputes (Baker 2021).

A recent initiative, the ‘Fast-Track Instrument’ (FTI), mirrors the MLI's approach and aims to facilitate the integration of key provisions from the UN MTC into existing DTAs. This would strengthen countries' rights to tax profits generated within their borders from natural resources, offshore indirect transfers, technical services, automated digital services, and other areas, along with incorporating a broader application of the Subject to Tax Rule and provisions on capital gains from immovable property, pension funds, and arbitration (Picciotto 2023).

The discussion could also explore which organisations might lead such initiatives, with the OECD and the UN being the primary candidates, other possibilities might briefly be considered. Candidates may also acknowledge that the drive for a singular MTA is not new, tracing back to efforts from 1920 to 1960, especially between 1920 and 1939 (Broekhuijsen 2017). Despite these historical efforts, tax sovereignty remains a significant barrier to a unified MTA solution. However, some views suggest that significant inroads into tax sovereignty have already been made, positing that the OECD's role as a global tax authority could potentially evolve to include the development of an MTA (Hynes 2022).

Question 4

This question provides candidates with an opportunity to demonstrate their understating of exchange of information and in particular the boundary between requests made by revenue authorities for information to be exchanged that are likely to be classified as being 'foreseeably relevant' and those that are likely to be perceived as 'fishing expeditions'. Candidates may refer to the recent amendment (19 February 2024) to the Commentary on Article 26 OECD MTC 2017 but this is not required. Whilst there is no one way to answer the question the provides one possible schematic.

EOI is founded on mutual assistance provisions in DTAs, Tax Information Exchange Agreements (TIEAs) and regional or multilateral conventions, notably the Convention on Mutual Administrative Assistance in Tax Matters (MAAC) developed by the OECD and the Council of Europe, and the Agreement on Mutual Assistance in Tax Matters (AMATM) by the African Tax Administration Forum (ATAF). EOI primarily takes place in three main forms (whether alone or in combination): on request, automatic and spontaneous but other techniques may also be used (e.g. simultaneous examination and industry wide examinations (Dourado 2022)).

- EOI on request (EOIR) involves one country's Competent Authority (CA) requesting specific information from another country's CA under an international agreement.
- Automatic exchange of information (AEOI) occurs when CAs of two or more countries periodically exchange predetermined types of information, such as income details (e.g. interest, dividends, royalties, pensions) without prior request, based on an international agreement. Countries agree in advance on the types of information to be exchanged and the timing of these exchanges (Global Forum on Transparency and Exchange of Information for Tax Purposes, Establishing and Running an Effective Exchange of Information Function, a joint Global Forum and ATAF Toolkit 2020).
- Spontaneous exchange of information (SEOI) happens when a CA, during its tax law enforcement, discovers information that may interest a treaty partner and shares it without a prior request. This form's effectiveness relies on tax inspectors recognising pertinent information during investigations. If the information leads to tax adjustments, the providing CA should seek feedback from the recipient administration (Global Forum on Transparency and Exchange of Information for Tax Purposes, Establishing and Running an Effective Exchange of Information Function, a joint Global Forum and ATAF Toolkit 2020).

Art. 26(1) OECD MTC 2017 sets the legal basis for EOI and accommodates any method that may be developed and agreed upon by the contracting states (CSs) (Dourado, 2022). Where the conditions are fulfilled, EOI is mandatory due to use of the word "shall". The requirement that CSs exchange information under Art.26 OECD MTC can be said to support national revenue interests, facilitate the allocation of taxing rights and aid in resolving disputes over income sources and taxpayer (TP) residence. More specifically, it aids the enforcement of domestic tax laws in CSs, ensuring compliance with the respective DTA provisions and establishes a framework for information exchanges – EOIR, AEOI & SEOI – extending beyond the residents or taxes covered by the relevant DTA (prior to 2000, Art 26 was limited by Article 2 (Dourado 2022) but some countries have a reservation on this aspect of Art. 26 e.g. Thailand and Morocco (Positions on Art. 26, [2.1])). A central aspect of Art. 26(1) is that information exchanged is "foreseeably relevant" (FR), which is discussed below. Art.26 also sets limitations to prevent abuses like bank secrecy and specifies conditions under which exceptions to EOI are allowed, such as when compliance would breach either CS's laws or administrative practices, or when disclosure could reveal trade secrets or contravene public policy (Art. 26(3)).

Foreseeable relevance (FR)

Has been described as a "precondition" for information to be exchanged (Urinov, 2016) and guides EOI allowing for broad information sharing while preventing indiscriminate 'fishing expeditions' (Commentary on Article 26 OECD MTC 2017, [4.4]). Prior to the inclusion of the FR criterion, the information requested had to be "necessary" and some countries replaced the necessary condition with "relevant" (Commentary on Article 26 OECD MTC 2000, 2003, [5]). Whilst the OECD has stated that FR is synonymous with "necessary" (Commentary on Art.26 [4.1]), there is a view that FR is broader (Teck 2009 and Dourado, 2022).

The FR condition is not defined in the OECD MTC 2017 and so there is an argument that per Article 3(2) reference should be made to domestic law to determine its meaning. However, the context may require an alternative interpretation - i.e. an autonomous interpretation; as tehre is a view that Art. 26 operates in "an international tax situation" (e.g. condition of information exchange and the requested state is required to provide information even if it does not require it for its own purposes) and so warrants an autonomous interpretation of an undefined DTA term (Dourado, 2022). Where an autonomous interpretation of FR is adopted, other conditions arising under domestic law may still be relevant e.g. in the US, the Powell standards have to be satisfied (United States v Powell, 379 US 48, 57-58, 14 AFTR2d 5942 (1964).

As noted above, the Commentary on Art. 26(1), [5} provides that FR is intended to provide for EOI in tax matters to the widest possible extent and, at the same time, to clarify that jurisdictions are not at liberty to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer (TP).The RF criterion requires information to be reasonably expected to be relevant at the request time; its actual relevance after being provided is secondary (Commentary on Art. 26(1), [5]). The Commentary on Art.26 and various protocols to DTAs provide further details on what constitutes foreseeable relevance and a fishing expedition, ensuring that EOI promotes tax compliance and enforcement while protecting TP rights and confidentiality.

