Question 1

Introduction

The first model tax agreement was introduced by the OECD in 1977, then updated in 1992 and periodically thereafter to keep up with the changing landscape of international tax.

The two main purposes of a double taxation agreement (DTA) are the allocation of taxing rights in order to eliminate (or at least minimise) double taxation, and the prevention of tax evasion.

It also has a dual purpose in another sense, that it is both an instrument of domestic and international law. Any company that operates in more than jurisdiction has the potential to be subject to tax by more than one country.

Countries tends to tax residents on their worldwide income and assets, as well as claiming the rights to apply source taxation to income, which arises in their jurisdiction. Therefore, if a company is operating cross border it may be subject to source tax from the state it receives its income from, and residence tax in its home state.

Types of double tax agreement

There are various models, which are used to form the basis of a double tax agreement negotiation. The most widely globally used is the OECD model tax convention (MTC), which we shall use as the model for our discussion below. There are other models though, which are very similar including the UN model, which encourages broader source taxation and tends to be used between developing and developed nations, and the US model, which the US use as their template in all negotiations, which includes the concept of citizenship, and has limitation of benefit clauses.

The problems of Double Taxation

Juridical double taxation is where the same income is taxed in the hands of the same taxpayer by two different tax authorities. This could occur where a company in state A receives an interest payment from state B. State B may apply an interest WHT on the interest payment, and state A may tax the interest income as profits arising in A. This is the main kind of double taxation, which the DTA seeks to minimise.

Economic double taxation is where the same income is taxed by two different tax authorities in the hands of two different taxpayer. This might happen if one country requires a transfer pricing adjustment, and that income has already been taxed elsewhere (assuming a compensating adjustment has not been claimed)

Double tax is considered to be a bad thing. If a company is taxed on the same income more than once they can end up suffering a very high rate of taxation. This cost might mean they are unable to compete with a local company which is not subject to the same level of taxation on similar levels of income. The tax cost could become so crippling high as to prevent the company from being able to survive.

How the DTA reduces double taxation

The DTA minimises double taxation, firstly by allocating taxing rights. Certain types of income (such as royalties in the MTC model) or employment income (assuming <183 days spent in the other state), are only taxable in the state of residence. The source state is denied any taxing rights

And where the source state is permitted to levy tax on certain types of income, the DTA also restricts the amount of tax which source states may apply in some circumstances, such as in Article 10 the MTC sets a cap of 5% on dividend income (where 25% share capital is owned) or 15% otherwise. Likewise, Article 11 restricts the level of source tax on interest payments to 10%.

Where source tax is permitted, it has priority over residence tax. To the extent that both source and residence taxation is permitted, article 23 A & B prescribe a means for the residence state to give relief for the overseas tax suffered.

The credit method gives relief for the foreign tax suffered by way of a deduction from the total tax due in the residence state.
The alternative method is the exemption method, whereby profits which have already been subject to taxation at source are excluded from the tax calculation in the state of residence.

The MTC also allows a mechanism for the tax authority to make a transfer pricing adjustment under Article 9. Here if a multi-national enterprise has priced a transaction at a price other than that which would be expected to be concluded between independent parties, then the tax authority can request an adjustment to make it an arms length price.

Article 9 also offers the taxpayer the opportunity to claim for a compensating adjustment in the other corresponding country so that they do not suffer double economic taxation as a result of the income adjustment.

Prevention of Evasion

The second purpose of the double tax treaty is to prevent evasion. It has several clauses in which it achieves this to some extent.

The reference to "beneficial owner" in the interest, dividend and royalties articles (10, 11 & 12) means that treaty benefits can be denied if a conduit has been used. i.e. where a company in a specific territory has been inserted in the transaction chain in order to obtain specific treaty benefits ("treaty shopping"). The beneficial ownership clause means double tax treaty benefit can be denied if the conduit entity doesn't have the rights to enjoy the income itself (i.e. the entity might be contractual or legally obliged to pass the income on - though not necessarily a requirement)

In addition the OECD commentary to article 1 states that the MTC does not have to grant benefits where an arrangement has been undertaken with the main purpose of securing a favourable tax position (9.4)

There is also at present an optional limitation of benefits (LOB) clause in the commentary. This denies treaty benefits to people/companies not meeting the fit and proper requirements.

There are changes coming in to the next version of the MTC following the BEPS Action Plan 6 - treaty abuse (Base Erosion and Profit Shifting), which means in future treaties either the LOB clause plus and anti-conduit rules will be introduced into the main body, or a principle purpose test with LOB. These will therefore be gradually adopted as countries refresh their old treaties or enter into new ones.

