

Article

TORRIONE Henri (co-auteur), *The Non-discrimination Article in Tax Treaties*, in : European Taxation, 1991, p. 310-347.

INTERNATIONAL

The Non-discrimination Article in Tax Treaties

By John F. Avery Jones (United Kingdom), Henri-Robert Depret and Micheline van de Wiele (Belgium), Maarten J. Ellis and Kees van Raad (Netherlands), Pierre Fontaneau and Pierre-Marie Fontaneau (France), Raoul Lenz and Henri Torrione (Switzerland), Thomas W. Magney (Australia), Toshio Miyatake (Japan), Sidney I. Roberts and Sanford H. Goldberg (United States), Jakob Strobl and Jürgen Killius (Germany), Victor Uckmar and Guglielmo Maisto (Italy), and David A. Ward (Canada)*

CONTENTS

I. INTRODUCTION

II. THE NATIONALITY NON-DISCRIMINATION PROVISION

A. Why nationality?

B. In the same circumstances

C. Nationality of companies

1 An alternative interpretation: possible difference in meaning between incorporation and deriving its status

D. Cases of nationality according to residence status

Case 1: Discrimination against a national of State B resident in State A compared to a national and resident of State A

Case 2.1: Discrimination against a national and resident of State B compared to a national of State A resident in State B

Case 2.2: Discrimination against a national of State B who is a treaty resident of State A compared to a national of State A who is a treaty resident of State A

Case 2.3: Discrimination against a national and treaty resident of State B compared to a national of State A who is a treaty resident of State B

Case 3: Discrimination against a national of State B resident in a third state (State C) compared to a national of State A resident in State C

Case 4.1: Discrimination against a company incorporated in State C having its central administration in State B, compared to a company incorporated in State A, an incorporation principle state, having its central administration in State B, a central administration principle state

Case 4.2: Discrimination against a company incorporated in State C having its central administration in State B, a central administration principle state, compared to a company incorporated in State C having its central administration in State A, a central administration principle state

E. Dual nationals

F. Stateless persons

G. Other legal persons, partnerships and associations

H. Positive discrimination: other or more burdensome taxes

I. Apparent discrimination based on nationality

J. Conclusion on nationality non-discrimination

III. THE PERMANENT ESTABLISHMENT NON-DISCRIMINATION PROVISION

A. Meaning of "enterprise"

B. "Not less favourably"

C. Assessment of tax

D. Rate of tax

E. Special treatment of dividends received by a permanent establishment

F. Withholding tax

G. Relief for foreign tax

H. Personal allowances

I. Conclusion on the permanent establishment provision

IV. THE DEDUCTION AND OWNERSHIP NON-DISCRIMINATION PROVISIONS

A. The ownership non-discrimination provision: "similar enterprises"

1. The application of the ownership non-discrimination provision to partnerships

B. The ownership non-discrimination provision: imputation systems

C. The deduction non-discrimination provision

D. The deduction and ownership non-discrimination provisions: thin capitalisation

E. Conclusion on the deduction and ownership provisions

V. THE DEFINITION OF TAXES PROVISION

VI. CONCLUSION

* The authors wish to thank Catherine Bobbett for her editorial assistance.

I. INTRODUCTION

Article 24 of the OECD Model,¹ the non-discrimination article, which is our starting point for considering the non-discrimination articles adopted in tax treaties, has two main objectives. The first, in Paragraph (1), is to prevent discrimination of any kind by one state in taxing *nationals* of the treaty partner state, whether individuals or companies, nationality being defined in Paragraph (2). There is also a similar protection for stateless persons in Paragraph (3). The second objective is to prevent discrimination by one state in relation to *residents* of the other state in three cases, all relating to business income: in Paragraph (4), permanent establishments belonging to, in Paragraph (5), the deduction in computing business profits of interest, royalties and other disbursement paid to, and in Paragraph (6), enterprises owned by treaty partner residents. These we shall refer to as the permanent establishment, the deduction, and the ownership non-discrimination provisions respectively. The OECD Model applies these requirements, in Paragraph (7), to all taxes, including those imposed by local authorities. It will be seen that these provisions all apply to the taxation of the person and not the income, so that discrimination in taxing foreign income, compared to domestic income, is not covered.² We shall not restrict ourselves to treaties in the form of the OECD Model, as variations from it draw attention to difficulties which countries experience with the OECD Model.³ We shall look at each of the paragraphs of the OECD Model in turn.

II. THE NATIONALITY NON-DISCRIMINATION PROVISION

The first three paragraphs of Article 24 of the OECD Model, the non-discrimination article, are as follows:

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.
2. The term 'nationals' means: (a) all individuals possessing the nationality of a Contracting State; (b) all legal persons, partnerships and associations deriving their status as such from the laws in force in a Contracting State.
3. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirements connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances are or may be subjected.

A. Why nationality?

Apart from references to nationality in the dual residence and government service articles (and a cross-reference to the non-discrimination provision in the mutual agreement article),⁴ the non-discrimination article is the only place

where nationality is mentioned in the OECD Model. One might perhaps have expected instead a prohibition on discriminating against residents of the treaty partner state, which used to be found in the League of Nations, Mexico and London draft model treaties.⁵ But only Yugoslavia and the U.S.S.R. normally adopt a residence, as opposed to a nationality, non-discrimination provision in their treaties,⁶ although such a provision is also found in a few other, mainly older, treaties.⁷

The stateless persons provision in Paragraph 3 of the article, insofar as it applies to residents of the other state, is a prohibition on discrimination against a particular class of residents. Some states have the opposite of a residence non-discrimination provision by specifically providing that a state may distinguish between residents and non-residents solely on the grounds of residence.⁸ Since the

1. All references to the OECD Model are to the 1977 Model. The non-discrimination article in the U.N. Model is identical.

2. See B.J. Arnold, *Tax Discrimination against Aliens, Non-residents, and Foreign Activities: Canada, Australia, New Zealand, the U.K. and the U.S.* (Toronto: Canadian Tax Foundation, 1991) [hereinafter "Arnold"], for examples of discrimination on this ground.

3. Our aim has been to refer fairly comprehensively to the non-discrimination article in treaties made by the countries represented by the authors, and to draw on other treaties to give examples, without intending to be comprehensive. This is made possible by the CD containing the world's tax treaties issued by the International Bureau of Fiscal Documentation in Amsterdam, the version used in preparation of this article was 01-04.

4. OECD Model, Arts. 4(2), 19 and 25(1) respectively.

5. Mexico Model, Art. XV, London Model, Art. XVI (League of Nations C.88.M.88.1946.IIA). Both compared the taxation of a resident of one state to that of a person resident or a national of the other (the source) state. These non-discrimination provisions did not extend to other taxes. There was no non-discrimination article in either the London or the Mexico Model estates and successions treaty.

6. U.S.S.R. treaties which compare a resident of the other state with (as in the OECD Model) nationals of the state applying the non-discrimination provision: Austria (1981) and Norway (1980); U.S.S.R. treaties which compare residents of the other state with third-state residents (as opposed to nationals of the taxing state in the OECD Model): Belgium (1987) (in addition to nationality), Canada (1985), China (1990), Denmark (1986) (in addition to nationality), Finland (1987), Germany (1981), the Netherlands (1986) (in addition to nationality) and Switzerland (1986) (in addition to nationality, but not applying to individuals). Yugoslavian treaties, all comparing residents of the other state to residents of the state applying the non-discrimination provision, with: Cyprus (1985), Czechoslovakia (1981), Hungary (1985), Norway (1983), Romania (1986) and Sri Lanka (1985).

7. Examples are contained in three current U.K. treaties: Barbados (1970), the Falkland Islands (1984) and Singapore (1966) (these are the only examples in treaties made by those countries), which seems rather dangerous with the United Kingdom's imputation system; and four former treaties: Ceylon, as it then was (1950) - this was the treaty considered by the Privy Council (as final court of appeal from Ceylon) in *Woodend Rubber Co. v. Comr. of Inland Revenue*, [1971] A.C. 321 [hereinafter "*Woodend Rubber case*"], - Jamaica (1965), Malaysia (1963) and Pakistan (1961); Sri Lanka treaties with Germany (1979), Sweden (1957), Yugoslavia (1985) and former Norway (1964), former Sweden (1957), former United Kingdom (1950) (mentioned above); Germany - Bulgaria (1987), - Czechoslovakia (1980); Denmark - Faroe Islands (1986), - Greenland (1979); Zambia - Kenya (1968), - Tanzania (1968), - Uganda (1968). The Belgium - Canada treaty (1975) permits a non-resident to elect to be treated as a resident for determining the rate of tax on certain types of income, which will indirectly prevent discrimination on residence grounds; this is necessary as Belgium has denied the benefit of lower separate rates of tax to non-resident individuals without a home in Belgium since the Act of 22 December 1989. The 1979 draft EC Directive on frontier workers contains a residence non-discrimination provision for income from dependent personal services and pensions of frontier workers.

8. E.g. the United States - Australia treaty (1982), the New Zealand - Australia treaty (1982), - Finland (1982) (also excluding existing provisions and any anti-avoidance provisions from the scope so long as the other state's residents or nationals are not treated worse than those of a third state), - Ireland (1986). The

OECD Model proceeds on the basis of different treatment of residents and non-residents, for example in charging withholding tax on payments to non-residents, a general provision prohibiting discrimination against residents of the treaty partner state would normally be too broad, unless it excluded investment income.

A nationality non-discrimination provision first appeared in a model tax treaty in the OEEC first report of 1958, which referred to the existence of such a provision in other commercial treaties. The OECD Commentary on the 1977 OECD Model (hereinafter "the Commentary") refers to its use in 19th century treaties of friendship or commerce. Perhaps because of its non-tax origin, the nationality provision is difficult to apply in relation to taxation, particularly when nationals are taxed in the same way as residents. We shall refer to residence as indicating the basis for taxation of a person's worldwide income, even though in some countries, such as the United States, nationals are taxed in this way without describing them as residents. We make no distinction between a state taxing its nationals and residents in the same way, as in the United States, and a state deeming its nationals to be residents, as is done in many states for companies.⁹

Curiously, the Commentary states that the provision is subject to reciprocity. According to the text,¹⁰ this is clearly not so, except in the sense that both states are equally bound, and if the other state breaches the provision, the usual remedies are available.¹¹ It is also not clear why only this part of the non-discrimination provision should be subject to reciprocity.

B. In the same circumstances

In the absence of the explanation in the Commentary, one would expect that, in order to determine whether there is any discrimination, an exact comparison is required to be made between a (real) State B national and a (hypothetical) State A national who is in the same circumstances. We shall refer to this hypothetical State A national as the *object of comparison*. As was said in a New Zealand case: "The word 'same' carries the connotation of uniformity, of exactness in comparison. The phrase does not ordinarily mean in roughly similar circumstances: it means in substantially identical circumstances and [in the nationality non-discrimination provision] it means in substantially identical circumstances in all areas except nationality."¹²

However, this is not the case as the Commentary explains that *in the same circumstances (dans la même situation)* "refers to taxpayers placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and fact."¹³ The French text of the Commentary, *dans les circonstances de droit et de fait analogues* (meaning, in analogous circumstances), seems to be even further from the meaning of the text of the OECD Model than the English version of the Commentary. In referring to similar, rather than identical, circumstances, no doubt the Commentary intended to prevent arguments about minor differences in circumstances, but, at least so far as differences of fact are concerned, it has had the opposite effect. It has enabled courts and tax authorities to argue that the provision does

not apply in a variety of cases because of some supposed difference in factual circumstances. As an example of such inappropriate reasoning, in France there is an exemption from capital gains tax for one residence in France owned by a non-resident French national individual.¹⁴ A Ministerial statement¹⁵ originally argued that the exemption would not apply to treaty partner nationals even where there was no specific rule in the treaty preserving the internal law from the effect of the nationality non-discrimination provision.¹⁶ The reason given was that nationals of the treaty state were not in the same circumstances because "expatriated French nationals abroad have generally preserved close personal and economic connections with France, and the majority of these persons will take up residence in France again. The preservation of these special connections with France places them in a situation different from that of foreigners who own a residence in France." We would prefer to say, rather than looking at hypothetical French nationals in general,¹⁷ the comparison should be made with a hypothetical French national who was factually identical to the foreign national in all relevant matters except nationality. The preservation by a hypothetical non-resident national of personal and economic relations is not

Norway - Turkey treaty (1971) allows different rates of withholding tax on residents and non-residents.

9. E.g. Australia, Canada, the Netherlands, Switzerland and the United Kingdom.

10. Examples of other treaty provisions which are expressly subject to reciprocity are not unknown; see, for example, the former United States - France treaty (1939), Art. 20, containing an undertaking to exchange information on conditions of reciprocity.

11. Para. 1 to the Commentary on Art. 24. It is possible that this statement is an error and it should have said that the provision requires reciprocal taxation treatment of nationals, as was stated in the OEEC Commentary (Report of September 1958, Para. 32). Another explanation is that it prevents a third state claiming the benefits under a most-favoured-nation clause (see 1931 League of Nations Report p. 13, 4 Legislative History of U.S. Tax Conventions p.4237)). Conversely, O'Brien, "The Nondiscrimination Article in Tax Treaties," 10 *Law and Policy in International Business* (1978) [hereinafter "O'Brien"], at 545, 609, regards this statement in the Commentary as a substantive provision.

12. See *Commissioner of Inland Revenue v. United Dominions Trust Ltd.*, 1973 1 New Zealand Tax Cases (N.Z.T.C.) 61,028 [hereinafter *United Dominions Trust*], at 61,033-4, per McCarthy P. and the similar definition by Richmond J. at 61,042: "identical as regards all matters (except nationality) which are relevant from a taxation point of view."

13. Para. 3 of the Commentary on Art. 24. This explanation is repeated in Netherlands - Turkey (1986) and France - Turkey (1987). The OECD publication *National Treatment of Foreign-controlled Enterprises*, 1985 states that the use of *in like situations* in the definition of National Treatment "should be sparing and not excessive, in other words, extensive to the point of negating the spirit of the Declaration on National Treatment" (Para. 3.5(c)). See, in France, J.Ch. Duchon Doris, "La clause de Non-discrimination dans les conventions fiscales," *Bulletin Francis Lefebvre* (December 1988), at 595, commentaries on the judgement of the Administrative Court of Nice (3 August 1988 No. 897/88/III) which refers to *general difference in circumstances* (différence générale de situation); and J. Turot, "Le juge fiscal et les clauses de non-discrimination," *Revue de Jurisprudence Fiscale* (June 1990), at 395.

14. Code général des impôts [hereinafter "C.G.I."], Art. 150C.I.b. See also text at note 118.

15. *Journal Officiel Débats Assemblée Nationale* (1982), at 226, reproduced in English in 22 *European Taxation* (May 1982), at 152, 153.

16. Some recent French treaties contain a rule preventing this exemption from contravening the nationality non-discrimination provision. See treaties between France and: Argentina (1979), Bulgaria (1987), Congo (1987), Cyprus (1981), Ecuador (1989), Egypt (1980), Hungary (1980), Jordan (1984), Mauritius (1980), Malta (1977), Norway (1980) and South Korea (1979).

17. A similar approach was taken in a U.S. case, not on the OECD Model: *Watson v. Hoey*, 59 F. Supp. 197 (SDNY 1943). It is suggested that this is not the correct approach under the Model.

a factual circumstance which needs to be assumed in order to make the comparison. The administrative court of Nice¹⁸ held that the internal law was discriminatory and contrary to the nationality non-discrimination provision in the treaty with Belgium (1964), which was in the form of the OECD Model and did not contain such a rule preventing the law from contravening the nationality non-discrimination provision. As a consequence, the tax administration has changed its practice, and now applies the exemption to treaty nationals where there is a tax treaty containing a nationality non-discrimination provision.¹⁹ It would have been better if the Commentary had not referred to *similar* factual circumstances, so that one was required to compare the real taxpayer with a hypothetical object of comparison in identical factual circumstances, except, of course, for their nationality.

It is much more difficult to carry out the implied requirement of ignoring any difference *caused by* nationality when considering whether the *legal* circumstances are similar, because the difference in legal circumstances may be inextricably linked to the difference in nationality. Unlike the case of factual circumstances, the Commentary's reference to similar, rather than identical, circumstances may sometimes assist in making the comparison where the legal circumstances of the two taxpayers are slightly different. But there will be cases where their circumstances are very different. Neither the OECD Model nor the Commentary deals with this situation. For example, if State A taxes its nationals on their worldwide income in the same way as residents – as occurs in the United States for both individuals and companies,²⁰ and in many other states for companies²¹ – is a State A national, who is resident in State B and taxable as a resident of State A, in the same circumstances as a State B national who is resident in State B and taxable in State A as a non-resident? One answer, favoured by van Raad²² and O'Brien,²³ is that they are, and, as the difference in nationality is eliminated as a possible ground for differential treatment by the nationality non-discrimination provision, all the consequences which flow from the difference in nationality must also be covered by this provision,²⁴ so that a difference in scope of tax liability, such as residence or non-residence, flowing directly from the difference in nationality should be treated in a non-discriminatory manner as well. Their view is basically that the reference to *the same circumstances* is inherent in the concept of non-discrimination and therefore redundant,²⁵ and that the explanation of the meaning of that expression in the Commentary goes beyond a permissible interpretation of the text of the OECD Model, and should therefore be disregarded.

There is a suggestion that the United States, at any rate, understood the Commentary in this sense because it made an observation,²⁶ meaning a disagreement with the Commentary.²⁷ This makes the point that the U.S. (State A) citizen is taxable on worldwide income, while the State B national resident in State B is taxable only on U.S.-source income; and so the two individuals are not in the same circumstances. To give effect to this observation, U.S. treaties normally amend the nationality non-discrimination provision to restrict its effect to nationals of State B who are resident in the United States, compared to U.S.

citizens and residents, and similarly for U.S. citizens resident in State B.²⁸ The latest version of the amendment, contained in the 1981 U.S. Model, achieves this by adding a new sentence at the end of Paragraph 1 of the OECD provision: "However, for the purposes of United States tax, a United States national who is not a resident of the

18. 3 August 1988, No. 897/88/III. Comments Francis Lefebvre. BF (December 1988) *Etudes*, at 595. A French writer, J. Turot, "Le Juge Fiscal et Les Clausules de Non-Discrimination," *Revue de Jurisprudence Fiscale* (June 1990), at 395-6, disagrees with the decision: "A Belgian national who is resident in Belgium is not in the same circumstances as a person who is resident outside the country of his nationality." We would argue that, from the point of view of France, a Belgian national resident in Belgium was in the same circumstances as a French national resident in Belgium.

19. Ministerial opinion, Mesmin, of 19 June 1989 - Debate of National Assembly, at 2807, No. 10842; ruling 8 M-2-89.

20. The United States does not normally include in its treaties a nationality provision relating to companies, see text *infra* at note 31. The expression *resident* is not used by the United States in relation to a corporation. See further under the heading *Nationality of companies* for a discussion of this subject.

21. There are sometimes exceptions to such a rule for companies, as in Canada and the United Kingdom. They are, in Canada, companies which were non-resident on 27 April 1965 (Income Tax Act [hereinafter "I.T.A."], Sec. 250(4)), and a corporation which is deemed not to be a resident of Canada under a tax treaty (I.T.A., Sec. 250(5)); and, in the United Kingdom, certain companies either generally or during a transitional period, see Finance Act 1988 [hereinafter "F.A."], Schedule 7 for details. There are no exceptions in Australia, but the only Australian treaty containing a non-discrimination provision, that with the United States (1982), does not contain a nationality provision relating to companies.

22. See K. van Raad, *Nondiscrimination in International Tax Law* (Deventer: Kluwer, 1986) [hereinafter "van Raad"], at 88.

23. See *supra* note 11, at 558.

24. See K. van Raad, "Netherlands Withholding Tax on Dividends Paid to Foreign Parent Companies and Nondiscrimination Clauses," *Intertax* (1982), at 183.

25. Some older treaties, many examples of which can still be seen in extensions of U.K. treaties made in the 1950s, where the extension is still in force, did not include reference to *the same circumstances*. A protocol to the Netherlands - Turkey treaty (1986) and the France - Turkey treaty (1987), having repeated the Commentary's explanation of *in the same circumstances*, adds that a national of one state, resident in a third state and doing business in the other state, should be given the same treatment as a national of the other state, resident in a third state and doing business in the other state. This might be taken to suggest that the comparison should be made between a resident and a non-resident taxpayer because in the Netherlands and Turkey a company which is a national will be taxed as a resident, but it is thought that this must be restricted to individual taxpayers.

26. Para. 60 of the Commentary on Art. 24.

27. See the OECD report to which the OECD Model is annexed, Part III B Para. 27, at 14. The only possible statement with which it disagreed seems to be the explanation of *in the same circumstances* in Para. 3 of the Commentary on Art. 24.

28. Even when the U.S. observation is adopted, there can be problems over a change of residence. This is illustrated by a U.S. revenue ruling, Rev. Rul. 74-239, 1974-1 C.B. 372, denying application of certain reliefs under a non-discrimination provision in a 1956 protocol to the former (1942) treaty with Canada requiring equal treatment of citizens of one state *residing in the other* (Canadian citizens residing in the United States), compared to the citizens of the other state (the United States). The ruling concerned a Canadian citizen resident, and therefore taxable, in the United States for only part of the year. The reliefs in question first related to using the head of household rate schedule, secondly to using optional tax tables (normally applicable to taxpayers with taxable income up to US\$ 50,000), thirdly to taking standard deductions and fourthly to making a joint return. The first and fourth reliefs required that the taxpayer not be a non-resident alien *at any time* during the year. The Internal Revenue Service's view is that the second and third reliefs have the same requirement. (The Internal Revenue Service [hereinafter "I.R.S."] has said in Rev. Rul. 83-90, 1983-1 C.B. 15, that they will not follow the decision to the contrary in *Nico v. Comr.*, 565 F.2d 1234 (2d Cir. 1977) reversing in part 67 Tax Court [hereinafter "T.C."] 647 (1972) [U.S. case reference].) The ruling was made on the ground that a U.S. citizen in that factual position would still have been fully taxable in the United States. The true comparison, it was said, was with a U.S. citizen who gave up his citizenship during the year, and was therefore a non-resident alien for part of the year; there was no discrimination on this basis. This was the only way to compare the two citizens for the part of the year when they were residing in the United States.

United States and a [treaty partner] national who is not a resident of the United States are not in the same circumstances."²⁹ It follows that the nationality non-discrimination provision does not apply in the United States to non-resident treaty partner nationals.³⁰ So far as companies are concerned, the United States does not normally include in its treaties a nationality non-discrimination provision, since it does not recognise the possibility of a U.S. incorporated company becoming non-resident, or a non-U.S. incorporated company becoming a U.S. resident, so there is never a U.S. company in similar circumstances to a foreign company.³¹ The same point was made in connection with the Technical and Miscellaneous Revenue Act 1988 in relation to estate tax on non-resident aliens where a credit is given to the extent that the estate is liable to U.S. tax.³² Occasionally, wording similar to the U.S. observation is included in treaties by other states.³³

The alternative view on how to deal with cases where the legal circumstances of the two taxpayers are very different, which is favoured by the authors other than van Raad, is that the view stated above wrongly ignores the Commentary's requirement that the two taxpayers must be placed, *from the point of view of the application of the ordinary taxation laws and regulations*, in substantially similar circumstances both in law and fact.³⁴ An obvious example of similar circumstances is that both taxpayers are, for example, taxed as residents or as non-residents. In making this statement, the Commentary therefore implies that if no such hypothetical taxpayer can exist, such as a non-resident State A national in cases where State A nationals are taxed as residents, the comparison should not be attempted. An exception to this rule may exist, however, where, by virtue of the dual residence article, the hypothetical State A national would, if his circumstances were the same as those of the State B national, be taxed, for the purposes of the treaty, as a resident of State B; he is then treated by State A in the same way as a State B national who is resident in State B.³⁵ It is suggested that the Commentary should deal specifically with the not-unusual case where the comparison is with two taxpayers in very different legal circumstances.

In two cases, courts have come to the same conclusion as we have, that comparison between a resident and national of State B and a national of State A who is taxed in the same way as a resident was impossible. In the first case, to which reference has already been made,³⁶ the New Zealand Court of Appeal dealt with a U.K. company paying the higher non-resident rate of tax on interest derived from New Zealand, otherwise than through a permanent establishment. The court stated that a company incorporated and managed outside New Zealand could never be in the same circumstances as a New Zealand company which was taxed on the basis of nationality.³⁷ Under internal law, while a New Zealand incorporated company (the object of comparison) could be managed and controlled in the United Kingdom, and therefore taxed there as a resident, it would still be a New Zealand resident. A U.K. incorporated company managed and controlled in the United Kingdom would not be a New Zealand resident, so that their circumstances were not the same. The contrary argument, that the only difference between the two companies was

their nationality, was described as superficial.³⁸ As was said in the case,

"the taxpayer claiming relief must be able to find by way of comparison a notional national of the other territory 'in the same circumstances.' Once it is accepted that 'same circumstances' includes 'residence' the Objector, in my opinion, cannot point to a notional New Zealand company which is 'in the same circumstances.'"³⁹

It was also stated that the purpose of the nationality non-discrimination provision was to prevent discrimination against nationals *as such*.⁴⁰ The relevance of the treaty definitions dealing with dual residence of companies, which is considered below,⁴¹ was not accepted in the case.

In the second case, the Belgian Supreme Court⁴² came to the conclusion that the comparison was impossible in a case on the treaty with France (1964), in which the nationality non-discrimination provision is in OECD Model

29. The former (1977) U.S. Model provided, "For purposes of the preceding sentence nationals who are subject to tax by a Contracting State on worldwide income are not in the same circumstances as nationals who are not so subject." Another formula often used in U.S. treaties is to change the first sentence to read: "The citizens of one of the Contracting States shall not, while resident in the other Contracting State, be subjected to other or more burdensome taxes than are the citizens of such other Contracting State residing in its territory," (former U.S. - Denmark treaty (1948)). A later version is the same but with linguistic differences. For an analysis of all the U.S. treaties in this respect, see van Raad, *supra* note 22, at 105. The United States also uses similar language in its commercial treaties, see van Raad, at 231.

30. The U.S. - Canada treaty (1980) has a separate paragraph dealing with this case, comparing the treatment in State A of State B citizens to third-state citizens.

31. Art. 24(2)(b) is not contained in either the 1977 or the 1981 U.S. Model. Exceptions where legal persons, partnerships and associations are included are the, mainly older, U.S. treaties with: Argentina (1981), former Belgium (1948), Denmark (1980), former Finland (1948), Germany (1954 and 1989), Greece (1950), Honduras (1956), Ireland (1949), Italy (1984), Luxembourg (1962), the Netherlands (1948, but deleted in the 1965 amendment), former Netherlands Antilles (1955), Pakistan (1948), Sweden (1939, this provision included in 1963 amendment), Switzerland (1951), Tunisia (1985) and former United Kingdom (1945). Most of these treaties refer to legal persons, etc. *created or organised* under the laws of one of the states, which is the expression normally used in Japanese treaties, see *infra* note 78. The treaties Denmark - Malaysia (1970), Cyprus - Yugoslavia (1985), in relation to Yugoslavia only, France - Bulgaria (1987) and Denmark - Yugoslavia (1981) also exclude companies.

32. H.R. 100-795, 100 Cong. 2S, at 593.

33. E.g. the Germany - Pakistan (1958), Pakistan - Poland (1974) and Peru - Sweden (1966) treaties all limit the provision to citizens resident in the other state.

34. If the Commentary is regarded as a supplementary means of interpretation within Art. 32 of the Vienna Convention of the Law of Treaties, it could be argued that the result of making the comparison where the two taxpayers are in very different legal circumstances is manifestly absurd or unreasonable, so that the supplementary means should be used to interpret the text of the OECD Model and treaties following it.

35. See the discussion in Cases 2.1 to 2.3 under the heading *Cases of nationality according to residence status*.

36. See *supra* note 12.

37. *United Dominions Trust*, *supra* note 12, concerning the former United Kingdom - New Zealand treaty (1966) which contained a nationality non-discrimination provision in the OECD Model form, except that it did not prevent "other" taxation. See Arnold, *supra* note 2, at 186, for further examples of nationality discrimination in New Zealand.

38. *Id.*, at 61,034.

39. *Id.*, at 61,038. A similar point was made at 61,042.

40. *Id.*, at 61,042.

41. See text *infra* at note 132.

42. 30 June 1988, *Fiscale Jurisprudentie/Jurisprudence Fiscale* [hereinafter "F.J.F."] (1988), at 202, reversing the decision of the court of appeals of Brussels of 13 January 1987, *Journal de Droit Fiscal* [hereinafter "J.D.F."] (1987), at 232, note Tixier and Malherbe.

form. The court held that, so far as the nationality non-discrimination provision was concerned, Belgium was not in breach of this provision by refusing the permanent establishment of a French incorporated company the same treatment as a Belgian company in taxing foreign and Belgian dividends relating to permanent holdings.⁴³ The reason was that, because the permanent establishment was liable to the corporate non-resident tax, rather than the corporation tax payable by resident companies, it was not in the same circumstances as a resident company. While not disagreeing with the result, it is suggested that it would have been more correct to have attempted to make the comparison with a company incorporated in Belgium with its central administration in France and a permanent establishment in Belgium, which would be in the same factual circumstances except for the state of incorporation. Although such a company would be taxed as a treaty resident of France having a permanent establishment in Belgium, it would, as a Belgian incorporated company, remain subject to Belgian corporate tax⁴⁴ and would accordingly be entitled, under Belgian internal law, to the tax credit on dividends attributable to the permanent establishment, unlike the actual permanent establishment of the French incorporated company. Since the two companies are subject to a different tax regime, they cannot be in the same circumstances legally, and it is therefore reasonable to say that the comparison is impossible.⁴⁵

On the other hand, the opposite result seems to have been reached by the French *Cour de Cassation*,⁴⁶ which decided in a comparable situation that the comparison was possible, and the discrimination was on account of nationality, rather than residence, and was therefore prohibited. The case concerned the three percent annual tax on French real property owned by a company whose seat (*siège*, in this context meaning central administration, rather than registered office) was outside France.⁴⁷ A French incorporated company cannot effectively have its central administration outside France, since under French law a person other than the company or its shareholders, for example, the tax authority, can continue to regard a French incorporated company whose central administration is outside France as a French company.⁴⁸ The Court found that imposing this tax on a Swiss incorporated company with its seat in Switzerland was a clear example of discrimination under the France/Switzerland treaty (1966),⁴⁹ the nationality non-discrimination provision of which is in OECD Model form, and thus discrimination based on incorporation in Switzerland was prohibited.⁵⁰ While this looks as if it is making the comparison which we have argued impossible, the circumstances were unusual since, apart from this three percent tax, a non-resident company is taxed on income and gains from real property in France in exactly the same way as a French company, because residence is not a criterion used in internal law in taxing a company.⁵¹ The Swiss company was therefore in the same circumstances as a French company, except for its nationality. The tax administration's argument that the only foreign companies in the same circumstances as a French company were those with their central administration in France was rightly rejected, because this was not a relevant consideration for the taxation of the company. An attempt to reverse the decision by legislation stating that the tax

charge arises by virtue of foreign place of central administration, regardless of nationality,⁵² has been held by the *Cour de Cassation* to be ineffective,⁵³ since under internal law the place of central administration determines nationality.⁵⁴

C. Nationality of companies

As nationality of companies is an unfamiliar concept, we shall first consider this in the countries represented by the authors. In the French text of Paragraph 2(b) of the Model, the definition of nationality of companies is "*les personnes morales... constituées conformément à la législation en vigueur dans un Etat contractant*," meaning legal persons...incorporated in accordance with the law in force in a Contracting State. Incorporation for this purpose need not mean the original state of incorporation.⁵⁵ Under the

43. The privileged inter-company dividend treatment (95 or 90 percent, now reduced to 90 or 85 percent, of the dividend received is exempt from tax) is granted only to dividends arising from a *participation permanente* (shares held for at least a full year of account). The taxation of dividends paid to a permanent establishment is dealt with below in the section on the permanent establishment non-discrimination provision under the heading *Special treatment of dividends received by a permanent establishment*. Without going into the details here, the effect of internal law is that a company subject to Belgian corporate tax can credit against the resident corporate tax first the Belgian withholding tax and, secondly, according to the then current rule for foreign dividends, a fictitious withholding tax with which the net amount of the dividends had been grossed-up, the excess credit being refundable; the permanent establishment of a foreign company subject to the corporate non-resident tax is denied such tax credits.

