DRAFT
DOUBLE TAXATION CONVENTION
ON INCOME AND CAPITAL

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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- *to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development ;*
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I

INTRODUCTION

1. The Fiscal Committee which was set up in March 1956, was instructed in July 1958 by the Council of the Organisation for European Economic Co-operation (O.E.E.C.) to submit a draft Convention for the avoidance of double taxation with respect to taxes on income and capital, together with concrete proposals for the implementation of such a Convention. In the four reports prepared by the Fiscal Committee between 1958 and 1961 and published by the O.E.E.C. under the title "The Elimination of Double Taxation", the Committee proposed in all twenty-five Articles which already constituted the basis of the Convention. Since the establishment in September 1961 of the Organisation for Economic Co-operation and Development (O.E.C.D.), under which its mandate was confirmed, the Fiscal Committee has agreed upon six new Articles and has embodied all the Articles hitherto established in a Draft Convention. Although further additions may be made to this Draft at a later stage as a result of complementary studies now under way, the Fiscal Committee has considered it timely to submit to the Council in the present Report the Draft Convention as developed thus far, together with certain proposals as to its implementation.

2. In the next chapter the report states the objects of the Draft Convention and gives a brief description of its content. The text of the Draft Convention is given in an Annex to the report ; in another Annex are given the detailed Commentaries designed to illustrate or interpret each Article. In a further chapter, after showing how far the twenty-five Articles proposed in the four previous reports have been effectively adopted in the Conventions concluded between Member countries since 1958, the report considers in what form and how the Draft Convention could be implemented in the O.E.C.D. It points out that there would be great advantages if the Member countries would conform to the Draft Convention when revising their bilateral Conventions or concluding new ones between themselves. The Draft Convention could also be the basis for multilateral Conventions among certain groups of countries, until it proves possible, after further studies, to conclude a multilateral Convention among all Member countries of the O.E.C.D. In the conclusions of the report, the Fiscal Committee submits to the Council concrete proposals as to the recommendations which it suggests should be made to Member countries in order that the Draft Convention may be the medium through which a substantial advance can be made forthwith towards the co-ordination of the bilateral Conventions and the abolition of double taxation.

II

GENERAL REMARKS AND BRIEF ANALYSIS OF THE CONVENTION

A. GENERAL REMARKS

3. The phenomenon of international double taxation, which can be generally defined as the imposition of comparable taxes in two (or more) States on the same tax-payer in respect of the same subject matter and for identical periods, and its harmful effects on the exchange of goods and services and movements of capital and persons, are so well known that it is superfluous to stress the urgency of the need to remove the obstacles that double taxation presents to the development of economic relations between the Member countries of the O.E.C.D. The elimination of double taxation between all Member countries of the O.E.C.D. is therefore necessary in order to complete in this particular field the work undertaken since 1948 by the O.E.E.C. and subsequently by the O.E.C.D. for the liberalisation of trade, current invisible operations, and movements of capital and manpower, and the action of other international or regional organisations in the same of related fields. It is, in particular, of vital importance to clarify, standardise and guarantee the fiscal situation of taxpayers in each Member country, who are engaged in commercial, industrial or financial activities in the other Member countries, through the application by all Member countries of common solutions to identical cases of double taxation.

4. Substantial progress had already been made towards the elimination of double taxation through bilateral Conventions or unilateral measures when the Council of the O.E.E.C. adopted its first Recommendation concerning double taxation on 25th February, 1955. At that time fifty-six bilateral general Conventions were signed between countries now Members of the O.E.C.D., as against twenty in 1939. Some degree of harmonisation between these Conventions was also achieved. These results were to a large extent due to the work commenced in 1921 by the League of Nations. This resulted in 1928 in the first model bilateral Conventions and finally in the Model Conventions of Mexico (1943) and London (1946), the principles of which were followed with certain variants in many of the bilateral Conventions newly concluded or revised during the following decade. Neither of these Model Conventions, however, was fully and unanimously accepted. Moreover, in respect of several essential questions they presented considerable dissimilarities which had to be removed and

certain gaps which needed to be filled in. What is more, since their appearance the extension of taxation and the development of international economic relations have made certain problems in the field of double taxation more difficult and have created new problems.

5. The increasing economic interdependence of the Member and Associated countries of the O.E.E.C. in the postwar period, and the economic co-operation established among them was also a new and important factor. This made it necessary to revise prevailing practices for solving cases of double taxation and to adopt a new approach towards finding common understanding and common solutions to problems of international tax law. There was growing recognition of the need to harmonise existing bilateral Conventions between Member countries on uniform principles, with uniform definitions, rules and methods, and to agree on common interpretation. It was also felt necessary to extend the network of such Conventions to all Member countries, several of which had so far concluded only very few Conventions and some none at all. It was against this new background of economic co-operation and along these new lines of thinking that the Fiscal Committee set to work in 1956.

6. The Fiscal Committee has the twofold aim of establishing a Draft Convention which would effectively resolve the double taxation problems that exist between the Member countries of the O.E.C.D. and which would be acceptable to all Member countries. The Fiscal Committee therefore set out to establish a series of Articles which could be easily interpreted and applied in spite of the differences in national taxation laws and economic interests. The Articles embodied in the present Draft Convention provide a means of settling on a uniform basis the most common problems of double taxation. In certain cases, supplementary provisions or solutions for special questions have been specified or outlined in the Commentaries on the Articles. Generally speaking, the Draft Convention can be directly applied by Member countries in concluding between themselves bilateral Conventions for the avoidance of double taxation with respect to taxes on income or capital.

B. BRIEF ANALYSIS OF THE ARTICLES OF THE DRAFT CONVENTION

7. The Draft Convention embodies the twenty-five Articles which were published in the Committee's four previous reports and the adoption of which was recommended to the Member countries by the Council of the O.E.E.C. In certain cases the Articles have been slightly modified in order to harmonize their provisions or their text. The Convention is completed by six new Articles. All these articles have been arranged in seven Chapters. Thus the original numbering of the first twenty-five Articles has not been retained.

8. The Draft Convention requires a Preamble and also terminal clauses concerning the signing. These should be drafted according to the constitutional procedure of the Contracting States concerned.

Chapter I

SCOPE OF THE CONVENTION

9. Articles 1 and 2 define respectively the persons and the taxes to which the Convention applies. Article 2 is framed so as to fix the terminology and nomenclature of the taxes covered by the Convention, to identify them clearly, to widen the Convention's field of application as far as possible by including taxes imposed by political subdivisions or local authorities, and to avoid the necessity of changing the Convention whenever changes are made in the taxation laws of the Contracting States.

Chapter II

DEFINITIONS

10. Article 3 defines certain terms or expressions systematically employed in the Convention: "Contracting State", "person", "company", "enterprise of a Contracting State", "competent authority", and states that any term not otherwise defined shall have the meaning assigned to it by the taxation laws of the Contracting States. The expressions "resident of a Contracting State" and "permanent establishment" are defined in Articles 4 and 5 respectively. The proper interpretation of certain terms or expressions such as "dividends", "interest", "royalties", "immovable property", and "professional services", is given in the special Articles dealing with these matters.

11. The object of Article 4 is to determine clearly "fiscal domicile", since this concept is used to define the persons to whom the Convention applies and, furthermore, in the case of conflict of residence, for determining the Contracting State on which the right to tax is conferred under the Convention. The Article defines under the term "resident of a Contracting State" individuals or other persons who under the domestic law of that State are liable to taxation therein by reason of the various personal connections they may have with it. The Article then establishes the successive criteria that must be applied where an individual is deemed to be a "resident" of more than one State. As regards persons other than individuals, the Article states that in cases of conflict of residence the State of residence is the State in which the place of effective management is situated.

12. The object of Article 5 is to define "permanent establishment", which is an essential concept for the application of the Convention. Thus Article 7 provides that the profits of an enterprise of one Contracting State may be taxed in the other Contracting State only if the enterprise carries on business in that other State through a permanent establishment situated there, and then only so much of them as is attributable to the permanent establishment. Article 5 lays down a general definition and then gives a list of the cases which are deemed to constitute a priori a "permanent establishment": it afterwards enumerates forms of activity which are not to be deemed to constitute a "permanent establishment". The Article has been framed according to liberal criteria and in the light of present-day forms of international, commercial, industrial and financial activity.

Chapter III
TAXATION OF INCOME

13. In order to avoid double taxation of a taxpayer, for instance, by the State of which he is a resident and by the State in which his income arises or his immovable property is situated, it is necessary to delimit clearly each State's right to tax. Articles 6 to 20 lay down rules attributing the right to tax in respect of various types of income for which detailed provisions are necessary. Article 6 settles the question so far as concerns immovable property by giving the right to tax to the State in which such property is situated.

14. Article 7 determines the attribution of the right to tax business profits in accordance with the criterion of permanent establishment and formulates the basic principle which must govern the calculation of the profits of the permanent establishment, namely, that the permanent establishment must be treated as an enterprise distinct and separate from the head office of the entreprise. It settles the question of the expenses which must be allowed as deductions in computing the profits of the permanent establishment and it also determines when and on what conditions such profits may be determined otherwise than on the separate enterprise principle. Finally, it secures that profits are to be calculated by a consistent method. More detailed rules and procedures with respect to allocation of income to permanent establishments will be considered by the Fiscal Committee in its future work.

15. Article 8 reserves the right to tax the profits of shipping, inland waterways transport and air transport to the Contracting State in which the place of effective management of the enterprise is situated. This rule thus avoids the double taxation to which the enterprises involved are particularly exposed by the very nature of their business.

16. Article 9 deals with the case of an enterprise of one Contracting State which is under the control of an enterprise of the other Contracting State and that of enterprises under common control. It provides that in calculating the profits the taxation authorities may rewrite the accounts of such enterprises where and to the extent that, by reason of the special relations between such enterprises, the accounts do not disclose the profit which may properly be taxed in the State concerned on the separate enterprise principle. More detailed rules and procedures for re-allocating income between related enterprises will be considered by the Fiscal Committee in its future work.

17. Articles 10, 11 and 12, relating to the taxation of dividends, interest and royalties respectively, are of particular importance. The establishment of common rules with respect to this subject was a matter of major difficulty owing to the divergences between the economic interests of Member countries, the very great dissimilarity in their laws and the differences of their theoretical concept of the question and also between the solutions adopted in practice in bilateral double taxation Conventions. These solutions were sometimes very different ; in certain cases they were difficult to interpret and they did not always constitute a successful remedy for double taxation. Their great number created many complications both for tax-

payers and for the taxation authorities responsible for administering the Conventions. Harmonisation of the rules on these questions was therefore both a highly necessary and a very difficult task.

18. The rules of attribution in the Draft Convention represent a balance of reciprocal concessions between the Member countries which favoured taxation by the State of residence and those which favoured taxation by the State of source. The compromise which has been achieved is based on the attribution of the exclusive right to tax royalties to the State of the recipient's residence, and on the division of the right to tax dividends and interest between the State of the recipient's residence and the State of source of the income. For this purpose, a right to levy tax at restricted rate is given to the State of source, which tax the State of residence must take into account in computing its own tax so as to avoid double taxation. Thus, Article 10 provides that the rate of tax imposed by the State of which the company paying the dividends is a resident shall not exceed 15 per cent of the gross amount of the dividends in the general case, and 5 per cent in the case of companies with certain holdings in the company distributing the dividends. Likewise, Article 11 provides that the rate of tax imposed by the State in which the interest arises shall not exceed 10 per cent of the amount of the interest. These formulae are designed to secure to countries wishing to do so the right to impose tax at the source at the maximum rate specified, and also, where the two States so agree, to make it possible to reduce that rate by bilateral negotiations, and even to stipulate a nil rate, which would in fact amount to exclusive taxation by the State of residence.

19. Articles 10, 11 and 12 are presented in almost similar form and, as far as possible with identical wording. Each Article sets forth the rule of attribution of the right to tax, defines the income the taxation of which it regulates, and then provides an exception to the above rule in cases where the recipient possesses in the other Contracting State a permanent establishment with which the holding on which the dividends are paid, the indebtedness on which the interest is paid, or the property or right in respect of which the royalties are paid, is effectively connected. Article 10 ends with a special clause the object of which is to prevent extra-territorial taxation of dividends and taxation of non-resident companies in respect of their undistributed profits. Article 11 contains a special provision the object of which is to define the source of the interest for the purposes of the Article. Finally, Articles 11 and 12 end with an identical safeguard clause to deal with excessive payments of interest or royalties.