The Mutual Agreement Procedure

A really useful tool within the double taxation agreement is the mutual agreement procedure (MAP). This is a process whereby if there is a disagreement between two tax authorities on the treatment of income, leading to double taxation, then the taxpayer can apply for MAP in order to request that the parties involved endeavour to reach an agreement. If no agreement is reached, it is now possible (since 2008 if the clause is included in the relevant DTA) for the taxpayer to apply for arbitration, whereby an independent panel

MAP is used even more widely, that is can be used to approve an Advance Pricing Agreements (APA) between two contracting states. This way a taxpayer can obtain some certainty in advance of undertaking a transaction on how to price it in order for it to be acceptable to both contracting states.

Article 24 is also used to ensure nationals of one state are not treated in a manner more burdensome than nationals of another.

How do the objectives differ from the past?

The relief from double taxation methods have changed very little. Though there is a trend globally towards increased use of the exemption method. (The UK recently switched over to using the exemption method for dividends instead of credit relief)

There is an increasing emphasis on preventing evasion, as this is a global problem which the tax authorities are increasingly determined to work together in order to clamp down on taxpayers evading paying the taxes that are due. This is seen in the introduction of the principal purpose test and other measures.

In recent years there has been a great deal more use an emphasis of the use of the special provisions articles. The DTA is now a means of allowing tax authorities from different states to exchange information with each other (Article 26). It used to be just used to facilitate information on request, but it has been broaden more recently, and now includes scope for permitting automatic information exchange, as well as spontaneous sharing of information where the contracting state suspects a loss of tax may be occurring in the other state.

And Article 27 was only introduced in 2003, giving a domestic state the jurisdiction to aid with the collection a tax debt of the other contracting state. In the past a foreign court would claim the competence of a states did not extend to the collection of another states taxes - this is known as "the revenue rule" and was quote in Government of India v Taylor legal case. Even as recently as 2008 the US relied on this stance to deny assisting Canada with the collection of Tobacco duties from a US company in the AG Canada case. But now having article 27 in treaties is over-riding this historical approach.

These "special provisions" articles also apply to all taxes, not just those which are subject to the DTA, thus widening the scope of the DTA quite considerably.

<u>Question 2</u>

To: Jacqui
From: T Adviser
Date: 13/12/16
Subject: Tax debt due to WRA

Hi Jacqui

Further to your recent email where you described the tax payment WRA is chasing the NRS for, I have summarised the key considerations for you below.

Timing of Addition of Article 27

There in a new article 27 which was introduced in the double tax convention (DTC) between Namica and Wernita, which permits WRA to request that the tax authorities of Namica assist them with the collection of the debt to WRA.

The revised convention containing this clause is effective from November 2009. I notice that the approach made from WRA was made in January 2012, and therefore after the article was in effect. However, you might question whether, since the debt in question applies to the period 2006-2008, whether the article can be applied.

Unfortunately in this regard it is bad news. The OECD commentary at 14 states that nothing prevents the article being applied to claims that arise before the convention comes into force, unless a specific clause to that effect has been inserted in the DTC. I do not believe any such special provision exists in the DTC in this case, as it follows the OECD model exactly.

Furthermore, there are two recent tax cases where this approach has been further taken by judges. In Ben Nevis Holdings UK, the article was used to helps the south African revenue service collect a debt in relation to a BVI company, where the debt arose from 1998-2000 and the article was only introduced into the treaty from 2008. The funds were in a London bank account, so foreign court requested the UK assist with the collection. The UK court decided the UK could assist in the collection, because the historical nature of the debt was not relevant to the article, so they froze the London bank account of the company, and then permitted the foreign tax authority to collect the debt once the case was settled. A very similar fact pattern existed in the more recent Kook v SARS case where again Article 27 was introduced into the relevant tax treaty after the debt arose, but the supreme court of South Africa still ruled it could be used to collect the historical debt.

These are tax cases of different foreign jurisdictions to Namica, so the foreign case law is only of persuasive value, I think it quite likely Namica would ultimately conclude this interpretation also. The inclusion in the OECD commentary is relevant, because if the case went to court the Vienna convention allows the use of supplementary aids, such as commentary, under article 32 (If the meaning using items described in article 31 is still not clear) and this would permit the commentary to be considered.

It is however necessary that the article has been brought into effect before the request for information is made. This seems to be the case as the request was made in January 2012 and the article was effective from November 2009.