44. See the example in the Belgian administration's commentaries on its tax treaties, Para. 4/02.

45. The permanent establishment non-discrimination provision in the treaty (Art. 17(3)) was not in the form of the OECD Model as it compared a permanent establishment to "similar" non-resident companies.

46. 28 February 1989, No. 328 P, 329, D and 330, H. Lazarski, "3% Tax on Real Property," 29 *European Taxation* (August 1989), at 285.

47. Under C.G.I., Art. 990D.

48. Under Art. 3 of the Corporate Law of 24 July 1966, third parties may rely on the statutory seat, which will be in France. Residence is not an expression used in connection with companies in internal law.

49. The tax administration had previously announced in a Ruling (7 Q-1-83; H. Lazarski, "Real Property Owned by Foreign Companies - Present Position Resulting from Publication of New Ruling," 23 *European Taxation* (September 1983), at 279) that the tax would not be levied on companies from treaty states where the treaty contained an administrative assistance article. The Swiss treaty did not contain such an article.

50. Under the French text of the treaty corresponding to the OECD Model (*constituée*); see discussion under the heading *Nationality of companies*, *infra*.

51. It was this feature which caused the European Court to decide that there was discrimination under the EEC Treaty in not granting the tax credit on dividends to an Italian insurance company in *Re Tax Credits: EC Commission v. France*, [1987] 1 C.M.L.R. 401.

52. Finance Act 1990, Art. 105 (*Journal Officiel*, 29 December 1989). For an English translation, see H. Lazarski, "3% Tax on Real Property - Latest Developments," 30 *European Taxation* (March 1990), at 77, 78. For a commentary, see H. Fontana, "Le régime fiscal de la taxe de 3% une interprétation législative qui infirme la jurisprudence," *Revue Fiscale Européenne - Droit International des Affaires* (January 1990), at 11.

53. Decision of 21 December 1990, No. 922 *Société Royal*, commentaries in *Bulletin Francis Lefebvre* 62/90, at 3, full text in *Revue de Jurisprudence Fiscale* 1/91 No. 106. The only official reaction to this decision is in Ministerial reply No. 39,775, published in the *Official Journal*, 6 May 1991, at 1,813, which acknowledges that the tax administration is bound by the decision, but indicates that the Government is studying the issue to find a way of giving effect to the tax.

54. See text *infra* at note 67.

55. It seems that there are circumstances where a company can be incorporated in more than one state at the same time, see *Arab Monetary Fund v. Hashim*, [1991] 2 W.L.R. 729 H.L. The Arab Monetary Fund had been incorporated in 21 member states. See American Law Institute, *Restatement of Foreign Relations Law of the U.S.* (1987), Sec. 213, Para. 9, for other references to states incorporating bodies in several states.

corporate law of many states,⁵⁶ a company incorporated in one state can effectively move its place of incorporation and continue as if it had been incorporated in a different state. For this purpose it will, following such a move, be treated as a national of the second state.⁵⁷ The German semi-official version of the OECD Model uses the word *errichtet*, meaning created. This, therefore, has the same meaning as the French, as does the expression *constituite* used in Italian treaties. According to the oddly worded⁵⁸ English text of the definition of national (all legal persons...deriving their status as such from the laws in force in a Contracting State), the meaning of which we shall consider later,⁵⁹ a company is a national of the state from which it derives its status as such from the laws in force.⁶⁰ The wording used by the Netherlands in its treaties closely follows the English text, while the Dutch language version of Belgian treaties sometimes follows the English version of the OECD Model, but more frequently follows the French. The Commentary explains that the purpose of the definition is to prevent difficulties arising in the determination of nationality of a company, when some states look to the origin of the capital or the nationality of the controlling shareholder.⁶¹ Neither of these tests is currently used in any of the countries represented by the authors.⁶²

The definition does not, however, eliminate all the differences between states, because there are two views about which system of law governs (*régit*)⁶³ a company. The first view is that a company is governed by the law of the state of incorporation. This view, to which we shall refer as the *incorporation principle*, is adopted, among the countries represented by the authors, in Australia,⁶⁴ Canada, the Netherlands, Switzerland, the United Kingdom and the United States. A foreign company is recognised so long as it exists according to the law of its state of incorporation.⁶⁵ The other view, adopted by the remaining EC member states represented by the authors, is that a company is governed by the law of the country where it has its real seat,⁶⁶ meaning its central administration.⁶⁷ This we shall refer to as the *central administration principle*. Internal law in most of such states requires that a company incorporated in a state must also have its central administration in that state.⁶⁸ But a company incorporated in another state with its central administration in a central administration principle state will most likely be recognised in the latter state, even though the central administration is outside the state of incorporation.⁶⁹

56. Canada and most of its provinces, Australia, several states of the United States and Switzerland, but not the Netherlands or the United Kingdom.

57. An unusual example of legislation occurred in Ontario (The *Compañía Shell de Venezuela Limited Act 1973*) and the Netherlands (bill for the continued existence of the *Compañía Shell de Venezuela* as a Dutch company, passed 23 January 1974) changing the state of incorporation of *Compañía Shell de Venezuela* from Ontario to the Netherlands, which would have been possible under Ontario law (and that of most Canadian provinces and federal law) without special legislation, if Netherlands law had also provided for the continuation of the corporation under Netherlands law as if it had been incorporated there.

58. Similar wording is, however, used in the United Kingdom in Tax Act 1988 [hereinafter "T.A."], Sec. 404(4)(b) in connection with dual-resident investing companies: "derives its status as a company from those laws" This wording is likely to have been taken from the OECD Model.

59. See the heading *An alternative interpretation: possible difference in meaning between incorporation and deriving its status*.

60. Note the contrast with Arts 3(2) and 4(1) which merely refer to the law (or laws in the latter) of the State. The Art. 24 definition, referring to the laws (*law* in the 1963 OECD Model) in force, is more clearly ambulatory, as it would have to be to make sense. See also Para. 19(b) of the Commentary on Art. 11, which supports an ambulatory interpretation in a definition referring to internal law: see J. Avery Jones, et al., "The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model," *British Tax Review* [hereinafter "B.T.R."] (1984), 14 and 90, at 37.

61. Para. 12 of the Commentary to Art. 24. At one time France looked to the nationality of the controlling shareholder to determine the nationality of a company, but this has been rejected by the courts (Case *Shell c/Epilbaum*: Court of Appeal, 14 April 1970; *Cour de Cassation*, 8 February 1972, No. 186; Court of Appeal, 22 May 1974 and *Cour de Cassation*, 10 March 1976, No. 461) concerning the French subsidiary of Royal Dutch Shell, in favour of a test to determine nationality on the basis of the *siège social*. The International Court of Justice 3, in refusing Belgium any *locus standi* to intervene against Spain over a company incorporated and managed in Canada but controlled by Belgians. Diplomatic protection could only be granted to nationals and the company was not a Belgian national as the control test did not apply to determine nationality. The test of control has been used in the United Kingdom, the United States and Belgium (Acts of 20 August 1919 and 23 August 1944) in statutes in relation to enemy aliens.

62. However, Dutch commercial treaties commonly include the nationality of the controlling shareholders as a test of nationality of a company for the purpose of such treaties: see van Raad, *supra* note 22, at 220-221. U.S. commercial treaties do not normally do so (such provision is included in the Treaty of Friendship with Belgium (1961)).

63. These are the words used in the official versions of Para. 12 of the Commentary to Art. 24. Each version quotes in the Commentary the definition in the language concerned. Para. 13 uses the expression "the State under whose law it is constituted" (*formée*), which appears to refer to the state of incorporation in both English and French. See *infra* note 93 for other expressions used in the Commentary in relation to companies. The OEEC and the OECD 1963 Commentaries ended the equivalent of Para. 12 of the Commentary to Art. 24 in the 1977 OECD Model with the words "No ambiguity need be apprehended therefore." This was wisely dropped in the 1977 Commentary.

64. Unusually, Australia has a statutory provision applying the law of incorporation to questions of the status of a foreign corporation: Foreign Corporations (Application of Laws) Act 1989.

65. Since the common law countries look only to the law of the state of incorporation, there is no difference between nationality, domicile or where a company has its registered office. In common law countries the state of incorporation would be regarded as the domicile of a company, rather than its nationality: *Gasque v. I.R.C.*, 23 T.C. 210 K.B.D.; *Egyptian Delta Land and Investment Co. Ltd. v. Todd*, 14 T.C. 119 H.L.; and, in the United Kingdom, see Statement of Practice SP1/90 Para. 6. The Arab Monetary Fund, referred to in *Arab Monetary Fund v. Hashim*, *supra* note 55, which was incorporated in each of its 21 member states, was stated by Lord Templeman to have multiple nationality but one domicile, the location of its head office. In *R. v. HM Treasury and I.R.C., ex p. Daily Mail and General Trust*, [1988] Simon's Tax Cases [hereinafter "S.T.C."] 787, the European Court held that Council Directive 73/148 on the abolition of restrictions on movement and residence within the Community for nationals did not apply to companies.

66. *Siège réel, tatsächlicher Sitz, principal établissement* (Belgium). Italy also applies its law if the company has its principal object, e.g. its only asset, in Italy. For the purpose of giving effect to the EEC Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, the United Kingdom Civil Jurisdiction and Judgments Act 1982, Sec. 42, defines the seat of a company as being in the United Kingdom, if it is incorporated (and has its registered office), or has its central management and control there.

67. *Administration centrale, Hauptverwaltung* (effective management and control: see German Civil Court in Civil Affairs (Bundesgerichtshof) decision in 97 *Entscheidungen des Bundesgerichtshofs in Zivilsachen* [hereinafter "BGHZ"], at 269, 272), *sede della amministrazione*. This is the meaning given to real seat by the Hague Convention of 1 June 1956 on the Recognition of the Legal Personality of Foreign Companies, and by the EEC Convention of 29 February 1968 on Mutual Recognition of Companies and Legal Persons (neither is in force). In Germany it is the place where the fundamental management decisions are put into practice, (*Id.*, at 269, 272).

68. See the International Law Association Draft Convention on Conflicts of Law Relating to Companies, 1958, which adopts as the personal law of a company the law of the state of incorporation and central administration, but did not commit itself to the position where these were to be found in different states.

69. For example, in France, Art. 3 Corporate Law of 24 July 1966, see *supra* note 48. France has entered into many treaties recognising other state's compa-

As will be explained below,⁷⁰ the company will then be governed by the law of the state in which it has its central administration.⁷¹ Although there are suggestions in German case law⁷² that a company incorporated elsewhere with its central administration in Germany will not be recognised for tax purposes, regardless of whether it would be for corporate law purposes, the prevailing view is that it would be.⁷³ No distinction need therefore be made for this purpose between Germany and other central administration principle states. Accordingly, the only time the existence of the company is not recognised for tax purposes is when the state of incorporation is a central administration principle state and the central administration is outside that state.⁷⁴

Japan is difficult to categorise for this purpose. The Commercial Code of Japan refers to foreign companies without defining them, but this is generally considered to refer to incorporation otherwise than under Japanese law.⁷⁵ However, a company incorporated outside Japan with a principal office in Japan is required to comply with Japanese company law.⁷⁶ Such a requirement is usual in states adopting the central administration principle. This uncertainty of definition does not create any problems in practice, as Japan normally⁷⁷ defines the nationality of a company in its treaties as the state in which the company is created or organised.⁷⁸

1. An alternative interpretation: possible difference in meaning between incorporation and deriving its status

It may be that in rare circumstances the French text of the definition of nationality of a company, referring to the state of incorporation (*constituée*), and the English text, referring to the state from which the company derives its status as such, give a different result. The English text may mean that, instead of looking to the state of incorporation, one should apply what we shall call the governing law relating to the company.⁷⁹ We shall refer to this as the alternative interpretation. In some central administration principle states, including Belgium,⁸⁰ France,⁸¹ Italy⁸² and Japan,⁸³ but not Germany,⁸⁴ a company with its central administration there, but incorporated elsewhere, is not merely recognised, but is also governed by the law of the state in which the central administration is situated,⁸⁵ so long as it is capable of complying with that law.⁸⁶ A good

nies Germany has recognised a company incorporated in Delaware with its central administration in Kentucky, which adopts the incorporation principle: Reichsgericht decision of 3 June 1927 published in 83 *Entscheidungen des Reichsgerichtshofs in Zivilsachen* [hereinafter "RGZ"], at 367. However, a company incorporated outside Germany with its central administration in Germany will not be recognised there. Germany has entered into non-tax treaties with the United States (1954) and Spain (1970) recognising each other's companies, see S.N. Frommel, "The Real Seat Doctrine and Dual-resident Companies under German Law: Another View," 30 *European Taxation* (October 1990), at 267. See *infra* note 81 in respect of Belgium.

70. See the heading *An alternative interpretation: possible difference in meaning between incorporation and deriving its status*.

71. See text *infra* at note 85.

72. For example, Germany has refused to recognise, for tax purposes, a U.K. incorporated company with its central administration in Germany: Decree of Baden-Württemberg Finance Ministry of 15 January 1985, *Deutsches Steuerrecht* [hereinafter "DSrR."] 1985, at 180; and Decree of the Finance Ministry of Hamburg of 15 January 1985, *Der Betrieb* [hereinafter "DB"] 1985, at 258. The Tax Court of Düsseldorf has similarly failed to recognise, for tax purposes, a Liechtenstein corporation with its central administration in Germany: *Entschei-*

dungen der Finanzgerichte [hereinafter "EFG"] 1987, at 202. See Lehner and Moris, "Die steuerliche Ansässigkeit von Kapitalgesellschaften," *Recht der Internationalen Wirtschaft* [hereinafter "RIW"] 1988, 201 at 212.

73. The German authors of this article respectfully take a different view from C.T. Ebenroth and C. Daiber, "Dual-Resident Companies under German Law," 30 *European Taxation* (July 1990), at 175.

74. A German incorporated company with its central administration in an incorporation principle state is, however, recognised in Germany, so long as it has a permanent establishment in Germany. See Ebenroth and Daiber, *Id.*, at 178.

75. Shinpan Chūshaku Kaisha-hō, *New Edition Commentary on Company Law*, Vol. 13, (Okamoto, 1990), at 521 - 523.

76. Commercial Code, Art. 482, which also applies if the company's principal purpose is to carry on business in Japan.

77. Exceptions are the following: (a) where the OECD Model's wording is used: British Virgin Islands (old United Kingdom 1962), former Canada (1964), Denmark (1968), Fiji (old United Kingdom 1962), Montserrat (old United Kingdom 1962), Sri Lanka (1967) and Spain (1974); and (b) where the treaty partner's corporation or company is defined as a corporation having its head or principal office or its headquarters, or being managed and controlled (excluding Japanese corporations), in the treaty partner state: Austria (1961), British Virgin Islands (old United Kingdom 1962), former Canada (1964), Fiji (old U.K. 1962), Montserrat (old United Kingdom 1962) and Pakistan (1959).

78. Other countries sometimes do this, see *supra* note 31 for some U.S. treaties, and see Czechoslovakia - China (1986); Austria - Philippines (1981); Denmark - China (1986); Finland - China (1986) (for China only), - Romania (1977) (created only and applying to Romania only); Philippines treaties with: Canada (1976), Denmark (1981), Korea (1984), Indonesia (1981), the Netherlands (1989), Singapore (1977), Sweden (1987) and Thailand (1982). U.S. internal law refers to companies created or formed under U.S. law.

79. This interpretation of the OECD Model gives the result which O'Brien, *supra* note 11, footnote 19, regarded as more logical, but difficult to reach, since the rest of the OECD Model was concerned with the residence of the company. His example of a French incorporated company managed in the United Kingdom is, however, a bad one, for the reason given in this text *supra* at note 48, but the reverse situation might have been appropriate.

80. Under Belgian Company Law (Lois Coordonnées sur les Sociétés Commerciales), Art. 197, any company whose principal establishment is in Belgium is subject to Belgian law, even though it is incorporated outside Belgium. See the case cited *infra* in note 87. An example of the reverse situation is a decision of the Brussels Civil Court of 26 February 1923 in which a Belgian incorporated company with its central administration in France was held not to be governed by Belgian law. See van Boxsom, *Rechtsvergelijkende studie over de nationaliteit der vennootschappen* (Brussels: Bruylant, 1984), at 21 - 29; and Rigaux, *Droit International Privé*, Vol. I, 2d ed., (1987), No. 134 - 146 and Vol. II, No. 710 - 728, (Brussels: Larcier, 1979). By a law of 22 December 1989 an exit charge to tax is imposed on a Belgian incorporated company moving its central administration outside Belgium (it was previously unclear from case law whether this applied).

81. See Art. 3, Corporate Law of 24 July 1966, and J.P. Foucault, *jurisclasseur Droit international* No. 353-A and B.

82. Art. 2505 of the Civil Code provides that a company incorporated outside Italy with its central administration in Italy is governed by Italian company law. An example of this may be found in one of the earliest U.K. cases on company residence, *Cesena Sulphur Co. Ltd. v. I.R.C.*, (1876) 1 T.C. 88 Exch., in which a U.K. incorporated company was subsequently registered in Italy as an Italian company.

83. Although Japan is not exactly a central administration state, Japanese law governs a company incorporated outside Japan with a principal office in Japan or whose principal purpose is to carry on business in Japan, see *supra* note 76.

84. Unless the company is also reincorporated there, in which case it ceases to be the same company as was incorporated under the law of the other state. Germany will be included here when the EC Convention on the Mutual Recognition of Companies (see *infra* note 85) comes into force.

85. This solution of applying the law of the state of the central administration is adopted as an option by Art. 4 of the EC Convention on Mutual Recognition of Companies and Legal Persons (not in force) for companies with their registered office and central administration within the EC, allowing the state of central administration to impose its mandatory company law provisions. Germany has stated, when ratifying the convention, that it will adopt this provision (Art. 2 of the implementing Federal Act of 18 May 1972, *Bundesgesetzblatt* [hereinafter "BGBl."] 1972 II, at 369). Belgium has done the same: Implementing Act of 17 July 1970, *Official Journal*, 18 June 1971, Art. 4.

86. For example, one-person companies may not be recognised. Belgium has, however, recognised a Liechtenstein Anstalt managed in Belgium on the basis of the EC Convention on the Mutual Recognition of Companies and Legal Persons, even though this was not applicable to Liechtenstein, and there is now legislation

example of this is the Belgian case in which a company incorporated in the United Kingdom moved its central administration to Belgium and became subject to the then applicable Belgian law limiting the life of a company to 30 years.⁸⁷ In Belgium, France and Italy, a company incorporated elsewhere which moves its central administration into one of those countries is not regarded as being reincorporated, but it continues as a foreign incorporated company governed by the law of the state of central administration;⁸⁸ in Germany, however, it would be regarded as a new German company. A company governed by the law of the country in which it has its central administration might be regarded as a national of that state under the English text of the OECD Model, because it derives its status as such, so far as the central administration state is concerned, solely from that state's law, even though the state of incorporation, if it is an incorporation principle state, would still regard it as deriving its status from the incorporation state's law. Examples of such companies are rare, as they can lead to two conflicting laws governing the company, as in the Belgian case of the U.K. incorporated company with its central administration in Belgium having an unlimited life in the United Kingdom and a 30-year life in Belgium.⁸⁹ There are doubtless many other conflicting legal requirements. Alternatively, such cases can lead to the company ceasing to be recognised in its state of incorporation. The alternative interpretation affects only central administration principle states; in incorporation principle states, the company would still be considered to be a national of the state of incorporation, because the company derives its status only from the state of incorporation.

In order to resolve this difference in interpretation, it is suggested that one should first compare the English and French texts of the OECD Model to come to a common meaning, which, it is suggested, should be derived from the French text which is clearer in meaning.⁹⁰ The reason for the language difference is presumably not to accommodate central administration principle states applying their own law to companies incorporated elsewhere with their central administration in these states, but only because the word *incorporated* would not have been appropriate in English to apply to *legal persons, partnerships and associations*. It is difficult to see why two words such as *incorporated or formed*,⁹¹ or even just *formed*,⁹² or as the OECD Commentary says, *organised*,⁹³ were not used in preference to the phrase "deriving its status as such" f an odd equivalent of the French phrase "*constituées conformément à la législation*." If a treaty is concluded in two languages each following the OECD Model,⁹⁴ one should try to find an interpretation which reconciles the texts having regard to the object and purpose of the treaty.⁹⁵ We prefer the French version as its meaning is more precise, although it may be difficult to justify this on the basis that it better reconciles the object and purpose of the treaty. The conclusion is therefore that, where English is one of the official languages of the treaty and French (or another language having the same meaning as the French text of the OECD Model) is the other, which is the case in most Canadian treaties, the alternative interpretation, that nationality refers to the place of central administration, is not applicable; but where English is the only official language, which is unlikely where a central administration

principle state is concerned,⁹⁶ this is a possible, but untried, interpretation.⁹⁷

D. Cases of nationality according to residence status

We shall now look at the position, from the point of view of State A, of an individual or company against whom discrimination is in issue, according to whether he or it is resident in State A (Case 1), or State B (Case 2.1) (including in both cases dual residents whose residence for treaty purposes is in State A (Case 2.2) or State B (Case 2.3)), or in a third state, State C (Case 3).⁹⁸ In all these cases we shall

permitting the formation of a *société privée à responsabilité limitée unipersonnelle*. Italy has recognised an Anstalt under an internal law provision (Provisions of the Law in General, Art. 16) reciprocally recognising other states' legal persons: Supreme Court, 14 April 1980, No. 2414, *Foro It., Rep.* 1981, voce *società*, No. 1303. This point will not arise within the EC when the twelfth company law directive of 21 December 1989, permitting one-person companies, comes into force.

87. *Lamot v. Société Lamot Ltd.* [hereinafter the "*Lamot case*"], Cour de Cassation, 12 November 1965, *Pasicrisie I* (1966), at 336. The 30 years were counted from the change of central administration. After that period, it would cease to exist in Belgium but continue to exist in the United Kingdom. Another example is to be found in *Re Harrods (Buenos Aires) Ltd.*, [1991] 3 W.L.R. 397, 408C, ChD and CA, in which evidence was given that an English incorporated company, operating wholly in Argentina, was governed by the law of Argentina.

88. In Belgium, it is necessary for the country in which the central administration was formerly situated to permit such a change, as the United Kingdom did in the *Lamot case*, *supra* note 87, while in Italy this is not necessary.

89. See *supra* note 87.

90. Particularly in view of Para. 13 of the Commentary on Art. 24, which uses *constituted (formée)* to define nationality.

91. As in the Civil Jurisdiction and Judgments Act 1982, Secs. 42 and 43, which gives effect to the EEC Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, in relation to a corporation or association. U.S. legislation uses *created or formed* in connection with both companies and partnerships.

92. See, e.g., F.A. 1989, Sec. 55(8)(b): "a company or partnership formed under the law of any part of the U.K. or another member state." Para. 12 of the Commentary on Art. 24 uses *formed* in relation to companies. Art. 58 of the EEC Treaty refers to "companies or firms formed in accordance with the law of a Member State....."

93. The Commentary refers separately to a partnership *created or organised* (Para. 3 of the Commentary on Art. 1), a body corporate *organised (constituée)* (Para. 3 of the Commentary on Art. 3) and also to the place of *incorporation or organisation (le lieu d'enregistrement ou de constitution)* with respect to a company (Para. 26 of the Commentary on Art. 4), used in a reservation by Canada and the United States; *incorporation* is also used in a U.S. reservation in Para. 85 of the Commentary on Art. 10), but it is suggested that *organised* is less acceptable English than *formed*. Para. 12 of the Commentary on Art. 24 uses *formed* in relation to a company. The League of Nations Mexico draft used *constituted* in connection with partnerships, companies and other legal entities in Art. II(4) of the Protocol. The Commentary also uses this expression in relation to a partnership (*société de personne*) in Para. 10 of the Commentary on Art. 3 in a reservation by Belgium, and in relation to a company in Para. 13 of the Commentary on Art. 24.

94. This occurs in 28 Canadian treaties which are always drafted in English and French.

95. Art. 33 of the Vienna Convention on the Law of Treaties.

96. See Belgium - Japan (1968), the only official version of which is in English, which defines nationality differently for each country, using the OECD Model's English wording for Belgium, and the normal Japanese variation of where the company is created or organised for Japan, see *supra* note 78. If this alternative interpretation applies, a Japanese incorporated company with its central administration in Belgium would be considered a national of each country: in Belgium because it derives its status from Belgian law by having its central administration there and in Japan by being created or organised under Japanese law. France - Japan (1964) is the same except that Japanese and French are the official languages; the point cannot, however, arise in the French language.

97. Unless the court were to look at the French language version of the OECD Model in interpreting a treaty in English.

98. See Para. 4 of the Commentary on Art. 24 for support for making this distinction between residents and non-residents. Treaties sometimes make clear

assume that a company is a national of its state of incorporation; the alternative interpretation, based on the English version of the OECD Model, is considered in Cases 4.1 and 4.2. As before, we are considering whether State A is discriminating against a State B national, and accordingly the object of comparison is a national of State A. A point to make initially is that the residence is not relevant in the same way for the nationals of each state. Since in the following examples we are looking at the position from the point of view of State A, it is relevant in that state if a resident of State B is also resident in State A. If State A taxes its nationals on worldwide income in the same way as it taxes its residents, a State A national who is resident in State B, as we have argued above, is not in the same circumstances in law, so far as State A is concerned, as a State B national who is resident in State B. The former is taxed in State A in the same way as a resident, and the latter as a non-resident. As the State B tax treatment is not a factor to be taken into account in State A, it is irrelevant whether State B nationals are effectively taxed as residents of State B when we are comparing the treatment of the two nationals by State A. In the following cases we shall assume that, unless otherwise stated, State A does not tax its nationals in the same way as residents.

Case 1: Discrimination against a national of State B resident in State A compared to a national and resident of State A

The simplest case is to compare the treatment in State A of a national of State B resident in State A, with a State A national who is also resident in State A. The State A national may be resident either because all nationals of State A are taxed in the same way as residents, or because he is actually a State A resident. The comparison to be made here is meaningful if State A subjects both such persons to worldwide taxation. The nationality non-discrimination provision has sometimes prevented discrimination against individuals when, under internal law, a relief is given only to resident nationals. In relation to tax reliefs for income earned while working abroad, this has occurred in France,⁹⁹ the United States,¹⁰⁰ possibly Italy,¹⁰¹ and formerly in Belgium.¹⁰² A further example is that in Switzerland it has recently been argued that not only the refusal to allow the interest deduction for foreigners resident in Switzerland who are subject to taxation at source, but also that taxation at source of the salary, was contrary to the non-discrimination provision.¹⁰³ The United Kingdom has a number of statutory provisions which favour Commonwealth citizens and which are therefore potentially discriminatory against non-Commonwealth treaty partner nationals, since anyone who falls within the normal treaty definition of U.K. national will also be a Commonwealth citizen.¹⁰⁴ Italy has a discriminatory exemption for prizes given by foreign states or international bodies for literary, artistic, scientific or social merit, as it is restricted to Italian citizens.¹⁰⁵

An unusual example of the nationality non-discrimination provision preventing discrimination under a different treaty has occurred in Germany. Case law provides that the former Germany-Italy treaty (1925), which was silent on who can claim relief under the treaty, is applicable to citi-

zens of either country. The German Supreme Court has applied an exemption given under that treaty in respect of employment income of a German national and resident working in Italy to a Dutch citizen resident in Germany and also working in Italy, on the basis of the nationality non-discrimination provision in the Germany-Netherlands treaty (1959).¹⁰⁶ Being able to apply the non-discrimination provision of one treaty to obtain a benefit under a different treaty would be unusual in modern treaties because, under the OECD Model, the application of the treaty is restricted to residents, rather than nationals.¹⁰⁷

In relation to companies, Canada, in particular, provides numerous examples of discrimination based on nationali-

that the comparison is only to be made between nationals of the same residence: see most U.S. treaties, *supra* note 26 and the U.S.S.R. - France treaty (1985) (nationals in the same circumstances with respect to residence).

99. There is an example virtually identical to the United States one (see note 100 *infra*), relating to the complete exemption from tax for earnings from work abroad for French resident nationals under *C.G.I.*, Art. 81A, which is accepted as extending to residents who are nationals of a treaty state.

100. Formerly, only a U.S. citizen working abroad for a minimum time could exclude an amount of foreign income, currently US\$ 70,000, from being taxed in the United States under Internal Revenue Code (I.R.C.), Sec. 911. A Revenue Ruling (Rev. Rul. 72-330, 1972-2 C.B. 444) accepted that the same exemption is available to U.S. resident aliens (who are taxed in the same way as citizens) under treaties containing this provision. In fact, the statute was subsequently changed by PL 95-615 Sec. 202(a) to extend the relief to all resident aliens, from 31 December 1987.

101. Under a former law, Decree 597 of 29 September 1973, Art. 3(2), an Italian citizen and resident was exempt from tax on income from employment carried on outside Italy. This example, which was not accepted as a prohibited discrimination by the tax authority, is also no longer in force but is essentially the same as the U.S. and French examples.

102. There was formerly a relief for Belgians working in Belgian colonies under Dép. 28.8.1973, No. Ci RH 243/256.215. When this was extended to persons working in non-treaty countries outside Europe, the relief was also given to non-Belgian nationals who had been resident in Belgium before working abroad.

103. *Das Schweizerische Steuerrecht: Eine Standortbestimmung*, M. Reich and M. Zweifel eds., 1989 ed., at 627. The Federal Tribunal in a case of 12 May 1965 (ATF 91 I 84) decided that there was no discrimination since taxation at source was only a special tax collection procedure, which was justified by the fact that foreigners with an A or B permit are resident in Switzerland only for a limited period of time, quite often only a few months, unlike Swiss nationals and foreigners with a C permit.