20. Article 13 relating to capital gains is applicable only when the laws of one or both Contracting States provide for the taxation of such gains. It lays down that gains from the alienation of immovable property or of certain specifically defined movable property may be taxed in the Contracting State in which the property is situated, while gains from the alienation of any other property are taxable only in the State of which the alienator is a resident.

21. The objects of Articles 14 to 20 are to settle cases of double taxation of income from personal services, whether for a salary or wages or for remuneration not in the nature of salary or wages, when, for

example, the recipient of the income resides in one Contracting State and performs the services in another. Generally speaking, the existing double taxation Conventions give the right to tax to the State in which the personal services are performed. The Articles in question follow the same principle in their generality. Income from independent personal services, which is the subject of Article 14, is brought under a similar taxing rule to that for business profits, the concept of a "fixed base" for the performance of the services being substituted for that of "permanent establishment". More detailed rules for allocating income to a fixed base will be considered by the Fiscal Committee in its future work.

22. Article 15 establishes, in paragraph 1, the general rule applying to salaries, wages and similar remuneration in respect of an employment, namely, taxation in the State where the employment is exercised. To this rule there are only two exceptions: one in the particular case of employment of short duration abroad, the object being to facilitate the international movement of qualified personnel (cf. paragraph 2 of the Article) — the other in the case of certain governmental functions (Article 19). Paragraph 3 of Article 15 specifies how the general rule is to apply to remuneration of crews of ships or aircraft in international traffic and of boats engaged in inland waterways transport, namely, taxation in the Contracting State in which the place of effective management of the enterprise is situated.

23. Articles 16 and 17 respectively state how the general rule is to apply in the case of members of company boards and in the case of public entertainers, and professional athletes, whether performing for a salary or wages or on their own account. Article 18 provides that pensions and other similar remuneration paid in consideration of past employment shall be taxable only in the Contracting State of which the recipient is a resident. Article 19 stipulates that remuneration, including pensions, paid in respect of services rendered to a Contracting State or to a political subdivision or local authority thereof may be taxed in that State. Article 20 provides that payments which students or business apprentices receive for the purposes of their maintenance, education or training abroad shall not be taxed in the State where they are temporarily residing for such purposes. Finally, Article 21 provides that all items of income which are not expressly mentioned in the foregoing Articles shall be taxable only in the State of the recipient's residence.

Chapter IV

Taxation of Capital

24. Article 22 is applicable only when the laws of one or both Contracting States provide for taxation of capital. In the case of capital, it is not possible to refer purely and simply to the rules as to the taxation of income from capital, because, as the foregoing paragraphs show, the different items of income are not all taxed exclusively in one Contracting State. Article 22 is designed to remove this difficulty by attributing the right to tax according to the nature of the property constituting the capital. Thus immovable property may be taxed in the Contracting State in which it is

situated. Movable property forming part of the business property of a permanent establishment, or pertaining to a fixed base used for the performance of professional services, may be taxed in the Contracting State in which the permanent establishment or fixed base is situated. Ships and aircraft operated in international traffic and boats engaged in inland waterways transport, and assets not being immovable property pertaining to the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. Finally, all other elements of capital shall be taxable only in the State of their owner's residence.

Chapter V

METHODS FOR ELIMINATION OF DOUBLE TAXATION

25. The rules in Chapters III and IV of the Convention concerning the attribution of the right to tax are not in themselves sufficient to avoid double taxation. Where under the Convention the State of source retains the right to tax certain items of income, or where the right to tax is shared between the State of residence and the State of source, the State of residence, which remains entitled to tax the total income of a resident, must take the necessary measures to avoid double taxation. The methods must commonly used for this purpose may be reduced to two main types : the exemption method and the tax credit method. By the first method, the State responsible for preventing the double taxation leaves the income or capital in question out of account in computing the total income or capital which it is going to tax. By the second method, such State takes such income or capital into account, but deducts from the total tax which it would otherwise charge an amount equal to the tax paid in the other State on the income or capital in question.

26. The Fiscal Committee recognised that double taxation could be effectually countered by either method, but the mode of applying them should be restricted to one clearly defined type in each case. Accordingly it drew up two Articles : Article 23 (A) is intended for Conventions between countries which generally use the exemption method, and Article 23 (B) for Conventions between countries which use the tax credit method. In Conventions between countries which each use a different method, both Articles must be included, the country to which each Article applies being specified in that Article.

27. Article 23 (A), paragraph 1, is based on the method which may be called « exemption with progression », whereby the income or capital in question, although left out of account in determining the total income or capital, is nevertheless taken into account in determining the rate of tax to be applied to the remainder of the income or capital. Article 23 (B) is based on what may be called the "ordinary credit method", whereby the deduction which the State concerned allows against the tax which it would otherwise charge is the amount of tax paid in the other State, the deduction being restricted, however, to the amount of tax in the first-mentioned State which is appropriate to the income or capital in respect of which a right to tax is given to the other State. Where the right to tax is

shared between the two Contracting States, as in the case of the Articles concerning dividends and interest, the State of residence cannot be expected to use the exemption method, because that would amount to its relinquishing the tax to which it is entitled. To settle this particular case, Article 23 (A) provides, in paragraph 2, that a country which usually employs the exemption method must employ the ordinary credit method.

Chapters VI and VII
Special and Final Provisions

28. The object of Article 24 is to ensure that discriminatory treatment in the form of other or more burdensome taxation shall not be applied in one of the Contracting States to taxpayers who are nationals of the other. Although this question has no connection with double taxation and this form of discrimination is exceptional between the Member countries of the O.E.C.D., provisions in this respect appear in a number of double taxation Conventions. The Fiscal Committee considered it important that the acceptance by the Member countries of the prohibition of tax discrimination on grounds of nationality should be clearly embodied as a principle in the Draft Convention, in view in particular of the force of example that this would have. A provision has been added that stateless persons must receive the same taxation treatment as nationals : this provision would be of special importance in a multilateral Convention. Further studies with regard to more detailed provisions in order to settle particular cases will be undertaken by the Fiscal Committee.

29. The Article also contains the provision that a permanent establishment owned by an enterprise of one of the Contracting States in the other State must not be less favourably taxed by that other State than enterprises of the latter. This provision, which is met with less frequently in double taxation Conventions than that concerning reciprocal taxation treatment of nationals, will give enterprises greater security in expanding their international business. Lastly, the Article contains a provision which so far has only rarely been adopted in double taxation Conventions : this secures non-discriminatory taxation treatment to enterprises of one Contracting State which are controlled by residents of the other Contracting State.

30. Article 25 establishes a procedure for consultation and agreement between Contracting States and defines the cases to which the procedure applies and how it is to be used. The rules in the first two paragraphs of the Article relate to the procedure for remedying taxation which is not in accordance with the Convention, apart from the remedies under the taxation laws of the Contracting States. The Article then provides a mutual agreement procedure for resolving problems which may arise out of the interpretation or application of the Convention and for cases of double taxation not provided for by the Convention. The Article finally states that an exchange of opinions may take place trough a Commission consisting of representatives of the competent authorities of the two States. The Fiscal Committee intends to consider whether in certain cases it may be necessary to provide for additional rules for giving proper effect to an agreement reached by the competent authorities. In the Commentary, it

is stated that in examining a particular case, the Commission may allow the taxpayer to make written or oral representations. It is also suggested that if special difficulties of interpretation should arise with respect to the Articles, the competent authorities might call upon the Fiscal Committee to give an opinion upon the proper understanding of the provisions in question. Finally, it is pointed out that when a multilateral Convention has been signed between the Member countries it may be useful to consider more precise rules for an international consultation procedure.

31. Article 26 establishes co-operation between the competent taxation authorities of the two Contracting States and defines the conditions under which information may be exchanged in order to enable each State to determine correctly the tax which it is entitled to levy under the Convention. This Article does not deal with reciprocal administrative assistance for the collection of taxes. Article 27 secures to diplomatic and consular officials taxation treatment not less favourable than that provided by the rules of international law or the provisions of special international agreements. Article 28 makes provision for the extension of the scope of the Convention in the case of States possessing overseas territories or responsible for the international relations of other States or territories. Finally, Articles 29 and 30 determine the conditions under which the Convention enters into force and ceases to have effect.

C. PARTICULAR REMARKS

32. The Fiscal Committee endeavoured, wherever possible, to lay down in each case one single rule. On certain points, however, it was thought necessary to leave the Convention a certain degree of flexibility compatible with efficacy. Member countries are therefore allowed a certain latitude with regard to fixing the rate of tax at the source on dividends and interest, the use of either the exemption or the credit method, and, under certain conditions, the allocation of profits to a permanent establish ment by apportionment of the total profits of the enterprise. Moreover, in order to facilitate the application of the Convention between certain of the Member countries, the Commentaries provide various possibilities of completing the Convention by special provisions, extending or restricting its scope, or setting aside or varying certain provisions in special cases. The Fiscal Committee considers that the freedom thus left to Member countries in the various cases mentioned above is not of a kind to prejudice the co-ordination of the bilateral Conventions.

33. Although Article 10 concerning the taxation of dividends can be directly applied by the majority of the Member countries, nevertheless it does not constitute a final solution in the case of the United Kingdom, Iceland, Ireland, Belgium, Germany and Greece. This is due to the fact that in these countries the taxation law avoids or mitigates economic double taxation, that is, the simultaneous taxation of a company's profits in its hands and of its distributed profits in the name or in the hands of the shareholders. In the case of these countries, therefore, the Article needs to be accompanied by special clauses that would be negotiated bilaterally. The Fiscal Committee nevertheless considers that this difficulty does not

detract from the value of the Article as a common rule, since the Article lays down principles on which the question should be settled. The Committee proposes to study this special problem further with a view to a final solution.

D. COMMENTARIES ON THE ARTICLES

34. For each of the Articles in the Convention there is a detailed Commentary which is designed to illustrate or interpret the provisions. In the more important cases, the Commentary also contains a general exposition of the problem and of the principal solutions adopted in the Model Conventions of the League of Nations or in the existing bilateral Conventions and states why the Fiscal Committee has chosen the solution proposed. As these Commentaries have been drafted and agreed upon unanimously by the experts appointed to the Fiscal Committee by the Governments of the Member countries, they are of special importance in the elaboration of international fiscal law. They are therefore a great improvement as compared to the Commentaries on the Mexico and London Model Conventions which were merely a working instrument, prepared by the Secretariat of the League of Nations, which did not commit the Fiscal Committee of that Organisation. Although the present Commentaries are not designed to be annexed in any manner to the Conventions to be signed by Member countries, which alone constitute legally binding international instruments, they can nevertheless be of great assistance in the application of the Conventions and, in particular, in the settlement of eventual disputes.

E. SPECIAL EXCEPTIONS IN FAVOUR OF CERTAIN MEMBER COUNTRIES

35. In recognition of the special position of some countries on particular questions, the Fiscal Committee considered that the provisions of certain Articles should be set aside or varied in their favour. Such exceptions have moreover already been given effect in the Recommendations relating to the avoidance of double taxation which were adopted by the Council of the O.E.E.C. and maintained under the O.E.C.D.

36. Thus, in view of her particular situation in relation to shipping, Greece will retain her freedom of action with regard to the provisions in the Convention relating to profits from the operation of ships in international traffic, to remuneration of crews of such ships, to capital represented by ships in international traffic and by movable property pertaining to the operation of such ships, and to capital gains from the alienation of such ships and assets.

37. Furthermore, notwithstanding the provisions of the Article concerning royalties, the Member countries have declared that they are prepared in bilateral Conventions, and subject to reciprocity, to concede to Greece, Luxembourg, Portugal and Spain a right to impose tax at 5 per cent on the gross amount of royalties, to which rate those four countries have for their part declared that they are prepared in such

Conventions to restrict their tax at the source, where the recipient of the royalties has not in their respective territories a permanent establishment with which the right or property giving rise to the royalties is effectively connected.