It may depend on whether the Namica court takes a static or ambulatory approach to their treaty interpretation. If they take a static approach then they should consider the laws in place at the time the agreement was signed, thus the conservancy measures should not be possible. If they take an ambulatory approach, then they will include measures introduced after the treaty was signed, and they may still seek to apply the conservancy measures.

Timing of Conservancy Measures

I notice that Namica only introduced conservancy measures into their domestic law in 2012, with effect from 1 October 2012. This date is after the date the WRA requested assistance in January 2012. The WRA should not therefore be permitted to request the funds are not dissipated

Whether or not this will make much difference given the assets are already under state supervision without you having access to move them I am not completely sure yet. I will research on what date those assets should cease to be under state supervision, as there is the possibility you might be able to move the assets once the state supervision expires say after a 10 year period from you having moved away. I will need to study in closer detail the operation of the Namica state laws to ensure such a move would be permitted, but this is an avenue we may be able to explore. It is possible due to the timing of the request that Namica may not be allowed to hand over the funds to the WRA.

I notice that the NRS have obtained a court order on WRA's request for your property in Namica to be put under the hold of a legal representative. I believe this action is not legal. Because the conservancy laws came into Namica after the last update to the double tax convention, the convention cannot have included paragraph 4 in relation to conservancy measures (OECD commentary 19 - this measure should only be included by states able to undertake conservancy measures under their own laws) Therefore the conservancy measures are not permitted to be undertaken by NRS in this regard.

There are some other possibilities which might enable us to contend the NRS should not help.

Legal and Beneficial Owner

We might have a line of approach in questioning the justification of the WRA debt. I understand that it arises on the assets which were under the state supervision of Namica, on the basis that you were the legal and beneficial owner at the time.

I would need a little bit more information on the assets in question, and to what extent you benefited from any capital growth, or interest on monetary sums, whilst these amounts were being held by Namica. That will allow me to analyse whether you really were the beneficial owner of hose assets during the time. The beneficial owner should be the person who ultimately enjoys the benefits from the ownership of those assets. As these assets were not at your disposal whilst held by Namica, I think we might be able to fight it on this point.

Further rights to appeal

The OECD commentary also recommends that claims only be collected when there is no further right of appeal. As we have not finished fighting your case with the WRA, I do not believe such a point has been reached., Therefore NRS should not settle the claim at this stage.

WRA is supposed to have already exhausted all domestic means available to ti before requesting the NRS assist with the collection.

Whilst we had discussed that the article 27 may be applied to historical claims already, the commentary states in paragraph 24 to article 27 that after a certain period of time the states in question may agree the obligation to collect the revenue claim no longer exists. As the debt relates to 2002-2008 it is already quite old - so we might be able to run this argument with the NRS, but only if they are willing.

So Jacqui - all is not yet lost. We do have some opportunities to explore. And the first thing I will do is file an injunction against the court order for your Namica assets, as I believe the move is not permitted under the double tax treaty currently in force.

Kind regards

T Adviser

<u>Question 3</u>

Introduction

Harmful tax competition is the concept that it is damaging to the world economies for countries to compete with each other on the basis of preferential tax regimes.

In the modern era where many company operate on a mutli national basis, they have the ability to decide to some extent which jurisdictions they earned their money in, in particular in relation to highly mobile income such as interest income and royalties. The concern is that multi national will choose to earn these profits in the low tax jurisdictions, and pay little or no tax in the other territories, thus avoiding paying their fair share of tax in the more developed OECD countries.

The OECD produced a report in 1998 describing harmful tax competition as an emerging global issues. Since then it has increased in importance and various measures have been developed to counteract the issue as business operate in an ever more globally orientated marketplace.

Economic Analysis

Von Schanz said that to the extent a person benefits from the obligations of the commune, they should be expected to contribute towards the cost of the commune, whether it be as a result of being a resident there or earning income there. This is where the basis of taxation comes form. So the fear with harmful tax competition is that sufficient taxes wont be paid to benefit the commune of the non-harmful regimes, and so those countries will lose out.

In theory, in a world of perfect competition, having different tax rates would lead to everyone locating their business to the country with the lowest tax rate. This could lead to a race to the bottom. If everything else was equal, companies would choose to operate in the lower tax jurisdiction in order to save costs. Thus the other territories would be forced to bring down their tax rate in order to compete.