A common requirement of EOI is the exchange of foreseeably relevant information for the application of the provisions of the related EOI agreement or for administering or enforcing the requesting jurisdiction's tax law. The competent authorities (Cas) of the requested and requesting country exchange information that is FR to secure the correct application of the provisions of the international agreement between them or of their domestic laws. Jurisdictions seeking information must identify the correct jurisdiction to ask, provide enough details to identify the TP(s), and establish the information's relevance to a specific tax investigation. Typically, knowing the financial institution holding the information is necessary (OECD, Tax Policy Studies - Taxation of Household Savings 2018). The assessment of foreseeable relevance primarily rests with the requesting jurisdiction, though CAs should consult if the relevance is unclear to the requested jurisdiction (Commentary on Art.26, [5]). Whilst the requested state may consult with the requesting state and ask it to clarify the FR nature of the information request where it becomes aware that the information requested may not be FR, the requested state is not required to provide information in response to a request that is a fishing expedition.

Whilst Article 26 OECD MTC 2017 does not specify what may constitute FR, Articles 5(5) of the OECD's Model Agreement on Tax Information Exchange Agreements refers to types of information that a requesting party should provide to support the FR nature of the request (a checklist, which broadly corresponds with Module 1, [24]-[25] on the Manual on Implementation of Exchange of Information) and it may be open to the requested state to conclude that the request involves a fishing expedition where the requesting country fails to provide items on the relevant checklist (Manual on Implementation of EOI".

The 2012 revision of Art.26 OECD MTC elaborated on 'group requests', specifying when they meet the standard of foreseeable relevance (Commentary on Art.26, [5]-[5.3]). The EU's adoption of Art.5(a) in Directive 2011/16/EU largely codifies the Berlioz judgment, setting limits on unspecified bulk requests and irrelevant information requests. Various examples are provided for in the Commentary on Art.26 [7] – application of the DTA provision - and [8] and in particular the example in the Commentary on Art.26 [8(f)]. Examples also include where:

- Country X is aware that clients of a specific tax agent have participated in a tax avoidance scheme involving investments in a company based in Country Y. Several of these individuals are under investigation, facing substantial potential tax liabilities. Despite exhausting all local information-gathering powers, Country X's tax authorities have been unable to secure a client list from the tax agent. Consequently, Country X has requested Country Y to identify all investors in the company who have an address in Country X. This request has been stated to meet the standard of FR as it targets a specific group—investors in the foreign company—and addresses a specific tax risk associated with the avoidance scheme (IEMI101350 HMRC 2024).
- An information request has been held by a Swiss Tribunal not to fulfil the FR criterion because the underlying investigation related to taxable periods prior to those in relation to which information could be exchanged. The Federal Supreme Court decided that it was FR and did not involve a fishing expedition (Michel 2017 & Case No. 2C_1162/2016)).
- The Swiss Federal Supreme Court has ruled that (i) the criterion of FR is satisfied—typically in cases involving lump sum payments—if there is a reasonable possibility that the requested information will prove significant at the time of the request, and (ii) the role of the country from which information is requested in making this determination is likely to be limited. Therefore, the assessment of FR primarily falls on the requesting country (Suter and Poletti 2021 referring to inter alia FC 16 April 2018 2C_28/2017).
- A request should not be deemed a fishing expedition solely because it (i) lacks the name and/or address of the TP under investigation, provided it contains sufficient alternative information to identify the TP, or (ii) features a different spelling of the name or presents the name/address in a different format, as long as there is enough additional information included to identify the TP (Commentary on Art.26 [5.1]).
- A group request that does not individually identify the TPs, but instead provides a detailed description of the group, the specific facts and circumstances leading to the request, an explanation of the applicable law, and the reasons for suspecting non-compliance within the group, supported by clear factual evidence, may not be considered speculative or akin to a fishing expedition (Commentary on Art.26 [5.2). This would also include information relating to any third party's actions that have actively contributed to the alleged non-compliance.

<u>Fishing expeditions</u>

As noted above, the requested state is not obliged to provide information in response to 'fishing expeditions' (FE). This is justified on the basis that the requested state is granted some control of the allocation of resources, the right to a defence of a TP and the right to confidentiality (Dourado, 2022). FE is not defined in the OECD MTC 2017 but is referenced in the Commentary on Article 26 and has been separately defined as being speculative requests lacking a clear connection to an ongoing inquiry or investigation (Manual on Exchange of Information, number 2023, poin8 (Dourado, 2022)). However, the requested state is expected to provide such information when the requesting state has provided a rationale explaining the foreseeable relevance of the information requested (Commentary on Art.26 [5]). A request will not constitute a FE simply because it does not contain the name and/or address of the TP under investigation ((Commentary on Art.26 [5.1]] however, other information would be needed in order to identify the TP.

Other examples where a request may be considered not to be foreseeably relevant and may constitute a fishing expedition include:

- A request concerning a group of TPs, where the individuals are not specifically identified, may be considered a FE. This is because a group request can make it challenging to prove that it is not speculative, especially if the requesting state cannot link it to an ongoing investigation into the affairs of any specific TP (Commentary on Art.26, [5.2). However, the Commentary does detail how the requesting state may be able to ensure the information is provided notwithstanding the lack of detail regarding the identities of the group members i.e. a detailed description of the group and the facts and circumstances that have led to the request, an explanation of the relevant law and why the TPs in the group have been non-compliant (Commentary on Art.26, [5.2).
- Various examples are provided in the Commentary on Art.26, [8.1].
- Revenue authorities may also provide examples, e.g. (i) where Country X asks Country Y for details of all properties owned by Country X residents in Country Y. Aside from difficulties in obtaining such information, this has been stated to be a FE because there is no specific customer and liability for whom the information is sought. The request is considered to be speculative because it is made in the hope that some useful information can be obtained rather than being linked to a risk with an identifiable customer or group of customers. The standard of FR is not met in this example (HMRC IEMI101350 2024) and (ii) a request for information about a group or group of persons income and/or transactions abroad for the purpose of analysing risks, conducting surveys or keeping statistics has been stated not to be permitted and would thus appear not to involve a request for information that is FR (Swedish Tax Agency No. 202 279494-18/111; Karlqvist 2018).
- Some DTAs may provide examples of FEs e.g. Additional Protocol to the Austria-Slovenia (where a CS randomly requests information about bank accounts held by residents located in the other CS).

