THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2021

MODULE 1

SUGGESTED SOLUTIONS

PART A

Question 1

This question requires candidates to consider a number of issues related to the term "enterprise" as it is used in the OECD MTC. There are a variety of approaches to answering this question. Nevertheless, candidates should address whether it is correct to say that the term "enterprise" is frequently used within the OECD MTC and that it is not defined therein. Candidates should also consider the relationship between domestic law meanings of enterprise and the changes made to the OECD MTC in 2000 that expressly included services within the definition of business following the removal of Art.14 from the OECD MTC. Whilst no marks are deducted for not referencing domestic law examples, it is open to candidates to include a given country's domestic rules where these support a particular argument.

Meaning

"Enterprise" is key for determining DTA entitlements. Per Art.3(1)(d) OECD MTC 2017 the terms "enterprise of a CS" and "enterprise of the other CS" mean respectively an enterprise carried on by a resident of a CS and an enterprise carried on by a resident of the other CS." As such, one might expect "enterprise" to be comprehensively defined. Whilst there is some guidance in the OECD MTC and the relevant Commentary, there is no comprehensive definition. It can be argued that there is a definition (Lang 2011), albeit an imperfect definition. The OECD MTC 2017 provides that enterprise constitutes the "carrying on of a business" and "business" is stated to include "the performance of professional services and… other activities of an independent character" unless the context otherwise requires: Arts.3(1)(c) & 3(1)(h). According to the Commentary, context refers to:

"the intention of the [CS] when signing the Convention as well as the meaning given to the term in question in the legislation of the other CS (an implicit reference to the principle of reciprocity upon which the Convention is based). The wording of the Article therefore allows the competent authorities some leeway." Commentary on Art.3(2), [12].

Thus it appears it may be possible to refer to the domestic law meanings of the CS applying the relevant treaty: Commentary on Art.3(2), [11] & [13.1]. Reference to the relationship between domestic law meanings and enterprise as found in the OECD MTC 2017 is found below.

Frequency of Use of Enterprise in MTCs

"Enterprise" is expressly referenced in Arts. 2, 3, 5-9, 13, 22, 24
& 29 OECD MTC 2017 and "business" is referenced in Arts: 3, 5, 7, 8, 10-13, 19-22, 26 & 29 OECD MTC 2017. Accordingly, enterprise is a frequently used term in the OECD MTC. Whilst the question does not require candidates to consider the frequency of use in the UN MTC 2017, "enterprise" features in Arts. 2, 3, 5-9, 13, 22, 24 & 29 and "business" features in Arts. 5, 7, 8, 10-12, 12A, 13, 19-22, 26 and 29 UN MTC 2017. Accordingly, the same is true of the UN MTC 2017.

Relationship between Domestic Law Meanings & DTA Concept

A historical analysis of the term "enterprise" reveals that the League of Nations 1920s drafts did not contain the term. Rather they referenced "industrial, commercial and agricultural undertakings". "Undertaking" was replaced by "enterprise" in the London Model Convention 1946, Article IV Protocol (Sasseville 2011). The Mexico Model had referenced "business" & "enterprise". It was agreed that enterprise should not be defined and that "profits" should encompass business profits but should exclude all profits from services (whether independent or not), profits from international air traffic and shipping, immovable property and passive income: OEEC Reports. The precise manner of calculating profits was left to the CSs. Thus the calculation of taxable income was to remain a domestic affair and the identification of profits a treaty affair (see changes made to the OECD MTC in 2008 & 2010).

In 2000, and as described below, Art.14 was deleted from the OECD MTC 2017 and thus Art.7 subsumed profits derived from "professional services". This deletion was envisaged to have a direct impact on those countries (typically civil law countries) whose domestic regimes excluded service income from business profits.

In terms of the relationship between domestic and treaty meanings of enterprise, this necessarily extends to the meaning of the term "business". A starting point is whether one considers that enterprise is defined in the
OECD MTC 2017. Where the view is that there is a definition, the OECD MTC provides some limitations on any domestic law meaning by providing parameters within which the term must be interpreted, i.e. professional service income is included in business profits and enterprise involves a business activity (Lang 2011). To support this contention, Coloumbe (1982) notes that "enterprise" must be distinguished from employment under Art.15 OECD MTC, which has an autonomous meaning (level of economic & personal dependence and evidence of a subordination link between the taxpayer & the person retaining the taxpayer's services).

Where one views the changes made in 2000 as purely highlighting that Art.7 subsumes income arising under Art.14 (Avery Jones 2011) there is ample scope to refer back to the domestic law meaning of the term. Avery Jones also notes that enterprise is a term that is often entirely unknown in common law jurisdictions and may be used in a manner in a country's domestic law that is of no relevance to tax treaties even where the country is a civil law jurisdiction (e.g. Germany & Austria typically use the term in the context of indirect taxation: Jones et al 2006).

Changes Made in 2000

Changes made to definition of business (including independent professional services) in the OECD MTC 2017 were necessary due to the removal of Art.14. The effect of this was that professional services can constitute a "business" even where the domestic law of a country does not consider that the performance of such activities constitutes a business (Commentary on Art.3(1), [10.2]). The Commentary further notes that CSs that do not wish for such services to be included within the scope of "business" (and therefore "enterprise") are free to omit the amended definition of business from their Conventions. Note that Italy & Portugal reserve the right to include an article on the taxation of independent personal services (Reservations on Art.3, [14]).

Whilst the question does not anticipate answers referencing the UN MTC, candidates may wish to refer to the fact that the change made to the OECD MTC in 2000 (removal of Art.14) was not made to the UN MTC and thus there has been no equivalent change to the "definition" of enterprise i.e. there is no equivalent to Art.3(1)(d) & (h) OECD MTC 2017. The Commentary to UN MTC, Art.3(1)(c) notes that even the matter of whether "enterprise" refers to an activity that is carried on or to an enterprise (one presumes a legally recognised person) is a matter left to the domestic law of the relevant CS (Commentary on Art.3(1)(c), [6].

Conclusion

Historical analysis reveals that initially enterprise was not used in the League of Nations' earlier drafts. It was then laterally decided that no comprehensive definition would be included in the MTC. It appears that whilst there are differences of opinion as to the precise nature of the OECD MTC's "definition" of "enterprise", there may be more agreement about the need for a more comprehensive definition of "enterprise" and/or "business" for DTA purposes, a priori if one takes the view that there is a definition of "enterprise" in the OECD MTC as it is difficult to make such a similar assertion in relation to the UN MTC.

