Answer-to-Question-_4_

Report on the impact of the OECD Model Tax Treaty on tackling Treaty Shopping

Introduction

The primary purpose of double tax treaties is to mitigate the problem of double taxation. Double taxation involves either the application of tax to the same income twice, or two persons (either people or businesses) being taxed on the same income.

Double taxation harms businesses by making them less competitive when operating internationally vs domestically, as well as harms the broader global economy.

History

Tax treaties have existed as a means of tackling this problem - with various degress of scuccess. The League of Nations famously attempted to tackle double taxation during the 1920s, but with little success.

The emergence of the OECD in the early 1960s ushered a new age of tax reforms, with increasing developments up to the OECD Model Tax Convention of 2017. With the MTC came beneficial treatments for particular scenarios, but the MTC is merely a guide to what a tax treaty should look like. Many of the items included within the MTC are optional, and indeed tax treaties are often very different between nations subject to their ability to negotiate the best deal.

The disparity in tax treaties, as well as the incredibly varied domestic law can lead to unintend structures which yield a prefential tax treatment, but nothing in terms of economic substance.

What is treaty shopping?

Treaty shopping is the act of artificially structuring your business operations to benefit from superior tax treatments.

To illustrate this, consider a country, which in this case we will refer to as A, issuing a loan to different country, B.

B levies WHT at 20% on interest payments to A, and does not have a tax treaty with A. As such, there is no means of mitigating the considerable impact this has on the transaction. This will lead to an inefficient structuring and cash being put into the hands of B's tax authority.

However - there has been an historic way of tackling this. A country, in this case C, could have a tax treaty with Country A giving some form of relief to interest payments between A and C, whilst also having no domestic WHT applied to interest payments.

It is clear that by structuring this loan back to back with the order ACB that WHT can be eliminated. C in this case ould be referred to as a "conduit" company - one which effectively does not perform any other operation besides artificially lowering the effective tax rate of a particualr structure by facilitating the movement of funds.

Whils the above structure is less common today, there are still entities such as the Netherlands which do not levy WHT on interest and as such are a frequent target of this kind of structuring.

Tackling treaty shopping

Article 29

The OECD Model and it's commentary outline various methods of tackling treaty shopping.

(i) **Principal purpose test**

The principal purpose test is a broad approach taken by authorities to combat treaty shopping. Effectively this means that entities which are entirely artifical in nature cannot access the treaty benefits.

(ii) **Limitation of benefit clauses**

Outlined in Aritcle 29 paragraphs 1-12, the benefits of the OECD Model are not extended to all. A specific list of those qualifying groups is included in the Article, as well as conditions to be met to access the benefits of the treaty. This is with the goal of eliminating artificial structures (such as specifying the type of corporation and activities that may be allowed).

(iii)**Ownership**

Aricle 29 commentary includes ownership tests as part of the commentary, namely the Base Erosion test. Effectively this checks that at least 50% of the economic rights are owned during a 12 month period to enable access to treaty rights.

Articles 10,11 & 12

The OECD model include specific measures to prevent treaty shopping in the form of the beneficial ownership clauses. Effectively, this will entitle the beneficial owner of the dividend,royalty and interest to be paid whilst suffering a reduced WHT where applicable (for example 5% on dividends if holding 25%, 15% maximum in all other cases) so long as they owner is resident in that state.

This added "look through" mechanism means authorities will verify where the beneficial owner of the profits is located before granting the the preferential withholding tax rate.

Alternative measures

whilst the OECD offers "guidelines", it ultiamtely deferrs the implementation of the many of it's measures to the contracting states. This lax approach, given the OECD's inability to pass of it's own accord, means many treaties implement the above measures in their own way. Such freedom is likely to leave gaps in interpretation.

The United States, unphased by European or OECD measures, simply does not allow the use of conduits as a means of reducing effective tax rates. If you are incorporated in the US, or are paying interest to the US you cannot conduit your way out of tax payments. The fact that this approach exists suggests that the OECD may have some capacity to

Conclusion

The OECD has taken significant steps in tackling the matter of treaty shopping through it's model treaty, with extensive measures in tackling the abuse of the beneficial treaty measures. The PPT, LOB and BO tests in particular are employed daily in corporate matters, with many countries having tax treaties which make use of these.

However, it is important to note that the OECD Model is not a binding document or law, it is simply a guide to countries for the integration of their own tax treaty.