104. The modern U.K. definition (post-British Nationality Act 1981 - it is not proposed to deal here with the many different earlier definitions to be found in treaties) of a U.K. national (individual) is (a) British citizens and (b) British subjects not possessing the citizenship of any other Commonwealth country or territory, provided they have the right of abode in the United Kingdom. Since all British citizens and all British subjects are Commonwealth citizens (British Nationality Act 1981, Sec. 37), all nationals of the United Kingdom within the treaty definition must also be Commonwealth citizens. A treaty partner national who is not also a Commonwealth citizen is therefore discriminated against. The internal law provisions favouring Commonwealth citizens are: T.A. 1988, Sec. 65(4) and Schedule 4, Para. 4(5) (the remittance basis of taxation normally applies to U.K. domiciled (if they were of foreign domicile it would apply anyway) Commonwealth and Irish citizens who are resident but not ordinarily resident in the United Kingdom. A treaty partner national who is domiciled and resident, but not ordinarily resident, in the United Kingdom is not entitled to the remittance basis under internal law, although he appears to be under the nationality non-discrimination provision); and Secs. 232 and 278 (personal allowances and tax credit on dividends given to non-resident Commonwealth citizens, discussed under the heading *Personal allowances* in the Permanent Establishment Non-discrimination Provision).

105. Presidential Decree of 25 September 1973, Art. 34bis.

106. See German Supreme Tax Court (Bundesfinanzhof) [hereinafter "BFH"] decision of 14 March 1989, IR20/87, *Bundessteuerblatt* [hereinafter "BStBl."] 1989 II, at 649, discussed in R. Betten, "Italy-Germany Tax Treaty: Applicability of the Treaty to a German Resident Dutch National," 30 *European Taxation* (February 1990), at 53.

107. See Art. 1 of the OECD Model.

ty.¹⁰⁸ The Income Tax Act provides various benefits to a "Canadian corporation," which is defined to include Canadian incorporated companies and exclude non-Canadian incorporated companies, unless they were resident in Canada before 19 June 1971. These reliefs include various roll-over and many other provisions, some of which require not only Canadian incorporation but also Canadian control.¹⁰⁹ Canada normally includes in its treaties a nationality non-discrimination provision relating to companies, which will prevent any discrimination based on nationality alone.¹¹⁰ Australia gives a deduction for research and development expenditure only to companies incorporated there, which is discriminatory.¹¹¹ The tax-exempt status of an "investment institution" in the Netherlands is restricted to companies incorporated under Dutch law.¹¹² This is an example of discrimination against a foreign incorporated company which is resident in the Netherlands because it is managed there.¹¹³ Belgian law also requires recognised joint investment funds (*fonds commun de placement*) to be managed by companies constituted and resident in Belgium.¹¹⁴ In the United Kingdom, a relief (business expansion scheme) for investment in unquoted companies requires that the company should be incorporated, resident and carrying on a qualifying trade wholly or mainly in the United Kingdom.¹¹⁵ It is discriminatory not to apply the relief for investment in an otherwise identical company incorporated in a treaty partner state.¹¹⁶ In the United States, the nationality non-discrimination provision prevented the charging of an excise tax on premiums relating to U.S. risks paid to a German insurance company which was engaged in an insurance business in the United States.¹¹⁷

Case 2.1: Discrimination against a national and resident of State B compared to a national of State A resident in State B

The next case to be considered is where both of the nationals are resident in State B, which is a comparison of the treatment by State A of two non-residents, one of whom is a national. We shall start by assuming that State A does not tax its nationals in the same way as residents. As permanent establishments are dealt with separately in the non-discrimination article, we shall assume here that we are looking at the position of two non-residents without a permanent establishment in State A. This situation is much less likely to give rise to discrimination, as in many cases non-residents pay a withholding tax only, which is unlikely to be discriminatory, as all non-residents are treated in the same way, regardless of nationality. Discrimination can arise in taxing professional services, which are excluded from the permanent establishment provision even though a fixed base is similar to a permanent establishment, salaries, and income and gains from real property. Examples of discrimination against non-resident non-

fer (Sec. 85(3)); share-for-share exchanges where a Canadian corporation issues shares (Sec. 85.1); the amalgamation of Canadian corporations (Sec. 87); and the transfer of property to a 90 percent shareholder on the winding-up of a taxable Canadian corporation. Other provisions include the prohibition against deduction of advertising expenses, unless the advertisement is made in a Canadian newspaper or periodical (defined to include *inter alia* those published by a company incorporated in Canada, three-quarters of whose members are Canadian citizens) (Sec. 19); the lower tax rate for the first C\$ 200,000 of business income of a Canadian-controlled private corporation (limited to a Canadian corporation) (Sec. 125(7)(b)) and the exemption from capital gains tax of up to C\$ 500,000 of gain on the shares of such a corporation (Sec. 110.6); the exemption of dividends received by a corporation from a taxable Canadian corporation (Sec. 112(1)); special tax regimes for investment corporations (Sec. 130), for mortgage investment corporations (Sec. 130.1(6)) and for mutual fund corporations (Sec. 131(8)), all defined as Canadian corporations; and special tax regimes for non-resident-owned investment corporations (Sec. 133(8)(d)), and deposit insurance corporations (Sec. 137.1(5)(a)), requiring incorporation in Canada.

110. Exceptions are the treaties with: the U.S.S.R. (1985), which has a residence discrimination provision, see *supra* note 6; and the United States (1980), in accordance with normal U.S. practice. There is no non-discrimination article in the treaties with Australia (1980), Denmark (1955), the Ivory Coast (1983), New Zealand (1980), Papua New Guinea (1987) and South Africa (1956) (no longer in force). The ownership non-discrimination provision does not prevent the requirement of Canadian control as this is always amended in Canadian treaties, see the heading *The deduction and ownership non-discrimination provisions*, below.

111. I.T.A.A., Sec. 73B. Australia has made a reservation against the whole of the non-discrimination article: Para. 61 of the Commentary on Art. 24. Only one Australian treaty, that with the United States, has a non-discrimination article, and this does not prevent discrimination against companies.

112. Corporate Income Tax Act 1969, Art. 28.

113. Another example is that only companies incorporated in the Netherlands are entitled to an exemption from the real estate transfer tax when acquiring real property in a reorganisation, Legal Transactions Tax Act (*Wet op belastingen van rechtsverkeer*), Art. 15(1)(h). This is an example of prohibited discrimination as Art. 24(7) of the OECD Model applies Art. 24 of the OECD Model to a tax not the subject of the convention. The Amsterdam court, in a decision of 3 October 1990, has decided that the non-discrimination rule in the Tax Agreement for the Kingdom (similar to a tax treaty between the Netherlands, the Netherlands Antilles and Aruba), which is virtually identical to Art. 24(4) of the OECD Model, could not be relied upon to qualify a Netherlands Antilles corporation for inclusion in a fiscal unity; the case is being appealed to the Supreme Court. A similar result was reached by the German Finanzgericht of Cologne in its decision of 30 May 1990 concerning a U.S.-incorporated, German-managed, company which wanted to be taxed on a consolidated basis (*Organschaft*) with its wholly-owned, German-incorporated and managed subsidiary; the company had based its claim for nationality-neutral treatment not on Art. 24(1) of the United States - Germany tax treaty, but on Art. XI(1) of the United States - Germany Friendship, Commerce and Navigation Treaty. The case is under appeal.

114. Act of 27 March 1957 relating to *fonds commun de placement*, *Official Journal* 13 April 1957 and Royal Decree of 22 April 1958 relating to the recognition of companies managing those funds.

115. T.A. 1988, Sec. 293.

116. Another example in the United Kingdom is the exemption from tax for charities (T.A. 1988, Sec. 505). The charitable body must be established under the law of part of the United Kingdom. This has been concluded from the context of the provision which refers to charities established by Act of Parliament, charter, deed of trust or will, indicating that only U.K. Acts, charters etc. are included (*Camille and Henry Dreyfus Foundation v I.R.C.*, 36 T.C. 126 H.L. [hereinafter "*Dreyfus case*"]). It should be noted that the exemption applies only to certain types of income, not including, e.g. foreign dividends which are covered by an extra-statutory concession (ESC B9). While not all bodies governed by the law of a treaty state would have objects which were exclusively charitable under English law, it seems that if a body did, it would qualify for the exemption under the non-discrimination provision. The Court of Appeal in the *Dreyfus* case found the objects of the foundation to be charitable, but the House of Lords did not comment on this point. The non-discrimination point was not raised in the *Dreyfus* case, perhaps because the then United States - United Kingdom treaty (1945) was not in the form of the OECD Model and only prohibited discrimination against nationals of one state resident in the other, for the reason given *supra* in note 29. This is a different point from the one *infra* in note 172 about not giving benefits to public and private bodies of the treaty partner state.

117. Letter ruling 7846060. The treaty also required residence in the United States, see *supra* note 29, which was satisfied under U.S. law, and hence under the treaty by virtue of OECD Art. 3(2), to the extent of its income effectively connected with a trade or business in the United States.

108. Canada has made a reservation against the whole of the non-discrimination article: Para. 61 of the Commentary on Art. 24. In practice, a nationality non-discrimination provision is normally included in Canadian treaties, only seven being without one. See generally Arnold, *supra* note 2, for discrimination in Canada.

109. The roll-over provisions include the transfer of property by a person or partnership to a taxable Canadian corporation for shares (I.T.A., Sec. 85(1) and Sec. 85(2)), and the winding-up of the partnership within 60 days of such a trans-

nationals are not unknown; the French three percent tax on properties owned by foreign companies is a good example. Another example, which has been mentioned above,¹¹⁸ is that France has made a reservation in the OECD Model to protect the exemption from capital gains tax under internal law for one residence in France owned by a non-resident individual, which applies only if he is a French national. There is also a potential example of discrimination against non-resident nationals in the United Kingdom where personal allowances are given to non-residents only if they are Commonwealth citizens. As explained above,¹¹⁹ anyone who is a U.K. national, within the normal treaty definition, will be a Commonwealth citizen; this refusal to give personal allowances therefore discriminates against treaty partner nationals who are not Commonwealth citizens. In practice, however, U.K. treaties normally¹²⁰ permit discrimination in relation to personal allowances, as the sentence in the permanent establishment non-discrimination provision in the OECD Model which denies personal allowances to treaty partner residents is normally put by U.K. treaty negotiators in a separate paragraph excluding discrimination on grounds of nationality as well.

If State A taxes its individual, or more commonly its corporate, nationals in the same way as residents, so that the object of comparison is also taxed as a resident of State A, we have argued above¹²¹ that the comparison is impossible, and discrimination is not prevented by the nationality non-discrimination provision. However, the object of comparison, a State A national resident in State B who is also taxed in the same manner as a resident of State A, may, at least if internal law deems nationals to be residents,¹²² be a dual resident. Consequently, one should hypothetically apply the dual residence provision to make him (or it) what we shall refer to as a *treaty resident* of either State A or State B, and therefore, for the purposes of the treaty,¹²³ in the same circumstances as a single resident of State A or B, before applying the non-discrimination provision. Applying the dual residence provision is particularly necessary when the treaty affects the liability of the State B resident, so that the comparison is only possible after applying the other treaty provisions to him; it seems reasonable to do the same for the object of comparison. Under the dual residence provision of the OECD Model affecting companies, which is the one more likely to apply here as taxing companies on the basis of nationality is more common than taxing individuals on that basis, a company will be a treaty resident of the state in which it has its effective management.¹²⁴ It is suggested that the dual residence provision should have been applied in the New Zealand, Belgian and French cases mentioned above.¹²⁵ Under the provision affecting individuals, there is a series of tests to determine treaty residence, the last of which is nationality, so that the comparison becomes impossible again if the reason for the State B national's treaty residence in State B is his nationality.¹²⁶ Applying the dual residence provision will not resolve the issue in all cases. If the State A national receives a benefit because of his internal law residence in State A, even though he is a treaty resident of State B, in many, if not most, states this cannot be taken away by the treaty.¹²⁷ One is therefore comparing an internal law resident of State A with a non-resident, even though for treaty purposes they are both residents of State B. It may there-

fore be that the tax regime applicable to the dual resident State A national is so different from that of the State B national that the comparison remains impossible, as in the Belgian case, but this would be less clear in the New Zealand case where only the rate of tax was involved. Also, since the non-discrimination provision applies to all taxes, and the dual residence provision will apply only to treaty taxes, the position relating to other taxes may well still be that the comparison is impossible, because it involves comparing a resident to a non-resident.

We shall next consider two subsidiary cases showing the effect of each of the possible results of applying the dual residence provision, on the assumption that it is applicable.

Case 2.2: Discrimination against a national of State B who is a treaty resident of State A compared to a national of State A who is a treaty resident of State A

Since the object of comparison is a treaty resident of State A, the result is the same as Case 1. The State B national may, of course, also be a dual resident but, as explained above, this is of no relevance in State A.

Case 2.3: Discrimination against a national and treaty resident of State B compared to a national of State A who is a treaty resident of State B

Having applied the dual residence provisions of the treaty and found that the object of comparison is a treaty resident of State B, we are now comparing two treaty residents of State B having different nationality. This is meaningful if State A recognises the position. In general, it will do so for

118. See text at note 14.

119. See *supra* note 104.

120. The only exceptions involving non-Commonwealth countries are Italy (1988) and Germany (1964), but the German treaty contains a provision giving personal allowances to German residents.

121. See the heading *In the same circumstances*.

122. See *supra* note 9 for examples and *infra* note 129 for the U.S. Model and some U.S. treaties which define residents to include citizens (although, as stated in that note, this will not give the result in the text because of the saving clause). If nationals are not deemed to be residents, whether the dual residence article can be applied depends upon whether a national is within the definition of resident in Art. 4(1). A company incorporated in the United Kingdom is regarded as domiciled there (*Gasque v. I.R.C.*, 23 T.C. 210 K.B.D.) and is therefore within Art. 4(1) anyway.

123. The Canadian legislation in this respect is unusual in treating a Canadian incorporated company which is not a treaty resident as a non-resident for all purposes: I.T.A., Sec. 250(5).

124. This is not used by the United States and often in Canadian treaties the question is resolved by mutual agreement.

125. Art. 4(3). This provision was contained in the France - Belgium treaty (1964), effectively in the former New Zealand - United Kingdom treaty (1966), and the France - Switzerland treaty (1966), which were the treaties concerned in the three cases. Application of the dual-residence provisions would not have affected the results of the Belgian or French cases; the New Zealand case is discussed under Case 2.3 below.

126. Art. 4(2). See also J. Avery Jones, et al., "Dual Residence of Individuals: the Meaning of the Expressions in the OECD Model Convention," *B.T.R.* (1981), at 15 and 104.

127. This is not true in all states. For example, in the Netherlands the The High Court (Hoge Raad) has decided (12 March 1980, *Beslissingen in Belastingzaken Nederlandse Belastingrechtspraak* [hereinafter "BNB"] 1980/170) that the excess of mortgage interest over deemed rental income of a house cannot be deducted in the Netherlands by a dual resident who is a treaty resident of Belgium since the treaty assigns the income to Belgium, although a treaty resident of the Netherlands would be entitled to the deduction.

individuals, although, of course, the situation cannot arise when the dual residence was resolved by the last test of nationality, as it would have done so in favour of State A. However, the saving clause adopted by U.S. treaties, under which the United States can continue to tax U.S. citizens as if there were no treaty,¹²⁸ will again mean that the U.S. (i.e. State A) national resident in the other state will not be taxed in the United States in the same way as the State B national and resident, because the United States will still tax the former's worldwide income. If the saving clause did not exist and the United States applied the dual residence tests to its citizens,¹²⁹ the observation in the Commentary¹³⁰ would not have been necessary as the United States would then give up its taxation on the basis of citizenship.

So far as companies are concerned, a company formed in an incorporation principle state with its central administration in another state (whether or not an incorporation principle state) will normally be recognised as existing as a company by all states. Assuming that the place of effective management, and hence its treaty residence, is in the other state, such a company can constitute the object of comparison: a company incorporated in State A which is a treaty resident of State B. But this is much less likely to occur if the company is incorporated in a central administration principle state, which may well say that the company does not exist under that state's corporate law if its place of effective management is in another state. Although in the New Zealand case mentioned above¹³¹ the dual residence provision of the treaty with the United Kingdom was not in OECD Model form, the effect was similar: a New Zealand incorporated company which was managed and controlled in the United Kingdom (and not in New Zealand), not having its centre of administrative or practical management in New Zealand, was a resident of both states under their internal law, but for treaty purposes became a U.K. resident only,¹³² and was therefore taxed in the same way, under the treaty, as any other U.K. resident company. A comparison could have been made between such a New Zealand company and a U.K. incorporated company resident in the United Kingdom, which differed only in nationality. We agree with the taxpayer's argument "that in so far as residence must be considered as one of the circumstances embraced by the words 'in the same circumstances,' then it should be judged by the definitions in the double taxation agreement and not by reference to [internal law]."¹³³ However, the court used internal law definitions of residence to determine that a New Zealand national could never be a U.K. resident. The court's reasoning is not convincing as it did not appear to appreciate that a "U.K. company" within the treaty definition could still be a New Zealand national,¹³⁴ and that, even if the defined expressions were not used in the non-discrimination article, they could still be used for the purpose of determining whether the object of comparison was in the same circumstances.¹³⁵ Perhaps the reason for the court's decision was that there was no interest article (and the other income article excluded interest) in the treaty concerned. We have already made a similar point about the application of the dual residence provision in relation to the Belgian case.¹³⁶ Regardless of whether these cases were correctly decided, it is suggested that normally the

treaty dual residence provision should have been applied in considering the non-discrimination provision.

Case 3: Discrimination against a national of State B resident in a third state (State C) compared to a national of State A resident in State C

The next situation involves nationals of each treaty state who are both resident in a third state. Unlike the 1963 OECD Model, the 1977 OECD Model specifically provides, by the addition of the second sentence of Paragraph 1 of the non-discrimination article, that third-state residents can benefit from the nationality non-discrimination provision. This is not normally¹³⁷ included in U.S. treaties since, as mentioned above, the comparison is made only with *resident* treaty partner nationals. The United Kingdom has made a reservation, the reason for which is not stated, against the second sentence of Paragraph 1¹³⁸ which is accordingly never included in treaties made by it. If State A does not tax its nationals in the same way as residents, this case is a comparison between two non-residents with different nationality, and is the same as Case 2.1 (national and resident of State B compared to a national of State A resident in State B). But the result is different from Case 2.1 if nationals of State A are effectively taxed as residents, because in that case the resulting dual residence in States A and C is not solved by the A/B treaty. It is not possible to apply the A/C treaty either, as we are dealing with discrimination against a State B national, to whom the nationality non-discrimination provision in that treaty does not apply (even though the object of comparison can, under the dual residence provision in that treaty, be a State A national resident in State C). The result in the latter case

128. U.S. Model Art. 1(4).

129. In the U.S. Model and some U.S. treaties, e.g. with Bangladesh (1980), the United States defines residents to include citizens so that they benefit from treaty reductions in the other state even if they are not actually resident in the United States. Although the dual residence article then applies to citizens, the effect of the saving clause is to remove the benefit of this result. The U.S. Model and most treaties provide for dual resident companies to be treaty resident in the state of their organisation, but sometimes the matter is left to be resolved by mutual agreement, as in the United States - Germany treaty (1989). In other cases, the company cannot claim treaty benefits but can qualify in its capacity as a payer of treaty protected income.

130. See text at note 26.

131. See *supra* note 12 and 37.

132. Art. II(1)(j), (k) and (l). Combining these definitions, a resident of the United Kingdom for treaty purposes included a company incorporated in New Zealand managed and controlled in the United Kingdom, which was not a New Zealand company, meaning that it was not managed and controlled in New Zealand and did not have its centre of administrative or practical management in New Zealand. The New Zealand internal law test of residence was either incorporation there or having the centre of its administrative management there.

133. See *United Dominions Trust*, *supra* note 12, at 61,042 - 3.

134. *Id.*, at 61,038, where White J. stated correctly that the notional New Zealand national would be a "United Kingdom company" according to the treaty definition, but that expression is used in the treaty only to define "resident of the U.K."

135. *Id.*, at 61,043, where Richmond J. stated that he "can see no justification for interpreting the words 'in the same circumstances' in the light of phrases specially defined in the double taxation agreement for purposes quite different from those of [the non-discrimination article]."

136. See text at note 42.

137. Exceptions are the treaties with Bangladesh (1980), China (1984), Italy (1984), Malta (1980), the Netherlands Antilles and Aruba (1986 never in force), New Zealand (1982) and Sri Lanka (1985). Canada also excludes this provision in many of its treaties, see Arnold, *supra* note 2, at 153.

138. Para. 63 of the Commentary on Art. 24.

is the same as we have argued above, that the comparison is impossible because the object of comparison is also taxed as a resident of State A, which the State B national is not, and so they are not in the same circumstances. It cannot therefore be said that there is any prohibited discrimination.

The alternative interpretation¹³⁹ gives rise to a further possible case with two variations, relating only to companies.

Case 4.1: Discrimination against a company incorporated in State C having its central administration in State B, compared to a company incorporated in State A, an incorporation principle state, having its central administration in State B, a central administration principle state

Since, under the alternative interpretation, we are no longer restricted to the state of incorporation to define nationality, we can consider a case involving discrimination against a company incorporated in a third state (State C), with its central administration in State B. Under the alternative interpretation, State B, a central administration principle state, regards the company as its national, because it derives its status from its law, on account of the central administration being in State B. We assume that State B also treats the company as a resident. State A is unlikely to tax such a company as a resident since its place of incorporation and central administration are both outside that state. The object of comparison is a company incorporated in State A (an incorporation principle state) having its central administration in State B. Since State A is an incorporation principle state it will, under internal law, in all such states represented by the authors, tax the object of comparison in the same way as a resident. As we have argued above, a comparison between a resident and a non-resident is impossible to make in these circumstances. The only meaningful way in which a comparison can be made between these two companies is if the object of comparison is a treaty resident of State B, as it was under Case 2.3. State A may also have to apply the A/C treaty, on the ground that State C, an incorporation principle state, also regards the company as its national. This is effectively the same situation as was dealt with in Case 3.

Case 4.2: Discrimination against a company incorporated in State C having its central administration in State B, a central administration principle state, compared to a company incorporated in State C having its central administration in State A, a central administration principle state

There is a variation to the previous example with the difference that State A applies the central administration principle, so that the object of comparison is a company incorporated in State C having its central administration in State A, which regards it as its national and as deriving its status from its law. This means that one is comparing two companies incorporated in State C, one with its central administration in State A, and the other in State B. Assuming that the state in which the central administration is situated taxes the company as a resident, this raises the same issue about the comparison between a resident and a non-resident being impossible.

E. Dual nationals

If an individual is a national of both states, it is possible for discrimination to take place if there is a provision of State A's law directed *against* State B nationals (or foreign nationals generally), regardless of whether or not they are also nationals of State A. On the other hand, if the internal law provision is one *in favour of* State A nationals, as is usual,¹⁴⁰ a dual national will not be discriminated against, as he can qualify for the favourable treatment. The object of comparison must be an individual who is a national of State A only. If the alternative interpretation¹⁴¹ is correct, dual nationality can also occur with a company.¹⁴² This arises when a company incorporated in one state, applying the incorporation principle, so that it treats the company as its national, has its central administration in the other state, so that the company derives its status from its law, and is regarded as its national.¹⁴³ The U.K. company in the Belgian case¹⁴⁴ would be an example of this occurring.

F. Stateless persons

Stateless persons, not unreasonably, must be residents of one of the treaty states to benefit from the non-discrimination provision applicable to them.¹⁴⁵ The Commentary explains that this is to prevent stateless persons who are not resident in either state from being privileged compared to nationals of the other state, as they could otherwise claim freedom from discrimination in both states. Variations are permitted which do not require stateless persons to be residents of either state, which are commonly used, presumably because this was the text of the 1963 OECD Model.¹⁴⁶ Another variation does not allow stateless persons to claim freedom from discrimination in their state of residence.¹⁴⁷ The stateless persons provision is used in only 72 treaties out of about 1000 in total in the world.¹⁴⁸ A legal person, presumably, cannot be stateless, as it must derive its status from or, in the French version, be incorporated (*constituée*) under, some system of law.¹⁴⁹ If a company is incorporated in a central administration principle state which allows the central administration to be in another state (such as Luxembourg), and if the company has its central administration in the Netherlands, an incorporation

139. See the heading *An alternative interpretation: possible difference in meaning between incorporation and deriving its status*.

140. See the examples in Case 1.

141. See the heading *An alternative interpretation: possible difference in meaning between incorporation and deriving its status*.

142. There is also the possibility of the company being incorporated in more than one state, as in *Arab Monetary Fund v. Hashim* (*supra* note 55). The Arab Monetary Fund was incorporated in all 21 of its member states.

143. For an example see *supra* note 96.

144. See *supra* note 87.

145. Para. 17 of the Commentary on Art. 24. Also see Para. 20 for the definition of stateless person.

146. This is used in eight Belgian treaties and one former treaty, seven French treaties and five German treaties, among others.

147. Paras. 18 and 19 of the Commentary on Art. 24. For examples, see Belgium - Canada (1975), - Tunisia (1975), Canada - Dominican Republic (1976), - Israel (1975), - Pakistan (1976).

148. The greatest use is by France (20) and Belgium (12 plus 1 former treaty). The other states represented have used it in the following numbers of treaties: Germany (7), Canada (7), Italy (4), the Netherlands (2) and the United Kingdom (1). It has not been used at all by Australia, Japan, Switzerland or the United States.

149. This point is also made by Rigaux, *Droit International Privé*, Vol. I, 2d ed., (Brussels: Larcier, 1987), No. 135.

principle state, Luxembourg will say that the company is governed by the law of the Netherlands, while the Netherlands will say the reverse. Since no law governs the company, it is not clear whether it can be said not to exist, or whether it exists but is stateless. There is an example of trustees possibly being stateless in Canada.¹⁵⁰

G. Other legal persons, partnerships and associations

Since the definition of national covers "legal persons, partnerships and associations,"¹⁵¹ the addition of the last two is relevant only when they are not legal persons; otherwise there would have been no need to mention them separately.¹⁵² It is not clear why in the English version the existing definition of "person" in Article 3 is not used here,¹⁵³ particularly as the second sentence of the nationality non-discrimination provision applies to *persons* who are not residents of either state, implying, incorrectly, that the listed items are all within the definition of person. The French version is more consistent in using *personne morale* both in the definition of company in Article 3 (where the English version uses *body corporate*), and in the non-discrimination article, where the English version refers to *legal person*, although there is no difference in meaning between these two expressions in English. Presumably the present list is intended to be wider than *person*, otherwise the same expression would have been used, but whether this is so depends on the width of expressions such as "body of persons" used in the definition of person. The definition of "national" will in any case include associations which are not legal persons and which are not taxed as companies, and are therefore not persons within the meaning of Article 3. Vogel points out that the definition of national is also narrower since it does not include entities which are taxed as companies but are not legal persons. These entities are within the definition of company and therefore qualify as persons,¹⁵⁴ but the extent of this difference depends on whether such entities are partnerships or associations, which many of them are. Examples include partnerships taxed as companies, unincorporated associations in the United Kingdom, and associations without legal personality in Japan, which are taxed as companies.¹⁵⁵ One reason for not referring to the defined expression *company*, which includes an entity taxed as a company, may be because the non-discrimination provision applies to all taxes. Whether or not an entity is subject to an income or capital tax covered by the treaty should not be relevant to the question whether the entity is protected against discrimination in relation to other taxes to which it is subject. Excluded from the ambit of legal persons, partnerships and associations are foundations where these are not legal persons, which is usually the case in Italy and sometimes the case in Germany; and in the Netherlands those cooperatives, mutual insurance companies and "funds for joint account" which do not have legal personality; the last of these (*fonds communs de placement*) is also to be found in Belgium. It is not clear whether trustees, including trustees of pension funds, can qualify as nationals on the basis that the trustees themselves are individuals or companies. In Canada, trustees are deemed to be an individual separate from the persons who are the

trustees, but such individual is not given a nationality.¹⁵⁶ In Australia trustees were formerly deemed to be hypothetical taxpayers but were not given a residence,¹⁵⁷ and, on the same reasoning, would not have a nationality. One would not expect the nationality of the trustees to be a relevant factor in taxing them in their capacity as trustees, for which the proper law of the trust would seem to be more analogous to the provisions dealing with legal persons, partnerships and associations. The proper law of a trust is not referred to in the definition of national, and so trustees may be excluded.¹⁵⁸ Of course, where a state taxes trustees without regard to the existence of the trust, nationality may be a relevant factor.

So far as *partnerships* are concerned, it is unclear whether the provision prevents discrimination only when taxing the partnership itself,¹⁵⁹ or whether it is also intended to prevent discrimination by the source state in taxing partners, of whatever nationality, in a partnership created by the laws of the treaty partner state which does not regard the partnership as a person.¹⁶⁰ The former seems more probable as there can only be discrimination against a part-

150. See text at note 156. In the United Kingdom, all the trustees would have to be nationals for the trustees to be U.K. nationals, on the analogy of provisions dealing with residence or domicile. There are no provisions relating to the nationality of trustees in U.K. tax law.

151. The OECD and Council of Europe draft multilateral mutual assistance treaty adds *and other entities*, which suggests that the list in the OECD Model was not thought to be sufficiently comprehensive. This addition is sometimes made in treaties: this is done in all Malaysian treaties containing the nationality provision except that with Germany (1977); about 37 U.K. treaties, including many extensions of former U.K. treaties, particularly with Denmark and Switzerland; many other states make this addition in a few of their treaties, and it is to be found in the Nordic Convention (1989). See also East Germany - India (1989) and - China (1987), referring to *legal person, partnership or organisation*.

152. Sometimes in treaties the provision is limited to legal entities: e.g. Bulgaria - France (1987) and Italy - Yugoslavia (1982) (for Yugoslavia only).

153. "The term 'person' includes an individual, a company and any other body of persons." Presumably the context requires that the definition should not be used in the second sentence of Art. 24(1), because otherwise it would not cover nationals who are not within the definition of person. Belgian treaties with Austria (1971), Denmark (1969), former Finland (1954), Greece (1968), Luxembourg (1970), the Netherlands (1970) (no reference to partnerships), former Sweden (1953), former United Kingdom (1967) (no reference to partnerships), former United States (1948) (companies and other legal persons) limit this provision to companies, as does Germany - Spain (1966) and - Jamaica (no reference to partnerships for Jamaica) and France - China (1984). Before the law of 22 December 1989, Belgium used to discriminate against non-Belgian partnerships; excluding partnerships here prevented the taxpayer from using the nationality non-discrimination provision to prevent it. The normal wording used in about 22 Japanese treaties includes juridical persons and organisations without juridical personality treated as juridical persons for Japanese tax purposes, which has the same effect as limiting the definition to companies.

154. Art. 3(1)(b). See K. Vogel, *Double Taxation Conventions* (Deventer: Kluwer, 1991) [hereinafter "Vogel"], marginal number 53 to Art. 24.