Question 2

This question requires candidates to consider the work of the OECD and evaluate whether it allows for a variety of approaches to debt characterisation for the purposes of Art.9 OECD. Candidates may also note that Chapter X, TP Guidelines, is of direct relevance to Art.9 (Associated Enterprises) – as opposed to the interaction of permanent establishments (PEs) under Art.7. Thus, there is no need to discuss the work on the attribution of profits to PEs in relation to interest-bearing debt.

Candidates may start their answers by outlining the function of Art.9, considering the reason why debt characterisation is of relevance to Art.9 and considering interest deductibility. Art.9:

"deals with adjustments to profits that may be made for tax purposes where transactions have been entered into between associated enterprises (parent & subsidiary companies and companies under common control) on other than arm's length terms" (Commentary Art.9, [1]).

Commentary on Art.9(1) [3(b)] references debt characterisation, as well as interest rate adjustments, noting that Art.9(1) applies:

"not only in determining whether the rate of interest provided for in a loan contract is an arm's length rate, but also whether a prima facie loan can be regarded as a loan or should be regarded as some other kind of payment, in particular a contribution to equity capital."

The Commentary notes that national law may provide for different approaches to Art.9-type scenarios and that this may be consistent with the ALP approach, e.g. thin capitalisation provided the effect of the national rules is to assimilate profits of the borrower to an amount that would have accrued in an ALP situation: Art.9(1) [3(a)].

Debt Characterisation & Interest Deductibility

When considering financial transactions between associated enterprises (AEs) for the purposes of Art.9, it may be necessary to establish whether a particular transaction is "accurately delineated" as a debt instrument for tax purposes. Given that debt instruments typically generate amounts that can be deducted from income for tax purposes, it is considered appropriate to ensure that transactions between AEs are not manipulated in such a way as to generate greater deductions than an arm's length transaction would generate. Interest deductibility coupled with "accurately delineated" debt characterisation is therefore a component of the OECD's work in BEPS Actions 4 & 8-10 (in relation to Art.9).

DTAs & Interest Deductibility

Excessive interest financing is addressed in Arts.9(1) & 11(6). As noted above, Art.9(1) adopts the ALP and thus an approach to debt characterisation that is consistent with the TP Guidelines is preferred over the other possible approaches. Art.11(6) applies where there is a special relationship between the payer & the beneficial owner (or between both of them & some other person) and the interest paid exceeds interest that would be payable on the basis of the ALP. Art.11(6) applies to the excess amount, with laws of the CS and provisions of the relevant DTA applying to the ALP amount: Art.11(6) Commentary [32]. However, Art.11(6) only applies to the rate and not the characterisation of the relevant transaction: Art.11(6) Commentary [35]. Whilst it is open to CSs to remove the wording "having regard to debt claim for which it is paid" (as this requires that the transaction is a debt claim), those CSs that leave it in can only modify the interest rate charged (and not the amount of the loan for example). Candidates may note that in Art.11(6) Reservations [46], Mexico reserves the right to include a provision regarding the treatment of certain back-to-back loans, as a safeguard against abuse.

BEPS Actions

Action 4 deals with limiting base erosion involving interest deductions and other financial payments and Actions 8-10 are focused upon Aligning Transfer Pricing Outcomes with Value Creation.

TP Guidance on Financial Transactions

The Inclusive Framework on BEPS Actions 4, 8-10 ("2020 Report") was published in 2020 and followed the publication of a Discussion Draft (DD) in 2018. The DD provided guidance on Art.9 as it relates to the appropriate balance of debt and equity of an MNE, a priori where the relevant debt component has to be identified for tax purposes. This included the concept of "accurate delineation" of the transaction. The 2020 Report was included in the TP Guidelines as Chapter X. The 2020 Report provided for the first guidance on financial transactions in the TP Guidelines.

Chapter X, TP Guidelines

The guidance retains the "accurate delineation" approach for financial transactions that was included in the DD. Thus, the balance of debt and equity can be challenged by revenue authorities according to certain economically relevant characteristics (cash flow projections supporting a borrower's ability to meet its obligations, contractual terms, enforceable obligations to pay interest, industry factors, realistic alternatives to the lender and borrower etc. There may also be a need to carry out a functional analysis of the lender and borrower as well as relevant aspects of the business strategy associated with the transaction. This approach has been described as acknowledging the "unique features" of the financial services industry (KPMG 2020).

Whilst guidance on the application of the principles to be applied is provided (section B), it is also clear that the 2020 Report (and so Ch.X) does not prohibit the implementation of measures to address capital structure & interest deductibility in their domestic legislation as it envisages that the OECD approach is not the only approach for determining whether purported debt should be respected as debt [10.9]. The approach adopted by Ch.X is considered to be consistent with that of the Commentary on Art.9 (Savva & Ioannou 2020).

Approaches to Debt Characterisation for Interest Deductibility Purposes

Approaches in determining the capital structure of an MNE and its debt funding range from relying on the guidance within the 2020 report (and thus Ch.X), which outlines typical characteristics of debt funding) and more formulaic approaches to limiting interest deductions (such as ratio-based thin capitalisation rules: Art.9(1) Commentary [3(a)]. These approaches can be categorised into three broad specific anti-avoidance approaches: transfer pricing rules (whether the volume of debt is considered to be consistent with the arm's length principle); earning stripping rules (such as limiting interest deductibility to a certain percentage of EBITDA): and safe haven approaches (i.e. thin capitalisation rules). Features that may point towards an amount constituting debt per Ch.X [10.12] include:

"the presence or absence of a fixed repayment date; the obligation to pay interest; the right to enforce payment of principal & interest; the status of the funder in comparison to regular corporate creditors; the existence of financial covenants & security; the source of interest payments; the ability of the recipient of the funds to obtain loans from unrelated lending institutions; the extent to which the advance is used to acquire capital assets; and the failure of the purported debtor to repay on the due date or to seek a postponement."