F. RESERVATIONS OF CERTAIN MEMBER COUNTRIES ON SOME PROVISIONS OF THE CONVENTION

38. Most of the Articles of the present Draft Convention were agreed upon by the Fiscal Committee as a body of the O.E.E.C. and are therefore based only on the views of those countries which were members of that Organisation. With the creation of the O.E.C.D. and the addition of Canada and the United States as Members, there may be in due course modifications, if appropriate, in the Draft to take account of the views of those two countries. While Canada and the United States are in general agreement with the aims of the Draft Convention and its main provisions, there are nevertheless points on which the views of these two countries differ from those of the other Member countries of the O.E.C.D. It is therefore desirable to record their views on such points.

39. In this respect, the views of the United States fall into three categories. On some articles, a definite reservation has been made. On some others, a tentative or conditional reservation has been noted pending further study of the implications of those articles. With respect to certain other articles there is no disagreement in principle, but further elaboration and refinement seem indispensable, as the Committee recognises elsewhere in this Report.

40. The Draft Convention contains no provision for taxation based on citizenship. Since the United States has traditionally imposed tax on the basis of citizenship, (place of incorporation, in the case of companies), it reserves the right to do so when entering into tax Conventions with other O.E.C.D. countries. The United States also reserves its position with respect to taxes of political subdivisions and the taxation of capital gains, as indicated in the Commentaries relating to these subjects. As for those items on which the United States tentatively reserves its position, it seems necessary here only to list them :

1. the subordination of Article 7, governing taxation of commercial and industrial profits, to those articles dealing with specific types of income, such as interest, in the case of banks, securities underwriters, and other enterprises receiving principally this type of income ;
2. the exemption from tax of income from independent services where no fixed base is maintained in the taxing state and the exclusion of entertainers from this provision ; ...
3. the exemption from tax of profits accumulated by foreign corporations, including personal holding companies ;
4. the imputation of income to the use of immovable property;
5. the rejection of the principle of the "force of attraction of the permanent establishment" in cases where, as under United States law, jurisdiction to tax enterprises of the other Contracting State is limited in any event by the source of income ; and

6. the use of 25 per cent direct capital ownership as the criterion for reduction of the permissible rate of tax at source on dividends.

41. As regards Canada, certain reservations have been made on some provisions of the Draft Convention. These are recorded in the Commentary to the Articles concerned.

42. With regard to the other Member countries, certain reservations have also been entered which are recorded in the Commentaries on the Articles concerned. They are mostly of a limited scope and concern only seven of the thirty Articles of the Draft Convention. As already indicated, the particular difficulties that were involved in trying to establish common rules in relation to dividends, interest and royalties have only been resolved through a global compromise. However, certain points of detail in the compromise were not acceptable to some countries which entered reservations of a limited character, particularly on the rates of tax specified. Certain reservations were also entered on particular provisions in the Articles concerning fiscal domicile, capital gains and non-discrimination. Finally, a general reservation was entered by one country on the whole of the Article on exchange of information.

43. The Fiscal Committee considers that these reservations must be viewed against the background of the global results which have been obtained over questions which up to now have constituted the principal source of difficulty in the negotiation of bilateral Conventions. The success and progress represented by the degree of agreement achieved represents in itself must not therefore be lost of sight of on their account. The Fiscal Committee proposes to examine these reservations again in its further studies. It is understood that insofar as certain Member countries have entered reservations, the other Member countries, in negotiating bilateral Conventions with the former, will retain their freedom of action in accordance with the principle of reciprocity.

G. THE PROGRESS OF THE OTHER WORK OF THE FISCAL COMMITTEE ON DOUBLE TAXATION

44. Under its terms of reference, the Fiscal Committee was requested, when submitting to the Council its Draft Convention relating to the avoidance of double taxation with respect to taxes on income and capital, to report at the same time on the progress of the work relating to problems of double taxation with respect to taxes on estates and inheritances and to indirect taxes. In the case of taxes on estates and inheritances, the preparatory work for the establishment of a Draft Convention is now sufficiently advanced for the Fiscal Committee to hope to be able to submit the draft to the Council before July 1965. The problems of double taxation with respect to indirect taxes will be examined by the Fiscal Committee subsequently.

III

IMPLEMENTATION OF THE DRAFT CONVENTION

A. RESULTS OF THE RECOMMENDATIONS OF THE COUNCIL RELATING TO THE AVOIDANCE OF DOUBLE TAXATION

45. On the occasion of each of the Fiscal Committee's four earlier reports the Council of the O.E.E.C. recommended to the Member countries that they should adopt the Articles proposed by the Committee either when revising existing Conventions between themselves or when concluding new ones. It also instructed the Fiscal Committee to report to it on measures taken by Member countries to implement the Recommendations. Since the Fiscal Committee's first report in July, 1958, twenty-three bilateral Conventions and one Protocol have been concluded between Member countries of the O.E.C.D. These Conventions may be grouped as follows :

— Revised bilateral Conventions : 8
— New bilateral Conventions : 15
Total : 23

The annexed Table 1 shows how the series of Articles recommended in July 1958, July 1959, July 1960 and July 1961, respectively, have been adopted in the bilateral Conventions concluded since those dates. The results can be considered as, on the whole, encouraging. The Table shows that in the great majority of cases the Articles proposed by the Fiscal Committee were adopted either word for word or in their fundamental purport. It should be pointed out in this connection that certain Conventions signed after the publication of the Fiscal Committee's reports had in fact been initialled some time beforehand. In these cases the question of adopting the Articles proposed in the reports did not arise for the negotiators and the more or less close correspondence between certain Articles of these Conventions and those proposed by the Fiscal Committee is therefore coincidental. It is important to note that in many cases these Articles have been used as a basis in bilateral negotiations for the conclusion of double taxation Conventions between certain Member countries and third countries, and that several Articles have actually been adopted in the Conventions that have been signed with those countries.

46. By means therefore of the Articles established by the Fiscal Committee and the Recommendations of the Council, a further advance has been made in the extension and harmonization of the bilateral Conventions

TABLE 1. ARTICLES EMBODIED IN CONVENTIONS SIGNED BETWEEN MEMBER COUNTRIES FROM JULY 1958 TO JULY 1963

Bilateral Conventions		Date of Signing	Articles proposed by the Fiscal Committee in its first four reports (according to the numbering employed in the Draft Convention)																							
			1st Report July 1958				2nd Report July 1959										3rd Report July 1960					4th Report July 1961					
			2	5	4	24	8	14	15	19	16	18	17	20	6	22	7	9	21	1	28	10	11	12	23A	23B	25
Denmark-Sweden	R	21. 7.58	×	×	×	×																				
Germany-Luxembourg	N	23. 8.58	×	×	×	+																				
France-Italy	R	29.10.58	—	—	—	—																				
Germany-Norway	N	18.11.58	+	+	+	+																				
Germany-Switzerland	P	20. 3.59	o	o	o	+																				
Germany-Sweden	R	17. 4.59	+	+	+	+																				
Austria-Sweden	R	14. 5.59	+	+	+	×																				
Germany-Netherlands	N	16. 6.59	×	+	—	—																				
Germany-France	R	21. 7.59	+	+	+	+																				
Austria-France	R	8.10.59	×	×	×	×	×	×	×	×	×	×	×	×	×	—										
Ireland-Sweden	N	6.11.59	×	+	—	×	×	+	+	×	+	+	+	+	+	+										
Austria-Norway	N	25. 2.60	×	+	×	+	×	×	×	×	×	×	×	×	×	×										
Italy-United Kingdom	N	4. 7.60	×	×	—	×	×	—	×	×	×	×	×	×	×	—										
United Kingdom-Sweden	R	28. 7.60	×	+	×	×	×	+	×	×	×	×	+	+	+	×	×	+	×	o	×					
Italy-Norway	N	25. 8.61	+	+	×	+	+	+	×	+	+	—	—	×	×	+	+	+	+	×	+	+	×	+	×	+	×
Greece-Sweden	N	6.10.61	+	+	+	×	—	+	×	+	+	+	+	+	+	×	+	+	+	+	—	×	+	—	—	—	×
Austria-Denmark	N	23.10.61	×	+	+	+	+	+	+	+	+	+	+	+	+	+	×	+	+	×	×	×	×	—	×	o	×
Germany-Denmark	R	30. 1.62	×	+	+	+	+	+	+	×	+	+	+	+	+	+	×	×	+	—	×	—	×	×	×	o	×
Germany-Ireland	N	17.10.62	×	+	—	+	×	+	+	×	+	+	+	+	+	+	×	+	—	o	o	×	×	×	×	×	×
Austria-Luxembourg	N	18.10.62	+	+	+	+	+	+	+	+	+	+	+	+	+	×	×	+	+	×	o	+	+	×	—	o	+
United-States - Luxembourg	N	18.12.62	×	+	o	×	×	o	—	×	×	×	o	×	×	—	—	+	—	—	o	×	×	×	o	×	×
Spain-France	N	8. 1.63	×	×	×	×	×	×	×	×	×	×	×	+	×	o	×	÷	×	+	×	—	—	—	—	—	+
Spain-Norway	N	25. 4.63	×	×	+	×	×	×	+	+	+	+	×	×	×	+	+	+	+	+	—	×	+	—	×	o	+
Spain-Sweden	N	25. 4.63	+	+	+	×	+	+	+	×	+	+	+	+	+	+	+	+	+	÷	o	×	×	+	+	o	+

NOTES: "R" refers to a revised Convention replacing the Convention formerly in force.
"N" refers to a new Convention.
"P" refers to a Protocol modifying the Convention in force.
"+" indicates that the Article has been embodied in its entirety.
"×" indicates that the Article has not been wholly embodied in the proposed form, but that the text adopted keeps the essential provisions of the Article.
"—" indicates that the Article has not been embodied or that the adopted text differs essentially from the Article.
"o" indicates that the Convention or Protocol does not deal with the question covered by the Article.

between the Member countries. It is particulary interesting to note that certain Member countries which in 1958 had not yet concluded any double taxation Conventions, or had concluded only very few, have since made special efforts in order to remedy the situation. Thus Spain, which had no Conventions, signed three Conventions with France, Norway and Sweden, respectively, during the early months of 1963, and is now negotiating with Germany. Luxembourg which by 1st January, 1958, had concluded only one Convention, with Belgium, has since concluded Conventions with the United States, Germany, France and Austria and is now negotiating with the United Kingdom. Ireland which had only three Conventions in 1958, has since signed Conventions with Sweden and Germany, and is at present negotiating with France, Denmark and the Netherlands. Greece, which was in the same position, has since signed a Convention with Sweden and is now negotiating with France, Italy and Switzerland. However, in the case of Iceland, which in 1958 had concluded two Conventions, and Portugal and Turkey, which at that date had concluded none at all, the situation has remained unchanged.

47. Eighty-five bilateral Conventions for the avoidance of double taxation with respect to taxes on income and capital are now concluded between the Member countries of the O.E.C.D. The following figures illustrate the progress achieved as compared with the situation existing in 1939, on 25th February, 1955, when the Council of the O.E.E.C. first recommended the Member countries to pursue their efforts to eliminate double taxation by concluding bilateral Conventions and on 11th July, 1958, when the Council of the O.E.E.C. recommended Member countries to adopt the series of Articles contained in the first report of the Fiscal Committee.

CONVENTIONS CONCLUDED BETWEEN THE COUNTRIES NOW MEMBERS OF THE O.E.C.D.

— Number of Conventions in 1939 : 20
— Number of Conventions as at 25th February, 1955 : 56
— Number of Conventions as at 11th July, 1958 : 70
— Number of Conventions as at 15th March, 1963 : 85

The attached Table 2 shows the Member countries of the O.E.C.D. which have bilateral double taxation Conventions between themselves. It also shows that twenty-eight bilateral negotiations are proceeding, fifteen of which are for the conclusion of new Conventions, and thirteen for the revision of existing ones. In seven cases, draft Conventions have already been initialled by the negotiators or are in course of signature. The Fiscal Committee hopes that these twenty-eight negotiations will speedily result in the signature of Conventions in conformity with the Draft Convention which it has established.