155. Under Corporation Tax Law, Art. 3. These are defined as "an association or foundation that is not a corporation and that has a stipulation for its representative or administrator." Corporate Tax Law, Art. 2, item viii.

156. I.T.A., Sec. 104(2).

157. *Union Fidelity Trustee Co. v. F.C. of T.*, 69 Australian Tax Cases [hereinafter "A.T.C."] 4084. The I.T.A.A. was amended in 1978 to correct this.

158. United States - Mexico (1989) and United States - Peru (1990) (both relating to exchange of information only) specifically include trusts and estates in the definition of national.

159. This is suggested by Para. 3 of the Commentary on Art. 24, referring to *tax-payers* (individuals, legal persons, *partnerships* and associations).... [our italics]. See Vogel, *supra* note 154, marginal number 54 to Art. 24, which supports this interpretation.

160. It is considered that the statement in the Commentary, that the OECD Model does not apply to partnerships not taxed as a company (Para. 3 of the

nership if the partnership itself is taxed. If this were not the case, third-state residents could claim treaty protection from discrimination merely on the basis of the existence of a partnership formed under the law of a treaty state which did not tax the partnership. A partnership formed under the law of one of the states of the United States is defined by internal law as a domestic partnership, but since partnerships are transparent for income tax purposes, the effect of the nationality non-discrimination provision would be limited to other taxes, unless the point made above – that all the partners, whatever their nationality, in a domestic partnership can claim the benefit of the non-discrimination provision – is correct.¹⁶¹ The law governing the nationality of a partnership seems to be the law under which the partnership was created.¹⁶²

There is a further source of potential discrimination affecting partnerships; that is, whether an entity is treated in the other state in the same way as a domestic partnership. In France, Italy¹⁶³ and Switzerland¹⁶⁴ an entity similar to a domestic partnership which is governed by foreign law is not treated as transparent for the purpose of taxing a source of income in that country,¹⁶⁵ whereas a domestic partnership is transparent. Discrimination is therefore possible. The other states represented (Belgium, Germany, Japan, the Netherlands and the common law states¹⁶⁶) make no distinction based on the governing law in taxing partnerships.¹⁶⁷

The term *association* has a legal meaning in some countries, such as France, Italy, Japan, the Netherlands and Switzerland; it has no legal meaning in the common law countries¹⁶⁸ except Australia, where, for example, in New South Wales there is a statute recognising an incorporated association, which must not have the object of trading or securing pecuniary gain for its members.¹⁶⁹ Often an association is a legal person and so the specific reference adds nothing to the scope of the provision. However, in Belgium,¹⁷⁰ Germany and Italy some associations which are not legal persons exist; in the remaining common law countries none of them is a legal person, so the effect of the specific reference may be to prevent discrimination against them, if they are dealt with in tax legislation. Where there is no legal meaning of association in a state, such a body cannot be said to derive its status from the law, as it does not have any status.

The Commentary¹⁷¹ makes it clear that public bodies and non-profit making bodies, whose activities are specific to the state, are regarded as being for the benefit of the state and its nationals. There is no requirement to give the same reliefs to similar bodies of the treaty partner state. There have been a number of cases on this point.¹⁷²

H. Positive discrimination: other or more burdensome taxes

The Commentary¹⁷³ explains that positive discrimination, that is, discrimination in favour of the nationals of the other state, is allowed,¹⁷⁴ in spite of the words “other or more burdensome,” which might suggest the opposite, particularly in contrast to the reference to “not...less favourably levied” in the permanent establishment non-discrimination provision.¹⁷⁵ The reference to *other* taxation

Commentary on Art. 1), is not applicable to the non-discrimination article because partnerships are specifically included.

161. A nationality non-discrimination provision relating to partnerships is not normally included in U.S. treaties anyway; for the exceptions see *supra* note 31.

162. The American Law Institute, *Restatement of the Law of Foreign Relations of the U.S.* (1987), Sec. 213 states that under common law systems a partnership is not an entity having nationality.

163. This was expressly permitted by an exception to the non-discrimination article in the United Kingdom – Italy treaty (1960) but not the later treaty (1988). The latter adds the following to the definition of *person* “...but does not include partnerships which are not treated as bodies corporate for tax purposes in either Contracting State.”

164. Federal Direct Tax Act, Art. 18(1).

165. In Switzerland and France, however, a foreign partnership remains transparent for the purpose of taxing a resident partner. This is not the case in Italy.

166. There is a possible exception in the United Kingdom requiring a qualifying insurer, for the purpose of the deduction for premiums for medical insurance for those over 60, to be *inter alia* a partnership formed under the law of part of the United Kingdom or a member state of the EC and having its central administration or principal place of business in a member state: F.A. 1989, Sec. 55(8)(b). A non-EC insurer could claim discrimination if it had its central administration or principal place of business in a member state.

167. In Belgium, domestic partnerships are transparent. The Act of 22 December 1989 restored the transparent treatment of foreign partnerships, see *supra* note 153. However, a foreign entity whose legal structure is analogous to a Belgian company is treated as a company and is potentially discriminated against: see the subheading, The Permanent Establishment Non-discrimination Provision, under the heading *Rate of tax*.

168. See, in the United Kingdom, *In re St. James's Club*, 2 De G.M. & G. 383 (1852) and *In re International Tin Council*, 3 W.L.R. 1159 C.A. (1988) for the exclusion of a members' club and an international organisation, respectively, from the meaning of *association* in relation to winding-up unregistered companies in the United Kingdom. The EEC Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters refers to an association of natural or legal persons. This is defined in the U.K. Civil Jurisdiction and Judgments Act 1982 giving effect to the Convention as “an unincorporated body of persons.” The word *association* is used in the U.S. Internal Revenue Code, §7701 (a)(30) (associations taxable as corporations), and in the Canadian tax legislation, I.T.A., Secs. 66(15)(b)(iv), 149(1)(d) and (f), and 149(5), but there is no definition. There is a similarity between this expression and the reference to “company, association or partnership” in the 20 partner limit in the U.K. Companies Act 1985, Sec. 716 and the reference to “partnership or association” in the Australian Federal Corporations Law, Sec. 112. In Australian tax legislation, “company” includes all bodies or associations, incorporated or unincorporated, but does not include a partnership.

169. Associations Incorporation Act 1984.

170. Non-profit making associations (ASBL) have legal personality under a law of 27 June 1921, but this status was lost unless three-fifths of the members were of Belgian nationality. This was changed in the law of 28 June 1984 to include Belgian residents. This appears to be discriminatory against non-residents who are not Belgian nationals.

171. Paras. 5 to 8 of the Commentary on Art. 24 of the OECD Model.

In Germany there have been cases to the effect that there is no requirement to exempt from tax the German income of a body for public welfare resident in the treaty partner state: BFH decision of 18 April 1975, *BStBl.* 1975 II, at 595. Similarly, a Swiss foundation need not be given the same exemption from inheritance tax as is given to German foundations: BFH decision of 3 August 1983, *BStBl.* 1984 II, at 9. There is a U.S. letter ruling, Ltr. Ruling 8030005, denying exemption from income tax to a Dutch pension fund for the same reason. The Belgian commentary repeats Paras. 5 and 7 only of the Commentary in Para. 24/14. See France – Sweden (1990) for a non-discrimination provision covering public legal entities.

173. Paras. 9 and 10 of the Commentary on Art. 24.

174. The same is true under the EEC Treaty, see *Hurd v. Jones*, 2 C.M.L.R. 1 (1986).

175. A number of U.S. treaties use the same expression, usually *more burdensome*, in both the nationality and the permanent establishment non-discrimination provisions: Belgium (1970), Brazil (1967, never in force), Cyprus (1980 and 1984), Egypt (1980), Iceland (1975), Israel (1975), Japan (1971), Korea (1976), Morocco (1977), the Netherlands (1948), Norway (1971), Philippines (1976), Romania (1973), Thailand (1965, never in force), and Trinidad and Tobago (1970). Former Belgium – Sweden (1953) and - Finland (1953) also used *more burdensome*. The United Kingdom – Farøe Islands treaty (1960 extension of 1950 treaty) uses *other or more burdensome* in both places. The Canada – U.S.S.R. treaty (1985) uses *higher or more burdensome* in the residence non-

must be to a tax different from that to which nationals are subject: as was said in the *Woodend Rubber* case "to speak in this context of 'other' taxation must...at least include some income tax other than the income tax to which resident [in a non-discrimination provision referring to residence, rather than nationality] companies are subjected."¹⁷⁶ *More burdensome* taxation must, on the other hand, refer to the quantum of tax.¹⁷⁷ The same meaning of *other or more burdensome* has been put forward in the Netherlands by Dirksen based on historical usage without knowledge of the *Woodend Rubber* case.¹⁷⁸ These two together mean that, while there is nothing to prevent the taxing state from charging nationals of the other state less of the same tax, it cannot charge a different tax, or the same tax on a different occasion,¹⁷⁹ even if it is less burdensome, although normally the taxpayer is unlikely to complain if it did.¹⁸⁰ The same applies to connected requirements, which the Commentary explains as the formalities connected with taxation, such as returns, payment, prescribed times, etc.¹⁸¹ Even though the tax on the non-resident company was less burdensome than that on a resident company paying the same amount of dividends,¹⁸² unusually, the non-resident taxpayer in the *Woodend Rubber* case did succeed on the non-discrimination issue.¹⁸³ Consequently, the non-resident company only paid tax on its profits and did not pay the additional tax on account of transfers back to its head office because resident companies were not subject to tax on such transfers, although they were subject to an additional tax if dividends were paid.

The statement in the Commentary permitting positive discrimination makes it more difficult to argue, as we have above,¹⁸⁴ that, where nationality is the sole criterion for taxation in State A, State B nationals who are not treaty residents of State A cannot be in the same circumstances as State A nationals. This is because it could be argued that by not taxing State B nationals on their worldwide income, State A is merely exercising a permitted positive discrimination in favour of State B nationals. It would follow that making the comparison between the two nationals is possible and all the benefits given to State A nationals by State A should also be given to State B nationals.¹⁸⁵ We doubt if this is intended.

An example of *other* taxation, if resident and non-resident companies can be in the same circumstances, which we have argued above they cannot be, can be found in the United Kingdom, where a non-resident company which is a national of the treaty partner state pays income tax, which will often be lower than corporation tax which is paid by resident companies, on U.K.-source income which is not earned through a permanent establishment. A case of permitted positive discrimination often found in internal tax law is based on the NATO treaty where members of visiting forces are not to be treated as residents with the exception of those who are nationals of the receiving state.¹⁸⁶ In the Netherlands, certain foreigners working temporarily in the Netherlands may claim a flat rate

remittances to a maximum of one-third of taxable income. Resident companies, on the other hand, paid an additional tax equal to one-third of the dividends paid, which was deductible from the dividends. This was in form an additional tax on the profits of the company, rather than a withholding tax on the dividends. Since resident companies did not pay tax on remittances abroad, the tax was an "other" tax, which was prohibited by the residence (as it was in that treaty) non-discrimination provision, even though the charge to tax was all part of income tax. It was also held that the tax did not contravene the equivalent of OECD Art. 10(5) as a tax on undistributed profits since it was a tax on profits, whether distributed or not, measured by remittances.

177. *Id.*, at 332A - B. It was agreed that the tax on the permanent establishment of the U.K. company, including the additional tax caused by transfers to head office, was less than it would have been if the company had been resident, presumably taking into account the actual dividends paid by the non-resident company. The provision in United Kingdom - Ceylon (1950) prevented discrimination against residents of the other state, rather than nationals. It prevented taxation which was *other, higher or more burdensome*. This wording was often used in older treaties, of which many examples are still in force, usually in extensions of former treaties to other territories. A number of treaties refer to higher or more burdensome: Austria - Bulgaria (1983) (in the permanent establishment non-discrimination provision), Ireland - Pakistan (1973) (in the permanent establishment non-discrimination provision), Sri Lanka treaties with: Czechoslovakia (1978), Pakistan (1981), France (1981), Japan (1967) and Romania (1984); and U.S.S.R. treaties with: Austria (1981), Canada (1985), Cyprus (1982), Denmark (1986), Finland (1987), France (1985), Germany (1981), India (1988) and Sweden (1981). Some French treaties refer to *other or higher* taxation. *Higher* seems to be the same as *more burdensome*, unless *higher* refers only to the rate of tax when it is used in conjunction with the latter.

178. See *supra* note 176. "Fiscale non-discriminatie," *Weekblad voor Fiscaal Recht* (1974), No. 5176-77, footnote 14 at 365, cited in van Raad, *supra* note 22, footnote 58 at 93. O'Brien, *supra* note 11, in his footnote 2, refers to language similar to the OECD Model in two 17th century U.K. treaties.

179. Such as the income tax (being the same tax as resident companies paid) on remittances by non-resident companies in the *Woodend Rubber* case, *supra* note 7. In that case it was unsuccessfully argued by the tax authority that it was the same tax, income tax, as was paid by resident companies, and that it was also imposed on profits, so that it could not be an "other" tax: *Id.*, at 326F.

180. But the administration could; as it tried to do unsuccessfully in Belgium in Court of Appeal, 1 December 1987 and note GEMIS, *Algemeen Fiscaal Tijdschrift* [hereinafter "A.F.T."] 1988, at 154, which resulted in discrimination against resident directors of Belgian companies whose imputation of the tax credit on their fees was limited to the resident tax excluding the six percent surtax (*taxe communale additionnelle*), as opposed to non-resident directors of Belgian companies who technically could impute the tax credit on their non-resident tax *inclusive* of the six percent surtax, rejecting the Revenue's argument of discrimination between residents and non-residents based on the internal law equal treatment rule.

181. Para. 10 of the Commentary on Art. 24. In *R v I.R.C. ex p. Commerzbank*, S.T.C. 271, 277c Q.B.D. (1991), the absence of entitlement to repayment supplement (interest on a tax repayment) in the United Kingdom, which is not paid to non-residents, was held to be a more burdensome connected requirement, but it did not breach the nationality non-discrimination provision in Germany - United Kingdom (1964) as it was discrimination against non-residents. The American Law Institute Federal Income Tax Project on U.S. Income Tax Treaties, Tentative Draft No. 16, adopted at its Annual General Meeting in 1991 [hereinafter "A.L.I. Tax Project"], at Part IV I.A.2, argues that differences in enforcement and collection methods should be capable of being justified by the different circumstances of foreign taxpayers.

182. The reason seems to have been that tax on the non-resident company was a maximum of one-third of taxable income when the remittances exceeded one-third of taxable income, while the additional tax on a resident company was one-third of the dividends paid out of the profits, whatever their amount.

183. The taxpayer ultimately lost on the ground of statutory override.

184. See the heading *Same circumstances in law and fact*.

185. This is one possible reason for the U.S. observation, *supra* note 29, that it would not tax treaty partner individual nationals and residents on their worldwide income, but it seems more likely that it was trying to avoid giving reliefs to them.

186. NATO Treaty, Art. X 4. In the United Kingdom, the exception applies to a British citizen, a British Dependent Territories citizen, a British National (Overseas) or a British Overseas citizen: T.A. 1988, Sec. 323, Capital Gains Tax Act 1979 [hereinafter "C.G.T.A."], Sec. 18(5); in Canada, see the Visiting Forces Act 1985, Sec. 22(3); in Belgium, see Com.I.R. (Official Comments of Ministry of Finance on the Income Tax Code) 139/17 to 172 for NATO personnel, 139/17 3 for SHAPE personnel and 139/17 4 for IMS personnel.

discrimination provision. Cf. the United States - Peru treaty (exchange of information, 1990) "different or more burdensome."

176. *Woodend Rubber* case, *supra* note 7. The Ceylon tax in question was a branch profits tax measured by reference to (rather than on) the remittances made out of the permanent establishment state, amounting to one-third of the

expense deduction of 35 percent against employment income, whereas a national is required to itemise the expenses.¹⁸⁷ There is a similar provision in relation to the ten percent deduction from employment income in some Swiss cantons. Switzerland also allows the taxation of non-Swiss citizens who are not working in Switzerland on the basis of their expenditure, with a minimum of five times the rental value of their house or apartment in Switzerland. In Belgium a non-national executive temporarily working there is treated as a non-resident and there are reliefs for expenses incurred while working abroad.¹⁸⁸ In Australia there is a provision deeming certain foreign contractors and employees who are not Australian citizens to be non-resident, if they are in Australia for certain prescribed purposes.¹⁸⁹ Non-Japanese nationals are presumed not to have an intention to live permanently in Japan and are therefore entitled to be taxed on foreign income on the remittance basis for the first five years.¹⁹⁰ There is a possible, more subtle, example of positive discrimination in the United Kingdom. A Commonwealth or Irish citizen is taxable in the United Kingdom as a resident, notwithstanding that at the time of the assessment he has left the United Kingdom for the purpose only of occasional residence abroad;¹⁹¹ a non-Commonwealth citizen is more favourably treated, since he cannot be treated as a resident in these circumstances.

I. Apparent discrimination based on nationality

There are many examples of cases where there is apparent discrimination against treaty partner nationals, but nationality is not the real reason for the discrimination. Often the discrimination is based on the grounds of residence, as in the usual denial of the imputation tax credit to non-residents by countries adopting this system.¹⁹² Other examples include discrimination based on the residence of the person's employer,¹⁹³ or the residence of an insurance company to which premiums are paid.¹⁹⁴ A borderline case is illustrated by a U.S. letter ruling¹⁹⁵ denying an investment tax credit to a U.S. resident U.K. national for the purchase of a yacht operated in a charter business outside the United States. A U.S. national would have been entitled to the allowances if the yacht were registered with the U.S. Coast Guard, which is only possible if the owner is a U.S. national. The ruling decided that the discrimination was not contained in tax law but in the Coast Guard regulations which were not within the tax treaty. To us this seems a poor argument.¹⁹⁶

J. Conclusion on nationality non-discrimination

The main problem in interpretation of the nationality non-discrimination provision arises when nationals are taxed in the same way as residents, which is extremely common in the case of companies. It would be useful if the Commentary could deal more fully with the relationship of nationality and residence. We have relied on the statement in the Commentary that the object of comparison must be in similar circumstances both in law and in fact to argue that where the object of comparison is taxed in the same way as a resident on account of nationality, the comparison is impossible and should not be attempted. There should be a clear statement in the Commentary that one is not to com-

pare a national and resident of State B with a State A national who is resident in State B but taxed in the same way as a resident in State A on the ground of nationality, unless he (or it) is a treaty resident of State B. If this is the correct approach, there is little scope for the operation of the provision. As might be expected, there seems to be little evidence of discrimination in practice, except in Canada in relation to companies, which, in spite of its reservation against the whole of the non-discrimination article, normally includes a nationality non-discrimination provision in its treaties,¹⁹⁷ and a few examples in other countries. Finally, for the reasons stated above, we recommend that the Commentary should not define *in the same circum-*

187. Resolution of 28 March 1990, No. DB89/6890, BNB 1990/188, revised on 28 December 1990 and relaxed by a Communication of the State Secretary of Finance on 8 March 1991, No. DB90/7030, *Infobulletin* 91/213, which permits a Dutch national to claim the flat 35 percent deduction if he or she has been living and working in a foreign country for an interrupted period of over 15 years.

188. Circular of 8 August 1983, Ci RH.624/325.294, *Bulletin des Contributions* [hereinafter "B.C."] (1983), No. 620 at 1974 *et seq.*; and Com.I.R. 139/6 to 139/9.8 and 142/2 to 142/5.11.

189. I.T.A.A., Sec. 23AA.

190. Income Tax Law Enforcement Order, Art. 16, item 1.

191. T.A. 1988, Sec. 334. In practice, the only purpose of the section is to make it more difficult for an ordinarily resident Commonwealth citizen (and, as mentioned above, *supra* note 104, all U.K. nationals within the modern treaty definition will qualify as Commonwealth citizens) to establish non-residence. The section is a substantive charging provision: *Reed v Clark*, S.T.C. 323 Ch.D (1985). Another U.K. example is that a consular officer or employee who is not a British citizen is exempt on foreign income and certain gains and treated as non-resident for certain purposes: T.A. 1988, Sec. 322, C.G.T.A. 1979, Sec. 149B(1)(f).

192. See also, *e.g.*, in Germany, BFH decision of 18 April 1975, *BStBl* 1975 II, at 595 (tax-exempt foreign company still taxable on German-source income); BFH decision of 30 April 1975, *BStBl* 1975 II, at 706, discussed in 16 *European Taxation* (1976), at 164 (U.K. and Swiss residents in a German limited partnership taxed on hidden reserves on transfer to a company, when a German resident would not have been taxed; held not discriminatory as they were taxable only on German-source income); and BFH decisions of 8 January 1969, *BStBl* 1969 II, at 466, and 13 January 1970, *BStBl* 1970 II, at 790. The Swiss Federal Tribunal has decided that taxing non-residents at a progressive rate determined by their worldwide income is not prevented by the United States - Switzerland treaty (1951) (17 February 1956, *Archives* 25, at 142) and the tax administration has decided that not refunding the 35 percent withholding tax to non-residents was not discriminatory as it was based on residence (Locher, *Doppelbesteuerung Schweiz - Deutschland*, B §3, IV, No. 4).

193. In the Netherlands, Art. 38(2) of the General Act on Taxation deems foreign tax to have been paid if an employee works abroad for three months for a Dutch-resident employer, with the result that the employment income is exempt in the Netherlands. Whether this might breach a nationality provision is discussed in "Netherlands: 'Cyprus Construction' Terminated," 26 *European Taxation* (April 1986), at 127. It seems that the discrimination has nothing to do with nationality, and working for an employer of a different residence is not a case of the same circumstances.

194. See, in Germany, BFH decision of 4 June 1975, *BStBl* 1975 II, at 709 that it is not discriminatory to disallow the deduction of an insurance premium paid by a Dutch citizen resident in Germany to a Dutch insurance company, when German citizens were allowed to deduct premiums paid to German companies. See, in Belgium, Court of Appeal Brussels, decision of 15 November 1988, A.F.T. (1989), at 123, which reached the same conclusion in a similar case (premiums paid by a German citizen resident in Belgium to a German insurance company). The Court answered as if the argument of the nationality non-discrimination provision had been put forward, while the taxpayer limited his arguments to Art. 31.1 of EC Council Regulation 1612/68 of 15 October 1968 (*Cf* L. De Broe discussing this decision in *Fiscologue International* No. 62 (22 February 1989), at 1 - 6). The taxpayer submitted the case to the Supreme Court where it is pending.

195. No. 8139044.

196. The discrimination might, however, be justified on defence grounds, see Para. 30 of the Commentary on Art. 24.

197. Only five Canadian treaties do not contain a non-discrimination article.

stances to mean in similar circumstances, at least so far as facts are concerned.

The English version of the definition of nationality of a company is ambiguous and it would be better if, like the French text, it referred to the state of incorporation of a company, so that it would be clear that "the alternative interpretation" does not apply.

III. THE PERMANENT ESTABLISHMENT NON-DISCRIMINATION PROVISION

The first sentence of Article 24(4) of the OECD Model, to which we shall refer as the permanent establishment non-discrimination provision, is the first of the provisions preventing certain types of discrimination against residents, as opposed to nationals, of the treaty partner state:

4. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.

A. Meaning of "enterprise"

The permanent establishment non-discrimination provision and the next two paragraphs, which will be considered below, all use the expression *enterprise*. This is used in the legal,¹⁹⁸ and consequently the tax, systems of all the civil law countries represented by the authors, being a term derived from economics. Although the expression was formerly explained to a limited extent in the League of Nations 1933 Draft Convention,¹⁹⁹ even that limited explanation was not adopted in the OEEC draft of 1958. It remains undefined in the OECD Model, where the definition of *enterprise of a Contracting State* is given in terms of an enterprise carried on by a resident of that state, without expanding on the meaning of enterprise.²⁰⁰ The Commentary explains that whether an activity is performed within the framework of an enterprise, or is deemed to constitute in itself an enterprise, is to be interpreted under domestic law.²⁰¹ This statement overlooks the fact that the term *enterprise* is not universally used in domestic law; none of the common law countries represented by the authors uses it, and its meaning is unclear in those countries.²⁰²

The Commentary's reference to the framework of an enterprise is useful in indicating, for example, that when considering a sole trader one is looking at the business activities of the person, rather than the person himself. "A business carried on by a person"²⁰³ therefore seems to convey the same sense in English, and the use of that phrase in place of *enterprise* might have prevented the obscure English version of the OECD Model. The French version of the definition of permanent establishment in Article 5: "...une installation fixe d'affaires par l'intermédiaire de laquelle une entreprise exerce tout ou partie de son activité" (meaning, a fixed place of business through which the enterprise carries on all or part of its activities), is much clearer than the English version: "...a fixed place of business through which the business of an enterprise is wholly or partly carried on." As it is unlikely to be referring to the business of a business, one looks for another meaning,

which could be that the enterprise in this sense means exclusively the person carrying on the business.²⁰⁴ It is clear, however, from the definition of *enterprise of a Contracting State* of an enterprise carried on by a resident of a Contracting State²⁰⁵ – that this is not the case, but it is much more apparent from the French text, which refers to the enterprise's *activities*, that this meaning is not intended. A better English version would refer to a fixed place of business through which the activities of the business are carried on. Article 7, the business profits article, read with the definition of "enterprise of a Contracting State," is also

198. In Italy there is a definition of entrepreneur (*imprenditore*) in Art. 2082 of the Civil Code: an entrepreneur is a person conducting professionally an organised economic activity for the purpose of production or exchange of goods or services. According to the literature, an enterprise is the economic activity carried on by the entrepreneur (P.G. Jaeger, "La nozione d'impresa dal codice allo statuto," , at 35). In Germany, *enterprise* (*Unternehmen*) is used internally in VAT law. In Switzerland it is used to determine whether an activity needs to be registered in the Commercial Register. In the Belgian official commentaries to their tax treaties at Para. 7/105, it is defined as an economic unit or organisation capable of producing operating profits in the sense of an internal law provision. It is not otherwise defined in Belgian law. A Belgian author, Himpler, in "Imposition des 'bénéfices des entreprises' dans le cadre des conventions fiscales conclues par la Belgique avec les Etats de la CEE, les Etats-Unis d'Amérique, le Japon et la Suisse," *Journal de Droit Fiscal* (1982), at 193, cites another author (van Rijn, Vol. I (1976 ed.), at 63 No. 39) who quotes from a European Court judgment: "An undertaking [*entreprise* in French] is constituted by a single organization of personal, tangible and intangible elements, attached to an autonomous legal entity and pursuing a given long term economic aim," (*Klöckner-Werke AG and Hoesch AG v. European Coal and Steel Community*, Cases 17 and 20/61 [1962] ECR 325, 341). In the Netherlands, *enterprise* (*onderneming*) has been defined judicially as "a permanent organisation of capital and labour with a view to making profits by participating in market activities." There is no definition in France, but the following features are considered necessary: the activity must be exercised in an independent manner, it must consist of a repetition of well-defined actions, and it must have an economic character.

199. "The term 'enterprise' includes every form of undertaking, whether carried on by an individual, partnership, corporation or any other entity." (Protocol to draft convention, Fourth session of the Committee, 1933.) An even less helpful definition was used in the Mexico and London drafts: "The term 'enterprise' includes any kind of enterprise whether it belongs to an individual, a partnership, a company or any other legal entity or *de facto* body."

200. Art. 3(1)(c).

201. Para. 4 of the Commentary on Art. 3.

202. See *infra* note 209 for a few exceptional cases of the use of enterprise in common law countries. In Canada, the I.T.A. uses business in the English version and *entreprise ou affaire* in the French. The 1963 OECD Commentary (Para. 17 on Art. 24) records that using *entrepreneur* instead of enterprise was considered, so as to cover the case of the individual, rather than the enterprise, being taxed, but for unstated reasons *enterprise* was chosen. As van Raad, *supra* note 22, footnote 26 at 137, points out, this alternative would conflict with the definition of *enterprise of a Contracting State* which, by incorporating the definitions, means an enterprise carried on by an individual, company or body of persons resident in a Contracting State. The OEEC Commentary continued by stating that the choice between the two might depend on the terminology used in the treaty (Para. 17), but this was dropped in the 1963 OECD Model, presumably because *enterprise* was used throughout.

203. One cannot restrict this to business alone because several of the references to enterprise, such as its exercising its activities or being taxed, must include the person carrying on the enterprise. See also Art. 7 of the Commentary quoted *infra* note 204.

204. See also Para. 1 of the Commentary on Art. 5 and Para. 1 of the Commentary on Art. 7 of the OECD Model: "...the first question is whether the enterprise has a permanent establishment..." This suggests, even more clearly, that it is referring to the person carrying on the business. But as was correctly stated in the New Zealand case previously referred to, *United Dominions Trust* (*supra* note 12), at 61,036, *per* McCarthy P.: "These terms [U.K. or N.Z. enterprise, defined as an industrial or commercial enterprise or undertaking carried on by a resident of the U.K. or N.Z.] do not mean the U.K. or N.Z. organisation carrying on the activity but, as I have already pointed out, the actual industrial or commercial enterprise or undertaking itself." See also *Id.*, at 61,046, *per* Richmond J.

205. OECD Model, Art. 3(1)(c).

clearer in French: "*Les bénéfices [d'une entreprise exploitée par un résident d'un État contractant] ne sont imposables que dans cet État, à moins que l'entreprise n'exerce son activité dans l'autre État contractant par l'intermédiaire d'un établissement stable qui y est situé*" (meaning, the profits of an enterprise carried on by a resident of a Contracting State shall be taxable only in that State unless the enterprise carries on its activities in the other state through a permanent establishment), compared to the English "...unless the enterprise carries on business in the other State...." It is suggested that the English version of these articles should be improved.

In the OECD Model, and under the internal law of many states, a person can carry on more than one enterprise.²⁰⁶ In Belgium, France, Germany, Italy and Japan, a company is always treated as carrying on an enterprise,²⁰⁷ even though its activities consist of passive investment. Because of this, the scope of the income covered by the business profits article, and consequently the permanent establishment non-discrimination provision, may be narrower in common law countries. This is so because a company may or may not be carrying on a business, depending on its activities, and consequently may or may not be carrying on an enterprise, if enterprise has the same meaning as business. For example, an investment company may not always be regarded as carrying on a business, and hence would not be regarded as carrying on an enterprise, in a common law country.²⁰⁸ Consequently, it could not have a permanent establishment which would be taxable, or protected from discrimination.