Issues: the FR criterion is designed to enhance tax information exchange but faces challenges in interpretation and application, balancing effective EOI with TP rights protection, and avoiding invasive practices. Issues include:

1) Interpretation variability: as noted above FR is not defined in the OECD MTC 2017 and whilst there is support for an autonomous interpretation, variability in interpretation remains. Such variability can lead to discrepancies in how countries interpret data collection and sharing extents, impacting international cooperation and creating TP uncertainties. Differences in the application of reciprocity principles can lead to inconsistent EOI outcomes. Additionally, some courts apply the proportionality principle, requiring that data exchange should not overburden tax administrations lacking in resources or technical capabilities for secure data handling (Valderrama 2020 and Michel 2017). There is also the point that some contracting states may include Protocols in their DTAs that seek to define FR using some or all of the elements in the aforementioned checklist (e.g. Portugese Republic – Republic of Panama, Protocol, [8]) – however, it has been stated that it is not clear that the requirement for a name and address may not be compatible with the EOI standard (Dourado, 2022).
2) Risk of overreach and privacy concerns: the broad application of foreseeably relevant might lead to excessive data requests, infringing on TP privacy. While designed to prevent fishing expeditions, distinguishing between legitimate and excessive requests remains contentious. The OECD Commentary suggests that not all TP details are necessary for a valid request, but clarity is needed when a request potentially involves multiple TPs, to avoid breaching uninvolved parties' privacy (Huiskers-Stoop, Breuer and Nieuweboer 2022).
3) Compliance and administrative burden: Assessing the relevance of requested data can significantly burden jurisdictions, especially those with limited resources, encompassing data collection efforts and compliance with legal standards. Legal and procedural uncertainties: The subjective nature of the "foreseeably relevant" standard can lead to legal ambiguities, requiring revenue authorities to balance domestic and international laws against the necessity to protect sensitive information.
4) Protection of TP rights: It is vital to balance EOI effectiveness with safeguarding TP rights, ensuring that data security and usage are transparent to maintain TP trust.
5) Evolving standards and practices: As the international tax landscape evolves with new economic activities, adapting the "foreseeably relevant" criterion to remain effective and relevant is a continuous challenge, necessitating ongoing international dialogue and cooperation.

<u>Conclusion</u>

While the "foreseeably relevant" criterion under Art.26 plays a vital role in international tax cooperation, addressing its associated challenges is crucial for ensuring that EOI is both effective and respectful of TP rights and privacy. Balancing these concerns requires careful interpretation, clear guidelines and ongoing international collaboration. Candidates may include a reference to the recent amendment to the Commentary on Article 26 OECD MTC 2017, [11] and [12] as an example of the ongoing work in this area (however, such reference is not required): on 19 February 2024, the OECD Council approved an update to the Commentary on Article 26 OECD MTC 2017, [11] and [12] which clarifies that information received through administrative assistance can be used for tax matters concerning persons other than those in respect of which the information was initially received. It also provides interpretative guidance on confidentiality, in particular regarding the access of taxpayers to information exchanged when such information has a bearing on their tax situation and regarding reflective non-taxpayer specific information, including statistical data, about or generated on the basis of exchanged information.

Question 5

The question provides candidates with an opportunity to demonstrate their understanding of the operation of withholding taxes (WHTs) at a general level, as well as considering the reasons why a country may (or may not) determine to levy a withholding tax on dividends, interest and royalties (and capital gains where relevant) derived by non-residents. It also provides an opportunity for candidates to demonstrate their knowledge of the operation of Arts. 10-12 OECD MTC 2017 at a high level, as well as at a more specific level in order to substantiate the points made. The inclusion of relevant examples from DTA practice, including relevant case law references are welcomed. Whilst there is no one way to answer the question, it is expected that answers would include a consideration of the nature of WHTs; reasons for relying on WHTs in an international context (which would include a consideration of the possible issues for not relying on withholding taxes) and a consideration of how the domestic law position may be modified in a DTA context. As noted in Art.10(2) Commentary [18]-[19], it is open to CSs to tax these amounts on an assessment basis but, given the wording, it is anticipated that answers will focus on deduction at source. WHTs on such payments are levied on the gross amount of the relevant payment, with the result that the rates seen in DTAs provide for a maximum amount of tax that can be levied on the relevant payment where the relevant conditions are satisfied (Haslehner 2022).

Nature of WHT

WHT on passive income refers to the tax automatically deducted from payments of interest, dividends, rent and royalties before these earnings are paid out to the relevant investor or property owner (these amounts are typically received net of any WHT). Typically, domestic rules regulate the circumstances in which WHT apply and also specify the relevant rate to be applied. The rate of WHT can vary across countries and may depend on the tax residency of the recipient, domestic laws of the paying entity and the provisions of any relevant DTA, with non-residents often subject to a different WHT rate than residents.

Reasons for relying on WHT

Numerous arguments for levying WHT on non-residents can be considered. It is acknowledged some considerations apply equally to a country's decision to levy WHT on residents. However, some of the below are more relevant to WHT levied on payments to non-residents and to WHT in a DTA context:

- Tax jurisdiction and revenue collection. WHT can be viewed as a mechanism for a country to exercise its tax jurisdiction over income generated within its borders by non-residents. This ensures that income earned in Country A by foreign entities or individuals is subject to taxation in Country A. This helps secure revenue from cross-border economic activities.
- Simplicity and efficiency. WHT applies when payments such as dividends, interest and royalties are made by a resident entity of Country A to a resident of Country B (who is a non-resident of Country A). This mechanism streamlines the tax collection process, enhances efficiency and lowers the risk of tax evasion. The resident payer in Country A is tasked with deducting the tax and remitting it directly to the Country A revenue authority. This often exempts non-residents from the need to file tax returns in Country A, especially when the WHT in Country A is considered a final tax.
- Tax compliance and enforcement. WHT acts as a tool for ensuring tax compliance and enforcement. By requiring the payer to withhold and remit the tax, reliance on non-residents voluntarily complying with the local tax obligations is reduced (again where the WHT operates as a final tax). It also helps revenue authorities to track cross-border transactions and enforce tax laws more effectively.
- Equity and fairness. WHT on non-residents may level the playing field between residents and non-residents earning income within a country. This ensures that foreign entities and individuals contribute to the public finances of the country where they are economically active, which could be described as being similar to how residents are taxed on their income.
- Policy objectives . Despite the generally uniform application of withholding taxes (WHTs), governments retain the flexibility to adjust WHT rates, and define relevant payments differently to align with specific policy goals. For example, a government might:

    1) Set lower WHT rates on interest payments to stimulate foreign investment in domestic bonds or to enhance business financing by making it more appealing for foreign entities to lend to domestic businesses. For instance, under their domestic laws, some Contracting States (CSs) may exempt interest paid to financial institutions from tax at the source, as WHT could hinder such transactions unless the debtor covers the relevant tax (Art.10 Commentary [7.7]).
    2) Apply different definitions to various types of payments to tailor tax outcomes to different economic or sectoral needs.