48. The process of extending and co-ordinating the double taxation Conventions between the Member countries is bound to be slow since it depends on the satisfactory conclusion of bilateral negotiations. It is therefore important that the procedure of bilateral negotiations should be expedited as much as possible. In this respect, the Draft Convention

TABLE 2. NETWORK OF BILATERAL CONVENTIONS FOR AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME AND CAPITAL BETWEEN MEMBER COUNTRIES OF THE O.E.C.D.

as at 1st July 1963

REPORTING COUNTRIES	SWEDEN	UNITED STATES	FRANCE	UNITED KINGDOM	F.R. GERMANY	DENMARK	NORWAY	NETHERLANDS	AUSTRIA	CANADA	ITALY	SWITZERLAND	BELGIUM	IRELAND	LUXEMBOURG	GREECE	SPAIN	ICELAND	PORTUGAL	TURKEY
SWEDEN		N														S	S	N		
UNITED STATES	N				N									N	S					
FRANCE											S		N	N		N	S			
UNITED KINGDOM					N										N					
F.R. GERMANY		N		N		S				N	N		N	S		N	N			
DENMARK					S						N			N						
NORWAY										N	S						S			
NETHERLANDS									N				N	N						
AUSTRIA								N			N				S					
CANADA					N		N					N	S	N						
ITALY			S		N	N	S		N			N				N				
SWITZERLAND										N	N		N			N				
BELGIUM			N		N			N		S		N			N					
IRELAND		N	N		S	N		N		N										
LUXEMBOURG		S		N					S				N							
GREECE	S		N		N						N	N								
SPAIN	S		S		N		S													
ICELAND	N																			
PORTUGAL																				
TURKEY																				
Number of Conventions concluded	16	15	14	14	14	11	11	11	10	9	9	9	8	5	5	4	3	2	—	—
Increase since 25th February 1955.	+4	+3	+3	+2	+5	+5	+5	+4	+5	+4	+5	+2	+1	+2	+4	+1	+3	—	—	—

Convention in force

S — New Convention signed to replace the Convention in force

N — Negotiations proceeding for the revision of the Convention in force

S — Convention signed but not yet in force

N — Negotiations proceeding for the establishment of a Convention

} Conventions concluded

established by the Fiscal Committee should facilitate the negotiations and so help to shorten them. Furthermore, Member countries should do their best to reduce as far as possible the time that must elapse both before the signature of draft Conventions that have been initialled and before the ratification and exchange of ratifications of Conventions that have been signed. In this way the substantial progress made in recent years towards the elimination of double taxation could be increased even more, and more speedily.

B. POSSIBILITIES CONCERNING THE IMPLEMENTATION OF THE DRAFT CONVENTION

a) General Remarks

49. The Fiscal Committee has sought primarily to construct a Draft Convention which can be used in bilateral negotiations between Member countries. Since the work of the League of Nations, the value of a Model Convention has been universally recognised not only by the national authorities but also by the taxpayers themselves. The particular advantage of the Draft Convention established by the Fiscal Committee is that it has been especially designed to meet the present-day needs of Member countries, by experts belonging to the Member countries' tax administrations and responsible for the negotiation and day-to-day administration of double taxation Conventions.

50. From the outset the Fiscal Committee's efforts were supported by non-governmental international organisations which have for many years played an active part in the struggle against double taxation. The Fiscal Committee would recall here that it was in response to a Resolution adopted on 2nd July, 1954, by the Executive Committee of the International Chamber of Commerce that the Council of the O.E.E.C. adopted its first Recommendation of 25th February, 1955, on double taxation, which subsequently was to result in the creation of the Fiscal Committee in March 1956. In a Statement adopted at its 17th Congress in Washington in April 1959, the International Chamber of Commerce considered that the Articles in the Fiscal Committee's first report constituted "a valuable step forward in the technique of double taxation agreements and an advance on the definitions previously proposed by the League of Nations in its Model Conventions". A Statement adopted on the 21st November, 1962, by the Council of the International Chamber of Commerce, and published under the title "Double Taxation in the Atlantic Community", said that the model articles proposed by the Fiscal Committee of the O.E.E.C. in its four reports represented "a valuable and promising advance in the struggle against double taxation". The International Fiscal Association, for its part, in a Resolution adopted at ts 14th Congress at Basle in September 1960, noted with satisfaction the first three reports of the Fiscal Committee. The Draft Convention finally established would already seem therefore to command the support not only of a large body of taxpayers in Member countries who are directly affected by double taxation, but also of business and University circles interested in the problem from the practical or theoretical point of view. The Fiscal Committee will

follow with great interest the comments of these groups concerning the Draft Convention and its possible improvements to assure that the Draft Convention and bilateral Conventions patterned after it will command the widest possible support and be the subject of the greatest possible understanding by those directly affected by it.

51. The manner in which the first twenty-five articles established by the Fiscal Committee have so far been incorporated in the bilateral Conventions recently concluded indicates clearly that the Member countries recognise that these Articles can provide effective solutions to double taxations problems as they now stand between them and that they answer a real need of co-ordination of the bilateral Conventions. The existence of these Articles has made it possible to simplify bilateral negotiations considerably and to reach agreement more speedily. They have also been an important factor in the change of attitude of certain Member countries which had not yet concluded any double taxation Conventions or had concluded them only with two or three principal economic partners. Finally, they have led many other countries to complete the network of their Conventions. It is certain that the results will be even more fruitful now that the Articles have been incorporated in a Draft Convention covering the most common problems of double taxation with respect to taxes on income and capital. It should also be mentioned here that the development of the Fiscal Committee's work, particularly with regard to dividends, interest and royalties, has given Member countries an opportunity to compare the effects of their fiscal legislations. Such a comparison could promote a desirable harmonisation of these legislations which would simplify the solution of double taxation problems and facilitate a more complete elimination of double taxation. Steps in this direction have recently been taken by Belgium in the context of the fiscal reform of 20th November, 1962.

b) Bilateral Application of the Draft Convention between the Member Countries of the O.E.C.D.

52. The Fiscal Committee considers that the need now is to consolidate and augment the results already acquired following the Recommendations of the Council of the O.E.E.C. To this end, a Recommendation of the Council of the O.E.C.D. inviting Member countries to follow the entire Draft Convention when revising existing bilateral Conventions between themselves or when concluding new ones, would be of the greatest value. It would make possible a further advance in the harmonization of the bilateral Conventions and thereby bring nearer the time when it may prove possible to conclude a multilateral Convention among all Member countries of the O.E.C.D.

53. Meanwhile, various questions remain to be examined and resolved by the Fiscal Committee. As mentioned earlier on, the Article concerning the taxation of dividends does not constitute a final solution in the case of certain countries and the Fiscal Committee proposes to pursue this particular problem. In addition, certain definitions adopted in the Draft Convention, particularly for the terms "immovable property", "dividends" and "interest", refer to the definitions employed in the domestic laws. In

order, however, to remove any possible "conflict of qualification" between national laws and avoid having recourse to the mutual agreement procedure in order to find a solution, it would be necessary to have definitions independent of the domestic laws. This would, of course, be indispensable in the case of a multilateral Convention. The Fiscal Committee therefore contemplates establishing such "international definitions" wherever appropriate, in order that the Draft Convention may be interpreted as an international instrument complete in itself.

54. Furthermore, the Fiscal Committee has recently brought under study the question of the improper use of double taxation Conventions and of the fiscal evasion which can result from the interaction of the Conventions and the domestic laws. The problems which may arise in this respect between two countries often involve third countries. Consequently the Fiscal Committee wishes to see how far it would be necessary to provide bilateral or multilateral solutions to this question. There are also several other problems as to which the solutions embodied in the Draft Convention may be subject to augmentation or refinement. These include a wider measure of agreement on the rules for allocating or re-allocating income to a permanent establishment or among related enterprises, the mutual agreement procedure and the provision against discrimination. Moreover, continued study of technical problems may lead to more detailed agreements concerning the precise meaning of the various provisions when applied in particular cases. Finally, the Fiscal Committee intends to undertake a thorough examination of the reservations that have been maintained by some Member countries on certain provisions of the Draft Convention, with the object of achieving full acceptance by all Member countries of the Articles in their entirety. The achievement by the Fiscal Committee of an even broader measure of agreement on both substantive and technical problems is important not only for the conclusion of bilateral Conventions on the basis of the Draft Convention but also to any multilateral Convention which may ultimately be evolved.

55. The Fiscal Committee noted that in its Statement of 21st November, 1962, mentioned above, the Council of the International Chamber of Commerce (I.C.C.) called upon the Member countries of the O.E.C.D. to consider urgently, as an alternative to the slow process of bilateral negotiations, the introduction of unilateral national legislation to implement the measures for avoidance of double taxation recommended by the O.E.E.C./O.E.C.D. modified as suggested by the I.C.C. either on a basis of reciprocity or preferably as independent action designed to stimulate the removal of this serious obstacle to international trade and investment. In this connection the Fiscal Committee draws attention to the fact that the rules contained in the Draft Convention are not intended for use as unilateral measures and that they cannot therefore be expected to be introduced as such in national laws.

56. In the same Statement the Council of the I.C.C. mentions as another alternative the conclusion of a multilateral Convention employing the model Articles devised by the Fiscal Committee, modified as suggested by the I.C.C., which would be binding between Member countries in the absence of a bilateral Convention. The Fiscal Committee considers that

in the present situation, the conclusion of a multilateral Convention binding the Member countries which do not yet have any bilateral Conventions between them would create certain difficulties if only for the reasons already stated in paragraphs 53 and 54 above.

c) MULTILATERAL APPLICATION OF THE DRAFT CONVENTION BY CERTAIN GROUPS OF MEMBER COUNTRIES OF THE O.E.C.D.

57. It might, however, be possible for certain groups of Member countries bound to one another by particular regional agreements to study the possibility of applying multilaterally among themselves the Draft Convention as at present established by the Fiscal Committee, subject to certain adaptations they may consider necessary to suit their particular purposes.

58. In this respect, the Fiscal Committee has noted certain observations in the report published in 1962 by the Fiscal and Financial Committee established by the Commission of European Economic Community (E.E.C.) in April 1960 and composed of independent experts. Section C of Chapter IV of the report, after recalling that Article 220 of the Treaty establishing the European Economic Community provides that "Member States shall, in so far as necessary, enter into negotiations with each other with a view to ensuring for the benefit of their nationals,... the abolition of double taxation within the Community...", contains the following statements :

> "The Fiscal and Financial Committee is convinced that in the interests of the Community the problem of double taxation should be resolved by harmonious, if not uniform, rules in the relations between each of the Member States with its five partners and consequently throughout the territory of the Common Market. To this end, the Fiscal and Financial Committee recommends that *the solutions proposed by the Fiscal Committee of the O.E.C.D.* should in principle be used as a basis for this settlement, so far as the co-ordination of certain taxes does not justify a different solution ; that to those solutions some amendments and additions might be made which appear to answer more adequately the specific needs of the Common Market ; and that in place of the network of the existing bilateral Conventions a multilateral Convention should be established as speedily as possible, in so far as it is not found preferable to combine in respect of certain taxes a co-ordinating multilateral Convention with a Convention for the prevention of intra-Community double taxation, or even with a Convention for mutual participation in the revenue from certain taxes..." "The best means of securing uniformity in the rules relating to the problem of double taxation is certainly a multilateral Convention to be concluded by the Member States of the E.E.C. The possibility is not to be ruled out, moreover, that the O.E.C.D. will present the final results of the work of its Fiscal Committee as a model multilateral Convention..." "The Fiscal and Financial Committee is in any case of opinion that so far as the E.E.C. is concerned the efforts directed against double taxation must finally result in the conclusion of a multilateral Convention on the model of the O.E.C.D , amended as may be necessary according to the suggestions formulated above...".