The interpretation of the expression *enterprise* has, not surprisingly, caused difficulty in common law countries as they do not use the expression internally.²⁰⁹ In Australia, the issue whether there was an enterprise arose in a case where two purchases of units in a unit trust were made by a Swiss resident using borrowed funds, for the purpose of making a profit. This was followed by the exchange of the units for shares in a listed company about six months later and the sale of the shares on the stock exchange two months later in a number of sales over a period of one month. The High Court (the final court of appeal) accepted that this constituted an enterprise as it was a transaction entered into for business or commercial purposes.²¹⁰ The Canadian Supreme Court has come to a similar decision in relation to an isolated "adventure in the nature of trade"²¹¹ carried on in Canada by an Irish resident, in applying the Canada-Ireland treaty (1955), in which *Irish enterprise* was defined as "an industrial or commercial enterprise or undertaking carried on by a resident of Ireland."²¹²

In the United Kingdom, there has been little consideration of the meaning of *enterprise*: as was said by an English judge, "enterprise...[has] no exact counterpart in the taxing code of the United Kingdom."²¹³ In Canada, the French version of the Income Tax Act uses *entreprise* where the English version uses business. The French version of a Canadian treaty can be interpreted under Article 3(2) of the OECD Model by reference to internal law in accordance with the French version of the Income Tax Act. This permits the English version of the treaty, using enterprise, to be interpreted on the basis that enterprise and business have identical meanings.²¹⁴ A number of U.S. treaties

206. Compare Art. 4(3) of the OECD Model, referring to the place of effective management of a person other than an individual, and Art. 8 of the OECD Model, referring to the place of effective management of a shipping enterprise. Canada uses the expression "business in internal law," and it is clear that a person can carry on more than one business: see the references to principal business in I.T.A., Secs. 39(5)(f), 66(15)(h) and 133(8)(d)(iv). A person can carry on more than one enterprise in the Netherlands. In the United Kingdom a person can carry on more than one trade.

207. In Germany, see Corporation Income Tax Law (Körperschaftsteuergesetz) [hereinafter "KStG"], Sec. 8(2); in Italy, see Consolidated Tax Act, Art. 89; in Japan, see Commercial Code, Art. 52; in Belgium, see Art. 33 of the Belgium Income Tax Code [hereinafter "B.I.T.C."] and Supreme Court decisions of 18 January 1963, *Pasicrisie* I, at 489, and 13 April 1978, *Pasicrisie* I, at 899. In Switzerland, the point is irrelevant for companies under internal law.

208. This may not be the case in Australia, see the *Thiel* case (*infra* note 210) discussed in the next paragraph. If, as that case decided, a transaction entered into for business or commercial purposes is an enterprise, the activities of a passive investment company would be included as an enterprise. In Canada, a company *prima facie* carries on a business, see I.T.A., Sec. 125(7)(e), which uses the expression "the business... the principal purpose of which is to derive income from property." In the United Kingdom, T.A. 1988, Sec. 130, defines an investment company as "any company whose business consists wholly or mainly in the making of investments..." but it is possible for an investment company not to qualify.

209. Apart from, in the United States, a now-repealed reference in connection with estate freezes which defined it as a business or other property which may produce income or gain (I.R.C. §2036(c)). The legislative history stated that it included not only an active trade or business but also an undertaking with respect to passive investment property, including a trust, but not an estate. This is clearly irrelevant to the treaty issue under discussion. It is also used in Australia, in connection with dividends and interest paid to non-residents, where it is defined in I.T.A., Sec. 128A, as "a business or other industrial or commercial undertaking." 210. *Thiel v. Comr. of Taxation*, [1990] 90 A.T.C. 4717 [hereinafter "*Thiel* case"]. The treaty was not in OECD Model form in that there was no "other income" article and no article dealing with capital gains not forming part of the capital assets of an enterprise. Therefore, the result of this single transaction not constituting an enterprise would have been that it was taxable in Australia under internal law, whereas if there had been repeated activity constituting an enterprise without its being carried on through a permanent establishment, it would not have been taxable. The court may therefore have been more inclined to find that there was an enterprise. It was said that it would be surprising if the profits were not exempt, *Id.*, at 4729.

211. This expression is used in the United Kingdom (T.A. 1988, Sec. 832) in the definition of trade, and in Canada (I.T.A., Sec. 248(1)) in the definition of business to denote isolated transactions which are taxed in the same way as trading transactions. It is used in case law in Australia.

212. *Tara Exploration and Development Co. v. MNR*, [1972] 72 Dominion Tax Cases [hereinafter "D.T.C."] 6288. In the Exchequer Court, Jackett P. held, with great doubt about the correctness of his conclusion, that, although business was defined to include an adventure in the nature of trade, such a business was not carried on, as required in I.T.A., Sec. 2(2), which implied repetition. However, even if this were wrong, he held that the treaty exempted the transaction, in spite of the treaty requiring that there was an industrial or commercial enterprise carried on by a resident of Ireland, 70 D.T.C. 6370. The Supreme Court decided the case on the basis of the treaty, which implies that they thought that the transaction was taxable under internal law, and the taxpayer had therefore carried on an adventure in the nature of trade. In spite of this, Interpretation Bulletin IT-459 considers that a taxpayer could engage in an adventure in the nature of trade without carrying it on. There are a number of English cases where a partnership (the definition of which requires carrying on a business) has been held to exist for an isolated transaction.

213. *Ostime v. Australian Mutual Provident Society*, [1959] 38 T.C. 492, 517 H.L. per Lord Radcliffe. The same point was made in Australia in the *Thiel* case, *supra* note 210, at 4719, 4721, 4726 and 4728. In another U.K. case, a Jersey partnership has been held to carry on a single enterprise for the purpose of a tax treaty, but the meaning of *enterprise* was not otherwise considered: *Padmore v. I.R.C.*, [1987] S.T.C. 36, 50b C.A. Business is occasionally used in tax legislation, e.g. T.A. 1970, Sec. 267 (scheme of reconstruction or amalgamation involving the transfer of a company's business to another company), and it is the main expression used in VAT. See also the subheading *The application of the ownership non-discrimination provision to partnerships* under the heading *The Deduction and Ownership Non-discrimination Provisions*, *infra*, for a discussion of the treatment of partnerships as an enterprise.

214. See also *Masri v. MNR*, [1973] 73 D.T.C. 5367 and *Abed v. The Queen*, [1982] 82 D.T.C. 6099 on the former (1942) United States - Canada treaty which defined enterprise as in the League of Nations draft, *supra* note 199.

avoid this difficulty of interpretation by not using *enterprise*, but referring instead to a permanent establishment of a *resident*.²¹⁵ Other U.S. treaties add a qualification to *enterprise*, by referring, for example, to an *industrial or commercial enterprise*.²¹⁶ This is sensible when *enterprise* is not used in internal law.

It is clear that, in the OECD Model, the scope of an enterprise, and therefore that of a permanent establishment, which implies the existence of an enterprise, does not include independent personal services, as there is a separate article dealing with such services when they are carried on through a fixed base in the other state.²¹⁷ That article makes no reference to an enterprise. In Belgium,²¹⁸ Germany, Italy and Switzerland, internal law excludes independent personal services from the scope of enterprise; whereas in France and the Netherlands, they are included. This raises the question whether the internal law definition of *enterprise* should be used in the latter countries, in accordance with the reference to internal law in Article 3(2) of the OECD Model, to interpret treaties in the form of the OECD Model in order to apply the permanent establishment non-discrimination provision to independent personal services, or whether this is a case where the context "otherwise requires." It is suggested that there is a strong reason in the context of the OECD Model for not following internal law in the latter countries because, otherwise, the separate treatment of professional services in Article 14 would be redundant, or *enterprise* would have a different meaning in Article 7 from the non-discrimination article.²¹⁹ The question is more difficult in the common law countries represented by the authors,²²⁰ where *enterprise* is not used in internal law, but the context of the OECD Model leads to the same result. This conclusion gives the odd result that discrimination is permitted in taxing independent personal services carried on through a fixed base, except on the basis of nationality.²²¹ It is not clear why this should be so, but it may arise from a failure to make consequential amendments to the OECD Model when references to a fixed base were generally added to references to a permanent establishment.²²² There are a few treaties which do specifically include a fixed base in this provision.²²³ There can be similar differences in interpretation of this non-discrimination provision if activities within the treaty definition of income from immovable property are included in the expression "enterprise" under internal law.

Although these activities will be dealt with under Article 6, they can, if they fall within the definition of permanent establishment, still qualify under the permanent establishment non-discrimination provision, as there is no requirement that they should be taxed under the permanent establishment article.²²⁴

The same point arises in Australia where internal law has a wide definition of royalty, which it adopts in its treaties. This restricts the profits which qualify under the business profits article, since the royalties article takes priority over the business profits article, but if the activities fall within the definition of permanent establishment, the permanent establishment non-discrimination provision will still apply.

B. "Not less favourably"

In contrast to the nationality non-discrimination provision, which prevents taxation which is *other or more burdensome* than the taxation and connected requirements to

Canada regards management fees as profits of an enterprise and therefore exempts them from the 25 percent withholding tax payable under internal law in the absence of a permanent establishment: Information Circular 76-12R4.

215. E.g. U.S. treaties with: Australia (1982), Belgium (1970), Canada (1980), Cyprus (1980), Egypt (1980), Finland (1970), France (1967), Iceland (1975), Israel (1975), Japan (1971), Korea (1976), Morocco (1977), the Netherlands (1948) referring to a citizen or corporation, Norway (1949), Philippines (1976), Romania (1973), Thailand (1965, never in force) referring to national or corporation, and Trinidad and Tobago (1970) referring to national or corporation.

216. E.g. an industrial or commercial enterprise or undertaking: U.S. treaties with: Austria (1956), former Australia (1953), Greece (1950), Luxembourg (1962), the Netherlands (1948), Pakistan (1957) and Switzerland (1951); a commercial or industrial undertaking: Germany (death duties) (1980) and the United Kingdom (1975, and death duties 1978); a commercial or industrial enterprise: France (death duties) (1978); an enterprise or undertaking: Jamaica (1980); every form of undertaking: former Denmark (1948) and former Italy (1955). U.S. Technical Explanations sometimes expand the meaning: Spain (1990) points out that individuals will normally be covered by the dependent or independent services articles, although a sole proprietor of a business would be included in *enterprise*; China (1984) states that it has the same meaning as in other U.S. treaties - the trade or business activities undertaken by an individual, company, partnership or other entity. Occasionally other states include definitions: Australia - Singapore (1969) defines *enterprise* to include undertaking; see also the definition in Finland - Yugoslavia (1986), for the latter only, no doubt due to Yugoslavia's different commercial system.

217. Arts. 14 and 7(7) of the OECD Model, and Para. 4 of the Commentary on Art. 14, which makes the point that the concept of permanent establishment should be reserved for commercial and industrial activities. This point is made in the U.S. Technical Explanation of the treaty with Spain (1990): "...it is understood that most activities carried on by natural persons (individuals) will be covered by Articles 15 (independent personal services) and 16 (dependent personal services) and will not be considered enterprises."

218. Unless they are carried on by a company, in which case they are taxed as profits of a business.

219. Vogel, *supra* note 154, marginal note 25 to Art. 7, also argues for a universal meaning of *enterprise*.

220. The problem is less important in Canada, since *entreprise* is used in the French language version of its legislation.

221. The point may be made that there is nothing to prevent other forms of discrimination against non-residents, but because of the similarity of the concepts of permanent establishment and fixed base, it is strange that the latter is not specifically covered. The A.L.I. Tax Project, *supra* note 181, at Part IV IV, argues that the permanent establishment provision should apply to all types of income which are taxed on net basis.

222. In the 1963 version of the OECD Model, the reduced withholding tax on dividends, interest and royalties did not apply if the holding was effectively connected with a permanent establishment (but not a fixed base) in the paying state, while a fixed base was included in the gains, dependent services and capital articles. In the 1977 OECD Model, this exception was extended to holdings effectively connected with a fixed base: see Arts. 10(4), 11(4) and 12(3). Perhaps a similar extension should have been made in the non-discrimination provision. A possible, but not very convincing, way of covering a fixed base is to regard the Commentary relating to the permanent establishment provision, Paras. 21 to 25 of the Commentary on Art. 24, as being part of the Commentary on Art. 7, which is incorporated into fixed base by Para. 3 of the Commentary on Art. 14. It is interesting that a Belgian case relating to discrimination under former law against a fixed base of a Dutch partnership was argued on the basis of the Treaty of Rome and not the tax treaty: Court of Appeal of Brussels, 3 November 1987, *R.G.F.* 6-7, (June 1988), at 185.

223. E.g. Norway treaties with: the Ivory Coast (1978), Luxembourg (1983), Morocco (1972), Poland (1977), Portugal (1970) and Tanzania (1976); and the Nordic Convention (1989). In Germany - Ivory Coast (1979), the provision is applied to a fixed base, but only for the taxation of immovable property. The Technical Explanation (29 September 1981) to the United States - Canada treaty (1980) states that a fixed base is covered by the permanent establishment non-discrimination provision, but this treaty uses *resident* instead of *enterprise* in this connection.

224. This is implied by Art. 7(7). See Vogel, *supra* note 154, marginal note 25 to Art. 7, for a discussion of this point in relation to German law. The Belgian

which nationals are subject, this provision merely requires that taxation should not be *less favourably* levied on a permanent establishment than on a resident. Connected requirements are not mentioned in this provision, no doubt because a permanent establishment may well need to be taxed in a different way from a resident, although references to connected requirements are occasionally included in treaties.²²⁵ It is suggested that *less favourably* means the same as the nationality provision's *more burdensome*, in the sense of the quantum of the tax. If this interpretation is correct, it would have been preferable for the drafting to have been consistent in the two provisions.²²⁶ The wording is also too narrow to prevent discrimination in relation to such matters as information requirements, limitation periods, interest and penalties.²²⁷ As was said in an English case: "repayment supplement [interest on a tax repayment], although connected with the levy of taxation, does not affect the *amount* of that levy."²²⁸ In determining whether there is less favourable taxation, it has been stated in another English case²²⁹ that the provision is not necessarily offended by a higher tax burden on a permanent establishment in a single year. This arises particularly since Article 7(6) of the OECD Model requires the use of the same method year by year to determine the profits of a permanent establishment. The use of the same method, if different from the method of taxing a resident, but producing no greater tax will almost inevitably produce different results which in some years may be more, and in others less, favourable than those of a resident.

Contrary to the position under the nationality non-discrimination provision, which also prevents "other" taxation, the charging of a different tax on a permanent establishment is permitted by this provision, so long as the quantum of tax is not greater than that payable by a resident.²³⁰ An example of a different tax being charged on a permanent establishment can be found in Belgium where the non-residents tax, which the permanent establishment of a non-resident company pays, is charged at a higher rate than the normal corporation tax paid by resident companies; only the fact of the higher rate, and not the charging of a different tax, is discriminatory. This is discussed under the heading Rate of tax below.

Unlike the requirement that the object of comparison should be in the *same circumstances* in the nationality non-discrimination provision, here the comparison is with an enterprise carrying on the *same activities*,²³¹ which means the same type of business. Presumably the circumstances of a permanent establishment are assumed to be sufficiently different from those of a resident company so that there would be no point in trying to apply a same circumstances test. However, some treaties in this respect do refer to the same circumstances as well.²³²

C. Assessment of tax

The same deductions, depreciation allowances, treatment of losses and capital gains, and tax incentives²³³ as are given to resident taxpayers should obviously be allowed in taxing a permanent establishment by virtue of this provision.²³⁴ Discrimination is clearly prevented by this provision in cases when only residents can claim a relief. A number of examples can be given, such as the U.K. provi-

sion permitting the deduction of charges on income (such as interest) paid by a resident to a non-resident,²³⁵ and the similar Dutch provision in connection with charitable deductions.²³⁶ In the Netherlands, the tax exemption for an investment institution applies to a company incorporated and managed in the Netherlands. It is not therefore available to a company incorporated in the Netherlands with its place of effective management, and therefore its treaty residence, in a treaty partner state; the company is, under the treaty, taxable in the Netherlands only if it has a permanent establishment there. As this is a permanent establishment of a treaty partner resident, it must, under this provision, be given the same tax benefit as a company incorporated and managed in the Netherlands.²³⁷ The Netherlands has

official commentaries on their tax treaties at Para. 7/105 exclude agriculture and forestry, and four other types of profits from the scope of *enterprise* for this reason. 225. Germany - Netherlands (1959) and Italy - Brazil (1978) contain a connected requirements provision here. Germany - Netherlands (1959), Germany - Sri Lanka (1979), Germany - Egypt (1959) and Belgium - U.S.S.R. (1987), also prevent "other" taxation. See also the former United Kingdom - Ceylon treaty (1950) which prevented "other, higher or more burdensome" taxation in the permanent establishment non-discrimination provision; this wording was often used in older treaties. The Commentary (Para. 9 on Art. 24), in a passage which is new to the 1977 OECD Model version, mentions, as an example of permitted positive discrimination, that a permanent establishment can be taxed on the basis of separate accounts.

226. The Commentary in fact uses "more burdensome" in connection with the permanent establishment provision: Para. 22 on Art. 24. See text at notes 176 and 177 for the nationality provision. See also *supra* note 175 for U.S. treaties using the same expression in both provisions.

227. See the Commentary's explanation of connected requirements for the nationality non-discrimination provision in Para. 10 on Art. 24.

228. See *R. v. I.R.C. ex p. Commerzbank*, *supra* note 181.

229. *Sun Life Assurance of Canada v. Pearson*, S.T.C. 461, 515a Ch.D (1984). This point is not dealt with in the Court of Appeal.

230. This is made clear in Para. 22 of the Commentary on Art. 24.

231. Cf. OECD Art. 7(2), attributing to the permanent establishment the profits which a separate enterprise carrying on the same or similar activities might be expected to make.

232. E.g. United States - Australia (1982), the only Australian treaty to contain a non-discrimination article; treaties between France and: Ireland (1968), Israel (1963), Spain (1973) and Yugoslavia (1974); six Indian treaties; and the "treaty" between the Netherlands and the Netherlands Antilles and Aruba (1964). Japan - Kenya (1970) refers only to *the same circumstances*. France - Lebanon (1962) and Italy - Israel (1968) add *under the same conditions*, and 16 Indian treaties and France - Malaysia (1975) refer to *the same circumstances and the same conditions*. Germany - Argentina (1975) refers to *other similar enterprises*, as in the ownership provision.

233. Japan has made a reservation against extending to permanent establishments the benefit of tax incentive measures introduced for national policy objectives: Para. 65 of the Commentary on Art. 24. Japanese treaties with Indonesia (1982) and the Philippines (1980) allow the restriction of incentives to nationals.

234. Paras. 26 to 29 of the Commentary on Art. 24. Para. 17 of the Commentary on Art. 7 makes it clear that one cannot deduct interest or royalties paid to the head office in computing the profits of the permanent establishment, and so this cannot be done on the grounds of discrimination. Former Belgium - Norway (1967, this is not included in 1988) and Netherlands - Norway (1990) contain a specific provision requiring the deduction of interest and royalties paid to third parties. Belgium - Netherlands (1970) and Belgium - Luxembourg (1970) expressly provide in a protocol for the same carry-forward of losses of the permanent establishment as for resident companies, which is in fact granted by Belgian internal law.

235. T.A. 1988, Sec. 338(4). Another example is the setting of surplus franked investment income, i.e. dividends from U.K. resident companies (the definition of franked investment income in T.A. 1988, Sec. 238 being restricted to such income of a U.K. resident company) against losses under T.A. 1988, Sec. 242 so that the tax credit on the dividends can be reclaimed.

236. Corporate Income Tax Act, Art. 16.

237. Corporate Income Tax Act, Art. 28. This is the reverse of the case dealt with at the text to note 112, where discrimination on the grounds of incorporation in the treaty state with management in the Netherlands was prevented by the nationality provision.

recently accepted that the "business allowance," which was available only to resident individuals, can be claimed by non-residents with a permanent establishment there.²³⁸ In France, internal law permits the payment of interest on loans contracted abroad by French legal entities without withholding tax, but the tax administration gives the same exemption from withholding tax to interest paid by permanent establishments where there is a treaty with a non-discrimination article.²³⁹ In Belgium, the non-resident tax²⁴⁰ limits the deductions available to Belgian establishments to those affecting Belgian taxable profit.²⁴¹ This limitation does not apply to resident companies. As a result, the tax administration²⁴² rejects the deduction of head office expenses under internal law but accepts them under a treaty.²⁴³ In the United States, no capital gain is recognised when a U.S. parent liquidates an 80 percent subsidiary, but this does not apply where a permanent establishment holds this percentage. There is a similar rule in Canada with a 90 percent requirement.²⁴⁴ When the United States Technical and Miscellaneous Revenue Act 1988 changed the source rules for sales of inventory, the change did not override treaties, so discrimination is still prevented by its treaties. A final example used to be the absence of the possibility in Germany of consolidating the profits and losses of a permanent establishment in Germany with those of a German corporation whose shares were attributable to the permanent establishment, but this is now permitted.²⁴⁵ None of the other countries represented by the authors permits this, and therefore possible discrimination exists where the corporation has losses which would reduce the tax on the permanent establishment if it were a resident corporation.²⁴⁶

A branch profits tax which, when added to other taxes, is in excess of the tax payable by resident companies, which will invariably be the case, is clearly contrary to this provision, as the United States Treasury recognised in stating that the application of the recently introduced branch profits tax would be prevented by treaties.²⁴⁷ A number of treaties, including, for example, almost all²⁴⁸ Canadian treaties,²⁴⁹ make an exception to this provision to permit charging such a tax.²⁵⁰ The tax which contravened the residence (instead of a nationality) non-discrimination provision in the *Woodend Rubber* case²⁵¹ was an example of a branch profits tax measured by the amount of remittances abroad.²⁵²

In addition to the branch profits tax on earnings of a branch in the United States of a foreign taxpayer, the United States imposes a tax on the "excess interest" of a branch. This is an amount of interest which is allocated to, and deducted by, the U.S. branch in computing its earnings subject to the branch profits tax in the same manner as if the branch had paid it directly. Under the U.S. tax system applicable to a branch of a foreign corporation, the branch may deduct a portion of the interest paid by the foreign "parent" corporation. This portion is determined by a formula which allocates the entire interest paid by the corporation among all its branches and its head office according to the assets attributable to each. If the amount apportioned to the U.S. branch, and therefore deductible by it, exceeds the interest actually paid by the branch (the "excess interest"), this excess is treated as interest paid by

the U.S. branch to the head office, and is subject to a withholding tax on the amount of such excess interest at the rate applicable under the Internal Revenue Code or a treaty to interest paid by a U.S. corporation to the foreign corporation. As there is no similar withholding tax charged on U.S. corporations, this appears to be discriminatory, but the Internal Revenue Service argues that the result is similar to the taxation of a U.S. subsidiary which deducts the interest paid or accrued. It states that the excess interest is

238. Individual Income Tax Act, Sec. 44m, see ruling of 3 January 1990.

239. C.G.I., Art. 131, see D.A. van Waardenburg, "Interest on Loans Contracted Abroad," 29 *European Taxation* (September 1989), at 312, 315.

240. B.I.T.C., Art. 147 Sec. 2 and Art. 148 Sec. 1.

241. This discrimination is, however, confirmed in a treaty situation, see Art. 7(3) of the OECD Model: "there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment"

242. Com I.R. 144/3 and Court of Appeal decision of 12 March 1962, *S.A. de droit suisse L'Helvétia*.

243. Para. 7/331 of the Belgian commentaries, applying Art. 7(3) of the OECD Model: "including executive and general administrative expenses."

244. For other provisions in Canada, see *supra* note 109.

245. KStG, Sec. 18. See *infra* note 334 for a case where the discrimination point was not dealt with as the treaty was held not to be applicable. Such consolidation with a permanent establishment used to be allowed in the Netherlands.

246. This will apply only where such consolidation is permitted between resident companies.

247. General Explanation of the Tax Reform Act of 1986, published by the Joint Committee on Taxation, 4 May 1987, at 1043. It was stated that Congress believed that it was merely arguable that the tax was in breach of treaty non-discrimination provisions, *Id.*, at 1038. See also the OECD publication, *National Treatment for Foreign-controlled Enterprises*, at 40. Interestingly, Canada did not disclose its branch profits tax in this publication.

248. Except those with Denmark (1955), Finland (1959), Ireland (1966) and Norway (1966).

249. The standard method used by Canada is to include a provision allowing branch tax in the dividends article, particularly as some of the treaties do not contain a non-discrimination article. This is done in 37 Canadian treaties, some of which permit imposing tax on the earnings of a company attributable to the permanent establishment, and others provide that the permanent establishment "shall remain subject to the additional tax on companies other than Canadian corporations." In a few cases the provision is in the non-discrimination article. Normally the rate is limited to 15 percent or 10 percent in those treaties in which a lower withholding tax rate is allowed on dividends to affiliated or parent companies.

250. *E.g.* U.S. treaties with: Argentina (1981) limiting the tax to that of distributed profits of a resident company, Australia (1982) contained in the Technical Explanation only, Barbados (1984), Belgium (1970) for Belgian permanent establishment of U.S. taxpayer only, Bermuda (1986); Canada (1980) contained in the dividends article (see *supra* note 249), Egypt (1980) to the effect that it is not discriminatory for permanent establishment profits to be deemed to be distributed as dividends, France (1967) referring to comparable tax burden, Iceland (1975) for permanent establishment in Iceland, Netherlands Antilles (1986, never ratified), New Zealand (1982) limited to 5 percent, Norway (1971) for permanent establishment in Norway, Sri Lanka (1985) for permanent establishment in Sri Lanka limited to 15 percent of remittances, and Trinidad and Tobago (1970) for permanent establishment in the United States; U.K. treaties with: Belgium (1987), Canada (1978), France (1968), Fiji (1975), India (1981), Kenya (1973), Luxembourg (1983), New Zealand (1983), Norway (1985) for Norway only, Sri Lanka (1979) for Sri Lanka only, Zimbabwe (1982); Norway treaties with: Indonesia (1988), Kenya (1972), Korea (1982), Pakistan (1986), Poland (1977), Tanzania (1976) (all referring to the rate on retained profits), Zimbabwe (1989) (5 percent); France - Turkey (1987), Germany - Brazil (1975), - Kenya (1977), - Zimbabwe (1988); Netherlands - Zimbabwe (1989); Israel - South Africa (1978); Malta - Sweden (1975); see *supra* note 249 for Canadian treaties.

251. See *supra* note 176.

252. The treaty wording in the permanent establishment provision was "other, higher or more burdensome," rather than "less favourably levied," and the tax was held to be discriminatory as being "other." This would not have contravened the OECD Model provision, unless it was less favourable. Germany - Brazil (1975) permits a 15 percent withholding tax on distributions from a permanent establishment. A Protocol to the treaty excludes this tax from the permanent establishment non-discrimination provision.

"the functional equivalent of interest paid on parent debt funding with respect to a subsidiary."²⁵³ It is not clear why this argument is used here but not in relation to the branch profits tax itself.²⁵⁴

D. Rate of tax

Reference has been made above to the Belgian legislation charging the profits of a permanent establishment to the non-residents tax which is at a higher rate, 43 percent, than that charged on resident companies, currently 39 percent. The higher rate is clearly discriminatory, which is why Belgium has made a reservation against this provision in the OECD Model.²⁵⁵ Normally, however, in its treaties, Belgium gives up this reservation by providing in the treaty for a reduction in the rate of tax on the permanent establishment's profits to the maximum rate paid by resident companies.²⁵⁶

In the United Kingdom, the small companies rate of corporation tax is, by virtue of this provision, available to a permanent establishment of a resident of the treaty partner. This is in accordance with the Commentary.²⁵⁷ On the other hand, Canada has a lower rate of tax on the first C\$ 200,000 of profits of a Canadian-controlled private corporation, defined to include only corporations incorporated in Canada which are not controlled by non-residents or by Canadian public corporations. Not all Canadian-resident corporations carrying on the same activities will accordingly qualify for the reduction, since some of them will be foreign controlled, and some will be controlled by public corporations. Therefore, this lower rate is not available by virtue of this provision to permanent establishment profits of corporations resident in the treaty partner state.²⁵⁸ If there is a minimum rate of tax on the profits of permanent establishments, this is discriminatory only if it is higher than that payable by a resident. In determining this, the profits of the whole of the enterprise can be taken into account.²⁵⁹ In Belgium, the charging of tax on a minimum amount of profits of the permanent establishments of foreign companies which do not provide proper accounts may be discriminatory.²⁶⁰ This amount has recently been substantially increased, which will make the discrimination issue more important.²⁶¹ Germany has made an observation in the Commentary that it does not consider it discriminatory to charge a minimum rate of tax on the profits of a permanent establishment which is not much higher than the minimum rate applicable to the profits of resident enterprises.²⁶²

In relation to the split-rate system of company taxation used either now or formerly in France, Germany, Japan and the Netherlands (before 1940),²⁶³ the Commentary again records that there are two opposing views about whether this should be applicable to a permanent establishment, but does not attempt to adjudicate between them.²⁶⁴ There was authority in Germany that a 49 percent rate of tax on the permanent establishment of a French company, when resident companies were charged tax at 15 percent on distributed, and 51 percent on undistributed, profits, was not discriminatory on the ground that the permanent establishment non-discrimination provision in a

1959 treaty was primarily concerned with computation of income; when withholding taxes payable by a German

253. I.R.S. Notice 89-80, 1989-30 *Internal Revenue Bulletin* 10.

254. This point is made by the A.L.I. Tax Project, see *supra* note 181, at Part IV. IV.

255. Para. 64 of the Commentary on Art. 24. The reservation is stated to be applicable where this is warranted by the treatment given by the treaty partner state to the permanent establishments of Belgian companies.

256. In 26 Belgian treaties, the rate is limited to the resident companies rate. There is a lower rate band of tax applicable to resident companies which are not owned 50 percent or more by another company. This does not apply to a permanent establishment, as most treaties refer to the maximum rate of tax on resident companies. An exception is the treaty with Switzerland (1978). The higher non-resident tax rate is permitted in the treaties with Canada (1976), Poland (1976) and Sri Lanka (1983). In some other treaties there is a formula which may limit the rate, depending on the rate of tax on resident companies: France (1964), Luxembourg (1970), the Netherlands (1970) and Tunisia (1975). In Ireland (1970) and former United Kingdom (1967) the rate is limited to five percentage points above the resident tax. Belgium - Bulgaria (1988) and - U.S.S.R. (1987) compare the taxation of the permanent establishment of one of the states to that of a permanent establishment of a third treaty state, which is effectively a most-favoured-nation treatment. The non-discrimination provision in the former U.S. treaty (1948) had prevented the payment of higher taxes than those charged on residents and, by an exchange of notes (see Rev. Rul. 69-326, 1969-1 C.B. 365, and Dbr. 27 February 1969 No. CI.R.9 USA/243.553, *Bulletin der belastingen* [hereinafter "*B.B.*"], at 462, 436) it was agreed to apply the lower resident rate (30 percent) then in force to the proportion of distributed profits; this position, although expressly provided for in the 1970 treaty, became meaningless since an equal corporate rate was in the meantime provided for distributed and undistributed profits. The former Belgium - Luxembourg treaty (1921), preventing different or more burdensome taxes on citizens of the other state, was held by the Court of Appeals of Ghent (29 January 1963, published in *Revue Fiscale*, 1963, at 432) to prevent the higher rate of tax being charged on the profits of a permanent establishment of a Luxembourg company. India - Sweden (1988) permits a higher rate on permanent establishment profits. Italy - Sweden (1980) limits the rate to that on domestic undistributed profits.

257. Para. 39 of the Commentary to Art. 24 allows taking into account either the gross profits of the company in determining the rate of tax on the permanent establishment, which the United Kingdom does, or just the profits of the permanent establishment (Para. 41).