Conclusion

Candidates may conclude that there is some still some scope for flexibility in approach when determining whether a country that adopts the TP Guidelines in characterising debt for interest deductibility purposes under its domestic law in a manner that is consistent with the OECD's approach. It has been stated that it is possible for more than one approach to apply and that this overlap may result in inconsistent treatment e.g. an interest deduction being disallowed under the TP approach but allowed under an earning stripping approach.

Whilst no marks will be deducted for not mentioning country practice, it is open to candidates to consider to what extent country practice is consistent with the 2020 guidance now contained within Chapter X, TP Guidelines e.g. whilst there have been modifications to the US law in

recent years, it is generally accepted that Treasury Regulation 385-1(b) effectively implements common law factors that identify amounts as constituting debt; the US common law has been described as generally being aligned with the OECD Guidance (indeed some of the terms of the features of debt relied upon by the USA are also found in the OECD Guidance (e.g. Tylers vs. Tomlinson 414 F.2d 844 (1969) & Fin Hay Realty v US) but there are some notable differences such as a greater focus on the perspective of the debtor in the OECD Guidance: Duff v Phelps 2020. A further example is provided by Colombia: (an OECD member since 2018) whilst it has not as yet incorporated the TP Guidelines into domestic law it is anticipated it will in due course.

Question 3

This question requires candidates to consider the OECD work on the digital economy (DE) and focus on the extent to which it can still be said to be guided by the concept of value creation (VC). Reference should be made to work throughout the period 2013-21. Candidates are expected to discuss the definitional issues relating to key terms, such as VC & DE. Candidates may include references to work in this area in other contexts, such as countries' unilateral introduction of rules that seek to tax the DE.

There are a variety of approaches to answering this question. However, it is advisable to first identify the central issue: whether a review of BEPS' work on the DE reveals a connect/disconnect between VC and the proposals for taxing the DE. Consideration should then be given to the meaning of key terms before evaluating the work of the OECD and arriving at a conclusion.

VC

A central idea justifying the BEPS project was to "ensure that profits are taxed where economic activities take place and value is created". VC is employed particularly in connection with the use of tax havens, where activities exist but no value is considered to be created (Lennard 2018). VC was seen as addressing the use of legal structures regarded as lacking economic substance, such as shell companies that have little or no substance in terms of office space, tangible assets and employees (BEPS Action Plan 2013, 13-14) and was also referenced in the BEPS work on Transfer Pricing in 2013. Thus, it could be said that the notion of VC was to be used as a nexus test for certain business activities.

DE

There is no generally agreed definition, and this has been referred to as creating a hurdle to measure the DE (IMF, 2018). Previously the OECD has noted that it was impossible to put a fence around the DE (OECD 2015). Since then several approaches to defining have been noted but there is no universally agreed definition: (i) a bottom-up approach that characterises industries & firms' outputs or production processes to decide whether or not they should be included in the DE (US Bureau of Economic Analysis 2018); (ii) a top- down or trend based approach that identifies key trends driving the digital transformation and then analyses the extent to which these are reflected in the real economy (Van Alstyne 2016); (iii) flexible approach that breaks the DE into core & non-core components thereby finding a compromise between adaptability and the need to arrive at common ground (UNCTAD 2019); (iv) the G20's 2020 approach that builds on the flexible approach allowing for users to analyse the DE from a particular perspective that sits within a set of possible perspectives. Whilst the G20 definition has been arrived at in order to measure economic value, the G20 envisages that it "may well find application in policy areas such as... taxation".

BEPS & DE

BEPS envisioned transparency & substance requirements as key weapons in the battle against tax avoidance. The question requires candidates to consider the extent to which the BEPS work on DE is consistent with the "substance" aspect of this focus. Candidates should note this starting point and track the work of the OECD to determine whether they consider its most recent work on the DE as being guided by or inconsistent with notions of VC. Some of the relevant OECD work is considered briefly below.

BEPS Final Report 2015

The OECD notes that DE is increasingly becoming the economy and that it is difficult if not impossible to ring-fence it. They also noted it may be preferable to address the DE through broader BEPS recommendations, such as indirect taxation, CFC rules, artificial avoidance of PE and better aligning TP outcomes with VC.

Interim Report 2018

The OECD recognised three DE characteristics that make it challenging to achieve fair taxation: businesses with a significant economic footprint without a physical presence; reliance on intangible assets; and profit generated from user created content & user effects (Australian Parliamentary Services 2020). This contained four sets of interim measures that had several design principles as a backdrop: (i) alternative application of the PE threshold; (ii) withholding taxes, a priori for certain industries; (iii) turnover taxes on internet advertising, digital service levies or equalization levies; and (iv) specific regimes to deal with large MNEs, such as the UK & Australian diverted profits taxes.

October 2020 Blueprints & Public Consultation

A proposal in late 2019 for a "unified approach" under Pillar One was published and this preceded two blueprints (Pillars One & Two in 2020) and a public consultation in 2021 on Pillars One & Two. Pillar One addresses new business models that have developed in the broader digital economy by expanding the taxing rights of market jurisdictions, where multinationals may or may not have a physical presence. Pillar One effectively creates a new nexus test: that of the "market jurisdiction" and its implementation has been estimated to yield a relatively small increase in corporate income tax revenues (0.2-0.5% & roughly $5-12bn US). Pillar One involves types of taxable profit that may be allocated to a market jurisdiction, which include: residual profit of a business that can be reasonably associated with the sustained and significant participation of that MNE in the economy of a market jurisdiction; and the tax due on the remuneration of baseline distribution & marketing operations in each market jurisdiction in line with arm's length principle (ALP).

Pillar One has been described as (i) creating a new nexus independent of physical presence and (ii) involving a move away from the ALP. Pillar One is seen as being particularly controversial at the political level and complex in its application. The focus of Pillar One is therefore on the country in which the relevant multinational operates. Pillar Two – referred to as the global anti base erosion proposal (GLOBE) – focuses on addressing tax avoidance through global minimum taxation and is intended to further limit the incentives for businesses to locate functions & activities (and profitability) in low tax jurisdictions. GLOBE is anticipated to raise approx. $40-70bn of additional revenue by way of a 12.5% minimum tax on companies whose headquarters are in the relevant jurisdiction (cf. the US's GILTI regime that levies 10.5%). The focus of Pillar Two is therefore on the "home country".