Issues with WHT

Various issues could be mentioned, including:

- Cash flow impact. The immediate deduction of taxes at source can strain the cash flows of individuals and businesses. This effect is especially pronounced for those with tight budgets, as taxes are deducted as income is earned rather than at the time of filing annual tax returns, potentially limiting available funds for operational or personal expenses.
- Over-withholding. In the context of a DTA, the standard rate at which WHT is applied might not always align with the Taxpayer's entitlement to relief as specified under the DTA. Such misalignment may result in excess tax being collected. e.g. if a country imposes WHT on royalties based on its domestic laws but the DTA grants exclusive taxing rights to the state of residence, the initial application of WHT may be followed by a refund once the TP's entitlement under the DTA is confirmed (Wassermeyer 2010). It is also possible for a default rate of tax to be withheld when for example a minimum holding period in Article 10 has not been satisfied as at the date of payment of the dividend and then once the holding period is subsequently satisfied a refund may be available to the extent the relevant condition(s) has/have been satisfied. Notwithstanding this possibility, the process of obtaining a refund can be complex and may temporarily tie up the TP's funds.
- Administrative burden. WHT is typically deducted by the payer and transferred to the local revenue authority. The process of calculating, deducting and remitting taxes to the revenue authority for various payments may add a significant compliance burden for businesses. This burden is particularly acute for small businesses that may lack the resources to efficiently manage these tasks, thereby increasing their operational costs. Subjecting a private person to the legal obligation of properly administering tax law has been referred to as an inherent flaw of WHT , a priori in situations where identifying the relevant recipient may be a complex process e.g. where collective investment vehicles with multiple tiers of entities are involved (Lee and Yoon, 2018). Furthermore, withholders may be subject to penalties or may not be permitted to claim the relevant payment as a deduction where they have not withheld as required. Whilst typically the withholder may be a resident, and where payment is a cross border payment from the source state to the resident state, there may be instances where , for example, a non-resident is required to withhold (Lee and Yoon, 2018).
- Disincentive to work or invest. High WHT rates can deter savings and investment by reducing the attractiveness of earning, for example, interest or dividends.
- Gross basis. WHT is often levied at a flat rate on the gross amount of the relevant income, and where withholding agents are responsible for withholding then gross income becomes a more straightforward exercise (than net income calculations) for the withholder. However, gross income as a basis may be viewed as unfair on the recipient (Lee and Yoon, 2018).
- Complexity and lack of understanding. The mechanisms and regulations surrounding WHT can be complex, leading to misunderstandings among TPs about their obligations, the amount of tax being withheld and what do to when they have overpaid tax. This complexity can result in unintentional non-compliance and dissatisfaction with the tax system.
- Definitional issues. While not strictly part of the WHT concept, the application of rules concerning general WHT rates and specific exemptions or reductions is intricately linked to other aspects within a DTA. E.g. whether a payment qualifies as royalties can impact the applicability of WHT, as seen in the case of Tech Mahindra Limited v FCT [2015] FCA 1082, where fees for technical services were classified as royalties under the India-Australia DTA. Additionally, determining whether the recipient of a dividend is the beneficial owner may affect WHT rates, illustrated by Velcro Canada Inc. v The Queen (2012), which addressed beneficial ownership under the Canada-Netherlands DTA. Issues of definition can further complicate the WHT process.
- Challenges of, inter alia, the digital economy. Both PEs and WHT have been described as being "under considerable pressure" from a BEPS perspective and at least some have noted that an appropriately expanded use of WHT may contribute to overcoming issues raised by BEPS provided that it does not undermine taxpayer rights etc. (Lee and Yoon, 2018).

Different rates and conditions under DTA provisions

The bilateral nature of DTAs means that the provisions within each DTA can vary significantly, especially concerning the allocation of taxing rights, definitions of relevant amounts, and WHT rates, including any conditions attached to concessional rates or exemptions in the source state. Candidates have several points they could discuss, as outlined below. While the focus here is primarily on Art.10, candidates may explore Arts. 11 & 12 in more detail if they choose.

The capacity of the source state to levy WHT varies by payment type. For example, the right to tax royalties is solely allocated to the resident CS under Art.12(1) OECD MTC 2017, whereas both CSs may tax dividends under Art.10, albeit to varying degrees. Additionally, different DTAs may adopt varied approaches to source taxation of the same payment. For instance, Art.12(1) OECD MTC 2017 grants exclusive taxing rights to the state of residence of the beneficial owner, while Art.12 UNMTC provides the residence state of the beneficial owners a non-exclusive right, allowing the source state to tax up to a certain limit. In practice, DTAs may implement either the OECD approach (e.g. Art.12(1) US MTC) or the UN approach, as seen in various Reservations and Positions on Art.12(1), where countries like Australia, Chile, Korea, Mexico and Poland reserve their right to tax at source.

When assessing DTA WHT rates on dividends, different rates may apply based on factors including the foreign ownership interest held by the non-resident e.g., Art.10(2)(a) specifies a maximum 5% rate on dividends where a resident (who is the beneficial owner) of the other CS holds at least 25% of the capital of the company paying the dividends. This contrasts with the default maximum rate of 15% under Art.10(2)(b), applied when dividends are paid to the beneficial owner without significant ownership interest. This 15% rate is considered reasonable as the source state can already tax the profits of the paying company (Art.10(2) Commentary [9]). A study from 2012 highlighted a downward trend in rates on participation dividends since 1990 (Petkova 2020).

Similar provisions are found in DTAs, with some reducing the WHT rate to 0% when the foreign ownership percentage exceeds a certain threshold. For instance, if the beneficial owner, a resident of the other CS, directly holds at least 80% of the voting power of the company paying the dividend, then there is no taxation in the state where the dividend-paying company is located (e.g. Art.10(3) Germany-Australia DTA). This variation in rates depending on foreign ownership levels is typically described by distinguishing between "portfolio" and "participation" interests held by the non-resident in the paying company.