258. The nationality non-discrimination provision cannot be invoked because not all Canadian incorporated corporations are entitled to the relief, and the ownership non-discrimination provision is always changed in Canadian treaties to make the comparison with enterprises owned by third-state residents, see *infra* note 349, in which case there is no discrimination on that ground.

259. Para. 40 of the Commentary on Art. 24. Denmark - Netherlands (1957) specifically prevents Danish minimum rates applying to Dutch residents.

260. Art. 248 of the B.I.T.C. and Art. 146 of the Royal Decree implementing the B.I.T.C. For a discussion of this issue, see Vandeborgh and Dillen, "De belastbare forfaitaire minimum winsten voor buitenlandse ondernemingen: een discriminatoire bepaling in de Belgische fiscale wetgeving?" (The tax on deemed profits of foreign enterprises: a discriminatory provision in Belgian tax law?), *Rechtskundig Weekblad* (7 March 1981), Col. 1753. The authors of that article regard the law as discriminatory. The tax authority accepted that the provision was discriminatory before 1974 and then changed its mind without giving any reasons. The minimum tax is expressly provided for in the business profits article in 17 Belgian treaties, which must impliedly override the more general rule in the permanent establishment provision in the non-discrimination article.

261. Royal Decree of 12 February 1990, published in *Moniteur belge* (27 February 1990), at 3553. See also A. Huyghe, in *Fiscologue International* (12 March 1990), No. 75 at 1, who agrees with the authors of the article cited *supra* note 260, that this rule is discriminatory. However, A. Bax, "Het beginsel van de gelijke behandeling van Belgische vaste inrichtingen in het kader van de Belgische dubbelbelastingovereenkomsten," *A.F.T.* (June - July 1991), at 183 et seq. - on the basis of Para. 22 of the Commentary on Art. 24(4) ("it is the result alone which counts") - considers this rule not to be discriminatory, unless it is shown that the amount of profit would be lower if the method applicable to Belgian companies had been used.

262. Para. 59 of the Commentary on Art. 24.

263. Canada has a provision for refunding tax on dividends paid by certain private corporations which has a similar effect.

264. Paras. 42 and 43 of the Commentary on Art. 24. For provisions excluding the application of the split-rate system, see the Japanese treaties with: Egypt (1968), Fiji (1970), France (1964), Montserrat (1970), Romania (1970) and the British Virgin Islands (1970).

company were taken into account the rate was, the court said, not discriminatory.²⁶⁵

The imputation system raises similar questions in relation to dividends paid out of profits derived from a permanent establishment. Here the Commentary²⁶⁶ is against giving the tax credit in these circumstances on the literal wording of the OECD Model, a conclusion which is accepted by states adopting this system.²⁶⁷

E. Special treatment of dividends received by a permanent establishment

The Commentary states that there are two views on whether privileges for domestic-source dividends received from subsidiaries should be accorded to shareholdings attributable to a permanent establishment,²⁶⁸ and recommends that states should make their position clear in a protocol²⁶⁹ or any other document annexed to the treaty.²⁷⁰ The treatment of dividends from substantial holdings paid to a permanent establishment is most likely to arise for banks and insurance companies. The Commentary finally concludes in favour of applying the special privileges, subject to amending the treaty so that the reduced treaty rate of withholding tax applies to such dividends in the permanent establishment state.²⁷¹ Normally, the reduced withholding tax will not apply in these circumstances, subject to the exception discussed under the next heading, since the holding in respect of which the dividends are paid will be effectively connected with the permanent establishment.²⁷² If the inter-company dividends exemption did not apply, there would otherwise be full tax in the permanent establishment state, and so the company would suffer tax both at the level of the paying company and in the permanent establishment.²⁷³ The Commentary recommends that, if states cannot charge the reduced rate of withholding tax, the relief for intra-group dividends should be applied to qualifying dividends paid to a permanent establishment.²⁷⁴ As van Raad points out,²⁷⁵ the arguments against applying the special treatment are extremely weak. In France, the *Conseil d'Etat* has applied the permanent establishment non-discrimination provision to grant to the French permanent establishment of an Italian insurance company the exemption of 95 percent of the dividend from tax which is normally applicable to dividends from a ten percent holding in a French company.²⁷⁶ In the United States, it is understood that a claim for the 100 percent dividends-received deduction on dividends paid to a permanent establishment in the United States was settled in favour of the taxpayer.²⁷⁷ In the light of this, it is interesting that the Technical Explanation to the United States-Canada treaty (1980) not only excludes the relief,²⁷⁸ but states that this is merely clarifying in nature, since neither state would interpret the provision to provide for the granting of such reliefs. It might be asked why the United States excludes the relief in so many treaties if it is merely declaratory of existing law. In Belgium, although the exemption of 90 (or in some cases 85) percent of the amount of a dividend from tax, where the shares have been held for the whole year, applies equally to a resident company and a permanent establishment, the withholding tax (*précompte mobilier*) charged on a dividend is refunded to a resident company to the extent that it is not credited against the cor-

porate tax, whereas it is neither refundable nor creditable against the tax payable by a permanent establishment.²⁷⁹

265. See BFH decision of 13 January 1970, *BSI* 1970 II, at 790, 792; *DB*, 1970/960; and discussed in 10 *European Taxation* (June 1970), II/119. This argument will not be available after the abolition of withholding tax in the EC on dividends paid to a parent company.

266. Para. 44 of the Commentary on Art. 24.

267. The French case on granting the imputation credit to an Italian insurance company, *Re Tax Credits: EC Commission v France*, [1987] 1 C.M.L.R. 401, was decided according to the EEC Treaty and not the tax treaty.

268. Paras. 31-37 of the Commentary on Art. 24.

269. The relief is denied either in the treaty itself or in a protocol in the U.S. treaties with: Aruba (1986, never ratified), Canada (1980), Netherlands Antilles (1986, never ratified) and New Zealand (1982) (see *infra* note 270 for other cases); Canadian treaties with: Barbados (1980), Finland (1959), possibly, by virtue of the personal allowances sentence which omits reference to civil status, Trinidad and Tobago (1966), Germany (1981) (referring to personal allowances, reliefs and reductions for taxation purposes), and Singapore (1976). Germany - Belgium (1967) and Germany - Zambia (1973) contain such a provision but recent treaties do not, as this has not been necessary since 1977. Belgium - Luxembourg (1970) first sentence of Para. 8 of the Protocol and Belgium - Netherlands (1980) Protocol, XV(2), expressly provide equal treatment. Italy - Sweden (1980) provides that the special treatment of inter-company dividends is not available. Before 1973, in the United Kingdom dividends could be paid within a group without withholding tax and a number of treaties prevented this treatment from applying to dividends paid to a permanent establishment, e.g. United Kingdom - Austria (1969).

270. The United States, less satisfactorily because unilateral material is not an interpretative source recognised by Art. 31(2) of the Vienna Convention on the Law of Treaties, sometimes puts clarifying material in other documents which are presumably not annexed to the treaty, such as a technical explanation or a Senate Foreign Relations Committee report; this is done in relation to this point in the treaties with: Australia (1982), Bangladesh (1980), Jamaica (1980), Malta (1980) and Morocco (1977).

271. For example, nine U.K. treaties provide that the rate of withholding tax in the dividend article will apply, although under the imputation system there is no withholding tax on dividends: Botswana (1977), Finland (1969), France (1968), Ireland (1976), Israel (1962), Japan (1969), Luxembourg (1967), Swaziland (1968) and Zambia (1972). France - Italy (1989) provides in the non-discrimination article that the treaty rate of withholding tax applies to dividends, interest and royalties paid to a permanent establishment (this currently has no effect in relation to interest and royalties); Germany - Brazil (1975) provides in the dividend article for the treaty rate of withholding tax in these circumstances and a protocol saves this from the non-discrimination provision; and all Belgian treaties deny the reduced withholding tax, except Belgium - Luxembourg (1970) which provides in a protocol for the treaty rate of Luxembourg withholding tax on dividends paid by a Luxembourg company to the Luxembourg branch of a Belgian company holding 25 percent of the capital. The right to apply the full withholding tax (*précompte mobilier*), in spite of the permanent establishment non-discrimination provision, is often expressly preserved in Belgian treaties affecting Belgium only: Canada (1975), Czechoslovakia (1975), Finland (1976), Hungary (1982), Italy (1983), Ivory Coast (1977), Malta (1974), Pakistan (1980), Philippines (1976), Poland (1976), Romania (1976), Sri Lanka (1983), Thailand (1978) and the United Kingdom (1987).

272. See OECD Art. 10(4) and Belgian administration commentaries 10/401 to 10/404.

273. Para. 32 of the Commentary on Art. 24.

274. Para. 37 of the Commentary on Art. 24.

275. See *supra* note 22, at 147, 148.

276. Judgment No. 50,643 of 18 November 1985, reported in 38 *Droit Fiscal* (September 1986), No. 9 at 275 and discussed in "Foreign Parent Companies: Affiliation Privilege for Branch of Italian Company," 26 *European Taxation* (May 1986), at 157. This is accepted by the tax authority as being of general application where there is a non-discrimination article: Instruction of 31 July 1986, see D.A. van Waardenburg, "French Permanent Establishments of Foreign Corporations Receive Better Tax Treatment," 27 *European Taxation* (February 1987), at 43. Under the EEC Treaty, the European Court has also decided that the denial of the *avoir fiscal* to permanent establishments of EEC insurance companies is discriminatory (28 January 1986, Case 270/83, RIF No. 1020), and the tax authority has changed its practice.

277. *Schlumberger Ltd. v U.S.* 190-75, Court of Claims, 27 June 1975. The case is mentioned in O'Brien, *supra* note 11, at 570.

278. Art. XXV(6)(b), added by the 1983 protocol.

279. Where the shares are not held for the whole year, there is no difference in treatment between a resident company and a permanent establishment receiving

This discrimination is authorised in a few treaties²⁸⁰ and specifically prevented in a few others.²⁸¹ In Japan, while dividends paid to a permanent establishment enjoy the same exemption from tax as dividends paid to a resident company, the withholding tax on the dividend can be set against the corporation tax due from a resident company but not from a permanent establishment.²⁸² Exemption of such dividends is given by U.K., Swiss and Dutch internal law; therefore no question of discrimination arises.

The same issue can arise with foreign dividends.²⁸³ Under this provision, the same treatment should be accorded to foreign dividends in taxing the permanent establishment as is given to resident companies. This is generally the case, except in Australia, where certain foreign non-portfolio dividends are exempt when paid to an Australian company but taxable when paid to an Australian permanent establishment of a treaty partner resident,²⁸⁴ and there is no credit for foreign taxes paid on a portfolio dividend paid to a permanent establishment; and in Canada, where dividends paid out of exempt surplus are not exempt in the hands of a permanent establishment, as they are when paid to a resident company. Belgium discriminates against a permanent establishment receiving foreign dividends in subjecting them to a non-creditable non-refundable *pré-compte mobilier* as opposed to the exemption from *pré-compte mobilier* granted to resident companies.²⁸⁵ Reliefs for foreign tax are considered below.

F. Withholding tax

As has been pointed out in relation to dividends, the reduced rate of withholding tax is not applicable to dividends, interest and royalties paid by a company resident in one state to a permanent establishment in the same state belonging to a resident of the other state.²⁸⁶ The net profits of the permanent establishment, which will include such dividends, interest and royalties, will be taxed in the permanent establishment state at the rate applicable to business profits. There is nothing in the dividends, interest or royalties articles to prevent the full rate of withholding tax being charged at the time of payment.²⁸⁷ But if the withholding tax charged at the full internal rate is a separate tax, as opposed to a method of advance collection of the tax on business profits,²⁸⁸ this results in a prohibited discrimination, provided there is no such withholding tax on payments to residents.²⁸⁹ It is, however, permitted, if there is such a withholding tax on payments to both residents and non-residents, as is the case, for example, in the United Kingdom on annual interest and certain royalties. The Commentary suggests that this problem should be settled in negotiations.²⁹⁰ Under Swiss internal law, withholding tax is refunded in these circumstances, so that discrimination cannot arise.²⁹¹

G. Relief for foreign tax

The Commentary clearly states that a permanent establishment is entitled to credit for foreign tax in the same way as domestic enterprises are entitled to it under internal law.²⁹² It is a matter for concern that several states accept that this is the effect of the OECD Model, but decline to give credit on the ground that there is no procedure for doing so in internal law. In the United Kingdom, the permanent estab-

lishment of a Canadian insurance company has been refused credit under the permanent establishment non-discrimination provision in the treaty with Canada (1978), which follows the OECD Model.²⁹³ The statement in the Commentary about giving credit to a permanent establishment was accepted in principle as being the correct interpretation of the treaty.²⁹⁴ However, the court pointed out

a dividend: there is no exemption for 90 percent of the dividend, but the *pré-compte mobilier* is fully creditable and refundable in both cases. See Bax, *supra* note 261; J. Malherbe, "Le régime fiscal des dividendes et des distributions de liquidation d'origine étrangère reçus par des sociétés belges: droit interne, traités et projets de réforme," *J.D.F.* (July-August 1988), at 193; and P. Glineur, "Le régime des revenus définitivement taxés dans le chef des sociétés non-résidentes - Persistance de dispositions discriminatoires dans le cadre des conventions internationales préventives de la double imposition," *Revue générale de fiscalité (R.G.F.)* (May 1983), at 129 for a lengthy discussion of the inter-company dividend treatment and possible discrimination in Belgian domestic law.

280. Belgium - Germany (1967, protocol) and - United States (1987 protocol to 1970 treaty) confirmed by the Ratifying Act of 16 June 1989, see *Exposé des motifs*, Parliamentary documents, House of Representatives 88-89, No. 674/1.

281. Belgian treaties with: the Netherlands (1970) and Luxembourg (1970).

282. Corporation Tax Law, Arts. 142 (exemption) and 144 (credit for withholding tax).

283. The EC exemption from withholding tax of dividends from subsidiaries to their parents does not appear to give any benefit to permanent establishments in the EC of non-EC companies.

284. This result requires that the treaty provide, as it normally does, that income which is attributable to the permanent establishment is deemed to have a source in Australia, thus giving the dividends an Australian source. In the absence of a treaty, the foreign dividends attributed to an Australian permanent establishment are not taxable.

285. Taxing provision Arts. 164, al. 2, a, and 192, al. 3, B.I.T.C.; exemption, Art. 88 Sec. 1 of Royal Decree implementing B.I.T.C.

286. Arts. 10(4), 11(4) and 12(3) of the OECD Model, and see Belgian treaty commentaries 10/401 to 404, 11/401 to 404, and 12/401 to 404.

287. Para. 47 of the Commentary on Art. 24.

288. An example of the latter is the Australian provisions in Division 3B of Part IV concerning deductions from royalties paid to non-residents on account of the tax to be assessed on the recipient.

289. This arises in Australia, although it is not usually material as Australia has only one treaty containing a non-discrimination provision, where the withholding tax is a separate tax charged under Division 11A of Part III of I.T.A.A. Since 1 July 1987, following the repeal of the exception in Sec. 128B(1), the withholding tax, which applies only to unfranked dividends, is the only tax charged on dividends paid to the Australian permanent establishment of a non-resident company, and direct assessment of the dividend is not permitted. This could contravene the non-discrimination article in the U.S. treaty as it is a provision introduced after the date of the treaty, and only discriminations existing at the time of the treaty are excluded. In Japan, there is a procedure for a permanent establishment of a non-resident company to apply for an exemption from withholding tax (Income Tax Law, Art. 180). There is no equivalent exemption in Japan for the permanent establishment of an individual. No exemption is granted in Japan on withholding tax on income from the transfer of land, interest on bonds and deposits, dividends and distributions from anonymous partnerships. In the case of interest and royalties, discrimination does not arise in many states as there is no withholding tax in these circumstances and the tax is assessed on the permanent establishment, the deduction from royalties being on account of this tax and not a true withholding tax.

290. Paras. 46 to 50 of the Commentary on Art. 24. See France - Italy (1989) for an example of the treaty rate of withholding taxes being applied to dividends, interest and royalties paid to a permanent establishment. See *supra* note 271 for some examples of this in relation to dividends.

291. Law on Withholding Tax, Art. 24(3).

292. Para. 51 of the Commentary on Art. 24. A similar statement should have been included with respect to exemption.

293. *Sun Life Assurance of Canada v. Pearson*, [1984] S.T.C. 461, 516b Ch.D. (This point was not dealt with in the Court of Appeal.) Other references to internal law not giving effect to a treaty non-discrimination provision in the United Kingdom are to be found in *R. v. I.R.C. ex p. Commerzbank* (*supra* note 181), but the taxpayer did not qualify for relief under the non-discrimination article.

294. "As regards unilateral relief, Para. 51 of the Commentary, as I understand it, recommends that a credit available to an enterprise resident in one state should be allowed as a credit to a branch in that state of an enterprise resident in

that under internal law credit could only be given to a resident. It was held that credit could not be extended to a permanent establishment in accordance with the non-discrimination provision because the internal law giving effect to the treaty by delegated legislation did so "subject to the provisions of this Part of this Act," one of the provisions of which was that credit is given only to a resident.²⁹⁵ This restriction was said to override the provisions of the treaty. While this may be correct as a matter of internal law, such reasoning is contrary to Article 27 of the Vienna Convention on the Law of Treaties: "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."²⁹⁶

Similar reasoning has been adopted in other countries. In the Netherlands, third-country income, which is exempt in the hands of a resident, is in practice taxable in the hands of a permanent establishment of a treaty partner resident. Foreign income of a permanent establishment is normally exempt in France, Italy and Japan, and so the question of credit or exemption does not normally arise. There is an exception to this rule in Japan where certain financial income of a permanent establishment arising in a low tax country is regarded as domestic-source income; in this case no credit is given for any foreign tax.²⁹⁷ There is no internal law provision giving credit in this case in compliance with the non-discrimination provision. There is a similar exception in Italy; if foreign income is treated as domestic for the purpose of taxing a permanent establishment, no credit for any foreign tax is given under internal law. There is no mechanism for giving credit on the basis of the non-discrimination provision.

Credit has been denied in Germany under former law,²⁹⁸ not because of internal law, but on the basis that the treaty did not provide for credit in these circumstances. This arose in relation to the German permanent establishment of a Japanese company receiving income from Argentina and Brazil. The position at that time was more complicated in that, while, as in the United Kingdom, credit under internal law was applicable only to residents, that rule was not applicable under a treaty, although the internal law provision could still apply if the treaty did not avoid double taxation.²⁹⁹ The Lower Tax Court of Hamburg³⁰⁰ denied the credit to the permanent establishment, on the ground that it was not a resident, arguing that, because the Japanese company could obtain credit for the foreign tax in Japan, the permanent establishment was not being less favourably taxed than a German company; indeed, if credit were given, it would be more favourably taxed. This reasoning is not convincing because the non-discrimination provision requires that the taxation should not be less favourably levied in that other State (Germany), and therefore what happened in Japan should be irrelevant.³⁰¹ The Court stated that no decision was required on whether the Commentary could be relied upon, but stated that in principle it should not be, as the treaty was concluded on the basis of the 1963 OECD Model, the commentary to which did not contain anything on this point. In fact, the 1977 OECD Model contains a statement that it is intended that existing treaties should be interpreted in the spirit of the new commentary.³⁰² The 1977 Commentary refers to the potential problem of double credit, once in the perma-

nent establishment state, and again in the residence state of the enterprise, concluding that states should settle these problems in their bilateral negotiations.³⁰³ If all states concerned apply the credit system, and so long as credit is fully available, double credit does not in fact arise if credit is given in the permanent establishment state. This is because the tax in that state will be reduced by the credit given for tax on income arising in the source state. This, in turn, reduces the amount of the credit in the residence state for the tax on the profits of the permanent establishment. The overall result is not, however, the same if the profits of the permanent establishment are exempt in the residence state. Giving credit in the permanent establishment state gives a benefit, as the tax in the permanent establishment state is reduced and the additional profits caused thereby are exempted. On the other hand, denying credit to a permanent establishment means that, compared to a resident, the total tax in the source state and the permanent establishment state will be higher for a permanent establishment, which is contrary to the permanent establishment non-discrimination provision.

In Belgium and the United States credit is given to permanent establishments under internal law, so that this issue does not arise.³⁰⁴ In the Netherlands, in relation to divi-

the other state" (at 515j). It is not clear why unilateral relief was referred to when the court held that the non-discrimination provision could not override internal law (see below). The court, in our view, misread Paras. 52 to 54 of the Commentary on Art. 24, dealing with states (of which the United Kingdom is not an example) which allow credit only by treaty, as referring to the only cases of credit being given by treaty.

295. At 516c. The only exception is that credit is given to the permanent establishments of non-resident banks (T.A. 1988, Sec. 803).

296. It is probable that this point is a codification of existing international law which applies therefore to treaties concluded before the Vienna Convention entered into force (27 January 1980), see Sinclair, *The Vienna Convention on the Law of Treaties*, 2d ed. (Manchester: University Press, 1984), at 84.

297. Art. 279(5) of the Income Tax Law Enforcement Order and Art. 176(5) of the Corporation Tax Law Enforcement Order. However, if tax is imposed in the state in which the activities are conducted, it is no longer regarded as Japanese-source income.

298. Present law (Income Tax Law (EStG), Sec. 50(1) No. 2, and Sec. 50(5) S.3 No. 1) allows a credit by a permanent establishment in the case of business income but the definition of permanent establishment is narrower.

299. EStG, Sec. 34c(1) (internal law) and (2) (treaties). This is a different case from the one mentioned in Para. 52 of the Commentary on Art. 24 of credit only being allowed by treaty, which raises the issue of trying to obtain the benefit of other treaties.

300. 9 August 1985; "Tax Treaty Between Germany and Japan," 26 *European Taxation* (October 1986), at 320.

301. A similar reason for not giving credit in the United Kingdom, that the home state should give the credit, was explained in H. McGregor, "Old Exemptions, New Credits: the Rights of the Permanent Establishment under the Double Taxation Agreement between the U.K. and the U.S.A.," *B.T.R.* [1978], at 20, 26.

302. OECD Report to which the OECD Model is annexed, Part III, at 15, Para. 30.

303. Para. 53 of the Commentary on Art. 24. The United States - Canada treaty (1980) states in Art. XXV(b) that the permanent establishment non-discrimination provision applies notwithstanding the credit article, thus making it clear that credit is available. The Technical Explanation states: "The [permanent establishment non-discrimination] paragraph specifically overrides the provisions of Article XXIV (elimination of double taxation), thus ensuring that permanent establishments will be entitled to relief from double taxation on a basis comparable to the relief afforded to similarly situate residents." In view of the statement in the Commentary that relief should be given, this addition may not be necessary but it is a helpful clarification. It also represents U.S. internal law, see *supra* note 304.

304. Credit is given in the United States to a non-resident alien or foreign corporation doing business in the United States by I.R.C., Sec. 906. In Belgium, see Income Tax Code Arts. 198 and 199.

dends, interest and royalties from developing countries, which is the only situation when credit is given unilaterally to a Dutch company, credit is not given to a permanent establishment in practice, but it is thought that it should be.³⁰⁵ The question of giving credit to a permanent establishment does not arise in Switzerland, as this is granted only by treaty to residents.

A permanent establishment cannot, on the basis of the permanent establishment non-discrimination provision, claim the benefit of a treaty with a third state because it is not a resident of either state and, under Article 1 of the OECD Model, a treaty applies only to residents of at least one of the states.³⁰⁶ This raises a particular problem about what happens if credit for foreign tax is granted only by treaty and not by internal law, as is the case in the Netherlands (apart from on dividends, interest and royalties from developing countries) and Switzerland. If the comparison is to be made with all resident enterprises carrying on the same activities, there is no discrimination because some will have income from non-treaty states. But if the comparison is with a resident enterprise carrying on the same activities, including deriving income from the same third state with which there is a treaty, it is arguable that there may be discrimination prevented by the permanent establishment non-discrimination provision, even though this arises from making the comparison with a different treaty. The Commentary, however, suggests otherwise, since the permanent establishment is not a resident of either of the treaty states.³⁰⁷ In dealing with credit for the permanent establishment, the Commentary refers to a discussion dealing with a permanent establishment taking the benefit of treaties generally, thus implying that it cannot indirectly claim credit by comparing itself with a resident enterprise having foreign income from the same treaty state. Presumably the reason is that the treaty restricts the credit to residents, and therefore the non-discrimination provision cannot be used to extend another provision of the same treaty.

The question arises about the treatment of withholding tax imposed in a third state on income attributable to a permanent establishment, which is charged at a different rate from that which would have been imposed on a resident. Suppose a company resident in State A has a permanent establishment in State B, to which is attributable income from State C. Under the A-fC treaty the rate of withholding tax is ten percent, and under the B-fC treaty it is five percent. How should the income attributable to the permanent establishment be taxed in State B? It is suggested that State B should give credit only for the five percent withholding tax which would have been imposed on a State B resident under the B-fC treaty,³⁰⁸ or possibly that it should give credit unilaterally for all the State C tax, regardless of the rate. State C can still impose the ten percent withholding tax applicable under the A-fC treaty, as the permanent establishment non-discrimination provision in that treaty relates only to taxation in State C and not State B. The Commentary leaves the point open, stating that states should settle the problem in negotiations, although we are not aware of any case where this has been done.³⁰⁹

H. Personal allowances

The second sentence of the permanent establishment non-discrimination provision is as follows:

This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

The Commentary explains that this is aimed at preventing individuals enjoying such allowances both in their residence state and, by virtue of the permanent establishment non-discrimination provision, in the permanent establishment state.³¹⁰ A borderline case is illustrated by the Dutch profit-related deduction for unincorporated businesses. Previously this had been denied to non-residents with a permanent establishment in the Netherlands, but the practice has been changed on the basis that the allowance is related to the business and not to the personal circumstances of the taxpayer.³¹¹ The United Kingdom, which does discriminate with regard to personal allowances on nationality grounds under internal law,³¹² almost always³¹³ puts this sentence in a separate paragraph, so that it also qualifies the nationality non-discrimination provision, thus permitting the discrimination. The United States and Canada often do the same.³¹⁴ Sometimes states do the

305. Decree for the Avoidance of Double Taxation, Arts. 4 and 5.

306. Paras. 52 and 54 of the Commentary on Art. 24.

307. *Id.*

308. See K. van Raad, "Issues in The Application of Tax Treaty Non-Discrimination Clauses," 42 *Bulletin for International Fiscal Documentation* (August-September 1988), at 347.

309. Para. 53 of the Commentary on Art. 24.

310. Para. 24 of the Commentary on Art. 24.

311. Finance Ministry Ruling No. IFZ89/1549, *Infobulletin* 90/138.

312. T.A. 1988, Sec. 278, gives personal allowances to non-residents only if they are Commonwealth or Irish citizens, which would be discriminatory for the reasons given *supra* in note 104 but for the fact that the United Kingdom normally varies the OECD Model, see *infra* note 313.

313. Except in the treaties with Canada (1978) (which has no effect so far as Canadian citizens are concerned as they are Commonwealth citizens and entitled to the allowances anyway, see note 312), Germany (1964) and Italy (1988). While not in a separate paragraph, this provision in the treaty with Greece (1953) allows the denial of such allowances to Greek nationals. The treaty with Malaysia (1973) allows the denial of allowances to non-nationals as well as non-residents. In a number of treaties (those with Austria (1969), Belgium (1987), Faroe Islands (1950), Fiji (1975), Finland (1969), France (1968), Germany (1964), Greece (1953), Ireland (1976), Kenya (1977), Luxembourg (1967), Mauritius (1981), Namibia (1962), Portugal (1968), Netherlands (1980), Norway (1985), Singapore (1966), South Africa (1968), Sweden (1983), Switzerland (1977) and Zambia (1972)) the United Kingdom agrees to give to residents of the other state a proportion (from 1990-91 *the whole*: F.A. 1988, Sec. 31) of its personal allowances corresponding to the proportion of their income which is U.K.-source income, and then proceeds to include this provision in the treaty, presumably in case an individual carrying on business through a permanent establishment could otherwise claim the whole of the allowances.

314. U.S. treaties with: Bangladesh (1980), British Virgin Islands (1981, never in force), Jamaica (1981), Pakistan (1957) and Tunisia (1985); Germany - Turkey (1986); all Canadian treaties containing this provision except Brazil (1984), China (1986), Germany (1981), Italy (1977), Netherlands (1986), United Kingdom (1978) and United States (1980), and there is no reference to personal allowances at all in Canada - Norway (1966), which does not contain a permanent establishment provision. Treaties concluded by Malaysia and Singapore treaties generally provide that Malaysia or Singapore is not obliged to give treaty partner nationals not resident in the treaty partner state the allowances it gives to its resident nationals. Canada - Belgium (1975) provides for the treaty partner resident taxpayer to elect for certain types of income to be taxed as if he were resident, which will entitle him to personal allowances. Belgian treaties with Bulgaria (1988), India (1974), Malaysia (1973), Portugal (1969) and

opposite by specifically providing for allowances to be given to nationals or residents of the treaty partner state.³¹⁵ There is a wide variation in the provisions dealing with personal allowances that in practice are included in treaties. The Commentary³¹⁶ makes clear that this provision is applicable only to individuals. The reference to civil status also refers to individuals in most countries, as, of course, does the reference to family responsibilities. The Lower Tax Court of Hamburg, in the case mentioned above,³¹⁷ referred to this provision in connection with a claim for double taxation relief by a permanent establishment for third-state income, but decided the case on other grounds, without deciding whether it was limited to individuals, although the generally held view in Germany is that it is.³¹⁸ Some states in fact refer to individuals, rather than residents, in this sentence of their treaties.³¹⁹

I. Conclusion on the permanent establishment provision

The largest amount of commentary on the OECD Model is in respect of this provision, which suggests that numerous practical difficulties have arisen or were contemplated. The Commentary mentions disputed interpretation by states, and the need to settle differences in negotiations, in connection with: dividends received by permanent establishments, the application of the split-rate system of company taxation, the application of withholding tax to dividends, interest and royalties paid to a permanent establishment, and the credit for foreign tax.³²⁰ Our impression is that these suggestions regarding the need for clarification are not often taken up, leading to difficulties of interpretation. We suggest that further consideration should be given to these difficulties both by the OECD, in the hope of finding some solutions which are generally acceptable, and by states when negotiating treaties.

IV. THE DEDUCTION AND OWNERSHIP NON-DISCRIMINATION PROVISIONS

Paragraphs 5 and 6 of Article 24 of the OECD Model, which will be referred to as the deduction and ownership non-discrimination provisions respectively, are as follows:

5. Except where the provisions of paragraph 1 of Article 9,³²¹ paragraph 6 of Article 11, or paragraph 4 of Article 12,³²² apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.
6. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

A. The ownership non-discrimination provision: "similar enterprises"

The reference in the ownership provision to *similar enterprises*³²³ is the third differently worded reference to the object of comparison in the non-discrimination article, the other two being "nationals...in the same circumstances" in

U.S.S.R. (1987) are in a separate paragraph, and in Belgium – Singapore (1972) the sentence about personal allowances is in the nationality provision.