It is also important to consider that the OECD doesn't provide significant guidance to domestic legislation. Whilst the Vienna Convention of 1969 clearly states that countries should enter into tax treaties in good faith and is binding (the concept of "pacta sunt servanda", many countries do not have tax treaties as a "lex specialis" (a law which overrides future and present legislation at the time of signing). Countries such as the United States can overrule their tax treaties with domestic legislation, with little regard for the Vienna Convention.

Despite these challenges, the OECD has managed to significantly shape the global approach to treaty shopping, improviong the global economy in it's wake.

Answer-to-Question-_3__

Introduction

The ability to raise taxes is a key function for all countries. Teachers, doctors and national security all are public goods without which a modern economy simply cannot function without.

The incentive to attract increasingly large corporate groups/wealthy individuals as a means of contributing to tax revenues is a source of great debate even among those not inclined to read tax legislation or qualify as advisors/accountants.

History

For countries to attract companies and investment through their fiscal regime has been a major area of policy for hundreds of years. By offering a better treatment on corporate profits, or for investment companies can persuade major corporate groups to locate themselves in a jurisdiction they otherwise may not consider. Ireland is perhaps the most prominent example of this, with its 12.5% tax rate, but even the UK has played a role in it's increasingly beneficial investment offerings (in particular the extension of full expensing in November 2023).

The presence of tax havens has been a concern for the global economy for a significant period of time. From the creation of the Principate of Monaco to the emergence of the Panama Papers the focus that society has had on tax havens has grown ever stronger. This does lead to the question: what are tax havens?

Tax havens are typically regarded as those with very low to zero tax rates on various forms of income (earned, capital and corporate being primary focuses), countries with very beneficial treaties and ones which may be used to store significant wealth abroad which would be untaxed.

A key challenge for national lawmakers, as well as organisations such as the OECD or suprantional groups such as the EU is; how best to address the impact these low tax jurisdictions.

OECD Report

The 1998 report from the OECD included information on the activity of tax havens, a "black list" of countries and suggestions for the implementation of Controlled Foreign Company ("CFC") regulations and diverted profit taxes.

A CFC is an entity in a state, A, other than than one in which the primary company is operating, B,- but where the profits for the CFC would typically taxed in country B. Several tests have been introduced to determine a CFC, as well as how and where their income should be taxed. Examples common in the UK are the low profits exemption which excludes

The report also included guidelines on the introduction of CFC rules as a means of reducing the impact of tax havens through improved reporting and taxation.

BEPS Action point 5

The BEPS project has been a major initiative over the last 15 years, with major actions points coming into force during the 2010s and now into the 2020s. Action Point 5 focused on

Pillar 2

Pillar 2 is perhaps the most prominent of these examples, and is proving a major challenge for corporates with consolidated revenues in excess of EUR750m (being the threshold at which Pillar 2 is required in reporting)

Pillar 2 sets a global effective minimum tax rate of 15% per country. That is to say - every country in which a company in excess of the above revenue threhold operates must either suffer a 15% in said country OR suffer a top up tax equal to the differnce between their ETR and the 15% minimum.

Pillar 2 is a major undertaking and has required global corporates to signfiicantly overhaul their internal reporting to comply with the incredibly detailed guidelines the OECD has outlined.

The impact of Pillar 2 is still to be seen, as the very first accounting periods in which it is

European Union - DAC 6

DAC 6 is an EU Directive which requires companies to maintain detailed records and report any activities in countries which have a particularly low tax rate or have uncooperative tax authorities.

Whilst there are several means of qualifying for report, the most common is a list of countries which the EU keeps a readily available register online.

Further, it is important to note that the DAC initiative includes the sharing of information between jurisdictions. This exchasnge of information has been critical to tackling complex international structuring - and it is also important to note that this information cannot be typically withheld by a state simply because they are a bank or another organisation handling sensitive documentation - an authority requesting the information must be provided it.

Other Challenges

The challenges faced by the OECD in it's push for the eradication of harmful competition are numerous.

Before considering the legal matters, it is important to reflect on the global and digital nature of the modern economy. How and where revenue and related profits are generated becomes increasingly complex. Pillar 1 was initially designed to tackle tech companies and their profits being offshored to where their server, hq or directors were. This has since become a catch all legislation for large corporates, but the endeavour to find ways of tackling big tech are symbolic of the challenge.

It is also important to consider the impact of getting jurisdictions to agree. The BEPS project included 4 action points with minimums standards, despite pushing for a much more encompassing set of changes.