59. The Fiscal Committee also noted the agreement by the Ministers of the Member States of the European Free Trade Association reached at a meeting at Lisbon on 10th May, 1963. The Ministers considered the importance for the development of the commercial and economic relations between the Member States of an equitable and uniform solution of the problem of eliminating international double taxation within the E.F.T.A. area and agreed that it would be desirable to examine the possibility of concluding among the Member States a multilateral Convention for the avoidance of double taxation on the basis of the O.E.C.D. recommendations.

d) Establishment of a Draft Multilateral Convention among the Member Countries of the O.E.C.D.

60. The Fiscal Committee remains of the opinion that the conclusion of a multilateral double taxation Convention among the twenty Member countries of the O.E.C.D. would have definite advantages and intends to give thorough consideration to the question. It recalls that at its 5th Congress in Tokyo in May 1955, the International Chamber of Commerce adopted a resolution inviting the O.E.E.C. to undertake an investigation of the possibility of concluding a multilateral Convention among its Members, in view of the great advantage of securing uniformity of principle and practice in double taxation matters in a vast area of world trade.

61. For the reasons indicated in paragraphs 53 and 54, however, the Fiscal Committee considers that the continued improvement and augmentation of the attached Draft Convention is necessary in order to permit its use in even greater numbers of bilateral Conventions between Member countries and to facilitate the subsequent conclusion of a multilateral Convention among all Member countries.

IV

CONCLUSIONS

62. In conclusion, the Fiscal Committee proposes that the Council of the O.E.C.D. may wish to :

1. recommend Member countries to pursue their efforts to conclude bilateral Conventions for the avoidance of double taxation with respect to taxes on income and capital with those Member countries with which they have not yet entered into such Conventions and to revise those of the existing Conventions which may no longer be in keeping with present day needs ;
2. recommend Member countries, when concluding new Conventions or revising existing Conventions between themselves, to conform to the Draft Convention, as interpreted by the Commentaries thereto and having regard to the derogations and reservations in those Commentaries and in the report of the Fiscal Committee ;
3. request Member countries to notify to the Organisation the text of any new or revised bilateral Conventions between them and, where appropriate, the reasons why the provisions of the Draft Convention have not been adopted in such Conventions.

63. Furthermore, the Fiscal Committee proposes that the Council may wish to :

1. recommend to those Member countries which are Members of regional groupings to examine, as and when appropriate, the possibility of concluding among themselves multilateral Conventions on the basis of the Draft Convention and to inform the Organisation in due time of the result of their examination and of any difficulties encountered with regard to the provisions of that Convention ;
2. instruct the Fiscal Committee to examine the information so furnished and to report to it as and when appropriate.

64. Finally, the Fiscal Committee proposes that the Council may wish to instruct it to :

1. seek solutions to the problems referred to in paragraphs 53 and 54 of this report, and to report to it by 1st July, 1965 ;
2. report to it, as and when appropriate on the possibility of concluding a multilateral Convention for the avoidance of double taxation with respect to taxes on income and capital among all Member countries of the O.E.C.D.

3. submit to it by 1st July, 1965, a Draft Convention for the avoidance of double taxation with respect to taxes on estates and inheritances;
4. report to it at the same time on the programme of work envisaged for the study of the problems of double taxation with respect to indirect taxes.

65. The Fiscal Committee considers that a Recommendation of the Council of the O.E.C.D. based on the above proposals would contribute effectively to further substantial progress in the harmonisation and extension of the bilateral Conventions and the elimination of double taxation between the Member countries. By the uniformity of the solutions proposed and the resulting stability in the fiscal situation of taxpayers, the adoption of the Draft Convention in future bilateral Conventions will substantially reduce the fiscal obstacles to the development of the exchange of goods, services, capital and persons between the Member countries.

66. The Fiscal Committee recommends that the present Report be published and given appropriate publicity by the O.E.C.D. Secretariat.

ANNEXES

ANNEX I

DRAFT CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME AND CAPITAL

SUMMARY OF THE CONVENTION

TITLE AND PREAMBLE

CHAPTER I
Scope of the Convention

Art. 1	(Art. XVIII)	Personal Scope
Art. 2	(Art. I)	Taxes covered

CHAPTER II
Definitions

Art. 3		General definitions
Art. 4	(Art. III)	Fiscal domicile
Art. 5	(Art. II)	Permanent establishment

CHAPTER III
Taxation of income

Art. 6	(Art. XIII)	Income from immovable property
Art. 7	(Art. XV)	Business profits
Art. 8	(Art. V)	Shipping, inland waterways transport and air transport
Art. 9	(Art. XVI)	Associated enterprises
Art. 10	(Art. XX)	Dividends
Art. 11	(Art. XXI)	Interest
Art. 12	(Art. XXII)	Royalties
Art. 13		Capital gains
Art. 14	(Art. VI)	Independent personal services
Art. 15	(Art. VII)	Dependent personal services
Art. 16	(Art. IX)	Directors' fees
Art. 17	(Art. XI)	Artistes and athletes
Art. 18	(Art. X)	Pensions
Art. 19	(Art. VIII)	Governmental functions
Art. 20	(Art. XII)	Students
Art. 21	(Art. XVII)	Income not expressly mentioned

CHAPTER IV
Taxation of Capital

Art. 22	(Art. XIV)	Capital

CHAPTER V
Methods for elimination of double taxation

Art. 23(A)	(Art. XXIII)	Exemption method
Art. 23(B)	(Art. XXIV)	Credit method

CHAPTER VI
Special provisions

Art. 24	(Art. IV)	Non-discrimination
Art. 25	(Art. XXV)	Mutual agreement procedure
Art. 26		Exchange of information
Art. 27		Diplomatic and consular officials
Art. 28	(Art. XIX)	Territorial extension

CHAPTER VII
Final provisions

Art. 29	Entry into force
Art. 30	Termination.

NOTE : The Roman numerals in brackets refer to the numbering of the Articles in the Fiscal Committee's first four reports published in 1958, 1959, 1960 and 1961, under the title "The Elimination of Double Taxation".

TITLE

Convention between (State A) and (State B) for the avoidance of double taxation with respect to taxes on income and on capital

PREAMBLE

Note: The Preamble of the Convention shall be drafted in accordance with the constitutional procedure of both Contracting States.

CHAPTER I

SCOPE OF THE CONVENTION

Article 1

PERSONAL SCOPE

This Convention shall apply to persons who are residents of one or both of the Contracting States.

Article 2

TAXES COVERED

1. This Convention shall apply to taxes on income and on capital imposed on behalf of each Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are, in particular :

a) In the case of (State A) : .....
b) In the case of (State B) : .....

4. The Convention shall also apply to any identical or substantially similar taxes which are subsequently imposed in addition to, or in place of, the existing taxes. At the end of each year, the competent authorities of the Contracting States shall notify to each other any changes which have been made in their respective taxation laws.

CHAPTER II

DEFINITIONS

Article 3

GENERAL DEFINITIONS

1. In this Convention, unless the context otherwise requires :

a) the terms "a Contracting State" and "the other Contracting State" mean (State A) or (State B), as the context requires ;

b) the term "person" comprises an individual, a company and any other body of persons ;

c) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes ;

d) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State ;

e) the term "competent authority" means :

1. in (State A) .....
2. in (State B) .....

2. As regards the application of the Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the Convention.

Article 4

FISCAL DOMICILE

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the law of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then this case shall be determined in accordance with the following rules :

a) He shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If he has a

permanent home available to him in both Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closest (centre of vital interests) ;

b) If the Contracting State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either Contracting State, he shall be deemed to be a resident of the Contracting State in which he has an habitual abode ;

c) If he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national ;

d) If he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated.

Article 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially :

a) a place of management ;
b) a branch ;
c) an office ;
d) a factory ;
e) a workshop ;
f) a mine, quarry or other place of extraction of natural resources ;
g) a building site or construction or assembly project which exists for more than twelve months.

3. The term "permanent establishment" shall not be deemed to include :

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise ;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery ;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise ;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise ;

e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

4. A person acting in a Contracting State on behalf of an enterprise of the other Contracting State — other than an agent of an independent status to whom paragraph 5 applies — shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

CHAPTER III

TAXATION OF INCOME

Article 6

INCOME FROM IMMOVABLE PROPERTY

1. Income from immovable property may be taxed in the Contracting State in which such property is situated.

2. The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of professional services.

Article 7

BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through, a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it

were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles laid down in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8

SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT

1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

3. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.

Article 9

ASSOCIATED ENTERPRISES

Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Article 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but the tax so charged shall not exceed :

a) 5 per cent of the gross amount of the dividends if the recipient is a company (excluding partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends ;

b) in all other cases, 15 per cent of the gross amount of the dividends.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights assimilated to income from shares by the taxation law of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the recipient of the dividends, being a resident of a Contracting State, has in the other Contracting State, of which the company paying the dividends is a resident, a permanent establishment with which the holding by virtue of

which the dividends are paid is effectively connected. In such a case, the provisions of Article 7 shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company to persons who are not residents of that other State, or subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may be taxed in the Contracting State in which it arises, and according to the law of that State, but the tax so charged shall not exceed 10 per cent of the amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this Article means income from Government securities, bonds or debentures, whether or not secured by mortgage and whether or not carrying a right to participate in profits, and debt-claims of every kind as well as all other income assimilated to income from money lent by the taxation law of the State in which the income arises.

4. The provisions of paragraphs 1 and 2 shall not apply if the recipient of the interest, being a resident of a Contracting State, has in the other Contracting State in which the interest arises a permanent establishment with which the debt-claim from which the interest arises is effectively connected. In such a case, the provisions of Article 7 shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the Contracting State in which the permanent establishment is situated.

6. Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the interest paid, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case,

the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12

ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

3. The provisions of paragraph I shall not apply if the recipient of the royalties, being a resident of a Contracting State, has in the other Contracting State in which the royalties arise a permanent establishment with which the right or property giving rise to the royalties is effectively connected. In such a case, the provisions of Article 7 shall apply.

4. Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the royalties paid, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13

CAPITAL GAINS

1. Gains from the alienation of immovable property, as defined in paragraph 2 of Article 6, may be taxed in the Contracting State in which such property is situated.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing professional services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in the other State. However, gains

from the alienation of movable property of the kind referred to in paragraph 3 of Article 22 shall be taxable only in the Contracting State in which such movable property is taxable according to the said Article.

3. Gains from the alienation of any property other than those mentioned in paragraphs 1 and 2, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14

INDEPENDENT PERSONAL SERVICES

1. Income derived by a resident of a Contracting State in respect of professional services or other independent activities of a similar character shall be taxable only in that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, the income may be taxed in the other Contracting State but only so much of it as is attributable to that fixed base.

2. The term "professional services" includes, especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15

DEPENDENT PERSONAL SERVICES

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned, and

b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remune-

ration in respect of an employment exercised aboard a ship or aircraft in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

Article 16

DIRECTORS' FEES

Directors' fees and similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

Article 17

ARTISTES AND ATHLETES

Notwithstanding the provisions of Articles 14 and 15, income derived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised.

Article 18

PENSIONS

Subject to the provisions of paragraph I of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

Article 19

GOVERNMENTAL FUNCTIONS

1. Remuneration, including pensions, paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof in the discharge of functions of a governmental nature may be taxed in that State.

2. The provisions of Articles 15, 16 and 18 shall apply to remuneration or pensions in respect of services rendered in connection with any trade or business carried on by one of the Contracting States or a political subdivision or a local authority thereof.

Article 20

STUDENTS

Payments which a student or business apprentice who is or was formerly a resident of a Contracting State and who is present in the other Contracting State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that other State, provided that such payments are made to him from sources outside that other State.

Article 21

INCOME NOT EXPRESSLY MENTIONED

Items of income of a resident of a Contracting State which are not expressly mentioned in the foregoing Articles of this Convention shall be taxable only in that State.

CHAPTER IV

TAXATION OF CAPITAL

Article 22

CAPITAL

1. Capital represented by immovable property, as defined in paragraph 2 of Article 6, may be taxed in the Contracting State in which such property is situated.

2. Capital represented by movable property forming part of the business property of a permanent establishment of an enterprise, or by movable property pertaining to a fixed base used for the performance of professional services, may be taxed in the Contracting State in which the permanent establishment or fixed base is situated.