315. Belgian treaties with: Denmark (1969), Ireland (1970), former Sweden (1965) and Tunisia (1975) (all giving same allowances as to non-resident nationals); Canada (1975), Netherlands (1970) (same allowances as residents); France (1964) (allowances given to nationals of the other state); Greece (1968) (same allowances as resident citizens); Morocco (1972) (same allowances as resident nationals); and Luxembourg (1970) (Belgian resident entitled to the same average rate of tax on income taxable in Luxembourg as a resident); on the other hand, the treaty with U.S.S.R. (1987) provides that tax reliefs generally given by other treaties need not be given to nationals, residents or permanent establishments of residents of the other state. Belgium discriminates against non-residents without a permanent home in Belgium compared to non-residents with one in connection with personal allowances, but this is not prevented by this provision, except in the treaties with Greece, Morocco, the Netherlands and Canada, see H. Philippe, "Niet-verblijfhouders - Nieuwe regeling van de belasting der niet-verblijfhouders: discriminatie bij de bepaling van de belastingdruk?" (Non-residents – new non-resident tax system: discrimination in the tax burden?), *Fiskoloog Internationaal* No. 86, 15 January 1991, at 1; see also *supra* note 313 for U.K. treaties; Germany – Spain (1966), Canada – Italy (1977) in addition contain the normal provision not giving allowances to residents of the other treaty state under the permanent establishment provision. Dutch courts have decided two cases on this provision in the Belgium – Netherlands treaty: a Belgian resident with Dutch-source income was not permitted to take his wife's losses into account, as a resident taxpayer could have done (District Court 's-Hertogenbosch, 5 May 1990, *Fiscaal-up-to-date* 91/11); a married Belgian resident was entitled to the same personal allowance for married taxpayers as a Dutch resident (Supreme Court, 19 December 1990, *BNB* 1991/123). A similar article extending personal allowances to treaty residents is contained in Netherlands – Surinam (1975). In a decision of 5 February 1991 the District Court of Arnhem decided that a resident of Surinam who became a resident of the Netherlands on 1 November 1985 was not entitled to personal allowances for single-earner families in the Netherlands in respect of income earned in the last two months of 1985 because of the requirement that the taxpayer be a resident for more than six months.

316. Para. 24 of the Commentary on Art. 24.

317. See *supra* note 300.

318. See the editorial comment in 26 *European Taxation* (1986), at 320, 322; and Vogel, *supra* note 154, marginal note 133 to Art. 24.

319. U.S. treaties with Belgium (1970), Cyprus (1980 and 1984), Egypt (1980), Iceland (1975), Israel (1975), Jamaica (1981), Japan (1971), Korea (1976), Morocco (1977), Norway (1971), Philippines (1976) and United Kingdom (1975); Belgian treaties with Germany, (1967), Canada (1975), Denmark (1969), Greece (1968), former Sweden (1965), Ireland (1970), former Italy (1970), Tunisia (1975), Luxembourg (1970), Morocco (1972) and Netherlands (1970); and Netherlands – Surinam (1975). The U.S. treaties with Brazil (1967), the Netherlands (1948), former Philippines (1964), Thailand (1965, never in force), and Trinidad and Tobago (1970) refer to not granting the allowances to non-resident *nationals*, which when undefined will only include individuals.

320. Paras. 35, 45, 50 and 53 of the Commentary on Art. 24.

321. Adjustment of profits of associated enterprises to the arm's length amount.

322. Excessive interest or royalties by reason of a special relationship between the payer and the owner. The U.S. treaties with the British Virgin Islands (1981, never in force) and Hungary (1979) do not contain any of these exceptions at the start of the deduction provision.

323. The French version of the 1963 OECD Model has *les autres entreprises de même nature*, while the French version of the 1977 OECD Model has *les autres entreprises similaires*, the latter being closer to the English text which is the same in both versions. A number of treaties add a reference at the end of this provision to the same circumstances or the same conditions, or both: e.g. United States – Australia (1982); France – Malaysia (1975); France – Egypt (1969); Indian treaties with Belgium (1974), Indonesia (1987), Malaysia (1976), Mauritius (1982), Nepal (1987), Norway (1986), Romania (1987), Singapore (1981), Syria (1984), Tanzania (1979), Thailand (1985) and Zambia (1981); and Malaysia – Pakistan (1982). Canada – Indonesia (1979) adds a requirement that the third-state-owned enterprise should be in substantially similar circumstances to the treaty-partner-owned enterprise.

the nationality and stateless persons provisions and "enterprises...carrying on the *same activities*"³²⁴ in the permanent establishment provision. *Similar enterprises* could mean enterprises owned either by residents of the same state only, or by residents of a third state. The difference is significant. In a number of countries, such as the Netherlands, the United Kingdom and the United States,³²⁵ two resident subsidiaries of a resident parent can group certain profits and losses and make transfers of assets between them without realising a gain, but this is not possible if the parent is non-resident. If *similar enterprises* refers to companies owned by third-country residents, as for example the U.K. Revenue maintains,³²⁶ these internal law rules are not discriminatory, but if the comparison is with companies owned by residents of the same state, they are.³²⁷

The Commentary³²⁸ does not directly answer the question which is the correct comparison but, in stating that "Its [the ownership provision's] object therefore is to ensure equal treatment for taxpayers residing in the same State..." it suggests that the comparison is with resident-owned enterprises only. If the other meaning had been intended, the Commentary would instead surely have explained that the object was to prevent discrimination because the company was owned by residents of the particular treaty partner, say South Africa, compared to other non-residents. The suggested interpretation is impliedly supported by the OECD study on thin capitalisation³²⁹ which states that the ownership provision "aims broadly at preventing 'tax protectionism' *i.e.* the deterrence by tax measures of investment from outside the country." If the alternative meaning, that *similar enterprises* are those owned by third-country residents, had been intended, this remark would not have been relevant, as the provision would have prevented only very limited tax protectionism. Another indication that the correct interpretation is that comparison is intended to be with domestically owned enterprises can be obtained from the United Nations Model Commentary³³⁰ where a possible amendment to the draft to make the comparison with third-state owned enterprises, which had been proposed by some of the developing countries, was discussed. That commentary records strong opposition by members from developed countries³³¹ to such a fundamental change, which confirms that they regarded it as clear that the correct comparison was with an enterprise owned by residents of the same state. Finally, the OECD publication, National Treatment for Foreign-controlled Enterprises,³³² explains that the only difference between its proposals, which clearly make the comparison with domestically owned enterprises, and the ownership provision of the OECD Model, is that the former requires foreign control, while the latter applies to any degree of foreign ownership. It is therefore submitted that the comparison should be made only with enterprises carried on by residents of the source state which are also owned by persons resident in that state.

The issue of what is the proper comparison has been decided by the Swedish Supreme Court³³³ in a case involving the transfer of an asset between two Swedish companies owned by a Dutch holding company. The ownership provision in the Sweden-Netherlands treaty (1968) is in OECD Model form. Had the holding company been

Swedish, the transfer would not have involved the realisation of a gain on the asset transferred. The Court relied on the Commentary and stated that the purpose of the ownership provision was to provide equal treatment for enterprises owned by residents of the treaty partner state. It therefore held that the relief applied in these circumstances. This is also the view generally held in Germany, so far as the transfer of assets is concerned.³³⁴ In spite of specifying in its treaties that the comparison is to be made with domestically owned enterprises,³³⁵ the United States takes the view that it can tax the capital gains on distributions in the liquidation of a U.S. company owned by a foreign parent although it does not do so if the parent is domestic.³³⁶ This is stated to be because the enterprise is

324. This expression is sometimes used in the ownership provision. O'Brien, *supra* note 11, at 583, makes the point that the phrase *similar enterprises* is roughly equivalent to "same activities" in the permanent establishment provision. The U.S. treaties with Belgium (1970), Egypt (1980), Finland (1970), France (1967), Iceland (1975), Israel (1975), Japan (1971), Korea (1976), Morocco (1977), New Zealand (1982), Norway (1971), Philippines (1976), Poland (1974) and Romania (1973), and also Germany - Argentina (1978), say *carrying on the same activities* instead of *similar enterprises*. Occasionally, U.S. treaties do not use *similar* or *carrying on the same activities* but merely refer to a corporation, instead of an enterprise, see *supra* note 351: Brazil (1967, never in force), former Israel (1960, never in force), Netherlands (1965 amendment to 1948 treaty), former Philippines (1964, never in force), Trinidad and Tobago (1970) and former United Kingdom (1966 amendment to 1945 treaty). See *infra* note 337 for further variations. Two remaining old U.K. treaties, with the Faroe Islands (1950) and Greece (1953), and France - Malaysia (1975) add the words *in respect of the like income, profits and capital* to other enterprises. This formula was often used in older U.K. treaties and can still be found in extensions of former U.K. treaties.

325. Where the common ownership is at least 99 percent, the companies can apply for fiscal unity, Company Income Tax Act 1969, Art. 15(1).

326. *B.T.R.* [1978], at 198. United Kingdom - New Zealand (1984) and Germany - Argentina (1978) refer to same activities (the expression used in the permanent establishment provision). All other U.K. treaties containing the ownership provision use the same terms as the OECD Model. See *infra* note 348 for U.S. treaties making it clear that the comparison is with enterprises owned by residents of the same state.

327. Subject to a qualification mentioned by O'Brien, a qualification which he describes as too restrictive an interpretation, that it is possible that the comparison should be made separately for each subsidiary, in which case there would be no group. O'Brien, *supra* note 11, at 583.

328. Para. 57 of the Commentary on Art. 24. There is a suggestion that comparison with resident-owned enterprises is intended when the Commentary provides that the object of the provision is not to subject foreign capital to identical treatment to that applied to domestic capital, *i.e.* that the comparison is to be made at the level of the enterprise only, impliedly still between foreign-owned and domestically-owned enterprises.

329. *Issues in International Taxation*, No. 2, (Paris: OECD, 1987) [hereinafter "the OECD thin capitalisation study"].

330. U.N. Model, Para. 6 of the Commentary on Art. 24, at 223. This amendment is made in Brazilian treaties with Argentina (1980), Italy (1978) and Norway (1980); Finland - Philippines (1978); and Pakistan - Poland (1974).

331. These included, of the countries represented by the authors, France, Germany, Japan, the Netherlands, Switzerland, the United Kingdom and the United States.

332. 1985, at 55, note 23.

333. Regeringsträtten dom No. 2225 - 1987, 19 November 1987, J. Kesti, "Non-discrimination Clause," 28 *European Taxation* (December 1988), at 401 and commented upon by D. Oliver, *B.T.R.* [1989], at 141.

334. Vogel, *supra* note 154, marginal note 165 to Art. 24. An attempt to apply an *Organschaft* (consolidation of profits) between the German branch of a Swiss company and a German company failed under former law as the branch could not rely on the treaty; the question of discrimination was not dealt with, BFH decision of 20 February 1974, *BStBl.* 1974 II, at 616. Such consolidation is now permitted under KStG, Sec. 18.

335. See *infra* note 348.

336. Notice 87-66, 1987-2 C.B. 376. See also the legislative history of the Technical and Miscellaneous Provisions Act 1988, Senate Rep. 100-445, 100 Cong. 2d., at 74, where the Senate made the same point, but restricted the operation of

not similar, in that assets are removed from the U.S. taxing jurisdiction when the parent is foreign. It seems that this interprets *similar enterprises* to mean enterprises in similar circumstances, since it argues that the ownership provision applies only if the enterprise is in substantially similar circumstances in law and fact, which is what the Commentary says in relation to the meaning of same circumstances in the nationality provision.³³⁷ In our view, this is of doubtful relevance in interpreting the ownership provision as the only factual difference is that of ownership by treaty partner residents. The Technical Explanation to the new United States/Germany treaty (1989) puts forward a different justification, that the difference is based on whether the parent company is liable to corporate tax, because the relief would not apply if the parent was an exempt domestic organisation. The difficulty with this argument is that it treats a domestic exempt organisation as similar to a foreign corporation, which, apart from its liability to domestic tax, is clearly not the case.³³⁸ It might be arguable if the Commentary's definition of *same circumstances* applied here, but it does not. The OECD publication, *National Treatment for Foreign-controlled Enterprises*, does not assist in the interpretation of the OECD Model since its proposals are directed in this case to the parent company, unlike the OECD Model which looks only at the tax on the subsidiary. A foreign parent company is obviously not in a comparable situation to a domestic one, as required by the OECD declaration on foreign-controlled enterprises.³³⁹ It is therefore submitted that a necessary consequence of accepting that the comparison is with a domestically owned company is that this type of situation allows taxable gains to be transferred outside the jurisdiction. A better solution to the U.S. position would be to amend the provision in suitable cases.

The following are examples of cases which would also be prevented if the comparison is with an enterprise owned by residents of the state of residence of the enterprise. Formerly, in Italy the transfer pricing rules applied only where the parent company was non-resident; an Italian parent with a foreign subsidiary was not therefore subject to a transfer pricing adjustment, as Article 9 cannot create a tax charge in the absence of internal law.³⁴⁰ Thus the profits of an Italian company could have been increased by pricing adjustments only if it had a non-resident parent. In the United States, no gain is recognised on the distribution of assets in the liquidation of an 80 percent owned subsidiary, provided the parent is a U.S. person.³⁴¹ In Belgium, a subsidy for making films available to Belgian nationals not under the control of a foreign enterprise was later extended to EC nationals and, subject to reciprocity, to third-state nationals.³⁴² In the Netherlands, a company under foreign control does not qualify for treatment as an investment company.³⁴³ There is an Australian provision³⁴⁴ preventing the deduction of interest on loans which finance transactions between companies under foreign control, such as the sale of an asset between two Australian subsidiaries of a non-resident parent, under which there is no change in the ultimate beneficial ownership of the assets transferred. This may breach the ownership provision in the treaty with the United States, the only non-discrimination article in an Australian treaty.³⁴⁵

The Swiss Decree of 14 December 1962 against the abuse of tax treaties, which denies treaty benefits to companies under foreign control, does not breach the ownership provision, since it does not affect the tax paid in Switzerland by a foreign-owned company, but only the withholding tax in the treaty partner state. The Federal Tribunal has held that the Decree is in accordance with Switzerland's treaties, but without discussing non-discrimination.³⁴⁶ In the United States, a subchapter S corporation is one which elects to be transparent for tax purposes. A requirement for making the election is that there must be no non-resident alien shareholders. This may be discriminatory since a domestically owned similar corporation would not be liable to any tax, but the position is complicated because a corporation owned by U.S. citizens resident in the treaty partner state would still qualify, and therefore the requirement is not one based on residence alone; the nationality provision has no application since it is the taxation of the corporation which is in issue.³⁴⁷

Some treaties make clear which interpretation is intended. The United States normally specifies comparison with domestically owned enterprises,³⁴⁸ and Canada normally

the amendment so that corporations completely liquidated before 10 June 1987 were not caught, on the ground that the I.R.S. had previously considered that certain liquidations were protected by the ownership provision. The A.L.I. Tax Project, *supra* note 181, at Part IV.V.B., argues that this treatment should not be considered discriminatory. Another possible U.K. example is that a U.K. company is treated as transferring an asset at its base value for capital gains tax on a transfer to its U.K. resident parent, but not to a non-resident parent; does the ownership provision mean that it can make such a transfer to its treaty-partner-resident parent, even though the gain would then be outside the United Kingdom charge to tax since most capital gains are taxable only in the residence state?

337. Para. 3 of the Commentary on Art. 24. France - Malaysia (1975) and 19 Indian treaties all in the *same circumstances* and under the same conditions (or in seven Indian treaties only the former) in the ownership provision. United States - Australia (1982) has in the *same circumstances*.

338. This point is forcibly made by the A.L.I. Tax Project, *supra* note 181, at Part IV.I.A.5.

339. O.E.C.D., 1985, at 23 - 24: "The addressees of these measures are parent companies as representing the group as a whole and, therefore, the proper level of comparison for the purpose of National Treatment is between domestic and foreign parents." See p. 144 for the Declaration which defines national treatment in terms of not less favourable treatment in like situations. Like situations are explained at 17.

340. Consolidated Tax Act, Art. 76(5).

341. I.R.C., Sec. 337(a). Similar provisions apply to tax-free spin-offs, split-ups and reorganisations: I.R.C., Sec. 361(a).

342. Royal Decree of 23 October 1963 (aid to Belgian filmmaking industry) *Official Journal*, 5 November 1963. The subsidy is a percentage of the tax on shows. The non-national residing in Belgium qualified subject to reciprocity. Extension to EC nationals and third-state nationals, Royal Decree of 12 May 1972, *Official Journal*, 27 May 1972.

343. Corporate Income Tax Act 1969, Art. 28.

344. Division 16G of Part III of I.T.A.A.

345. The non-discrimination provision excludes any provisions of internal law in force on the date of signature of that treaty (1982), but this provision was enacted later.

346. Decision of 22 November 1968 (ATF 94 I 659).

347. O'Brien, *supra* note 11, at 585, considers that the law is discriminatory. The situation is similar to the one described in the text *infra* at note 377 of the deduction for distributions to non-resident beneficiaries of Canadian trusts. If the election were allowed to be made by a non-resident, there would be no U.S. tax on U.S. business profits. The Technical Explanation to the new United States - Germany treaty (1989) argues that the reason for the exclusion of non-resident aliens is that they are not net basis taxpayers, rather than because they are foreign. However, the prohibition is against discriminating against foreign ownership, whatever the reason.

348. United States treaties with Belgium (1970), Brazil (1967), Egypt (1975 and 1980), Finland (1970), France (1967), Israel (1965 and 1975), Japan (1971), Korea (1976), Morocco (1977), Netherlands (1965 amendment to 1948 treaty),

specifies comparison with enterprises owned by third-state residents, thus allowing it, for example, to charge a lower rate of tax on profits earned in Canada by a Canadian-controlled private business corporation, which would otherwise clearly be discriminatory.³⁴⁹

As in the case of the permanent establishment non-discrimination provision,³⁵⁰ the United States sometimes refers in its treaties to a corporation, rather than an enterprise.³⁵¹ The United States has imposed increased reporting and record-keeping requirements on domestic corporations 25 percent owned by a foreign shareholder.³⁵² It has argued that the effect is to impose equivalent obligations on U.S. and foreign-owned corporations so as to enable the same type of information to be obtained from both. It is, however, considered that the provisions are discriminatory, as the treaty test requires that the connected requirements should not be greater, not that they should be reasonable in the circumstances. The provisions are stated in the Senate explanation to override treaties.

1. *The application of the ownership non-discrimination provision to partnerships*

In relation to partnerships, only the entity, if it is taxable as such, can benefit from the ownership provision, and not the partners resident in the other state. The provision clearly applies if the partnership is itself taxed.³⁵³ The question does not arise in relation to the taxation of profits if the partnership, rather than the partners, carries on the enterprise or the partnership is completely transparent (whether or not the partnership is required to make a return) as is the case in Australia, Belgium,³⁵⁴ Canada, France, Germany (except for trade tax), Italy (except for local income tax), Japan, the Netherlands, Switzerland and the United States.³⁵⁵ A completely transparent partnership will not be liable to tax³⁵⁶ and cannot therefore be a resident; consequently, it cannot come within the definition of enterprise of a Contracting State.³⁵⁷ If, however, the enterprise is carried on by each partner in common, the provision would be applicable to each partner separately to prevent more burdensome taxation of the non-resident partners. A U.K. partnership³⁵⁸ with individual partners³⁵⁹ falls between being completely transparent and being taxable as an entity. It receives a single joint assessment, but the amount of the tax payable is determined by the circumstances of the partners.³⁶⁰ As such it is, within the ordinary meaning of language, a body of persons³⁶¹ and therefore a person within the meaning of the treaty.³⁶² Since it is liable to tax, it is a resident for the purposes of the treaty,³⁶³ and therefore its business can qualify as an enterprise of a Contracting State. There is one argument against this. The term "body of persons" is defined in U.K. tax law in a way which probably does not include a partnership as we know it today.³⁶⁴ However, it is considered that the context requires that the definition should not be used, pursuant to Article 3(2) of the OECD Model, because otherwise a partnership would not be covered by a treaty, which is unlikely to have been intended.³⁶⁵ A U.K. partnership also has a residence by virtue of a statutory provision.³⁶⁶ It has been held to be a single enterprise.³⁶⁷

New Zealand (1982), Norway (1971), Philippines (1964 and 1976), Thailand (1965), Trinidad and Tobago (1970) and the former United Kingdom (1966 amendment to 1945 treaty, but not in the 1975 treaty which follows the OECD wording, as does the estate tax treaty (1978)); however, the U.S. Treasury Technical Explanation states that the comparison under the 1975 treaty is with same state residents). The same occurs in New Zealand treaties with Denmark (1980), Finland (1982), India (1986), Ireland (1986) and the United Kingdom (1983); Japan - Thailand (1963); and Korea - Thailand (1974).

349. This occurs in all 32 Canadian treaties containing this provision; U.S. treaties, in addition to Canada, with Poland (1974) and Romania (1973); and see *supra* note 330 for a number of Brazilian treaties doing this. The fact that Canada specifically provides for comparison with enterprises owned by third-state residents gives some slight support for the view that the comparison under the OECD Model is with same-state-owned enterprises, because otherwise Canada would not have needed to make the alteration to protect its discrimination against non-Canadian-controlled corporations.

350. See *supra* note 215.

351. U.S. treaties with Australia (1982), Belgium (1970), Canada (1980, using *company* instead of *corporation*), Cyprus (1984), Egypt (1980), Finland (1970), France (1967), Iceland (1975), Israel (1975), Japan (1971), Korea (1976), Morocco (1977), Netherlands (1965 amendment to 1948 treaty), Norway (1971), Philippines (1976), Poland (1974, also using *company*), Romania (1973), Thailand (1965, never in force), Trinidad and Tobago (1970) and the former United Kingdom (1966 amendment to 1945 treaty, the current U.K. treaty uses *enterprise*). Surprisingly, the U.S. Model (1981) uses *enterprise* in the permanent establishment and ownership provisions, but *resident* in the deduction provision. See *supra* notes 215 and 375 for the United States changing *enterprise* to *resident* in the permanent establishment and deduction provisions respectively. It is odd that this is not done consistently, e.g. in the treaties with Belgium, Egypt, Finland, France, Israel, Japan, Korea, Morocco, Netherlands, Norway, Philippines, Poland, Romania, Thailand, and Trinidad and Tobago, the change is not made in the deduction provision. This is unlikely to affect the interpretation of the treaty, see text *infra* at note 375.

352. I.R.C., Sec. 6038A. See Q. Cotton, "U.S. Expands Reporting Requirement and Adds Record-Keeping Requirement," 38 *Canadian Tax Journal* [1990], at 444.

353. An interesting mixed type of partnership exists in the Netherlands: an open limited partnership (*open commanditaire vennootschap*), under which the partnership is transparent as regards the general partners and an entity as regards the limited partners. Because of the partnership's status as an entity for the latter, the ownership provision may apply if the general partners are non-resident. See van Raad, *supra* note 22, at 193.

354. In Belgium, the transparency is not complete since the Act of 12 December 1990 (Art. 4) (new Art. 53 al. 2 of B.I.T.C.) limits the partner's deduction of the partnership's losses in certain cases.

355. A corporate partner which is owned by residents of the other state can, of course, qualify in its own right. The issue cannot arise if *corporation* is substituted for *enterprise*, see *supra* note 351.

356. In the sense of Art. 4(1) of the OECD Model, although it may be liable to pay withholding tax.

357. Defined in Art. 3(1)(c) as an enterprise carried on by a *resident* of a Contracting State.

358. This is so whether or not it is a legal person, which it is in Scotland but not in England.

359. If the partners are companies, the partnership computes the income but only the companies are assessed: T.A. 1988, Sec. 114.

360. T.A. 1988, Sec. 111.

361. *Padmore v. I.R.C.*, [1989] S.T.C. 493 C.A.

362. Many treaties specifically include partnerships in the definition of persons; for example, 28 Canadian treaties do this and the Technical Explanation to the United States - Canada treaty (1980) states that partnerships are included in that treaty, presumably as a body of persons.

363. OECD Art. 4(1).

364. See T.A. 1988, Sec. 832(1). This argument was not available in *Padmore v. I.R.C.* because of the context. The definition of person in the treaty concerned impliedly excluded reference to internal tax law.

365. This was a reason given by Fox L.J. in *Padmore v. I.R.C.*, *supra* note 361, at 499b.

366. The test for a non-resident partnership is that the control and management of the trade or business is situated abroad, as for a non-U.K. incorporated company: T.A. 1988, Sec. 112. Strictly, this defines a non-resident partnership, but must impliedly define a resident one as well: the Court of Appeal so held in relation to a Jersey partnership where the definition is the same as in the United Kingdom in *Padmore v. I.R.C.*, *supra* note 361, at 499g.

367. *Padmore*, at 500h. Cf. a Dutch transparent partnership (*maatschap* - professional partnership or *vennootschap onder firma* - business partnership) where each partner is deemed to carry on a separate enterprise: van Raad, *supra* note

Since a partnership has capital,³⁶⁸ it seems that the ownership provision can be applied to it, even though the effect will be to prevent indirect discrimination against a non-resident partner. It is not thought that there is in fact any such discrimination in the United Kingdom.

B. The ownership non-discrimination provision: imputation systems

Since it is only the taxation of the enterprise which is protected from discrimination, and not that of the non-resident owners of the capital, it follows that an imputation system which discriminates against non-resident shareholders is not prohibited by the ownership provision. It has, however, been argued that the effect of an imputation system which refunds tax to individual resident shareholders who are not liable to the full amount of the imputed tax, as in France, Germany, Italy and the United Kingdom,³⁶⁹ is to lower the corporate tax rate in proportion to the amount of dividends distributed, in just the same way as a split-rate system does. This is on the basis that the tax authorities are repaying some of the tax paid by the company to the shareholders, so that the "true" amount of corporation tax is the net amount after refund, which is equivalent to the company paying a lower rate of tax on distributed profits under a split-rate system. A split-rate system would clearly be discriminatory if it did not apply the lower rate to distributions to non-resident shareholders.³⁷⁰ The lowering of the corporate tax when there has been a distribution to a resident would be prevented by the ownership provision as being discrimination against enterprises owned by foreign individuals. The argument mentioned above, that the imputation system is discriminatory, depends on its leading to the equivalent result as the split-rate system. The same arguments cannot be applied to enterprises owned by foreign companies, unless possibly the foreign company is resident in an imputation state. It seems unlikely that these arguments would succeed, on the basis that one should merely look at the amount of tax paid by the company itself, which does not depend on the residence of the shareholders. The OECD publication, *National Treatment for Foreign-controlled Enterprises*, mentions these arguments and concludes that it is impossible to give a clear-cut answer to the question whether there is national treatment when the imputation credit is not repaid to the non-resident shareholder.³⁷¹ It merely recommends, as does the Commentary,³⁷² that the problem should be solved in negotiations.

C. The deduction non-discrimination provision

The deduction non-discrimination provision was new to the 1977 OECD Model, having no equivalent in the 1963 OECD Model, apart from a statement to the same effect in the Commentary.³⁷³ It is accordingly, in practice, found in fewer treaties. The current U.S. Model (1981) and some U.S. treaties refer to the deduction of payments by a *resident*, instead of an enterprise, an expression not used in internal law, but, as the provision refers to deductions made in determining taxable profits, presumably the use of the word *resident* has the same effect as the Model in referring to taxable profits.³⁷⁴ Canada does not include this pro-

vision in any of its treaties, except that with the United States and even this excludes from its scope discrimination relating to interest deductibility under existing law, no doubt because of Canada's thin capitalisation rules.

The former U.S. Model (1977) and a few U.S. treaties³⁷⁵ define *other disbursements* to include:

charges for amounts expended by such residents for purposes of such enterprise, including a reasonable allocation of executive and general administrative expenses (except to the extent representing the expenses of a type of activity which is not for the benefit of such enterprise, but constitute 'stewardship' or 'over-seeing' functions undertaken for such resident's own benefit as an investor in the enterprise), research and development, and other expenses incurred by such resident for the benefit of a group of related enterprises including such enterprise.

In the Technical Explanation to the United States-Canada treaty (1980), which follows the OECD Model apart from referring to a *resident* rather than an *enterprise*, there is a note to the effect that this provision does not require Canada to permit a deduction for disbursements consisting of distributions of income by a Canadian trust to a non-resi-

22, at 187. See also Vogel, *supra* note 154, marginal number 29 to Art. 7. The 1963 OECD Commentary (Para. 6 on Art. 3) suggested that the 1963 OECD Model might be interpreted by saying that each partner had a separate enterprise, but this statement is not included in the 1977 OECD Commentary. See *Meaning of "enterprise"* under the heading *The Permanent Establishment Non-discrimination Provision*.

368. Applying English law by virtue of OECD Art. 3(2). See Partnership Act 1890, Secs. 24(1) and 44.

369. But not in Belgium, Canada and Australia which do not refund the imputation credit. The imputation system can then be regarded as an adjustment at the shareholder level (see Para. 47 of the Commentary on Art. 10), which is not prevented by the ownership non-discrimination provision. In Belgium, since the Act of 28 December 1983 (*Official Journal*, 30 December 1983), dividends are taxable at a separate rate of 25 percent (final 25 percent withholding tax or assessment) without any imputation credit. The former imputation system still applies in certain cases.

370. P. Kaplan, "European Discrimination and American Retaliation," *B.T.R.* [1978], at 206. Para. 45 of the Commentary on Art. 10 equates the result of a split-rate system and an imputation system which gives refunds to resident shareholders paying less tax than the amount imputed. Vogel, *supra* note 154, marginal note 164 to Art. 24 argues that, contrary to Kaplan's view, the reduction in corporate tax depends only on the amount of dividends and not on their recipients; indirect disadvantages to non-residents are not covered. As mentioned by Kaplan, *Id.*, at 221, the U.S. Supreme Court decided, in *Biddle v. Comm.*, 302 U.S. 573, 58 S.Ct. 379 (1938), that the pre-1965 U.K. system, which provided for full imputation, was not discriminatory, being a reduction in shareholder taxation. Kaplan suggests that the Court did not fully appreciate the effect of the refund system.

371. 1985, at 22.

372. Paras. 53 and 64 of the Commentary on Art. 10.

373. Para. 17 of the Commentary on Art. 11, Para. 9 of the Commentary on Art. 12 (1963). Netherlands - Finland (1970) provides in a protocol that the *ownership* provision is to have this effect. About seven Belgian treaties concluded before 1977 contain a deduction provision.

374. U.S. treaties with Aruba (1986, never in force), Australia (1982), Barbados (1984), Canada (1980), China (1984), Cyprus (1984), Netherlands Antilles (1986, never in force), New Zealand (1982) and Sri Lanka (1985). United States - Norway (1971), however, limits the provision to the deduction of mortgage interest. See also *supra* note 215 for the United States not using *enterprise* in the permanent establishment provision, and *infra* note 351 for changing *enterprise* to *corporation* in the ownership provision. In the above treaties, except those with Australia, Canada and Cyprus, *resident* is used instead of *enterprise* in the deduction provision, but *enterprise* is still used in the ownership provision. The former U.S. Model (1977) used *enterprise* in the deduction provision. For the meaning of *enterprise*, see *Meaning of Enterprise* under the heading *The Permanent Establishment Non-discrimination Provision*.