However, there is some suggestion that this balance would eventually right itself. Those states receiving less income from taxes would not be able to invest so much in infrastructure, which could lead to the creation of other competitive differences and business choosing to locate elsewhere for no-tax reasons.

Features of harmful tax regimes

Typically a harmful tax regime will have no or low effective tax rates. This will be the underlying incentive for attracting overseas investment in the first place. These low taxes might be both on profits themselves, as well as having low rates of withholding tax on payments made out of the territory.

Often overseas investment is encourage to the detriment of local business, i.e. foreign investment is ring-fenced, with different (more beneficial) tax rules being applied to those investors as opposed to local businesses.

Generally these harmful tax regimes have a lack of transparency. Their investors like to maintain their privacy and not have to disclose things like who the beneficial owner of companies are etc, and not having to publish accounts etc.

Harmful tax regimes usually don't have much by way of information exchange measures for the same reason, because their investors prefer to not have to share their income details with tax authorities of other nations.

They are often generally associated with a lack of q requirement for underlying economic substance in order to benefit from the beneficial tax regime there. This is the item that is of primary concern to the OECD countries, as it enables companies to shift income there without really having much requirement to have the underlying business really being undertaken from there.

Locations with harmful tax regimes are often considered tax havens. It is also desirable to investors, if in addition to the above criteria, the haven also have some of the following
- good communication networks
- stable local currency
- good access to work permits
- good legal, accounting and tax advisors
- good banking system
- stable government

Measures to counteract harmful tax competition

In the 1998 the OECD report recommended various measures to counteract harmful tax regimes, and these have been developed quite significantly in recent years.

Tax treaties

To the extent that blacklisted countries failed to either change their rules to make them less harmful, or fail to comply re provision of information, the OECD recommended that countries terminate any double tax treaties with those territories (so their investor could not benefit from relief from double taxation) or refuse to enter into treaties in the first place.

Blacklist

A blacklist was created onto which were added by the OECD all countries thought to have a harmful tax regime. Countries were able to be removed from this list if they introduced certain measures, such as provision of information, removal of secrecy rule etc.

Gradually these blacklisted countries managed to get themselves removed from the list by becoming compliant with the OECD's requirements, and in particular by entering into Tax Information Exchange Agreements (TIEAs). Whereby at least the OECD countries were then able to see how much income was being held in these tax havens, and judge whether any tax was being avoided.

To the extent that any of the territories were linked to OECD countries, pressure was applied via those countries i.,e the UK to its crown dependencies and overseas territories (CDOTs),
Netherlands to Netherlands Antilles as was to encourage them to comply.

CFC Rules

In the harmful tax report countries were encouraged to introduce CFC rules. CFC rules differ by country, but all have the objective of being able to tax profits which are held offshore in a subsidiary in a low tax jurisdiction. They enable the parent to charge tax on a "deemed dividend" from the subsidiary, ie a means of charging tax on the profits within the tax haven company, even though those profits are subject to neither resident or source taxation in the parent. This way, even if profits were being kept permanently off shore in a base company or envelop jurisdiction, the parent company still has some recourse

Often one of the criteria is a low rate of tax. For example the UK considers any rate below 75% of the UK rate as a low tax. The US consider 90% of the US rate.

Another requirement to apply the CFC charge is that there is little or no economic substance to the activity in the tax haven subsidiary.

It is important that the CFC rules are not too widely drawn though. The EU denied in the Cadbury Schweppes cases where the UK parent claimed a CFC charge in relation to the Irish subsidiaries. The CFC charge was denied because it did not capture just wholly artificial cases.

More recent developments

The EU have intorudced their anti-tax avoidance package in 2016. This includes the requirement for all EU member states to introduce CFC rules. Most EU states have these already, but now it will extend to all of them. The CFC rules must however contain an exclusion fo substantive econmic activities, so only wholly artificial arrangements are caught.

There have also been significant information exchnage improvements. OVer 100 countries have signed up to the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters, which allows for the exhcnage of information on request, spontaneously when tax loss is suspected, and auhtomtically for certain data. These countries are all entering in MAAs agreements whereby they will exchange set information automatically (without request). Again this is greatly going to increase visibility fro the tax authorities.

The country by country reporting requirements introduced from 2016 following the BEPS project means there will be a much greater level of visibility on profits and income arising in all jurisdictions, which will give the global tax auhtorities greater tools with which to combnat tax evasion.

Other views beyond the OECD

It is worth noting that not everyone shares the OECD's views on harmful tax competition. The US took a dim view of the 1998 report, considering it to be "bullying" of less developed countries by the developed OECD states. The US considers that allowing some competition on the basis of tax is not necessarily a bad thing. There are other drivers to investment and tax is only one of those factors.