Conclusion

In conclusion, the 1998 Report has had a major impact on the landscape of harmful tax competition - both in guiding changes to domestic law such as those seen in Luxembourg and the UAE, as well as broader global initiatives building on the work being undertaken as part of the report.

CFC legislation are now standard practice across the Globe, but the increasingly complex nature of the economy has raised challenges for determining where items should be taxed.

Answer-to-Question-_5_

Introduction

The primary purpose of tax treaties is to eliminate the problem of double tax. However - it is not their only purpose.

Tax treaties are also used as a means to improve the economy more broadly. The EU will even allow certain freedoms to be infringed upon should certain tax practices by helpful to the common market.

History

Various approaches to treaties have been explored over time. The current version of the OECCD Model being from 2017 builds on work previously undertaken by

OECD backbround

The OECD is a group of economically developed countries which are relatively rich. They are looking to export capital and services to developing countries and as such there has been a view of taxing worldwide income from the activities/capital being exported throughout the globe.

This has been problematic for

OECD PROBLEMS

The OECD has also struggled to find ground in some areas - notably due to its reliance on the countries agreeing to measures. The Mutual Agreement Procedure "MAP" has notably had trouble in resolving disagreements on double taxation matters.

The GSK case related to transfer pricing is perhaps the most famous, involving the US and UK tax authorities not being able to find agreement between an uplift in a TP adjustment to the US (given the US had played a role in developing a particular brand) and the theoretical reduction in taxes due in the UK. GSK were taken to court by the IRS for an $8bn claim, eventually settlinng out of court for $3bn. There has recently been a measure introduced to enable the arbitration of MAP processes, but not all countries are subject to this.

Countries are also able to dismiss a claim for a MAP on their review of the facts, which shows how the Agreement Process is not

The OECD - MLI

The multi lateral instrument is perhaps the greatest success of the OECD. Altering tax treaties has proven challenging, as it is important to note that individual treaty clauses cannot be picked and chosen once signed - the document is signed as one and enforceable as one.

As such, renegotiations and clause changes have proven extremely challenging. The Multi Lateral instrument by the OECD of 2015 changed all of this. This instrument allows for additional clauses to be included by signatories to the instrument on a shopping cart basis. That is to say, signatories can pick and choose which aspects of the treaty they wish to be a part of. An example of this is the arbitration clause recently included for MAPs, which enables the resolution of a claim

A matrix of signatories is maintained by the OECD which is readily available, allowing a clear understanding of who has signed up for what.

Capital Export Neutrality ("CEN")

The approach taken by the OECD links to the economic concept of CEN, which was introduced in the 1970s - effectively the worst tax rate under CEN is that of the capital exporting country as they provide credit relief to foreign taxes suffered. This is clearly open for abuse as you would simply incoporate in a country with a low tax rate and operate from there.

UN Perspective

The UN is a considerably larger group of countries, including those within the OECD itself. As such, it is clear from aspects of the treaties and guidance coming from the UN that it has a clearer focus on developing nations.

UN Source and Attraction

This can be seen by it's focus on source taxation. Source taxation means that tax is effectively levied in the jurisdiction in which the economic activity is actually taking place.

The UN models also have a focus on the "force of attraction" principle. This means that if a company in one state is undertaking work in another state in which it has a permanent establishment - the permanent establishment will "attract" the economic activity into being taxable in that state rather than where the topco is resident.

The "force of attraction" approach is openly frowned upon by the OECD, but it does seem to tie more closely to Georg Von Schanz's view of "economic allegiance". Economic allegiance was an early concept in the development of international ta, but effectively

UN Articles 10,11,12

The UN model shows it's approach to source taxation via it's "... " approach to WHT % for dividends and interest. It also suggests a tax at source for royalties, something which the UN Model steers clear of.

Capital Import Neutrality

The focuse on source attraction also has ties to the economic concept of Capital Import Neutrality ("CIN"). This concept states that taxing things locally would improve

For CIN to ultimately be effective, a global effective tax rate would be required. It is interesting that almost 50 years after the concept was introduced, Pillar 2 is set to (in some regards) begin implementing this concept through the global minimum being enforced for major corporations and groups. CIN is also less open to abuse as tax is suffered at a domestic rate where profits are generated.

Conclusion

Whilst the OECD Model has it's weaknesses, the OECD has also shown several novel approaches to simplifying the world of international taxes through work on the MLI.