3. Ships and aircraft operated in international traffic and boats engaged in inland waterways transport, and movable property pertaining to the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

CHAPTER V

METHODS FOR ELIMINATION OF DOUBLE TAXATION

Article 23A

EXEMPTION METHOD

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraph 2, exempt such income or capital from tax but may, in calculating tax on the remaining income or capital of that person, apply the rate of tax which would have been applicable if the exempted income or capital had not been so exempted.

2. Where a resident of a Contracting State derives income which, in accordance with the provisions of Articles 10 and 11, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that person an amount equal to the tax paid in that other Contracting State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is appropriate to the income derived from that other Contracting State.

Article 23B

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow :

a) as a deduction from the tax on the income of that person, an amount equal to the income tax paid in that other Contracting State ;

b) as a deduction from the tax on the capital of that person, an amount equal to the capital tax paid in that other Contracting State.

2. The deduction in either case shall not, however, exceed that part of the income tax or capital tax, respectively, as computed before the deduction is given, which is appropriate, as the case may be, to the income or the capital which may be taxed in the other Contracting State.

CHAPTER VI

SPECIAL PROVISIONS

Article 24

NON-DISCRIMINATION

1. The 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.

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 law in force in a Contracting State.

3. Stateless persons shall not be subjected in a 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 State in the same circumstances are or may be subjected.

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.

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.

5. 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 Contracting 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 that first-mentioned State are or may be subjected.

6. In this Article the term "taxation" means taxes of every kind and description.

Article 25

MUTUAL AGREEMENT PROCEDURE

1. Where a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation not in accordance with the Convention.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.

Article 26

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment or collection of the taxes which are the subject of the Convention.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on one of the Contracting States the obligation :

a) to carry out administrative measures at variance with the laws or the administrative practice of that or of the other Contracting State ;

b) to supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State ;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

Article 27

DIPLOMATIC AND CONSULAR OFFICIALS

Nothing in this Convention shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

Article 28

TERRITORIAL EXTENSION

1. This Convention may be extended, either in its entirety or with any necessary modifications, [to any part of the territory of (State A) or of (State B) which is specifically excluded from the application of the Convention or] to any State or territory for whose international relations (State A) or (State B) is responsible, which imposes taxes substantially similar in character to those to which the Convention applies. Any such extension shall take effect from such date and subject to such modifications and conditions, including conditions as to termination, as may be specified and agreed between the Contracting States in notes to be exchanged through diplomatic channels or in any other manner in accordance with their constitutional procedures.

2. Unless otherwise agreed by both Contracting States, the denunciation of the Convention by one of them under Article 30 shall terminate, in the manner provided for in that Article, the application of the Convention [to any part of the territory of (State A) or of (State B) or] to any State or territory to which it has been extended under this Article.

Note : The words between brackets are of relevance when, by special provision, a part of the territory of a Contracting State is excluded from the application of the Convention.

CHAPTER VII

FINAL PROVISIONS

Article 29

ENTRY INTO FORCE

1. This Convention shall be ratified and the instruments of ratification shall be exchanged at ..... as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

a) in (State A): .....
b) in (State B): .....

Article 30

TERMINATION

This Convention shall remain in force until denounced by one of the Contracting States. Either Contracting State may denounce the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year ..... In such event, the Convention shall cease to have effect:

a) in (State A): .....
b) in (State B): .....

TERMINAL CLAUSE

Note: The terminal clause concerning the signing shall be drafted in accordance with the constitutional procedure of both Contracting States.

ANNEX II

COMMENTARIES ON THE ARTICLES OF THE DRAFT CONVENTION

COMMENTARY ON ARTICLE 1 CONCERNING THE PERSONAL SCOPE OF THE CONVENTION

Whereas older Conventions in general were applicable to "citizens" of the Contracting States, recent Conventions usually apply to "residents" of one or both of the Contracting States, without distinction of nationality. Some Conventions are of even wider scope inasmuch as they apply more generally to "taxpayers" of the Contracting States ; they are, therefore, also applicable to persons, who, although not residing in either State, are nevertheless liable to tax on part of their income or capital in each of them. The Convention is intended to be applied between Member countries of the O.E.C.D. and it has been deemed preferable for practical reasons to provide that the Convention is to apply to persons who are residents of one or both of the Contracting States. It is recalled that the meaning of the term "resident" is defined in Article 4 concerning fiscal domicile.

COMMENTARY ON ARTICLE 2 CONCERNING TAXES COVERED BY THE CONVENTION

1. The Article is intended to make the terminology and nomenclature relating to the taxes covered by the Convention more acceptable and precise, to ensure identification of the Contracting States' taxes covered by the Convention, to widen as much as possible the field of application of the Convention by including as far as possible, and in harmony with the internal legislation of the Contracting States, the taxes imposed by their political subdivisions or local authorities — and to avoid the necessity of concluding a new Convention whenever the Contracting States' taxation legislation is modified, by means of the periodical exchange of lists and through a procedure for mutual consultation.

Paragraph 1

2. This paragraph defines the subject of the Convention : taxes on income and capital ; the term "direct taxes" which is far too imprecise has therefore been omitted. It is immaterial on behalf of which authorities such taxes are imposed ; it may be the State itself or its political subdivisions or local authorities (constituent States, regions, provinces, "départements", Cantons, districts, "arrondissements", circles ["Kreise"], municipalities or groups of municipalities, etc.). The method of levying the taxes is equally immaterial : by direct assessment or by deduction at the source, in the form of surtaxes or surcharges, or as additional taxes ["centimes additionels"], etc.

Paragraph 2

3. This paragraph explains what is meant by taxes on income and capital. Such taxes comprise taxes on total income and on each element of income, on total capital and on each element of capital. They also include taxes on profits derived from the alienation of movable or immovable property, i.e. in particular capital gains and profits on real property, as well as taxes on capital appreciation. Finally, the definition extends to taxes on the total amounts of wages or salaries paid by undertakings ("payroll taxes" ; in Germany, "Lohnsummensteuer" ; in France the "versement forfaitaire à la charge des employeurs").

4. Clearly a State possessing taxing powers — and it alone — may levy the taxes imposed by its legislation together with any duties or charges accessory to them : increases, costs, interest, etc. It has not been considered necessary to specify this in the Article, as it is obvious that in the levying

of the tax the accessory duties or charges depend on the same rule as the principal duty.

5. The Article does not mention "ordinary taxes" or "extraordinary taxes". Normally, it might be considered justifiable to include extraordinary taxes in a draft Convention, but experience has shown that such taxes are generally imposed in very special circumstances. In addition, it would be difficult to define them. They may be extraordinary for various reasons ; their imposition, the manner in which they are levied, their rates, their objects, etc. This being so, it seems preferable not to include extraordinary taxes in the Article. But, as it is not intended to exclude extraordinary taxes from all the Conventions, ordinary taxes have not been mentioned either. The Contracting States are thus free to restrict the Convention's field of application to ordinary taxes, to extend it to extraordinary taxes, or even to establish special provisions.

Paragraph 3

6. This paragraph lists the taxes in force at the time of signature of the Convention. The list is not exhaustive. It serves to illustrate the preceding paragraphs of the Article. In principle, however, it will be a complete list of the taxes imposed in each State at the time of signature and covered by the Convention.

Paragraph 4

7. This paragraph provides, since the list of taxes in paragraph 3 is purely declaratory, that the Convention is also to apply to all identical or substantially similar taxes which are subsequently imposed in addition to, or in place of the existing taxes. This provision is necessary to prevent the Convention from becoming inoperative in the event of one of the States modifying its laws.

8. Each State undertakes to notify to the other any amendments made to its tax laws by communication to it at the end of each year, when necessary, a list of new or substituted taxes, imposed during that year.

Reservations on the Article

9. Canada and the United States reserve their position on that part of paragraph 1 of the Article which states that the Convention shall apply to taxes of political subdivisions or local authorities.

COMMENTARY ON ARTICLE 3
CONCERNING DEFINITIONS

1. This Article groups together a number of general provisions required for the interpretation of the terms used in the Convention. It should be observed, however, that the meaning of some important terms is explained elsewhere in the Convention. Thus, the terms "resident" and "permanent establishment" are defined in Articles 4 and 5 respectively, while the interpretation of certain terms appearing in the Articles on special categories of income ("immovable property", "dividends", etc.) is clarified by provisions embodied in those Articles.

Paragraph 1

THE TERM "PERSON"

2. The definition of the term "person" given in subparagraph (*b*) is in substance similar to the one commonly included in current double taxation Conventions. The provision is not worded as an exhaustive definition and should be read as indicating that the term person is used in a very wide sense (cf. especially Articles 1 and 4). The definition explicitly mentions individuals, companies and other bodies of persons. From the meaning assigned to the term "company" by the definition contained in sub-paragraph (*c*) it follows that, in addition, the term "person" comprises any entity which, although itself not a body of persons, is treated as a body corporate for purposes of tax. Thus, e.g. a foundation ("fondation", "Stiftung") may fall within the meaning of the term person.

3. If differences exist between two Contracting States in the taxation of profits of partnerships or like taxable units, the tax treatment of the partnership or like taxable units on the one hand and of the resident or non-resident partners on the other hand, could give rise to double taxation or non-taxation. In this case special appropriate provisions should be agreed upon by the Contracting States concerned and adopted in their bilateral relations.

THE TERM "COMPANY"

4. The term "company" includes in the first place all corporate bodies. In addition, the term covers other taxable units which are treated as corporate bodies according to the tax laws of the Contracting State in which they are organised. The definition is drafted with special regard to the Article on dividends. It should be noted that the term company has a bearing only on that Article and Article 16 on taxation of directors' fees and paragraph 6 of Article 5 on permanent establishment.

THE TERM "ENTERPRISE"

5. The question whether an activity is performed within the framework of an enterprise or is deemed to constitute in itself an enterprise has hitherto always been interpreted according to the provisions of the national law of the Contracting States. No definition, properly speaking, of the term "enterprise" has been attempted in this Article ; also no such definition can be found in the double taxation Conventions in force.

6. The laws of some Member States do not treat a partnership as a taxable unit and, consequently, a partnership as such cannot be regarded as "a resident of a Contracting State" under Article 4 on fiscal domicile ; where such a Member State is concerned, it could be maintained that an enterprise carried on by a partnership is not strictly "an enterprise carried on by a resident of a Contracting State". In such a case, it may assist towards a clarification of the meaning of the term "an enterprise of a Contracting State" if each participation in a partnership is looked upon as a separate enterprise, the test being whether the partner holding the participation is a resident of the one or the other Contracting State or of a third State. The Member States concerned may consider adopting this line of interpretation in bilateral relations.

THE TERM "COMPETENT AUTHORITIES"

7. The definition of the term "competent authorities" has regard to the fact that in some O.E.C.D. Member countries the execution of double taxation Conventions does not exclusively fall within the competence of the highest fiscal authorities, but that some matters are reserved or may be delegated to other authorities. The present definition enables each Contracting State to nominate one or more authorities as being competent.

Paragraph 2

8. The rule of interpretation laid down in paragraph 2 corresponds to similar provisions normally appearing in double taxation Conventions. The rule of interpretation in paragraph 2 of Article 6 on the taxation of income from immovable property, which has to be regarded as "lex specialis" is in no way affected by the present general rule of interpretation.

COMMENTARY ON ARTICLE 4 CONCERNING FISCAL DOMICILE

1. General Comments

1. The concept of domicile has various functions and is of importance in three cases :

a) in determining a Convention's field of application with respect to physical and legal persons ;

b) in solving cases where double taxation arises in consequence of a double domicile ;

c) in solving cases where double taxation arises as a consequence of conflict between domicile and source.

2. The Article is intended only to define the meaning of the term "resident of a Contracting State" and to solve cases of conflict between two domiciles. For further elucidation of the Article some general comments are made below referring to the two typical cases of conflict, i.e. between two domiciles and between domicile and source. In both cases the conflict arises because, under their internal legislation, one or both Contracting States claim that the person concerned has his domicile in their territories.