Tax Competition within the OECD

Whilst the members of the OECD in theory believe tax competition is bad, there is no doubt that individual countries, despite being members of the OECD, do still use tax a means to compete. There is a global trend in the reduction of tax rates. The UK has dropped its rate in recent years from 28% down to 20%, and will decrease it further 17% in the future. Other European countries look set to drop their rates also. Ireland seems to have benefitted from its low tax rate policy, with their rate of 12.5%, the lowest rate within the OECD, and a country that has been subject to much criticism for its tax regime.

The EU

The EU has rules against the freedom of estlabishment. under this rule it is unfair for nationals of one member state to be treated more favourably than nationals of another member state. Therefore countries are not allowed to introduce subsidies which are beneficial to only their own companies. The UK has recently had to alter and phase a withdrawl of its patent box legislation, as this fell foul of the EU freedom of establishment rule, because it offered a favourable tax rate only to UK companies with IP income re patents.

Question 4

Introduction

A territorial system is one that taxes on a basis of residence or source. They only tax income which arising in or is attributable to their territory.

Most countries tax residents on their worldwide income and profits. They also apply source tax on income to the extent it arises within their territory.

A country's right to tax income is determined by there being some nexus or link between the state and the income being earned. These are known as connecting factors. Conecting factors for residence may include, residence, nationality, citixenship, domicile. Source connecting factors might include situs (the location of an asset) as well as the concept of "pay" and "use"

The pay rule is that source taxation can be applied to by the state where the payeris located. The use rule is that source taxation can be applied by the state where the asset from which the payment is generated is located. I.e. The location which holds the underlying IP.

The US taxes US citizens, regardless of where they may be in the world and where they are deriving their income from. This is why they might be considered to have a non-territorial method of taxation.

Economic Stance

Von Schanz described the concept of economic allegience said that to the extent a person benefits from the obligations of the commune, they should be expected to contribute towards the cost of the commune, whether it be as a result of being a resident there or earning income there.

This links with the concept of a connecting factor.

Vogel said that source was only non-ambiguous in what it excludes, which is taxation under a basis of residence! He was making the point that this concept is very broadly drawn and can include many types of income. This is why it is not unusual for more than one state to claim source taxation rights, due to difference in application of say one country using the pay rule and another using the use rule for a particular type of income.

Economic Considerations of Tax Base

Economists consider that tax should be uniform and neutral so as not to distort the relative competitiveness of different companies.

Capital Export Neutrality

This is the idea that in order to maximise economic output, one should maximise the amount of choice of markets for outbound investors, so tax inwards receipts should be kept the same regardless of the territory which goods/services are being exported to.

This can be achieved by giving full credit relief for source taxation, thus negating any soucre tax paid. Then all exporting companies simply face residence taxation on their progfits, which is the same for every exporter in that state. This would mean giving a refund where the source tax was in excess of the residence tax due - which in practice is not something which many countries would likely do in practice.

Thus a country which wishes to maximise its level of exporting would probably follow a credit based double tax relief system.

Capital Import Neutrality

This is the idea that the best way to boost econmic growth is to allow the consumer the maximum amount of choice of products. This can be achieved if tax levied is the same regardless of the vehicle or means of investment which any overseas companies can use to sell products/services into the state.

It is likely such a state wishing to maximise imports would prefer the exemption method of tax relief, as it is easierr to apply and therefore more efficient.

Non-Territorial Taxation Systems

To some extent CFC rules might be considerred to go against the concept of territorial taxation. CFC rules differ by country, but all have the objective of being able to tax profits which are held offshore in a subsidiary in a low tax jurisdiction. They enable the parent to charge tax on a "deemed dividend" from the subsidiary, ie a means of charging tax on the profits within the tax haven company, even though those profits are subject to neither resident or source taxation in the parent.

It is internationally acknowledged though that CFC tax rules are a useful tool in the battle against tax evasion, and they are growing in popularity rather than diminishing. The EU have intorudced their anti-tax avoidance package in 2016. This includes the requirement for all EU member states to introduce CFC rules. Most EU states have these already, but now it will extend to all of them. The CFC rules must however contain an exclusion fo subtantive econmic activities, so only wholly artificial arrangements are caught.

Conclusion

Most of the developed countries do operate a territorial system, although this is not the case absolutely everywhere. However, the CFC are perhaps contrary to this concept.