Value Creation in the Context of DE

Morse (2018) notes that: VC may encompass one or more employees, sales, production capacity, management & capital; what VC does not constitute is clearer than what does, i.e. income should not be allocated to a jurisdiction where a corporation has only a paper presence; and there is a need to consider location savings, a priori in developing countries where certain inputs cost less than in other parts of the world (e.g. wages, real estate, etc). Should rules relating to taxing rights include these location savings or should they be excluded because it cannot be said that the companies create the savings? Lennard (2018) notes that previous work on formulary apportionment may provide context for a discussion of how to tax the DE and notes that, given that several factors can be relevant to VC, countries may be incentivised to encourage VC meanings that will benefit their countries (e.g. customer base for a market country, allocation of risk to capital for a country with a financial centre etc): Morse (2018) & Lennard (2018).

Conclusion

As seen above, differing definitions of DE & VC may impact candidates' answers on the extent of connection between VC and the OECD's work on DE. It is expected that candidates acknowledge this and also highlight the perceived move away from the ALP and the differing challenges posed by the DE vis- à-vis the ability of countries to tax what is considered to be their "fair share". Candidates could sum up by referencing the difference between the location of consumers (as per the market jurisdiction) and the location of the work that is done to create

the good/service. For example, the Ministers of Finance of Sweden, Finland & Denmark made a collective statement in 2018 that the provision of data by consumers is what adds or creates value (Lennard 2018). Accordingly, it is unsurprising that there is support for the view that Pillar One's allocation of profits to the market jurisdiction even where the relevant seller has no physical presence in the consumer's jurisdiction is inconsistent with the notion of aligning profits with the location of value creation. It has been suggested that in order for consistency between VC & Pillar One, customer bases should be treated as intangible assets but it is acknowledged that a move to treating customer bases as intangible assets would need to apply across all businesses and not just the DE. Furthermore, certain domestic rules do not currently allow for such tax treatment (e.g. German direct tax laws): Freeman & Lamzus 2020.

As Lennard (2018) notes, given the varying notions of VC & DE, the most realistic solution may be to provide for a system whereby norms agreed upon at the international level trump any countries' unilateral measures where those measures are in conflict with the internationally agreed upon norms. Such a suggestion, whilst perfectly reasonable, may nevertheless the lack of support from various important international partners. Whilst there will be no marks deducted for not mentioning specific countries' unilateral measures, it is open to candidates to mention the various taxes brought in by countries to address the perceived issues with the international DE taxation (such as the Indian equalization levies, the diverted profits taxes in Australia & the UK and the US' GILTI regime), as well as the work of the UN Committee of Experts in this space (proposal for Art.12B UN MTC 2017 that allows for a withholding tax to be levied on automated digital services in certain situations). Such references provide context for the difficulties the OECD may find with locking in an international agreement.

Question 4

This question requires candidates to provide an overview of the key areas that a UN Tax Convention (UNTC) might contain and consider the issues that might arise if countries determined to ratify the UNTC. Whilst there has been talk of a UNTC in the media, with various recommendations being published by Financial Accountability, Transparency & Integrity (FACTI) in early 2021, candidates who are not familiar with these releases are still in a position to answer this question as it requires them to show an understanding of why a UNTC may be necessary and what benefits or problems may arise as a result of such a move. It also requires candidates to consider whether such a project is likely to be successful and to address the successes and failures of the OECD's work on BEPS.

In February 2021, the UN High Level Panel on FACTI for Achieving the 2030 Agenda published its report on Financial Integrity for Sustainable Development. FACTI called on governments to agree to a Global Pact for Financial Integrity for Sustainable Development including 14 recommendations to reform, redesign & revitalise the global architecture so it can effectively foster financial integrity for sustainable development. Relevantly, certain of these recommendations are related to international taxation. FACTI considers that the recommendations should be effected by way of an open & inclusive legal instrument with universal participation. (FACTI comprises former world leaders from countries such as Nigeria & Lithuania, central bank governors, business & civil society heads and academics.)

Nature of a UNTC: candidates should begin by noting that a UNTC would not be a model tax convention. Rather, it would constitute a legal binding international treaty in the same vain as the UN's other treaties (e.g. UN Convention on the Law of the Sea 1982). Of course, such a treaty may require individual member country ratification and/or translation of treaty law into national law.

Issues that a UNTC might contain. Candidates may reference the tax areas that FACTI has referenced as being of importance to meeting its objectives. It is also open to candidates to consider the key international taxation areas considered by the OECD and the literature more generally:

- Greater fairness in relation to tax cooperation (Recommendation 4: effective CGT; taxes equitably applied on digital services; MNEs taxed on group global profit; fairer rules & stronger incentives to combat tax competition, tax avoidance & evasion; introduce a global minimum corporate tax).

- Multilateral mediation mechanism to resolve disputes arising under the UN TC (Recommendation 4C)

- Global standards for the financial, legal, accounting & other relevant professionals (Recommendation 6)

- Further facilitation of global exchange of financial information (Recommendation 8)

- Establish a Centre for Monitoring Taxing Rights to collect & disseminate national aggregate and detailed data about taxation & tax co-operation on a global basis (Recommendation 11A).

- Create an inclusive intergovernmental body on tax matters under the UN (Recommendation 14B).

For and Against a UNTC

- The Final BEPS Reports are now 5 years old and although there have been a few notable accomplishments (e.g. country-by-country reporting) certain important areas have yet to be resolved, e.g. digital economy, which may never be resolved under Pillar One (Goulder, 2021). The counter to this is that these are complicated matters and good

results from BEPS may still come about, albeit it not for some time (mid-2021 being a self-imposed OECD deadline for BEPS 2.0).

- Notwithstanding the OECD's work, a recent report highlights that members countries are responsible for more than 2/3 of global corporate tax abuse (Global Alliance for Tax Justice, Corporate Tax Haven Index 2021).

- The same report notes that the OECD failed to detect & prevent corporate tax abuse enabled by its members and in some cases pushed countries to roll back their transparency. Possible counters include the fact that it is not always clear how accurate measures of abuse & avoidance are (not least because not all definitions of these terms align across countries) and that for certain countries facilitating tax abuse/avoidance is a side-product of a need to increase their economic standing and thus countries may well continue to be motivated to continue permitting certain types of nexus with their jurisdictions (even if these do not accord with internationally agreed upon standards) if it benefits their economies.