3. Generally the national legislations of the various States impose a comprehensive liability to tax — "full tax liability" based on the taxpayers' personal attachment to the State concerned (the State of "domicile"). This liability to tax is not imposed only on persons who are "domiciled" in a State in the sense in which "domicile" is usually taken in the legislations (civil law). The cases of full liability to tax are extended to comprise also, for instance, persons who stay continually, or maybe only for a certain period, in the territory of the State. Some legislations impose full liability to tax on individuals who perform services on board ships which have their home port in the State.

4. Conventions for the avoidance of double taxation do not normally concern themselves with the national rules of law of the Contracting States laying down the cases in which a person is to be treated fiscally as "domiciled" and, consequently, is "fully liable to taxation" in that State. They do not lay down standards which the national rules of law on "domicile" have to fulfil in order that claims for full tax liability can be accepted between the Contracting States. In this respect the States take their stand entirely on the national legislations.

5. This manifests itself quite clearly in the cases where there is no conflict at all between two domiciles, but where the conflict exists only

between domicile and source. But the same view applies in conflicts between two domiciles. The special point in these cases is only that no solution of the conflict can be arrived at by reference to the concept of domicile adopted in the national laws of the States concerned. In these cases special provisions must be established in the Convention to determine which of the two concepts of domicile is to be given preference.

6. An example will elucidate the case. An individual has his permanent home in State A, where his wife and children live. He has had a stay of more than six months in State B and according to the legislation of the latter State he is, in consequence of the length of the stay, taxed as being domiciled in that State. Thus, both States claim that he is fully liable to tax. This conflict has to be solved by the Convention.

7. In this particular case the Article (under paragraph 2) gives preference to the claim of State A. This does not, however, imply that the Article lays down special rules on "domicile" and that the national rules of law of State B are ignored because they are incompatible with such rules. The fact is quite simply that in the case of such a conflict a choice must necessarily be made between the two claims, and it is on this point that the Article proposes special rules.

8. What is stated above gives the general background of the Article. Special comments are made below.

2. Special Comments on the Article

Paragraph 1

9. The Conventions usually refer to the State of "domicile" in several Articles. It was felt that, for terminological reasons, it would be useful if a "shorthand expression" could be used in all cases where the State of "domicile" is mentioned. In the Article the term "resident" is used. This term is used in Conventions concluded by the United Kingdom and by the United States of America. In the Convention between the United Kingdom and France the expression un "résident" is used in the French text.

10. Paragraph 1 provides a definition of the expression "resident of a Contracting State" for the purposes of the Convention. The definition refers to the concept of residence adopted in the national laws (cf. General Comments). As criteria for the taxation as a resident the definition mentions: domicile, residence, place of management or any other similar criterion. As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the national fiscal legislations, form the basis of a more comprehensive taxation (full liability to tax). An individual, however, is not to be considered a "resident of a Contracting State" in the sense of the Convention if, although not domiciled in that State, he is considered as a resident according to the national law and is only subject to a limited taxation on the income arising in that State.

Paragraph 2

11. This paragraph relates to the case where, under the provision of paragraph 1, an individual is subject to tax as a resident in both Contracting States.

12. To solve this conflict special rules must be established which give the attachment to one State a preference over the attachment to the other State. As far as possible, the "preference criterion" must be of such a nature that there can be no question but that the person concerned will satisfy it in one State only, and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State.

13. The Article gives preference to the Contracting State in which the individual has a permanent home available to him. This is in accordance with the usual provisions in double taxation Conventions, and this criterion will frequently be sufficient to solve the conflict, e.g. where the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State.

14. If the individual has a permanent home in both Contracting States, the Article gives preference to the State with which his personal and economic relations are closest, this being understood as the centre of vital interests.

15. In the cases where the residence cannot be determined by reference to the above mentioned provisions, the Article provides as subsidiary criteria, first, habitual abode, and then nationality.

16. If the individual is a national of both Contracting States or of none of them, the question shall be solved by mutual agreement between the States concerned according to the procedure laid down in Article 25.

Paragraph 3

17. This paragraph concerns companies and other bodies of persons, not being individuals, irrespective of whether they are or not legal persons. It may be rare in practice for a company, etc. to be subject to tax as a resident in more than one State, but it is, of course, possible if, for instance, one State attaches importance to the registration and the other State to the place of effective management. So, in the case of companies, etc., also, special rules as to the preference must be established.

18. It would not be natural to attach importance to a purely formal criterion like registration which is used but rarely in double taxation Conventions. Generally, these attach importance to the place where the company is actually managed, but the formulation of this criterion varies from one Convention to another.

19. The formulation of the preference criterion in the case of persons other than individuals was considered in connection with the question of the taxation of income of shipping, inland waterways transport and air transport enterprises. A study of the existing bilateral Conventions for the

avoidance of double taxation on such income has shown that a number of Conventions accord the taxing power to the State in which the "place of management" of the enterprise is situated ; other Conventions attach importance to its "place of effective management", others again to "the fiscal domicile of the operator. The Conventions concluded by the United Kingdom in recent years provide, as regards corporate bodies, that a company shall be regarded as resident in the State in which "its business is managed and controlled". In this connection it has been made clear on the United Kingdom side that this expression means the "effective management" of the enterprise.

20. As a result of these considerations, the "place of effective management" has been adopted as the preference criterion for persons other than individuals.

3. Reservations on the Article

21. Ireland cannot envisage treating as non-resident in Ireland an individual who is resident in that country under Irish law. In Conventions which have been made by Ireland with other countries double taxation of the dual resident is relieved by way of exemption or of credit.

22. Since the United States has traditionally imposed tax on the basis of citizenship (place of incorporation, in the case of companies), it reserves the right to do so when entering into tax Conventions with other O.E.C.D. Member countries.

COMMENTARY ON THE ARTICLE 5 CONCERNING PERMANENT ESTABLISHMENT

1. The permanent establishment Article is the result of a good deal of discussion and much careful thought and consideration. During the drafting of the Article a number of proposals and suggestions were made which for good reason were finally rejected. In view of this, the Commentary does not restrict itself to giving the reasons for, and putting a gloss on, the proposals now contained in the Article. It also mentions the reasons for the rejection or omission of a number of the more important proposals that were not ultimately adopted, since these omissions are themselves of some significance and the reasons for them may be of interest.

Paragraph 1

2. For the sake of clarity, it is preferable to have a general definition of the concept of "permanent establishment" which is set out in a separate paragraph and not one which is almost hidden in a list of a number of agreed examples, as is the case in Article V, paragraph 1, of the Mexico and London Drafts of the Model Tax Convention published by the League of Nations. For this reason, the Article begins in paragraph 1 by attempting a general definition of "permanent establishment". This general definition attempts to bring out the essential characteristic of a permanent establishment, viz. that it has a distinct "situs", a "fixed place of business".

3. It could perhaps be argued that in the terms of the general definition some mention should also be made of the other characteristic of a permanent establishment to which some importance is attached in the Commentary on the Mexico and London Drafts, namely that, in the words of that Commentary, the establishment "must have a productive character — i.e. contribute to business earnings". In the present permanent establishment Article this course has not been taken. Within the framework of a well run business organisation it is surely axiomatic to assume that each part contributes to the productivity of the whole. It does not, of course, follow in every case that because in the wider context of the whole organisation a particular establishment has a "productive character" it is consequently an establishment to which profits can properly be attributed for the purpose of tax in a particular territory (see the Commentary on paragraph 3).

4. The criterion of "productive character" having been rejected, it would have been possible as an alternative to add to the general definition as it is now drafted in paragraph 1 of the Article the criterion of "profitability". This course was not taken mainly because the concept of profitability did not seem wholly relevant. There seemed to be three possible

ways of distinguishing such a concept. First, it would be possible to add at the end of the general definition as it now stands in paragraph 1, the words "and through which profits are made or realised" or some similar formula. But this is clearly unsatisfactory because a permanent establishment which makes profits one year may not do so the next and it would be a most unfortunate result if, because of fluctuations in profitability, certain business activities were deemed to constitute a permanent establishment in one year and not in the next. To some extent this difficulty could be surmounted by taking the second course and adopting a formula on the lines "and through which, taking one year with another, profits are made or realised", but this is by no means a complete answer to the problem, because even a branch establishment which year after year itself makes a loss may, nevertheless, in the context of the whole enterprise of which it is a part, "contribute to business earnings" in the sense that the League of Nations' Commentary seems to have meant. The third course is to draft an addition to the general definition in a manner which pays no regard to the question whether the establishment does or does not make distinguishable profits and to adopt the formula "... in which the business of the enterprise is wholly or partly carried on with the intention of realising profits". In many respects this third course could perhaps be regarded as the most satisfactory of the three, because it ignores what may be the actual accounting results of the enterprise and attempts to define its inherent profitability. But as will be seen, it is based upon a test not of fact but of motive and this is clearly a serious objection. To import a motive test into a set of rules intended to define with precision the taxation liabilities of individuals and companies is wholly undesirable and obviously unacceptable on that ground alone.

5. The general definition in paragraph 1 of the Article has, therefore, been drafted in its present form because it is the one which gives the greatest clarity and which promises to be the easiest to administer. There follows in paragraph 2 a list of prima facie examples of permanent establishments. In paragraph 3 there is provided a list of specific exceptions which, although they involve a fixed place of business should be excepted from the general rule in order to foster international trade or for convenience of administration. It is not, of course, suggested that the list in paragraph 2 is exhaustive. The last words of paragraph 3(*e*) also provide a generalised exception to the general definition laid down in paragraph 1. These words have the effect of restricting to some extent the effect of paragraph 1 and go some way to meeting criticism that the scope of the general definition is too wide.

6. During the drafting of the permanent establishment Article a good deal of consideration was given to the question whether it should contain some special provision for itinerant merchants, pedlars and watermen. After careful consideration it was decided that in such cases there should only be deemed to be a permanent establishment if there is a fixed place of business. Itinerants of this kind are, in general, subject to tax in the country of residence. A special provision to deal with these people seems unnecessary because their income will, in general be small and it is likely to be most difficult to tax them in any country except the one in which they reside. Moreover, any loss of tax which a country may suffer through giving up its right to tax itinerants from other countries is likely to be more or less

compensated by the fact it will have the sole right to tax itinerants residing within its own borders. It may be, of course, that countries with common frontiers will regard this problem as of sufficient importance to merit some special provision.

Paragraph 2

7. This paragraph contains a list, by no means exhaustive, of examples each of which can be regarded a priori as constituting a "permanent establishment". In the many bilateral Conventions concluded between O.E.C.D. Member countries there can, of course, be found other examples which, because of their importance in relation to the domestic taxation law of one or both of the contracting parties, have an equally strong claim to be included in this paragraph. In drafting this paragraph there were, however, three possible courses. First, there could have been compiled a composite paragraph which would necessarily have been of considerable length and would in effect have consolidated and brought together all the particular instances of permanent establishments which Member countries have found it convenient to include in their Conventions with one another. Secondly, there could have been drawn up a paragraph of medium length, selecting some of the more usual examples from existing bilateral Conventions and rejecting others, giving reasons for the choice. Finally, it would have been possible to take the minimum list of those examples common to, and agreed between Member countries. The method finally selected was to a considerable degree dictated by the nature of the task with which the draftsmen of the Article were faced. The main purpose of preparing a new permanent establishment Article was to delimit with some degree of precision the common ground between Member countries, in other words to compile an Article which Member countries would be able to accept with a minimum of discussion. With this purpose in mind it would have been a singularly useless exercise to pursue the first of the courses outlined above ; the resulting Article would have been of inordinate length and many of its examples would have been completely inapplicable to the circumstances of a large number of Member countries. Similarly with the second course ; to select from the many Conventions which exist examples worthy of inclusion would have been somewhat invidious and, unless the selection had been based on an extremely precise and detailed knowledge of the domestic law of each Member country — in the nature of things a most difficult test to satisfy — would have been scarcely less than impertinent. Moreover, the resulting Article would have suffered from many of the defects inherent in the first of the courses mentioned above ; some of its examples would have been inapplicable to the circumstances of many Member countries.