It has been observed that DTAs generally adopt an asymmetrical approach to rates for portfolio vs. participation interests more often than a symmetrical one. A 2012 study found that about 41% of DTAs featured symmetric (single-rated) WHT rates, while 59% had asymmetric (multi-rated) structures (Petkova 2020). Notable examples of DTAs lacking special rules for intercompany dividends include Art.10(2) Brazil-China and Art.10(2) Hungary-India. Recent trends indicate a shift towards asymmetrical rate structures even in countries like New Zealand and China that previously favoured a symmetric approach (Haslehner 2022).

Addressing avoidance and evasion

Key points include:

- A beneficial ownership (BO) condition that must be satisfied to access the relevant concessional rate of WHT. For example, Velcro Canada v The Queen (2012), where the TP was found to be the BO of the royalty for the purposes of the Canada-Netherlands DTA and so was able to access the reduced rate (10% - the rate at the relevant time) instead of the rate under domestic law (25%).
- The relevant reduced WHT rates will not be automatically granted where, for example, a BO is paid the relevant dividend and holds the relevant ownership interest but does not satisfy other conditions such minimum holding periods. For example, Art.10(2)(a) OECD MTC 2017 refers to a minimum holding 365-day period, including the date of payment. Whilst this language is found in CTAs that have adopted the dividend transfer transaction rule in the MLI, some CSs have reserved their right not to include a minimum holding period as provided for in Art.10(2)(a) (e.g. Luxembourg Reservations on Art.10(2) [77.1]).
- When considering reduced rates of WHT under Art.10, other provisions may restrict the availability of the reduced rate/exemption. For example, Art.29(9) may apply in certain circumstances, including in cases of certain types of DTA shopping (Haslehner 2022).
- DTA provisions may include a main purpose test, serving as a special anti-abuse provision, such as Art.10(6) of the Germany-UK DTA. The Commentary on Art.1 [61] further explains that the benefits of a DTA should not be available if a principal purpose of the transaction(s) was to secure a more favorable tax position that contradicts the object and purpose of the relevant provisions.
- A fairly recent study on DTAs in existence in 2012 found that higher rates of WHT on portfolio dividends was linked to increased concerns over tax avoidance/evasion and that more specifically an upward trend for portfolio dividends was evidenced until the mid-1990s, but this has since stabilised (Petkova 2020).
- CSs may implement specific domestic measures such as controlled foreign company rules or thin capitalization and other interest limitation rules related to relevant amounts. These measures are generally not seen as incompatible with DTAs, as discussed in the Commentary on Art.1 [23] and Art.10 [37].

Conclusion

Candidates might conclude by noting that at a very high level, WHT is one of the two major ways in which the limits of enforceable tax jurisdiction between the resident and source state are reflected in the distributive rules of DTAs (the pther beign the permanent establishment concept) (Lee and Yoon, 2018). Candidates may also summarise why countries impose WHTs and how closely they align with OECD MTC provisions. They might conclude that the taxation of payments in the source state varies among DTAs, requiring analysis of specific circumstances such as definitions, rates, ownership percentages, nature of ownership, holding periods, and purposes, especially in the context of dividends. This variation reflects differing policy objectives, such as incentivising investment while ensuring that reductions or exemptions are granted only to the intended beneficiaries under the DTA, particularly in cases involving non-residents. Ultimately, provided that WHT is able to protect TP rights, WHT may well continue to function as an intuitively appealing and practically effective means to protect the national tax base of countries (Lee and Yoon, 2018).

PART B

Question 6

Salaries

There is little detail about the type of employment but the combination of the reference to a marketing function and the fact there appears to be a private sector employer means it is likely that Art.15 would apply. It appears that salaries derived by Denis and Emma (as residents of Iveria) would be taxed in Iveria because the vast majority of their time in employment appears to be spent in Iveria (they only attend an annual retreat one weekend a year in Harmonia). Employment is considered to be exercised in the state in which the relevant employee is present, and it is clear Dennis and Emma are physically present in Iveria for the year (bar one weekend - candidates could mention that where this is considered to constitute employment being exercised in Harmonia it is possible that Harmonia may have taxing rights over a small proportion of their salaries). Therefore, it is likely that Iveria has the right to tax the salaries of both Denis and Emma. Candidates may note that no information is provided about the domestic law in either state.

Stock options

Employee stock options are often linked to future services and are a way to share profits with employees, encouraging investment in company growth (Kincha 2002 and De Broe 2022). However, they may be granted as a reward for past performance. Stock options may create tax issues because they may be taxed at a time that is different from the time when the employment services are rendered (Commentary on Art.15 [12]) and different countries may apply different taxing points including grant, vesting, exercise, and sale of the option or shares. The variation in country practices may be at least partly fuelled by countries' desire to tax any benefits at the earliest point in time (Kincha 2002). Whilst the OECD MTC 2017, Art. 15 does not refer to stock options, it does refer to "salaries, wages and other similar remuneration" in Article 15(1) and the Commentary on Art. 15, [2.1] and [12]-[12.15] and the OECD CFA's 2004 Report on "Cross-Border Income Tax Issues Arising from Employee Stock-Option Plans" both refer to the fact that amounts derived from stock options may fall within Art. 15 as "other remuneration" and / or Art. 13 depending on the circumstances.

Candidates may note that typically an option must vest (broadly the process by which a person gains the right to exercise stock options (e.g. satisfying any relevant conditions) as part of an employee compensation) before the option can be exercised. In this case, it is a condition that Denis and Emma are employed by Gallant Inc and as such the following proceeds on the basis that they either (i) do not exercise their options or (ii) exercise their options prior to their employment ending. It also appears that Denis and Emma may have received their stock options in respect of past services (as a reward for their role in Gallant Inc's advertising campaigns) as opposed to an incentive for future performance (note that the Commentary on Article 15, [12.11] refers to stock options needing to be demonstrably based on a person's previous performance in order to be viewed as not being an incentive for future performance) here the facts do not appear to suggest that the stock options have been granted as an incentive in return for future services. Whilst the facts do not state that the options have been exercised, it is possible that both Denis and Emma may seek to exercise their options before terminating their employment with Gallant Inc. (candidates may note that Denis may soon retire and Emma may soon resign). Candidates (i) can therefore consider which country is likely to have taxing rights where they do and do not exercise the relevant options and (ii) would be expected to note that no information is provided about the domestic tax law position in any countries and so it is not possible to determine the precise tax outcome in different scenarios, rather the focus is on the respective taxing. Rights of the various countries. It can also be noted that the options are non-transferable such that there is no requirement to discuss the sale of the options.