- According to the report, the greatest enablers of corporate tax abuse are: the Cayman Islands, Bermuda (according to the report the UK can impose or veto lawmaking in these countries); the Netherlands; Switzerland; Luxembourg; Hong Kong; Jersey (a British Crown Dependency); Singapore; & the United Arab Emirates. A possible counter is that there has been much progress already in relation to transparency & exchange of information and much of this work can be attributed to the OECD.

- The Cayman Islands was removed from the EU's Tax Haven Blacklist in 2020 following a major public relations campaign. A bid to re-list it in 2021 failed (Planting 2021). There is a view that BEPS activity is still commonplace, e.g. OpenLux, in which despite the existence of Luxembourg's beneficial ownership register, the identify of the ultimate owners was often still unknown.

- It has been reported that calls for the UN to replace the OECD in setting international tax standards gained momentum following criticism for its failure to deliver meaningful change in its long-awaited tax reform proposals. A possible counter is that meaningful change requires time dedicated to it and thus it is unrealistic to expect sustainable changes to be made overnight, a priori where the tax revenues of governments are tightly held and of particular significance following the Pandemic.

- UN is more representative with a wide membership. The counter to this is that even the OECD was unable to get all its members to agree to certain initiatives and it is possible that any UN initiatives may be similarly undermined by members not in agreement. A related point is that tax sovereignty is still important to most if not all countries and this threatens to undermine all tax agreements that require full agreement (consider the EU position with regards unanimity on tax matters & the sticking points).

- Certain areas that impact lower-income countries have yet to be picked up by the OECD, e.g. for countries to introduce resident wealth taxes they need access to data on offshore financial information, to which non-OECD member countries are less likely to have access. A possible counter is that much information is already available and the OECD has increasingly included non-members in its work.

- Many countries signed up to OECD/US-style DTAs that may not have best served their interests, e.g. giving up rights to withholding tax (Goulder 2021). The counter to this is that the UN MTC 2017 currently provides for enhanced source state taxing rights (and may soon include an extension of Art.12 to include withholding tax on automated digital services – new Art.12B) and it is open to countries to negotiate the specific provisions they will include in their DTAs.

- It is unlikely that the OECD MTC would ever include an article akin to Art.12B but if it did there is an argument that BEPS 2.0 (Pillars One & Two Digital Economy) would not be needed (Goulder 2021).

Conclusion: candidates may conclude by outlining to what extent they consider the suggestion for a UNTC is warranted. It is anticipated that candidates will sum up any shortcomings of the OECD's existing work to address problems with the international tax framework and consider whether the UN is likely to have more success in attempting to get member country buy-in to policies and ultimately international binding agreements that may undermine those countries' abilities to raise revenue & set their own policy agenda. The reality therefore of a UN TC is very much an open question, with reports of various high-income countries placing pressure on FACTI not to recommend a UN response but rather to continue to rely upon the OECD approach (Cobham 2021).

Question 5

This question requires candidates to consider the nature of international tax law (ITL), public international law (PIL) and customary international law (CIL) at a general level. Candidates should then focus upon the core element of the question, which is whether it can be said that double taxation agreements (DTAs) constitute CIL.

ITL

Refers to tax rules in cross-border contexts and has been described as forming part of International Economic Law (IEL), which in turn forms part of PIL: Herdegen 2016. The network of thousands of bilateral DTAs is described as the defining feature of ITL: Braumann 2020. As ITL is part of PIL, rules relating to PIL apply such as the application of the Vienna Convention on the Law of Treaties (VCLT) 1969 to the interpretation of tax treaties (Lang 2012).

PIL

Art.38 Statute of the International Court of Justice (ICJ) 1945 provides the most authoritative declaration on the sources of PIL: international conventions; international custom as evidence of general practice accepted as law; general principles of law recognised by civilised nations; judicial decisions and (subject to Art.59) teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

CIL

Has been described as “unwritten law deriving from practice accepted as law”: International Law Commission (ILC) 2018. It has also traditionally been a controversial aspect of international legal scholarship but it appears the ILC work of 2018 in relation to the methodology of identifying rules of CIL has provided some practical guidance as to when & how to identify CIL. ILC 2018 confirmed CIL has two aspects: state practice & opinio juris (recognition of its participants that they are under a legal obligation to conduct themselves in accordance with that custom). These two elements are to apply to all areas of international law. Therefore, in order to determine whether ITL constitutes CIL there is a need to separately identify both elements (Braumann 2020). There is support for the view that IEL forms part of CIL (Dumberry 2016) and this has extended to the notion that CIL could exist in ITL (Baistrocchi 2017, Avi- Yonah 2007 & Fleming 2018).

DTAs & CIL

Limit the application of domestic tax law of one of the possible tax jurisdiction to avoid double taxation (Braumann 2020). The crucial point in time at which to identify DTAs as CIL is when the network of DTAs becomes sufficiently dense so as to create normative effects on their own (referred to as “gravitational pull” by Braumann 2020). Consistent with the notion that CIL requires both elements to be satisfied, the existence of a treaty network is not sufficient. Rather there is also a need to assess the nature of the state practice and the extent of the opinio juris.

The ILC deals with situations where the repeated use of treaty provisions may point towards the development of CIL but notes that (discussing Diallo, an ICJ case not involving taxation) the conclusion of a treaty may also indicate that a desired result does not exist at CIL and thus there is a need for it to be established in black letter law (ILC 2018, Baxter 1970 & Braumann 2020).

There is the scope for parties to a DTA to be bound by a provision within the DTA but also to simultaneously be bound by CIL. Braumann (2020) acknowledges that this is hard to evidence as state practice is likely to be motivated by the desire to comply with [--] treaty obligations. As such, the ILC 2018 considers that opinio juris should be typically evidenced by (i) the adherence of states not bound by the treaty or (ii) in states’ application of the rule outside the scope of their treaty obligations. This is said to lead to the Baxter paradox (Baxter 1970) whereby the more states that ratify the treaty, the harder it is to prove that a customary rule exists in parallel to the treaty. Braumann (2020) applies this to a DTA context stating that it would be necessary to

prove CIL by demonstrating that states apply the relevant rule to taxpayers that are not covered by the DTA framework.