It is very true to say that the OECD has a degree of bias towards wealthy nations, which is demosntrated by its CEN/global tax approach. It is also only a group of c.30 countries, and whilst OECD members may still use the Model Treaty, their interest are very clearly not being represented here.

The UN has various measure which are very beneficial to those countries that need it most. Items such as higher WHT on dividends and a tax at source for royalties would clearly improve the public finance position of developing nations. However - these measures may actually dissuade foreign direct investment from those wealthy nations.

Overall - the push to Pillar 2 seems to suggest that a global approach to tax favours the UN push for economic inclusivity.

Answer-to-Question-_6__

Introduction

The focus of this advice is the impact of residency on the taxes due to be suffered by Angelica Co. Cross border business activities are likely to

A concern in this scenario is that Geronia will view business activies happenign in the warehouse as being trading in nature and will attempt to tax profits it deems to have arisen within its borders.

General Analysis

To determine which country has the right to tax in this scenario it is important to consider the residency the operation.

Residency (Article 4)

The OECD defines residency tests in Article 4 of the model treaty as being somewhat reliant on the agreement between contracting states.

(i) The first would be to identify where the business has incorporated (in this case it is clear that it is incorporated in Fragonia

(ii) It would then consider either where the place of central management is located OR the historic approach of place of effective management ("POEM")

Both the incorporation and "management" tests clearly indicate that Angelica is a tax resident in Fragonia.

Income (Article 6)

The OECD Article 6 informs on the taxation of income from immovable property. It can be summarised by the folllowing:

- 6(1) Income is typically taxed in the source state
- 6(2) Defines "immovable property" under the domestic defintion. In this case, a warehouse does meet this definition.
- 6(3) Specifies that rents on immovable property fall within the scope of paragraph 1, described above

As such, it is likely that the rent will be taxable in Geronia in line with the understanding that rent has been levied there from a fixed place of work.

Capital Gains (OECD Article 13)

This article allocates the capital gain rights on a disposal the same way that Article 6 does. As such, capital disposals resulting in a gain are to be taxed in Geronia.

Income from Employment (OECD Article 15)

OECD Article 15 states that taxes would be chargeable on employee income based on the recipient being in the contracting statec in excess of 183 days in a 12 month period OR if the paying entity is not resident in the contracting state. We have ascertained that Angelica is resident in Fragonia, however, the final clause of Article 15 says that if the salaries are generated from the permanent establishment in Geronia then authorities could claim taxes on this amount.

Year 1

- There are no specific concerns that a PE has been created in year 1, as the work being undertaken by Felicity was preparatory and auxiliary in nature to the activities of the business. The estate agent was also a third party, and unlikely to qualify as an employee

Year 2

- Income from rent will be taxed in the Geronia in line with Article 6, from what is a permanent establishment given a fixrd place of work. Angelica should be able to deduct the incidental utility expenses, whilst also suffering tax in Geronia on the $20,000 increase in rent. As such this would lead to a $5,000 additional income to the $200,000 rent, to be taxed at 20%.

Tax of 10% will also be due on the MV of $2mn of the property - to be paid to Geronian authorities in line with Article 6 (capital gains).

Year 3

- Year 3 has a clear risk of Geronia claiming taxing rights on the business activities being undertaken by the staff sent by

Angelica. In line with Article 15 paragraph 2c it is possible that tax is owed on the salaries paid for the assembly work. This was not auxiliary or preparatory and is a clear part of the operations of the business in a fixed place of work.

Given no products were sold and no contracts were signed in Geronia during this period, they were simply advertised then this should be considered as auxiliary work and not enter any proceeds into tax in Geronia.

Tax of 10% will also be due on the MV of $4mn of the property - to be paid to Geronian authorities in line with Article 6 (capital gains).

Year 4

The chargeable gain is likely to lead to a tax charge in Geronia on the basis that the increased valuation of the property has occured in Geronia and upon review of Article 13 - which will be levied at 20% of the $2mn gain (or $400,000). It is important to note that the OECD is not clear on the definition of "gain" and the assumption above has limited the gainn to MV at acquisition - MV at sale.

Conclusion

The final tax positions for year 1-4 of Angelic are in fact dependent on the contracting states finding agreement on the nature of residency.

Staff activity is likely to have generated taxes on the month in

Geronia spent assembling goods for sale as this cannot be seen as auxiliary work.

Beyond this, the OECD model allows Geronia to levy taxes on