Granting of options

As the stock options must be exercised before employment ceases, Denis and Emma should be advised that until such time as they exercise the options, the stock-options are likely to be dealt with by Art.15 and its Commentary as "other remuneration" Commentary on (Art.15(1) [2.1], some DTAs explicitly include stock options e.g. Protocol to the Japan-USA DTA 2003 [10]) - the state of source – where the employment is exercised – may tax the part of the stock option that constitutes remuneration derived from employment exercised in that state, even if the tax is levied at a later time when the employee is no longer employed in that state (Art.15(1) Commentary [2.2]). It is clear that both Denis and Emma have exercised their employment in Iveria and are also Iverian resident. As such, Iveria is likely to be the state in which the employment is exercised for the purposes of the options under Art.15 (Commentary on Art.15(1) [12.2]). This means that Iveria is likely to be able to tax any value attributable to the option itself that arises after the granting of the option (Commentary on Art.15(1) [12.23]). No information is provided about domestic tax law and thus it is sufficient to note which state has the right to tax and which state must provide relief from any resulting double taxation. However, it could be noted that where Emma ceases to be a resident of Iveria (because for example she moves to Konia), there would be a need to confirm how Iveria's domestic law treats such a scenario (e.g. where Iveria imposes a capital gains tax when Emma ceases to be an Iverian resident then Art. 15 may still apply - the

Commentary on Art.15 , [12.4] notes that Art. 15 does not restrict Iveria's right to levy such a tax. This information is not provided in the facts but can be noted to be of potential relevance to Emma.

Options are exercised

It is possible that Denis and Emma will seek to exercise the options before they cease employment with Gallant Inc. and as such they should also be advised that neither Art.21 (other income) nor Art.18 (pensions and similar remuneration) are likely to apply to any increase in value. Where the options are exercised or alienated, Art.13 may apply to any relevant increase in value. Art.13(5) is considered to apply in such situations as upon exercise of the option, Denis and Emma are considered to have transitioned from employees to shareholders. Art. 13(5) provides that the state of residence of the alienator has the exclusive right to tax the relevant gain (i.e. Iveria). Furthermore, if Denis and Emma decide to sell the shares, any gains from such sales would also fall under Art.13, with the taxing right being afforded to the resident state of the alienator (i.e. likely to be Iveria where they both continue to be Iverian resident but were Emma to move to Konia and become tax resident there then Konia may have the right to tax any gain). Whilst there is no information about any of the countries' domestic tax laws, it could also be noted that the exemption from taxation in the source state may apply notwithstanding that there is no taxation in the state of residence i.e. there is a view that it is only where a DTA contains a general "subject-to-tax" rule that non-taxation of the capital gain by the residence state results in a right to taxation by the source state (Reimer, 2022). As there is nothing in the facts to suggest that there has been an improper use of a DTA and as such it is not anticipated that candidates would spend time considering such a possibility.

Non-compete payment

Can be described as a contractual agreement that prevents someone entering into an employment agreement with a competing business once employment has ended. Non-compete agreements have been the subject of considerable scrutiny in recent times (e.g. there have been US and UK proposals to restrict their duration as they are seen by some as stifling competition (Halls and Judra 2024).

Although Emma has not yet signed a non-compete agreement nor received any payment, there is a possibility that she might do so in the future. Consequently, it is feasible to offer her some preliminary advice on the potential tax implications should she enter into such an agreement and receive a payment. Some initial points include:

- The conditions appear to be temporal (6 months) and geographical (rival companies in Harmonia and Iveria);
- The agreement does not appear to restrict her working for a rival company in Konia and so it may be possible for her to take a new job in Konia immediately upon terminating her employment with Gallant Inc.; and
- She may not remain resident of Iveria during the relevant 6-month period. It would therefore be necessary to consider her residence status, specifically whether she becomes a tax resident in Konia.

Likely position under the DTA – it would appear that a payment under the agreement would fall within Art.15 (OECD, Tax Treaty Treatment of Termination Payments, Discussion Draft 2013, [20]-[23]), which is consistent with practice across various countries (e.g. Germany and Belgium: De Broe 2022). However, some countries consider the payment may fall within Art.21 (e.g. the USA considers Art.21 US MTC and not Art.14 US MTC applies: Korfund Company Inc v CIR 1 TC 1180). Furthermore, payments under non-compete agreements in connection with past employment are likely to be considered to reward current non-activity rather than past employment and so would not be expected to fall within Art.18 (Ismer 2022). It would appear, therefore, that a payment under a non-compete agreement that applies following the termination of Emma's employment may fall within Art.15. Candidates may note that there would be a need to refer to the relevant country's domestic tax law also and that this information is not available in the facts. On the basis that Art. 15 applies, several approaches can be considered when determining which country is likely to have the right to tax any payment under the nom-compete agreements, including:

- State of residence when payment received. As it is unlikely that the payment is for employment activities performed before termination, it would be expected that Emma's state of residence when she receives the payment would have taxing rights. This may be Iveria or Konia, depending where she is resident at the relevant time (Art.15(2) Commentary [2.9]). "Replacement approach". The taxing right is allocated to the place where Emma would have performed the employment had she continued to be employed – e.g. Iveria (German BFH 9 September BStBl, II 867(1970); note the Court made an exception to this approach where the failure to honour the agreement could take place in any country, i.e. where the agreement did not restrict the geographical scope, in which case the taxing right may fall to the country of physical presence. In this case, it appears that the failure to honour the agreement may only apply in Harmonia and Iveria and as such, the exception may not appear to apply. Under the replacement approach, it would appear that Iveria has the right to tax the non-compete payment.
- Location during the 6-month period when the non-compete agreement is honoured. This location would be Emma's state of residence in a situation where she is respecting the non-compete agreement. In a case of dual residence, there would be a need to refer to, for example, the Iveria-Konia DTA to determine in which state she is a resident (Du Broe 2022).

- State of presence when payment received. This information is not provided but one might consider the position where Emma is present in Konia or Iveria when she receives the payment (Belgian Court of Appeals, Brussels, 29 June 2017 case 2015/FR/61).