DTA rules that may constitute CIL

Implications of finding any given DTA rule to be CIL are that it would apply to all states irrespective of them having entered into any DTAs with that rule. Applying this position to certain DTA rules, such as the primacy of source state taxation of business profits, it appears that were this to be considered CIL, the rule would apply to all relevant situations, i.e. it would prohibit the double taxation of business profits in all situations. Such a conclusion appears to conflict with the literature (e.g. Qureshi 1987) due to the sovereignty of states to legislate on fiscal matters. According to Braumann (2020), Art.7 OECD MTC provides a prohibitive rule which means that the residence state is required not to exercise its full taxing rights and thus evidence of state practice and opinio juris requires evidence of deliberate inaction & said inaction being accepted by the "inactive" state as being legally required (ILC 2018). Braumann considers Art.7 a concrete, straightforward jurisdictional rule and so a potential candidate for CIL emerging from a DTA provision.

Furthermore, Braumann notes that state practice in relation to Art.7 is generally widespread & consistent but it is skewed towards OECD practice and is thus not fully representative. In terms of opinio juris, evidence can include the administrative decisions, travaux preparatoires domestic laws etc. However, Braumann (2020) concludes that DTAs do not provide enough suitable evidence to prove opinio juris rather it is generally agreed that states enter into DTAs as a matter of choice, because it is in their best interests to so do and when it comes to international negotiations it is considered that states tend to stick with the status quo (Jogarajan (2018) & Pierson (2000)). Braumann applies the same type of analysis to the arm's length principle (ALP) as found in Art.9 OECD MTC and concludes that on the basis of extensive implementation alone, ALP may be a contender for CIL status but various other factors point away from such a conclusion (namely: widespread DTA practice has yet to be evidenced and textual repetition of ALP in DTAs does not equate with evidence of opinio juris).

Conclusion

Candidates may conclude by summing up their arguments for/against their viewpoint that DTAs (or provisions therein) form part of CIL. It is anticipated that candidates will reference the size of the DTA network, the nature of DTAs, the frequency with which certain rules & principles are contained within DTAs forming part of the network and may also attempt to asses whether a particular principle/rule could justifiably form CIL. In particular, any discussion of CIL would need to highlight state practice & opinio juris and evaluate the likelihood or otherwise of rules contained within DTAs constituting CIL.

Candidates may reference the non-tax literature on CIL & treaties, e.g. the view that general principles contained within treaties (as opposed to highly technical rules) are more likely to have the necessary "norm- creating" character that is need for a rule to be considered to be CIL (Dixon 2013 & the North Sea Shelf). They may also reference that the subjective aspect of opinio juris requires a fairly in-depth investigation into the motivations behind entering into DTAs and also agreeing to certain positions. Outside the DTA context, it has been reported that VAT regimes were adopted by a large number of states for a number of reasons, which were primarily concerns over fiscal stability, growth, tax administration & external influences (as opposed to feeling obliged to so do): Durner et. al (2009) & Bartlett (2009). Such a conclusion may also be arrived at in the context of government impact statements, which may be published before a DTA is entered into. A cost benefit analysis of these statements may similarly point away from a finding of opinio juris and thus a finding of CIL.

PART B

Question 6

Candidates are required to answer all three parts ensuring that they provide potential arguments & counter- arguments as to the existence of a permanent establishment (PE) in Country X, as well as detailing whether ABC Ltd or Country X revenue authority has the better arguments.

Context

The facts are loosely based on Samsung Heavy Industries 22 July 2020 involving the India[-]/South Korea[-] DTA. The case involved a determination of whether the core activities of the business were carried out through a PE in India or alternatively whether the relevant activities were of a preparatory or auxiliary nature. As noted below, the Supreme Court of India held that there was no PE and further that there was no valid basis upon which profits of 20% gross revenue could be attributed to the PE.

The following provides an overview of some of the arguments that candidates may put forward but is provided as a guide only and does not provide an exhaustive list of issues to be explored.

Potential Arguments for ABC Ltd

- The project could be broken down into specific parts, as has occurred in other cases, e.g. CIT v Hyundai Heavy Industries Co. Ltd. (2007) 7 SCC 422. On this basis, it can be argued that the project in Country X was solely for preparatory and/or auxiliary purposes. This is supported by the fact that the various tasks (including fabrication & procurement) all took place outside Country X.

- The office played a relatively minor role in relation to the project as a whole and had only two employees with minimal expertise that was relevant to the core activity of the project. Furthermore, the office was established to deliver documents in connection with offshore activity.

- An installation PE only came into existence following (and thus not before) the conclusion of the contract and the contract for supplies for the supplied platforms.

- Art.5(3) Commentary provides that only those profits that are properly attributable to the functions of the fixed base (here the office) and the assets used and risks assumed through the office are attributed to the PE.

- There is no basis for the 20% of gross revenue being attributed to the PE. Furthermore, the office did not make any profit & sales were made to the government. There is no evidence that any of ABC Ltd[-]'s transactions were not at arm's length.

- It is for the revenue authority of Country X to prove there was a PE and not vice versa (burden of proof).

Potential Counter-Arguments for the Revenue Authority

- The project was envisaged as a "fully-integrated project" and as such cannot be separated into discrete parts. As such, the project must be viewed as a whole and all activities as performed were part of the project and, thus, all relevant profits can be attributed to the PE in Country X.

- Insurance was to be taken out by ABC Ltd[-] for the whole project, which supports the contention that the contract should be looked at as a whole.

- Had the taxpayer wished to ensure that certain activities were viewed as preparatory & auxiliary, a liaison office (as opposed to a full office) could have been opened.

- The nature of the activities undertaken do not fall within any exemption of a finding of a PE. This is supported by a lack of any evidence to support a claim that the office here was restricted in relation to its activities cf: CIT v Hyundai Heavy Industries Co. Ltd. (2007) 7 SCC 422.

- 20% is a best judgment assessment and so enforceable where there is a PE and profits have not been attributed consistently with market practice.

Analysis

With limited facts, it is impossible to arrive at a conclusive decision. However, on balance, it is possible that a court would rule in favour of ABC Ltd. Indeed, the Supreme Court of India concluded that on similar facts that involved the 1985 India/South Korea DTA (these countries have since entered into a new DTA), there was no PE nor was the profit attribution justifiable.