375. U.S. treaties with British Virgin Islands (1981, never in force), Cyprus (1984) and United Kingdom (1975). It is sometimes defined in the Technical Explanation to the treaty, e.g. Germany (1989).

dent beneficiary out of income from a Canadian business or Canadian real property. Normally such payments would be deductible when paid to a resident beneficiary, but under Canadian internal law, they are not deductible when paid to a non-resident beneficiary. The reason given in the Technical Explanation is that, if a deduction were granted, a non-resident beneficiary would be charged only a withholding tax and so would pay much less tax on his share of the trust's business, or real property, income than a resident beneficiary who would be assessed to full Canadian income tax on this income. This point was included for the first time in the third version of the Technical Explanation,³⁷⁶ although the 22 September 1981 version noted that the treaty specifically provides for a country to continue any provision of its internal laws designed to ensure that a non-resident does not obtain tax treatment more favourable than that obtained by its own residents. Occasionally, other states make exclusions from the deduction provision.³⁷⁷

An example of the potential application of the provision arises from the rule in the United Kingdom that interest paid by a company to its non-resident parent or to a non-resident fellow subsidiary of a non-resident parent is not deductible under internal law.³⁷⁸ This rule is normally reversed in the interest article of treaties, so far as interest paid to a resident of the treaty partner is concerned. In the absence of such a reversal, the deduction provision permits the deduction, although in practice the provision is not included in a treaty which does not contain the reversal of the internal law rule.³⁷⁹ In the United States, a discount on a loan is deductible on an accruals basis if the holder is a related U.S. person, but deductible only on a payment basis if the holder is non-resident.³⁸⁰ This seems a case for the application of the deduction provision but it may not be covered by the wording of the provision, which refers to interest *paid*, although such a narrow interpretation would defeat the object of the provision in this case.

D. The deduction and ownership non-discrimination provisions: thin capitalisation

Both the deduction and the ownership provisions can be relevant to those thin capitalisation rules which re-characterise payments of interest if they do so only when it is paid to non-residents. It is clear that the deduction provision has this effect by its ordinary meaning, and this is confirmed by the OECD thin capitalisation study.³⁸¹ For this reason, Canada does not include the deduction provision in any of its treaties, except that with the United States, which specifically excludes from its scope the thin capitalisation rules under existing law. However, an adjustment of the profits to the arm's length amount because there is an excessive amount of debt is permitted by Article 9(1) of the OECD Model, since the amount of debt is a condition imposed in the financial relations between two related parties which differs from those which would be made between independent enterprises.³⁸² Such an adjustment is specifically permitted by the opening words of the deduction non-discrimination provision. Where the Article 9 exception to the deduction non-discrimination provision applies, thin capitalisation rules can

take effect even if they relate only to payments to non-residents.³⁸³ Also permitted is an adjustment caused by an excessive *rate* of interest under Article 11(6) although this article does not permit the *amount* of debt to be altered.³⁸⁴

One next has to consider whether the *ownership* provision nevertheless prevents the thin capitalisation rules from applying. Assuming that the thin capitalisation rules apply only to interest paid to a non-resident controlling shareholder, such as a parent company, and not to a similar domestic shareholder,³⁸⁵ and assuming the correctness of the above analysis, to the effect that the comparison to be made is with a company owned by a resident parent company, the ownership provision does, on the face of it, prevent the thin capitalisation rules from applying. The OECD thin capitalisation study,³⁸⁶ however, concluded that the ownership provision was in such general terms that the deduction provision must take precedence over it in relation to the deduction of interest, so that adjustments permitted by the deduction provision cannot be prevented by

376. 26 April 1984. The earlier versions were dated 19 January 1981 and 22 September 1981.

377. E.g. Brazil - Germany (1975) and - Belgium (1972) preserving the non-deduction of royalties in Brazil to a 50 percent shareholder (see Belgian administration commentaries Para. 24/42); and Malaysia - Italy (1984) permitting non-deduction in Malaysia unless tax is withheld.

378. T.A. 1988, Sec. 209(2)(d)(iv).

379. United Kingdom - Italy (1988) is an exception, containing the deduction provision but nothing in the interest article reversing the internal law rule preventing the deduction of the interest. Even if deductible under the deduction provision, the interest does not fall within the interest article for withholding tax purposes, where interest is defined to exclude anything within the dividend article, which includes income from other corporate rights subjected to the same taxation treatment as income from shares. Thus the dividend article includes such interest, but, perhaps, if deductible, it ceases to be a distribution.

380. I.R.C., Sec. 163(e)3.

381. See *supra* note 329.

382. This proposition is stated to be generally agreed in the OECD thin capitalisation study, *supra* note 329, Para. 48. There may, however, be problems over adjusting under Art. 9 the amount of debt owing to a fellow subsidiary resident in a non-treaty state.

383. The OECD thin capitalisation study, *supra* note 329, suggests that if the thin capitalisation adjustment is not permitted by Art. 9, the deduction provision will prevent the rules applying if they relate only to interest paid to non-residents (Para. 66(a)). This seems to be based on a proposition that, in the view of some states, Art. 9 is illustrative and allows adjustment of profits to an amount greater than the arm's length amount (Paras. 29, 30 and 50). Since the study concludes against this interpretation (Para. 50), Art. 9 prevents the adjustment anyway without needing to resort to non-discrimination.

384. Art. 11(6) deals with the amount of interest *having regard to the debt-claim for which it is paid*, which must mean that the amount of debt is to be taken as fixed.

385. This applies to the Canadian, Australian and French thin capitalisation rules. The Canadian rules apply to a non-resident shareholder who, with persons with whom he does not deal at arm's length, owns 25 percent or more of any class of shares in the Canadian corporation: I.T.A., Secs. 18(4) and (5). Under the Australian provisions, a non-resident holding company cannot be taken into account in determining whether there is a resident company group. The significance is that foreign equity can be taken into account only in the top company of a resident group. The subsidiaries are, therefore, treated as having no foreign equity, with the result that no interest paid to the foreign controller is deductible. The French rule limits the amount of loan from a foreign parent company (unless it has a permanent establishment in France) on which interest is deductible (C.G.I., Art. 212). It is not considered that the French *Conseil d'Etat* decision of 16 February 1990 Nos. 68627 and 68628 relating to Scandinavian Airlines Systems France [hereinafter "SAS case"], which permitted the discrimination in spite of the France - Sweden treaty (1936), has any application to the much wider wording of the OECD Model, since the treaty concerned had no deduction provision and only dealt with taxation in the state other than the one in which the company had its seat.

386. See *supra* note 329.

the ownership provision.³⁸⁷ While it is true that the deduction non-discrimination provision is more specific in subject matter in dealing with interest deductions, it might be argued that the ownership provision is in fact more specific in relation to interest paid to a treaty partner resident *shareholder*, such as a parent company, since the deduction provision applies to interest paid to any non-resident. Although we agree with the conclusion that the ownership provision should not be construed as conflicting with Article 9³⁸⁸ on the ground that provisions of the OECD Model should not be construed as conflicting with each other, it would have been better if there had been a specific reference to that article in the ownership provision, as there is in the deduction provision.³⁸⁹ Apart from Australia, Canada and New Zealand, who reserved their positions on Article 24 generally, the only state to make a specific reservation against the deduction provision is France,³⁹⁰ which has preserved its domestic thin capitalisation rules in some of its treaties.³⁹¹ Occasionally other countries include reference to thin capitalisation provisions in their treaties.³⁹²

387. Para. 66(b) and summary in Para. 87(b).

388. Or conflicting with Art. 11(6) or 12(4) if there are internal law provisions restricting the application of such provisions to interest or royalties paid to non-residents.

389. The issue does not arise in Canada, although it applies its thin capitalisation rules only to non-residents, because all Canadian treaties amend the ownership provision to make the comparison with an enterprise owned by third-state residents, see *supra* note 349. On that basis, there is no discrimination.

390. Para. 66 of the Commentary on Art. 24. Formerly there was also a nationality discrimination in that only French parent companies were excluded from these provisions, but following Finance Act 1989, Art. 73.1, non-French national parent companies can qualify for exemption so long as they are taxable in France, which in practice means that there is a permanent establishment in France to which the shares in the French company are attributable: see G. Blanluet, "Thin Capitalisation and Non-discrimination," 31 *European Taxation* (January-February 1991), at 56.

391. France - Turkey (1987) specifically excepts domestic thin capitalisation rules from the operation of the non-discrimination article in a protocol. The following treaties preserve application of the rules in Art. 212 of the CGI: Argentina (1979), Bulgaria (1987), Congo (1987), Cyprus (1981), Egypt (1980), Hungary (1980), Jordan (1984), Korea (1979), Malta (1977) and Mauritius (1980). France - Sweden (1936) did not apply to prevent the thin capitalisation rules in the SAS case (*supra* note 385), but the treaty is not in the form of the OECD Model.

392. *E.g.* Finland - Indonesia (1987).

393. I.R.C., Sec. 163(j).

394. See R.L. Doernberg and K. van Raad, "The Legality of the Earnings-Stripping Provision under U.S. Income Tax Treaties," 2 *Tax Notes International* No. 2 (February 1990), at 199-206.

395. See *supra* note 336.

396. See *supra* note 377.

397. The phrase beginning *notwithstanding* was new to the 1977 OECD Model, but must be implied in the earlier version. Presumably, it is sometimes omitted from treaties made after the 1977 OECD Model for this reason, see *e.g.* Netherlands - United Kingdom (1980) and United States - Bangladesh (1980), although the article may have been negotiated before the 1977 OECD Model was published.

398. Para. 58 of the Commentary on Art. 24. The United States normally includes all taxes, specifically including state and local ones, and this addition is contained in the U.S. Model; exceptions are the treaties with Barbados (1984), Bermuda (1986) and Canada (1980) limited, in relation to the United States, to taxes in the Internal Revenue Code. No extension to the taxes covered is made in the U.S. treaties with: Australia (1982), British Virgin Islands (1981, never in force), China (1984), France (1967), Ireland (1949), Japan (1971), New Zealand (1982), Pakistan (1957), South Africa (1946), Thailand (1965, never in force) and Trinidad and Tobago (1970). In Netherlands - Germany (1959, amended 1980) there is a specific reference to treaty taxes in the permanent establishment provision but not in the other provisions of the non-discrimination article which does not contain a provision defining taxes; the reason for the specific reference is not clear since presumably only treaty taxes are covered throughout the non-discrimination provision. Occasionally only national taxes are included, *e.g.* United States - Sri Lanka (1985) and Netherlands - Canada (1957).

399. U.S. treaties occasionally exclude customs duties, *e.g.* United States - Netherlands Antilles, - Aruba (1986, never in force), - U.S.S.R. (1973, by an exchange of letters) and - Germany (1990, in the Technical Explanation). As Arnold, *supra* note 2, at 33, points out, tax-substitutes such as oil and gas royalties are not covered. If a discriminatory relief is given by way of a government grant, this is presumably not prevented as it is not strictly a tax relief, although the two may be equivalent. As the OECD has noted: "tax reliefs which are used to implement government programmes are increasingly being referred to as tax expenditures, in part to emphasise their similarity to direct expenditure programmes and in part to ensure that they are subject to similar budgetary control procedures as are other government expenditures." See van Raad, *supra* note 22, at 261.

cle 9³⁸⁸ on the ground that provisions of the OECD Model should not be construed as conflicting with each other, it would have been better if there had been a specific reference to that article in the ownership provision, as there is in the deduction provision.³⁸⁹ Apart from Australia, Canada and New Zealand, who reserved their positions on Article 24 generally, the only state to make a specific reservation against the deduction provision is France,³⁹⁰ which has preserved its domestic thin capitalisation rules in some of its treaties.³⁹¹ Occasionally other countries include reference to thin capitalisation provisions in their treaties.³⁹²

The new U.S. internal law provision³⁹³ denying an interest deduction for certain payments to related tax-exempt parties raises similar issues. The provision overrides treaties, although it has been argued that similarly situated persons are treated similarly. There is, however, no reference to similar persons in the deduction non-discrimination provision, and the reference to similar enterprises in the ownership non-discrimination provision suggests similarity except for the residence of the shareholder. It is considered that the United States breached both provisions, although the issue cannot be tested as the legislation is stated to override treaties.³⁹⁴

E. Conclusion on the deduction and ownership provisions

The possibility of the ownership provision applying in relation to liquidation distributions to a foreign parent³⁹⁵ and other intra-group transactions when there is a foreign parent shows that the plain words of the provision can lead to unintended results. This suggests that it should be restricted to the internal taxation of the enterprise and not to distributions from the enterprise where assets leave the state's tax system. Clarification of this is needed either by modifying the wording of the OECD Model or the Commentary. The deduction provision, for example in relation to trust distributions in Canada,³⁹⁶ also shows the potential dangers of this provision applying to treat non-residents more favourably than residents.

In relation to thin capitalisation, we believe that a specific exception from the ownership provision should be made for re-characterisation of debt as equity in accordance with Article 9, as is done in the deduction provision.

V. THE DEFINITION OF TAXES PROVISION

The last paragraph of the non-discrimination article provides:

7. The provisions of this Article shall, notwithstanding the provisions of Article 2 [taxes covered],³⁹⁷ apply to taxes of every kind and description.

The Commentary makes clear that all types of taxes, including those levied by the state's political subdivisions and local authorities, are covered.³⁹⁸ The definition of taxes provision is extraordinarily wide³⁹⁹ and it is surprising that it has not been invoked more often, although sometimes in practice there are limitations made in treaties to extending the provision beyond the taxes covered by the treaty. For example, Canada never extends the taxes covered, and

most other states represented sometimes extend them and sometimes do not.⁴⁰⁰ The existence of such a provision in income tax treaties is presumably the reason why most states do not include a non-discrimination article in estate tax treaties.⁴⁰¹ Non-discrimination provisions are difficult to apply to estate taxes, particularly with common law states applying a donor-based tax, whereas the provision was designed for an income tax, which is donee-based.⁴⁰² The United Kingdom and the United States however, normally include a non-discrimination article in their modern estate tax treaties. In the United Kingdom-Sweden estate tax treaty (1980), there is no non-discrimination article, presumably because in the income tax treaty the non-discrimination article covers all taxes. All other estate tax treaties made by the United Kingdom after the introduction of the capital transfer tax in 1974 contain a non-discrimination article.⁴⁰³

Examples of discrimination concerning taxes not included in the taxes stated to be covered by the treaty which are prevented by this provision include, in relation to the nationality non-discrimination provision, the U.S. excise tax on premiums paid to a foreign insurance company in respect of U.S. risks,⁴⁰⁴ the French three percent per annum tax on foreign companies owning French real property,⁴⁰⁵ the real estate transfer tax⁴⁰⁶ in the Netherlands and the Spanish tax on work permits.⁴⁰⁷ In the 1963 OECD Commentary, Ireland made a reservation about charging higher stamp duty on the purchase of agricultural land by aliens.⁴⁰⁸ Other examples include, in relation to the permanent establishment non-discrimination provision, the capital duty payable on contributions to German branches, unless the company is established in the EC,⁴⁰⁹ and in relation to the ownership non-discrimination provision, the exemption from the EC capital duty on reorganisations as applied in the Netherlands.⁴¹⁰

VI. CONCLUSION

Having looked at each paragraph of the non-discrimination article, we can now consider how effective the article is as a whole in its purpose of preventing discrimination. The main problem is that, like "the dog [which] did nothing in the night-time,"⁴¹¹ we suspect that most of the effect is on statutory provisions which were never enacted because they would have been prevented by these provisions. It is not surprising therefore that there are few cases where internal law provisions have been upset by non-discrimination provisions. But our overall impression of the cases which have been raised is, the non-discrimination provision has not been as effective as it might have been. There is a considerable reluctance on the part of tax authorities and courts to accept that an internal law provision is contrary to the non-discrimination article. This is not an approach which we wish to support, as there is no reason why the non-discrimination article should be interpreted in a different way from any other treaty article. But one of the reasons for the reluctance to apply the ordinary meaning of the non-discrimination article is that it may be felt to be too inflexible in not recognising so-called valid reasons for what would appear to be discriminatory tax provisions, which are designed to preserve the integrity of the tax system. If one were starting again, something

which gives more room for justifying certain differences in treatment would be preferable. For example, the word discrimination is used only in the heading of the article, which, although it is part of the context within the Vienna Convention of the Law of Treaties,⁴¹² may not be sufficient to increase the scope of the ordinary meaning of the terms of Article 24. This leaves no room for arguing, for example, that different treatment is justified by the different circumstances of the two taxpayers or even that there is

400. Canada cannot bind its Provinces, although this limit on its power would not prevent extension of a treaty non-discrimination article to other federal taxes. Other cases which limit this provision to treaty taxes are to be found in: 31 U.K. treaties, compared to 34 treaties following the OECD Model, although the extension to other taxes has no effect in the United Kingdom since the enabling legislation under which treaties have effect by Order in Council covers only income tax, capital gains tax and corporation tax; before F.A. 1991, Sec. 16, there was an example of discrimination in VAT affecting grouping of a permanent establishment; 18 German treaties; nine Italian treaties: Brazil (1978), Canada (1977), India (1981), Malaysia (1984), Netherlands (1957), Philippines (1980), Portugal (1980), Singapore (1977) and U.S.S.R. (1985); nine Japanese treaties: Austria (1961), Canada (1986), China (1983), India (1960), Indonesia (1982), Malaysia (1970), Pakistan (1959), Singapore (1971) and United States (1971); seven Dutch treaties: Italy (1957), Luxembourg (1968), Pakistan (1982), Singapore (1971), Surinam (1975), South Africa (1971) and Yugoslavia (1982); seven Belgian treaties: Norway (1967), Indonesia (1973), Malaysia (1973), Sri Lanka (1983), India (1974), Portugal (1969) and Singapore (1972); four Swiss treaties: Canada (1976), Malaysia (1974), Singapore (1975) and South Africa (1967); three French treaties: Malaysia (1975), Philippines (1976) and Singapore (1974); and the only Australian treaty containing a non-discrimination article, United States (1982). See *supra* note 399 for U.S. treaties. Poland normally excludes various registration fees, such as the residence registration fee and the permit to open an enterprise, from the scope of this provision.

401. The OECD 1966 estate tax non-discrimination provision is the same as the 1963 income tax model, but the 1983 estate tax model non-discrimination provision only contains the nationality, stateless persons and definition of taxes provisions, on the grounds that the remainder was not relevant to estate taxes. Two Belgian estate tax treaties, Sweden (1956) and France (1959), contain non-discrimination provisions limited to estate taxes.

402. The United States discriminates against non-U.S. national spouses in its estate tax, but this does not appear to be prevented by the nationality non-discrimination provision.

403. All U.K. estate tax treaties containing a non-discrimination article limit its effect to treaty taxes, whereas, with the exception of the one with the United Kingdom, the United States includes all taxes, as do both versions of the OECD estate tax model.

404. See *supra* note 117. The United States - United Kingdom treaty (1975) includes this tax as a treaty tax which normally prevents its being charged when a U.K. insurer has no permanent establishment in the United States, since the equivalent of OECD Model Art. 7 will apply to it.

405. See C.G.I., Art. 990D, and *supra* note 47.

406. See *supra* note 113.

407. Germany - Spain (1966) (protocol).

408. Para. 21 of the 1963 Commentary on Art. 24. This is not repeated in the 1977 OECD Commentary because it no longer applies.

409. See Decree of Ministry of Finance of Lower Saxony of 31 October 1974 in Korn/Dietz, *Doppelbesteuerung, Systematic Supplement (Systematik Anhang)* B III, 160. The charge arises under Kapitalverkehrssteuergesetz [hereinafter "KVStG"], Sec. 2(1) No. 6.

410. A reduction in capital duty on shares issued by the Dutch transferee company is granted in reorganisations where the transferring (parent) company is resident in a member state of the EC. It follows that a transferor company incorporated in a treaty partner state outside the EC may entitle the Dutch transferee company to the same relief under the ownership provision, see van Raad, *supra* note 308, at 351. The Dutch courts accept that this is discriminatory but say that nothing can be done about it as the discrimination is imposed by the EC Directive on capital duty. It is not clear why this prevents extension of the relief to third states.

411. "Is there any point to which you would wish to draw my attention?"

"To the curious incident of the dog in the night-time."

"The dog did nothing in the night-time."

"That was the curious incident," remarked Sherlock Holmes. *The Memoirs of Sherlock Holmes*. Silver Blaze.

412. Art. 31(2).

covert discrimination by, for example, having a rule expressed as relating to non-residents, which is effectively discrimination against non-nationals.⁴¹³ In connection with the EEC Treaty, which does use the term in the text of Article 7, *discrimination* has been defined by an author as: unequal treatment in situations which are identical or comparable.... Each of the relevant articles of the Treaties are however "merely a specific enunciation of the general principle of equality which is one of the fundamental principles of Community law. This principle requires that similar situations shall not be treated differently unless differentiation is objectively justified."

Different treatment constitutes no discrimination when it is objectively justified or at least in economic matters not arbitrary.⁴¹⁴

A similar approach was taken by an English judge: "Time was when to discriminate in English meant to differentiate on wise and discerning grounds; now it means often...to differentiate without such grounds."⁴¹⁵ Differentiation with justification does not therefore amount to discrimination. In contrast, the OECD Model merely lists a number of circumstances requiring at least equal treatment, regardless of whether the grounds are justified or not,⁴¹⁶ namely:

- taxation (and connected requirements) of treaty partner nationals must not be other or more burdensome than a state's own nationals in the same circumstances;
- taxation of a permanent establishment of a treaty partner resident must not be less favourably levied than on resident enterprises carrying on the same activities;
- interest, royalties and other disbursements paid to a treaty partner resident must be deductible under the same conditions as if paid to a resident;
- enterprises with capital owned by treaty partner residents must not be subjected to other or more burdensome taxation (or connected requirements) than other similar enterprises.

This enumeration leaves, in our view, no room for recognising that there may be good grounds for the differing treatment in a particular circumstance because of the different circumstances of a non-national, a permanent establishment, a non-resident recipient of a payment, or a foreign-controlled enterprise, respectively. The consequence is that some discriminations, which from a tax policy perspective appear perfectly reasonable, have been justified by tax authorities on grounds which are difficult to reconcile with the wording of the OECD Model, often by claiming that the circumstances of the two taxpayers are not similar. The United States has attempted to argue that discrimination can be justified if it is based on a different *reason* from nationality or residence, such as the prohibition on non-resident aliens being shareholders in an S corporation being based on their not being net basis taxpayers. We do not think that this approach is correct on the wording of the OECD Model, although it might be if the expression *discrimination* were used in the text of the article.⁴¹⁷ This point was very clearly made in the United States in the House Reports in connection with the Omnibus Reconciliation Act 1989:

Some U.S. tax provisions under current law affect only foreign-owned United States businesses, but these provisions are designed solely to provide comparable treatment for these and other United States taxpayers in areas where the fact of foreign ownership interferes with the effective operation of

domestic tax rules.... In short, different but comparable tax treatment that reflects the different circumstances of foreign-owned and domestic-owned businesses does not necessarily constitute discrimination against foreign-owned businesses.

While not agreeing with its application to earnings stripping, in which context these remarks were made, we can sympathise with the intention behind them.⁴¹⁸ The problem is that, while a different treatment of foreign-controlled enterprises, which is designed to provide comparable treatment to those controlled by residents, may not be discrimination in the sense of the EEC Treaty, it may, and normally does, contravene the specific prohibition under the OECD Model against, in this case, other or more burdensome taxation of foreign-owned enterprises compared to similar domestically owned ones.

We can repeat from our previous discussion of each of the provisions a number of examples of perfectly reasonable discrimination which are hard to justify on the wording of the OECD Model. Under the nationality provision, companies incorporated and resident in the treaty partner state do not benefit from the same reliefs in the state applying the non-discrimination provision as companies incorporated there and taxed there as residents. On the face of it, this may violate the wording of the nationality non-discrimination provision in relation to companies which are nationals of the other state, but there is no reason for them to receive such allowances as they are not being taxed as residents in the state applying the non-discrimination provision. The issue is whether the circumstances of these two companies

413. Schermers and Waelbroeck, *Judicial Protection in the European Communities*, 4th ed. (Deventer: Kluwer, 1987), at 65 Para. 120, citing the *Sea Fisheries case (Commission v Ireland, Case 61/77 [1978] 2 C.M.L.R. 516)* in which Irish legislation detrimental to large fishing vessels was discriminatory because large vessels were in fact used only by foreign fishermen. It does not contravene the non-discrimination article to give discriminatory subsidies, which may be equivalent in effect to tax reliefs (tax expenditures). Granting a discriminatory relief as government subsidy, rather than as a tax relief which would be prevented by the non-discrimination article, might be another example of covert discrimination. It might also be asked why the article does not relate to subsidies as well as taxes.

414. Schermers and Waelbroeck, *Id.*, at 62, Para. 116 (footnotes omitted). The quotation incorporated in this passage is from *Ruckdeschel v. Hauptzollamt Hamburg-St. Annen*, [1979] 2 C.M.L.R. 445, at 481. See also Vogel, *supra* note 154, marginal number 5 to Art. 24, which discusses a definition under German internal law where discrimination occurs if there is no reasonable argument in favour of different treatment.

415. *Berkeley Administration v McClelland*, [1990] 2 W.L.R. 1021, at 1037, C.A. per Staughton L.J.

416. The French *Conseil d'Etat* decision in the SAS case, *supra* note 385, is an example of literal interpretation of a non-discrimination provision, although not a similar one to the OECD Model.

417. It should, however, be pointed out that in the OECD publication, National Treatment for Foreign-controlled Enterprises, which applies a test similar to the ownership non-discrimination provision but requiring control, it is stated that "... the real key to determining whether a discriminatory measure applied to foreign-controlled enterprises constitutes an exception to National Treatment was to ascertain whether the discrimination implied by that measure was actually motivated, at least in part, by the fact that the enterprises concerned are under foreign-control" (Para. 3.5(c)). The motivation for the internal law provision would not be an appropriate test for determining whether there was discrimination for tax purposes.

418. The A.L.I. Tax Project, *supra* note 181, at Part IV I.A.1, argues for a general principle of interpretation that reasonably comparable tax treatment should be permitted: "... it is neither appropriate nor administratively workable for every tax measure adopted by a country to be subject to invalidation through a strict and literal application of the general principle [of non-discrimination] to the great variety of issues that may arise amid the many complexities of modern economic life."

are the same. We have argued that they are not, except where the dual residence article can be applied so that both companies have the same residence for treaty purposes.

Intentional covert discrimination does not seem to have featured in tax cases, as it has under the EEC Treaty.⁴¹⁹ The French law applying the three percent tax to companies with their seat outside France, whatever their nationality, would have come close to being covert discrimination if it had not been held to be invalid, since companies incorporated in France must have their seat in France and therefore could not have been subject to the tax.

The permanent establishment non-discrimination provision is, as the Commentary states,⁴²⁰ particularly hard to apply, as is demonstrated by the 35 paragraphs of commentary explaining it, with four suggestions for clarifications to be included in treaties, compared to the single paragraphs concerning each of the ownership and deduction provisions. As an example, many countries fail to give a credit for foreign tax to a permanent establishment, which is said to be justified on the basis that a double credit might otherwise be obtained, in the permanent establishment state and the residence state, which we have shown to be an incorrect argument. The permanent establishment provision prohibits a branch profits tax, which many states regard as a substitute for the five percent withholding tax permitted in the OECD Model for inter-group dividends.⁴²¹ Many treaties are modified to permit charging a branch profits tax, but a country introducing one will not be able to make it effective in relation to treaty partner residents if its treaties contain the permanent establishment non-discrimination provision.

The deduction provision could, on its wording, permit deduction of payments by trustees to a non-resident beneficiary out of Canadian business income, thus placing the non-resident in a more favourable position than a resident, which is not something one would wish to achieve with a non-discrimination provision. The ownership provision provides a particularly striking example where its literal wording allows transfers of assets from a domestic subsidiary to a foreign parent without any tax liability, if this is the case between two domestic companies. The United States has argued that foreign companies and tax-exempt domestic organisations are similar enterprises in an attempt to justify the different treatment of liquidation distributions by an 80 percent subsidiary. This seems a doubtful interpretation of *similar enterprises*. The discussion in

the OECD paper on thin capitalisation about whether domestic thin capitalisation provisions are prevented from applying by the non-discrimination provision also shows the dangers of this approach.

It might be thought that the difficulties in these cases would be solved if the article referred to discrimination, with the same meaning as in the EEC Treaty, which would allow different treatment when it is justified. This could be made clear in the Commentary, or by an express reservation in the OECD Model itself for discrimination justified from a tax policy perspective. To return to the last of our examples, if the ownership provision had said that one must not *discriminate* against foreign-owned companies, it would be possible to argue, in a similar way to the United States House Report quoted above, that denial of relief for liquidation distributions was justified and therefore did not amount to discrimination, as the asset would pass out of the taxing jurisdiction of the subsidiary's state. But it is far from clear that the same result can be obtained under the OECD Model by arguing that the subsidiary owned by a domestic tax-exempt organisation is not a similar enterprise to a subsidiary owned by a foreign parent. But the problem of this approach is that, except in extreme cases like this last example, a state will always be able to justify discrimination by some policy argument because it is unlikely to introduce arbitrary discrimination in its law. Since there is no international norm against which such policy arguments could be measured, this approach would be generally ineffective. A limited solution might, however, be for the OECD to provide in the Commentary a list of exceptions to the wording of the OECD Model to deal with the more obvious points. If states wanted to preserve other discriminations they would need to be careful in negotiations to endeavour to exclude them from the ambit of the non-discrimination article. The United States has done this in relation to discrimination against non-residents on nationality grounds. Canada has been careful to do this by making the comparison in the ownership provision with third-state residents, rather than with residents of the state applying the provision. Other states need to do the same.

419. See *supra* note 414, and *Biehl v. Administration des Contributions du Grand-Duché de Luxembourg* (Case C-175/88) (1991) S.T.C. 575 in which a Luxembourg law based on residence was held to be covert discrimination by reason of nationality.

420. Para. 25 of the Commentary on Art. 24.

421. OECD Model, Art. 10(2)(a).

CUMULATIVE INDEX Nos. 1-9

ARTICLES

European Communities:

Dr. Roger H.A. Muray:

European Direct Harmonization -- Progress in 1990

74

Jonathan S. Schwarz:

Taxation of Undertakings for Collective Investment in Transferable Securities

51

Helmut Becker and Otmar Thömmes:

Treaty Shopping and EC Law

173

Canada:

A.B. McKie:

Reincarnation of Death Taxes

243

Eastern Europe:

Dr. Willem G. Kuiper:

The Multilateral CMEA Tax Treaty: Its Relevance Today
France:

246

Henry Lazarski:

Real Property Companies -- The Acquisition of Shares Versus Assets

131

Germany:

Claudia Daiber and Dwayne Reid:

Tax and Commercial Reporting Requirements for Resident Corporations With Permanent Establishments in High Inflationary Countries

220

Rainer Prokisch and Michael Rodi:

Double Taxation Conventions after Reunification

263

International:

Christo J.A.M. van Gennepe:

Dual Resident Companies -- The Second Sentence of