Where Emma becomes a resident of Konia under its domestic laws, is resident under the Iveria-Konia DTA and is also physically present in Konia when she receives the non-compete payment, then Konia may have the right to tax the relevant amount under Art. 15(2) (Commentary on Art.15(2) Commentary [2.9]). A different outcome may arise where Emma, for example, does not take up the job in Konia and remains living in Iveria or where she moves to a different country, etc.

Question 7

The question requires candidates to consider the taxation of business profits under Arts. 5 & 7 of the OECD MTC 2017, the extent to which the current MTC allocates taxing rights to the source state where business profits are derived from exploration/exploitation of natural resources, and the implications of introducing a specific shorter duration. Candidates may reference DTA practice, including that numerous DTAs are reported to already include a 30-day threshold, the Commentary on Arts. 5 and 7, and any relevant Reservations, Observations and Positions. Candidates may also refer to the recent OECD's Public Consultation on Activities in Connection with the Exploration and Exploitation of Extractible Natural Resources in November 2023 (Consultation 2023), which considered this issue. Candidates' answers should conclude by advising Magnolia whether it should or should not consider the possibility of reducing the period of time before a PE arises when considering these specific activities and at the very least summarise the major benefits / disadvantages of amending the relevant threshold.

Art.5 OECD MTC 2017. The concept of Permanent Establishment (PE) is crucial for the allocation of taxing rights on income from natural resources. An enterprise can be taxed in a country if it has a PE there, i.e. a fixed place of business through which the business of the enterprise is carried (note there is no discussion of dependent agency PEs here). Business profits derived from the extraction of natural resources in a Contracting State (CS) may be taxed by that CS where the conditions of Art.5(1) are satisfied. Art.5(1) requires (a) a POB; (b) a POB that is fixed (in both a geographical and temporal sense) and (c) that the business of the enterprise is to be carried out through that POB.

POB

POB covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A POB may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal (Commentary Art.5(1) [10]). Broadly, having the space at the disposal of the enterprise will involve the enterprise having the effective power to use that location and the activities it performs there (Commentary Art.5(1) [12]). There is no profitability requirement (Commentary Art.5(1) [7]). Art.5(2) provides a non-exhaustive list of examples of places of business, each of which can be prima facie regarded as constituting a PE under Art.5(1), provided it meets the Art.5(1) requirements and does not violate the Art.5(4) exceptions (Commentary Art.5(2) [45]).

Art.5(2)(f) specifically refers to mines, oil or gas wells, quarries and any other place of extraction of natural resources are included as examples of possible places of businesses. The term "any other place of extraction of natural resources" should be interpreted broadly and includes, for example, all places of extraction of hydrocarbons whether on or off-shore (Commentary Art.5(2) [47]). Furthermore, Art.5(2)(f) refers to the extraction of natural resources but does not mention the exploration of such resources, whether on or offshore (Commentary Art.5(2) [48]). Candidates may note that Art. 5(2)(f) does not refer to exploitation, but certain countries have a reservation on that provision e.g. Canada, Chile and Israel reserve the right in subparagraph (2)(f) to replace "of extraction" with "relating to exploration for or the exploration" (Reservations on Article 5(2), [198].

The Art.5(2) Commentary at [48] states that whenever income from exploration activities is considered business profits, the question whether these activities are carried on through a PE is governed by Art.5(1). Noting that it has not been possible to arrive at a common view on the basic questions relating to income from exploration activities, the Commentary states that CSs may agree upon the insertion of specific provisions, such as a non-resident enterprise being deemed: (i) not to have a PE in that other CS; (ii) to carry on such activities through a PE; or (iii) carry on such activities through a PE in that other CS if such activities last longer than a specified period of time' or (iv) to another rule.

POB that is fixed

Commentary Art.5(1) [21] – there must be a "link between the place of business and a specific geographical point". In connection with this, equipment used does not have to be fixed to the ground rather it is enough if that equipment remains on site. Since the place of business must be fixed it must have a "certain degree of permanency" (Commentary Art.5(1) [28]). However, a place of business may be fixed in a temporal sense even when the place of business exists for a short time where the nature of the business is such that it is only carried on for a short time (Commentary Art.5(1) [28]). This is particularly relevant in the case of recurrent activities (where one would consider the number of times the place was used, which may be over a number of years) or where the business activity is only carried on in that country but may also apply in special circumstances (such as the death of the relevant taxpayer, failed investment, or premature liquidation etc.).

The business of the enterprise is to be carried out through that POB

"Through which" the business must be carried on partly or wholly through the place of business, is said to be given a "wide meaning" so as to apply to any situation where business activities are carried on at a particular location that is at the disposal of the enterprise for that purpose, e.g. paving a road will be considered to be carrying on its business "through" the location where this activity takes place (Commentary Art.5(1) [20]). The business may be carried out by employees, automatic equipment, etc. (Commentary Art.5(1) [39]-[41]), e.g. automatic pumping equipment used in the exploitation of natural resources (Commentary Art.5(2) [127]).

Issues that Magnolia may wish to consider include:

- Industry disparities. PE thresholds vary across DTAs and countries, with a notable distinction between the standard 12-month duration for construction or installation projects under Art.5(3) and the proposed shorter duration for the extractives sector that Magnolia is considering. It could be noted that countries such as Australia, Chile, Greece, Korea, New Zealand and Turkey have reserved their right for a six-month threshold for activities related to natural resource exploitation (Reservation on Art.5(3) [201]; Reservations on Art.5(1) [188]-[195]), which may indicate a trend towards shorter durations for the extractives sector. A 30-day period is considered by some to be too short (ICAEW 2023, Deloitte (2023 & Michel 2024).. However, there are approximately 200 (out of over 3,000 DTAs) that include similar provisions e.g. a 30-day PE threshold is found in Australia-Norway DTA (Art.20), US-UK DTA (Art.21), and UK-Netherlands DTA (Art.23)). Magnolia may be advised to consider how these provisions have operated for those countries.
- Interpretation. Interpretative issues in relation to the application of the proposed provision may arise. Magnolia may need to consider how this provision will interact with other DTA provisions, e.g. will it sit within Art.5 or a standalone provision? It may be advisable to clarify that the proposed provision is based on the need to protect the situs principle in Art.6 (immovable property) over functions that are disaggregated between different specialised subcontractors that collectively and in substance amount to the offshore winning of petroleum, gas and minerals as opposed to viewing the proposed provision as a concession by the residence to "resource source state "countries over general mobile business income (Hattingh et. al 2024). Other interpretative issues may also include the meaning to be afforded to key terms in any such provision. As terms included within the proposed provision may not be defined therein, it would be expected that the domestic classification by the host state (resource source state) of income derived by non-resident enterprises may be required.
  A further justification is that the domestic law of the resource host state will tend to be informed by complex policy considerations and possibly also case law considerations. It is not clear whether the proposed provision would make reference to the need to refer to the domestic law of Magnolia as the resource source state. Notwithstanding the need to clarify which CS's law would apply, it is unclear whether Magnolia's domestic law includes such classifications. It is at least possible that Magnolia's domestic income tax regimes may refer to income from "immovable property"; "income from mining" or income from "offshore activities" as opposed to the terms in the proposed provision (Hattingh et al. 2024). Issues with day count tests more generally may include the fact that there is a need to be clear about when such periods start and end (Reimer 2022). Whilst there is minimal guidance in relation to the calculation of the 12-month period in the Art.5(3) Commentary, a site is considered to exist from the date the relevant contractor starts work (including preparatory work – although the preparatory work should have economic substance and actually serve the operation of the site or project (Reimer 2022)), will continue until the work is complete or permanently abandoned and temporary cessation should be ignored (Commentary Art.5(3) [54]-[55]). The OECD notes that activities at every stage of the extracting process are to be included such as exploration; development; production; and decommissioning (Consultation 2023 [188]).
- Magnolia would also need to consider whether the proposed provision should be restricted by a provision equivalent to Art.5(4) (i.e. preparatory and auxiliary activities) or whether there is no need given the shorter duration requirements under the proposed provision. The OECD notes that the proposed provision is not subject to Art.5(4) but acknowledges that some DTAs that already contain a provision similar to the proposed provision do subject it to Art.5(4) (Consultation 2023 [188]). As such it may be worthwhile for Magnolia to consider whether the proposed provision should operate subject to the Art.5(4) exception and the anti-contract splitting rule in Art.5(4.1).
- Higher compliance costs. The proposed shorter deemed PE duration may increase compliance costs and administrative challenges due to the variable presence of deemed PEs (Deloitte 2023). Magnolia may find the 30-day threshold too low, potentially incurring higher costs (e.g., registration costs and filings) than revenue gains (Intl Assn Oil and Gas Producers 2023). The impact on different types of enterprises is unclear, suggesting that compliance concerns might be more significant for smaller businesses exempt from certain reporting regimes, but less so for large Multinational Enterprises equipped with the necessary technology and processes for GloBE and ESG reporting requirements (ICAEW 2023). The OECD notes that about 200 DTAs include a similar provision, with 30 days being a common duration (Consultation, November 2023, [191]), suggesting it could be beneficial for Magnolia to explore if such provisions have led to increased compliance costs.
- Profit attribution. It may not be clear whether the proposed provision would result in profit attribution effected by Art.7 and Magnolia may wish to consider whether the implementation of a 30-day period is likely to create additional profit attribution difficulties. In connection with this: (i) it has been reported that attributing profits to "lower threshold" PEs (in connection with oil and gas operations with an existing lower PE threshold) has not created any particular challenges (Norwegian Shipowners Association 2024) but (ii) there is a more general concern with the attribution of profit in accordance with a simple days-presence allocation of profits is problematic as not all activities (and pricing of such activities) can be ascribed to physical presence in the

source country (Hattingh 2024). Whilst the OECD notes that profit attribution would be effected as per Art.7 (OECD, Public Consultation, November 2023, [191]) it has sought feedback on the specific issue of profit allocation and short duration PEs as part of its recent (Consultation 2023). Accordingly, it is unclear that the attribution of profits would be certain to create additional difficulties, but Magnolia may be advised to investigate further to see what issues have arisen in practice before determining to introduce such a provision into its DTAs, or a selection thereof.

- Fair treatment concerns. There is a possibility that tax burdens for non-residents operating through PEs and resident entities may diverge, which may not be consistent with existing DTA provisions (Deloitte 2023). Art.24(3) provides that: “The taxation on a permanent establishment which an enterprise of a CS has in the other CS shall not be less favourably levied in that other CS than the taxation levied on enterprises of that other CS carrying on the same activities.” Art.24(3) does not operate to restrict the taxation of residents and non-residents on differing bases, rather it focusses upon the result (Commentary Art.24(3) [34]) and notes that the purpose of the provision is to ensure that the PEs of non-residents are not discriminated against vis-à-vis resident enterprises in the same sector (Commentary Art.24(3) [35]). Should Magnolia choose to adopt the proposed provision, it may need to review and potentially revise the wording of its non-discrimination articles. This could involve either expanding their scope (for example, by explicitly including conditions related to taxation) or narrowing it (for instance, by exempting specific types of income such as earnings from the exploration or exploitation of natural resources. An illustrative case is Vietnam, which omits activities like oil exploration and production, as well as agricultural production, from the PE non-discrimination provisions in some of its DTAs, such as Art.23(2) of the UK-Vietnam agreement (Reimer 2022)).
- Unnecessary. Magnolia should evaluate whether the proposed provision will achieve its desired effect or if existing provisions, which reflect the OECD MTC 2017, already provide adequate coverage. It is generally considered that the relevant extractive activities would constitute a fixed place POB PE under existing regulations such as Art.5(2)(f). There is also the point that Art. 6 may apply in any event. Additionally, the anti-fragmentation rule in Art.5(4.1) helps prevent MNEs from splitting activities among affiliated entities to circumvent the creation of a PE (ICAEW 2023). In connection with this is that it has been stated that the purpose of such reduced thresholds in the case of the exploitation of oil and gas exploitation and exploration seek to address issues pertaining to stability and more specifically relocated or roaming places of business (Reimer 2022).

<u>Conclusion</u>

Candidates might conclude by summarising the key considerations Magnolia should take into account regarding the introduction of such a provision. It should also be noted that, generally, modifications some CSs make in their DTAs might not significantly affect the actual allocation of taxing rights, as income from these activities would typically be assigned to the state of situs regardless (noting that a number of CSs add further elements to the positive limbs in Art. 5(2) including use and exploitation of natural resources; exploration and exploitation of the sea bed and subsoil areas and their natural resources where these are performed for 30 days in a calendar / tax year (in the case of the Netherlands) and this is not considered to alter the general balance between the residence and source state in substance as the income from these activities would have been assigned to the source state under Art. 6, (Reimer 2022).