Whilst there is no indication of the duration of the installation, according to the OECD MTC 2017, this would need to be established for a minimum of 12 months before it constituted an installation PE under Art.5(3); 6 months under the UN MTC. Furthermore, Art.5(3) Commentary [57] recognises that when it comes to construction or installation projects, the relevant persons may need to be relocated continuously or from time-to-time and that this fact does not necessarily interfere with the finding of a PE. It further provides an example of the parts of a substantial structure (such as an offshore platform) being assembled at various locations within a country and being moved to allocation in the same country as constituting parts of a single project. However, this is different from the facts above, as the majority of the project was conducted outside of Country X, which is a critical aspect of any conclusion.

Conclusion

At the heart of the question is the disagreement about the finding of a PE. It has been noted that ABC Ltd. is likely to have the stronger argument, however, candidates may briefly summarise their arguments for siding with the revenue authority or ABC Ltd.

Whilst there is no requirement to specifically reference Covid-19, it is open to candidates to mention the recent OECD's Covid-19 Related Guidance on PEs, a priori construction and installation PEs, In particular, candidates could reference the OECD's acknowledgement that, at a general level, countries that have introduced public health measures in relation to the Pandemic may seek to either:

(i) treat the periods of Covid-19 related interruptions as any other interruption to the finding of a construction or installation PE due to length of time (12 months for the OECD MTC and 6 months for the UNMTC); or

(ii) "stop the clock" when determining the period of time threshold for finding construction and installation PEs where Covid-Related interruptions halt operations. (Updated Guidance on Tax Treaties and the Impact of the Covid-19 Pandemic, January 2021, hereafter "OECD Guidance 2021"). Candidates may also wish to reference any relevant examples of individual country policy in this regard.

The OECD's 2021 position is a more nuanced position than the one it announced in April 2020 (OECD Secretariat Analysis of Tax Treaties and the Impact of the Covid Crisis, April 2020, hereafter "OECD Guidance 2020"). The OECD Guidance 2020 focused upon the temporariness of interruptions caused by Covid-19 and thus it was considered that any Covid-19 related interruptions would be likely to be treated as any other temporary interruptions (i.e. discounted or rather included in the time calculation). The 2020 position is based upon the Commentary on Article 5(3), [55] where it is noted that a site should not be regarded as ceasing to exist when work is temporarily suspended due to bad weather, shortage of materials etc. It is acknowledged by the OECD in OECD Guidance 2021, [27] that their 2020 position was published relatively early on in the Pandemic (April 2020). Nine months later (January 2021) and with the knowledge that Covid-19 has not as yet been eradicated, the OECD has softened its approach a little and recognizes more explicitly that some countries may exclude the Covid-

10 related interruptions (OECD Guidance 2021, [27]). However, it still appears that the OECD is alive to the fact that generally the stop should nto be stopped and is also mindful of the fact that its “softened approach” should be interpreted as providing an opportunity for double non-taxation. See (OECD Guidance 2021, [26]) where it is stated that for those jurisdictions that determine not to include such time periods the exclusion “[...] cannot be relied upon to create instances of double non-taxation.”

In terms of country policy in this area, the stated approaches of Germany and Greece are briefly considered.

Germany notes that an interruption of construction and installation work caused by the Pandemic will not be counted for purposes of the PE time threshold under Article 5(30 OECD MTC provided certain conditions are satisfied (the duration of the interruption is at least two weeks; the personnel of the enterprise have been withdrawn from the construction site or have left it; and the relevant income will be taxed e.g. in the jurisdiction for residence of the enterprise or its personnel, where the suspension of the lapse of time results in the enterprise not having a PE in Germany. In this respect spontaneous information in tax matters can be provided to the tax administration of the other CS. Germany would not ignore the time of interruption as described in the guidance, nor would combine the time spent before and after the interruption so that the PE test does not start afresh after the pandemic related interruption. (OECD, January, 2021, Box 1)

Greece has provided that a construction site is not regarded as ceasing to exist when work is temporarily interrupted due to Covid-19 restrictions but rather the time of such interruption is included in the calculation of time thresholds for construction PES. 22 July 2020.

Question 7

To establish whether the contribution is covered by a DTA that is broadly consistent with the OECD MTC 2017, it is first necessary to check whether the contribution is listed as a tax to which the DTA applies in Art.2(3). If not, it may fall within Art.2. Candidates are expected to consider whether the contribution should still fall within Art.2. If it is does fall within Art.2, the contribution is covered by Xanadu's DTA network and should be included in any calculations to determine the extent of double taxation relief available. Where the contribution does not fall therein, it may also be noted that certain aspects of the DTA may still apply as certain provisions within the DTA are "not subject to Article 2 (e.g. Art.26(1) explicitly states that the exchange of information is not restricted by Article 2). Accordingly, even if the contribution is considered not to fall within Article 2, information pertaining to the contribution may be exchanged under Article 26.

Article 2 has been described as a mundane but "key provision" (Baker 2010). It is important because, as per the Art.2 Commentary, [1], its intended purpose is to:

- make terminology and nomenclature relating to taxes covered more acceptable and precise;
- ensure identification of the CS' taxes covered;
- widen the field of application by including, as far as possible and in harmony with the domestic laws of CS, taxes imposed by their political subdivisions/local authorities;
- avoid the necessity of concluding a new DTA whenever domestic laws are modified and notification of such changes.

Article 2 is also important because where a certain charge or tax does not fall within its scope, the taxpayer will not be able to benefit from double taxation relief and or any other DTA benefits subject to Art.2. It is only if the contribution falls within Art.2 that the contribution is covered by the DTA and relevantly that double taxation relief is available.

As the contribution is not listed in Art.2(3), the first question to ask is whether the contribution is a tax. The OECD MTC 2017 does not define taxation. The Art.2(2) Commentary, [2], does refer to a definition that is fairly unhelpful as it refers to types of taxes rather than stating the relevant characteristics of a tax. However, Commentary does refer to payments that are not taxes (e.g. social security charges because there is a direct connection between the amount charged and the individual benefits received). This exclusion speaks to the "unrequited" nature of taxation.

The contribution operates similarly to the BET but has a different rate and applies only to a subset of taxpayers. There is no apparent direct connection between the contribution and a benefit being received by the payors (in this sense it is similar to the BET). Thus. the contribution could be viewed as a tax under Art.2(2) according to the Commentary's guidance. Often domestic law definitions of tax either do not have statutory definitions of taxation or their statutory definitions are unhelpful. The courts have been readier to explore notions of taxation and candidates could reference various domestic examples of judicial definitions of tax. One possible example is provided by an Australian Court in Matthews v Chicory Marketing Board (Victoria) (1938) 60 CLR 263,276: a compulsory exaction of money by a public authority for public purposes, enforceable by law and not a payment for services rendered. Applying a judicial definition of tax, the contribution is likely to be classified as a tax due its compulsory and unrequited nature and the fact it is paid to a government authority and so is likely to be an income tax under Article 2(2).

There is an argument that the contribution could be described as an "extraordinary tax" and so that it would be reasonable to include it within Article 2's scope. The Art.2(2) Commentary, [5], provides that it is open to the CS to include a reference to "extraordinary taxes" in their DTAs and that whilst "it seems preferable not to include extraordinary taxes", Art.2 does not exclude "extraordinary taxes" and so CSs are free to restrict the application of the DTA in a number of

ways e.g. limited to ordinary taxes; excluding extraordinary taxes or making special provisions pertaining to "extraordinary taxes". However, Xanadu does not appear to have done any of these. Further discussion of the potential for the contribution to be classified as an "extraordinary tax" can be found below under the "Article 2(4)" sub-heading.

Brief mention should be made of the interest and penalties arising from the contribution and whether these are covered by the DTA (this of relevance to the double taxation relief also). Whilst generally such amounts will not be covered by Art.2, the Commentary at [4] was amended on 21 November 2017 to include certain interest and penalties (i.e. where taxes have been reduced or withdrawn under a mutual agreement procedure interest and penalties directly related to those taxes must also be withdrawn or reduced (see Art.25 Commentary, [49.1]-[49.2]).

As the contribution is likely to be a tax that is not listed in Art.2(3) and will be introduced after the signing of the relevant DTA(s), it is necessary to consider whether the contribution may still fall within Article 2 due to its falling with Art.2(4) (i.e. being classified as an "identical or substantially similar tax" to the BET). If it can be shown that it is "identical or substantially similar" to the BET, Art.2(4) is prima facie satisfied and the contribution is covered.

As noted above, the BET and the contribution are not identical as they apply universally and to a select group of entities respectively. Furthermore, there are rate differences between the two (30% and 5%) and the funds generated by the contribution are to be earmarked whilst it appears those from the BET are directed to a consolidated fund. Arguably, none of these distinguishing features is sufficient to negate the substantial similarities between the payments (e.g. earmarking of payments does not stop them from being classified as taxes). The tax bases are the same (business profits); the entities impacted by the contribution do not directly benefit from the payment of the contribution (in this sense the BET and the contribution are unrequited); and the collection mechanism is also identical. As such, Art.2(4) is arguably satisfied and the contribution falls within Art.2.

Candidates may cite relevant examples of cases that address similar issues (e.g. the Greek courts recently considered that because a payment constituted a "one-off tax" it was an extraordinary tax and could not a substantially similar tax for the purposes of Art.2 Greek/UK DTA Cases 153 and 154 / 2018, January 2018). More recently the Greek courts determined that where the relevant DTA is silent on whether extraordinary taxes are covered by Art.2, the payment should not be excluded: Case 2465/2018, November 2018. Candidates could note that the contribution is slated to be temporary but as it is to be levied on an annual basis it is unclear how long the contribution would remain on the statute book. Whilst the legal team do not have the benefit of hindsight, they could mention that if the contribution is not treated as a covered tax now but is in the future then this may result in legal challenges in the future. The point that an extraordinary tax can become an ordinary tax with the passage of time was also made by the Greek Court in case 2465/2018.

There is no mention that Xanadu plans to notify the other CSs of its plan to introduce a new tax. If Xanadu proceeds with the introduction of the contribution, it should notify the other CSs in order to comply with Art.2(4) OECD MTC 2017, which provides that "[t]he competent authorities of the CSs shall notify each other of any significant changes that have been made in their tax laws."

<u>Double Taxation Relief</u>

Where the contribution is determined to fall within Art.2, the contribution is covered by Xanadu's DTA network and therefore should be included in any calculations to determine the extent of double taxation relief available. Where the contribution is determined not to fall within Article 2 no double taxation relief will be available. However, notwithstanding the non-availability of double taxation relief in such a circumstance, and as noted above, certain aspects of the DTA may still apply as certain provisions within the DTA are "not subject to Article 2 (e.g. Art.26(1) explicitly states that the exchange of information is not restricted by Article 2). Accordingly, even if the contribution is considered not to fall within Article 2, information pertaining to the contribution may be exchanged under Article 26.

Conclusion

Candidates could note that one of the aims of DTAs is to provide certainty to taxpayers as to their potential tax liability in foreign countries and that Art.2 is tasked with this objective. Furthermore, Art.2 is a fixture of all DTAs and together with Art.1 (persons covered) provides the substantive scope of the DTA for negotiation purposes and provides the scope of application by government authorities, courts and taxpayers (Brandstetter, 2011). Other facets of the scope are found in Arts. 30 and 31 in the OECD MTC on the entry into force and territorial application.

Art.2 has been a relatively uncontested provision but there have been instances of its featuring in disputes involving taxes introduced after a DTA has been entered into, such as with the Diverted Profits Taxes (DPT) of the UK and Australia (e.g. EY's submission to the Australian Taxation Office in 2016 on the DPT) and more recently in the Greek courts (GR Supreme Administrative Court, 24 January 2018, Cases no.153 & 154; Supreme Administrative Court 21 November 2018, Case no. 2465); Brazil and whether a social contribution on profits was substantially similar under Art.2(4) in Brazil's DTAs with Austria, Denmark and Spain (CARF, Judgment no.1301-002.817 decided on 3.12.2018); and Poland, relating to the deductibility of state taxes paid in the USA under Art.2(1) (Wojewodzki Sad Administracyjny w Rzeszowie (Administrative Court Rzeszov) 16 October 2018, I Sa/Rz 745/18).