8. It is, therefore, the third course which has been taken. Basing itself on Article V of the Mexico and London Drafts, the Article attempts to comprise a list of examples which represent common ground on which Member countries are able to agree. There has been included in paragraph 2 most of the examples given in sub-paragraph 1 of Article V of the Mexico and London Drafts ; there is, however, one addition and there are one or two exceptions. There has been added "place of management" ; it is considered that this example should be specially mentioned since a "place of management" need not necessarily be an "office". On the other

hand, it did not seem necessary to include "head office". Insofar as this term is not covered, like "professional premises" which has also been omitted, by the general term "office" it seemed that the "head office" of an organisation would normally be a "place of management". "Installations" has also been left out as being a term so general as to be virtually meaningless. The terms "building site or construction or assembly project" cover constructional activities such as excavating or dredging. The provision that a building site or assembly project shall only be deemed to be a permanent establishment if it exists for more than twelve months is not intended to prevent a country from raising a tax assessment before a year has expired if it appears that the site or project is likely to last for more than twelve months. The period of twelve months may, of course, fall, in part, into more than one fiscal year.

9. During the drafting of the Article it was proposed that the term "warehouse" should be included as a separate item in paragraph 2. This example has been traditionally included in similar Articles as sufficiently important to merit particular mention. The purpose of including the term was, of course, to cover those warehouses in which the business of letting storage space or other facilities to third parties was carried on. The insertion of the term was not intended to treat as a permanent establishment a warehouse controlled by an enterprise, but used only for the storage, etc., of its own goods. It was, however, suggested that to insert the term would cause confusion and that the term "warehouse" in paragraph 2 read together with *a*) and *b*) of paragraph 3 would be misleading. It was accordingly decided not to include the term "warehouse" in paragraph 2. A warehouse in which the business of letting facilities for storage, etc. to third parties is carried on will be a permanent establishment under the general definition of paragraph 1 even though it is not specifically mentioned in the list of examples in paragraph 2. Paragraph 3, however, makes it clear that a warehouse is not a permanent establishment if it is used by the enterprise which controls it merely for the purpose of storage, etc.

Paragraph 3

10. This paragraph contains, first, a number of examples of forms of business activity which should not be treated as constituting permanent establishments even though the activity is carried on in a fixed place of business and, secondly, in the last few words of sub-paragraph *e*), a generalised exception to the rule laid down in paragraph 1 that a "fixed place of business in which the business of the enterprise is wholly or partly carried on" shall be regarded a priori as a permanent establishment.

11. The exceptions listed in sub-paragraphs *a*) to *e*) do not require much detailed comment. The first two and the fourth are common in the bilateral Conventions concluded between Member countries. Paragraph 3 *a*) of the Article relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Paragraphs 3 *b*) relates to the stock of merchandise itself and provides that the stock shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. Paragraph 3 *c*) covers the case in which a stock of goods or merchandise belong-

ing to one enterprise is processed by a second enterprise in another territory on behalf of, or for the account of the first-mentioned enterprise. The reference to the collection of information in paragraph 3 *d*) is intended to cover the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body ; to exempt such a bureau is no more than an extension of the concept of "mere purchase".

12. Comment is perhaps called for on the examples mentioned in paragraph 3 *e*). It is recognised that a place of business the function of which is solely that of advertising, or the supply of information, or of scientific research may well contribute to the productivity of its parent enterprise. To assume so is once more axiomatic. But the services it performs for its parent enterprise are so far antecedent to the actual realisation of profits by its parent body that no profits can properly be allocated to it ; accordingly it does not constitute a taxable unit. It should, of course, be emphasised that exemption should be given only so long as the place of business completely satisfies the conditions laid down. If, for example, the research establishment were to concern itself with manufacture, then exemption would be forfeited.

13. The last words of sub-paragraph *e*), "or for similar activities which have a preparatory or auxiliary character for the enterprise" require a special explanation of their own. The purpose of these words is twofold. In the first place, since it would be unreasonable to seek to claim that the list of examples quoted in paragraph 3 is, or in the nature of things could hope to be exhaustive, the last words of sub-paragraph *e*) are intended to cover any further examples (such as the organisation maintained solely for the purposes of servicing a patent or "know-how"contract) which are not listed among the exceptions in paragraph 3 but are nevertheless within the spirit of them. The words in question are, therefore, intended to make it unnecessary to attempt to produce an exhaustive list of exceptions which, even if it were comprehensive, would inevitably be of inordinate length and undesirable rigidity. In the second place, the words extend the principle underlying the examples in sub-paragraph *e*) to provide a generalised exception to the general definition in paragraph 1. To a considerable degree they delimit that definition and exclude from its rather wide scope a number of forms of business organisation which, although they are carried on in a fixed place of business, should not be treated as taxable units. To put the matter in another way, the last words of sub-paragraph *e*) refine the general definition in paragraph 1 and, when read with that paragraph, provide a more selective test by which to determine what constitutes a properly taxable permanent establishment. In view of the examples given, the reference to "similar activities" cannot lead to an arbitrary extension of the exemption set out in paragraph 3 *e*). It will, of course, be the responsibility of the enterprise to prove that the activities in question are of a preparatory or auxiliary character within the framework of the whole activities of the enterprise. If, for example, the results of the research carried on in a laboratory are not only used by the enterprise but are also sold to a third party, the paragraph would cease to apply. Alternatively, it would be possible for countries to include in bilateral agreements a provision that, where the results of the laboratory's research are used partly by the enterprise and in part are sold to third parties, the charge to tax on the per-

manent establishment should be limited to the profits arising from the sales to third parties. Such a provision would be analogous to the provisions relating to "mere purchase" in a number of Conventions.

Paragraph 4

DEPENDENT AGENTS AND EMPLOYEES

14. Whilst in paragraph 3 of the Article certain exceptions are made to the general definition in paragraph 1, it seems necessary in conformity with the international practice hitherto followed to treat certain groups of persons as permanent establishments on account of the nature of their business activities, even though the enterprise may not have a fixed place of business.

15. Persons who may be deemed to be permanent establishments must be strictly limited to those who are dependent, both from the legal and economic points of view, upon the enterprise for which they carry on business dealings (Report of the Fiscal Committee of the League of Nations, 1928, page 12). Where an enterprise has business dealings with an independent agent, this cannot be held to mean that the enterprise itself carries on a business in the other State. In such a case, there are two separate enterprises.

16. Having thus excluded the independent agents from the term "permanent establishments", it would likewise not be in the interest of international economic relations to treat all dependent agents as being permanent establishments. Treatment as a permanent establishment should be limited to dependent agents of those enterprises which, in view of the scope of their agent's authority or of the nature of their agent's business dealings, take part to a particular extent in business activities in the other State. Therefore, the Article proceeds on the basis that only persons having the authority to conclude contracts shall be treated as permanent establishments. The term "general authority" which has been commonly used in bilateral Conventions has been abandoned and replaced simply by the term "authority". In practice, it seems unlikely that any dependent agents have a completely unfettered authority to conclude contracts. In all cases the authority must be to some extent circumscribed. For administrative reasons, it seems advisable to avoid the difficulties which would inevitably arise if the question whether or not the dependent agent is a permanent establishment had to be decided by reference to the precise extent of his authority. When the agent has sufficient authority to bind the enterprise's participation in the business activity of the other country is such that he agent should be deemed to be a permanent establishment. The use of the term "permanent establishment" in relation to a person, presupposes, of course, that that person makes use of his authority repeatedly and not merely in isolated cases.

17. During the drafting of the Article, it was at one stage suggested that one of the tests that should be used to determine whether or not an agent is to be regarded as a permanent establishment should be the availability in the country in which the agent operates, and at the disposal of the agent of a stock of goods or merchandise belonging to the enterprise. This is, of course, a criterion commonly employed in bilateral Conventions for the

avoidance of double taxation. For a number of reasons, this suggestion was not pursued and in its present form paragraph 4 of the Article is founded on the view that the only real criterion is the nature of the authority entrusted to the agent ; in brief, whether or not he has, and habitually exercises, an authority to conclude contracts in the name of the enterprise.

18. Since the maintenance of a place of business exclusively for the purchase of goods or merchandise is not to constitute a permanent establishment (cf. paragraph 3 of the Article), a person should not be deemed to be a permanent establishment merely because he has an authority to conclude contracts which is strictly limited to contracts covering the purchase of goods or merchandise.

19. Under paragraph 4 of the Article, only one category of dependent agents, who meet specific conditions, is deemed to be permanent establishments. All independent agents and the remaining dependent ones are deemed to be permanent establishments. Mention should be made of the fact that the Mexico and London Drafts (Article V, paragraph 4, of the Protocol) and a number of Conventions, do not enumerate exhaustively such dependent agents as are deemed to be permanent establishments, but merely give examples. In the interest of preventing differences of interpretation and of furthering international economic relations, it appeared advisable to define, as exhaustively as possible, the cases where agents are deemed to be "permanent establishments".

Paragraph 5

INDEPENDENT AGENTS

20. Where the enterprise carries on business dealings through an agent of an independent status, it cannot be taxed in the other Contracting State (cf. the reasons given in paragraph 15 above). Corresponding provisions are included in the Mexico and London Drafts (Article V, paragraph 5, of th Protocol) and in numerous other Conventions for the avoidance of double taxation. In the Mexico and London Drafts and in the Conventions, brokers and commission agents are stated to be agents of an independent status. Similarly, business dealings carried on with the co-operation of a any other independent person carrying on a trade or business (e.g. a forwarding agent) do not constitute a permanent establishment. Such independent agents must, however, be acting in the ordinary course of their business. Where, for example, a commission agent not only sells the goods or merchandise of the enterprise in his own name but also habitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent).

21. Although it stands to reason that agents of an independent status, representing as they do a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise where they are acting in the ordinary course of their business (cf. paragraph 15 of the present Commentary), paragraph 5 is retained in the Article for the sake of clarity and emphasis

especially since a similar provision is contained in nearly all of the double taxation Conventions so far concluded.

The special problems which can arise in the case of insurance companies dealing by means of intermediaries or variously qualified representatives shall be further studied.

Paragraph 6

SUBSIDIARY COMPANIES

22. The Mexico and London Drafts (Article V, paragraph 8, of the Protocol) and numerous Conventions for the avoidance of double taxation, provide that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows, from the principle that, for the purpose of taxation, such as subsidiary company constitutes an independant legal entity. Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company.

23. Where, however, the subsidiary company, on behalf of its parent company, carries on an activity within the provisions of paragraph 4 of the Article, that subsidiary company is deemed to be a permanent establishment of the parent company. Where, for example, the subsidiary company, on the strength of an authority, concludes contracts of sale in the name of the parent company, the subsidiary company will be treated as a permanent establishment of the parent company (but only in respect of such activities). The parent company is subject to tax on so much of the profits accruing from such sales as is attributable to that permanent establishment. This does not affect the separate taxation of the subsidiary company's own profits.

24. For the same reasons, a parent company should not be treated as constituting a permanent establishment of its subsidiary unless it fulfills the conditions set out in paragraph 4 of the Article. The same rules should apply to two or more subsidiaries of the same company.

RESERVATION ON THE ARTICLE

25. Canada reserves its position on paragraph 4 of this Article. When negotiating Conventions with other Member countries, the Canadian authorities would wish to alter paragraph 4 so as to reflect the Canadian position that a person acting in Canada on behalf of an enterprise of the other contracting State who has a stock of merchandise from which he regularly fills orders on behalf of the enterprise in the other Contracting state should be regarded as a permanent establishment.

COMMENTARY ON ARTICLE 6
CONCERNING THE TAXATION OF INCOME FROM IMMOVABLE PROPERTY

1. All Double Taxation Conventions in force give the right to tax income from immovable property to the State of source, that is, the State in which the property producing such income is situated. This uniform practice in the Conventions is due to the fact that there is always a very close economic connection between the source of the income and the State of source. The rule laid down in paragraph 1 of the Article is in conformity with this practice.

2. Defining the concept of immovable property by reference to the laws of the State of situs, as is provided in paragraph 2, will help to avoid difficulties of interpretation over the question whether an asset or a right is to be regarded as immovable property or not. The Article, however, specifically mentions the assets and rights which must always be regarded as immovable property. In fact such assets and rights are already treated as immovable property according to the laws or the taxation rules of most O.E.C.D. Member countries. Conversely, the Article stipulates that ships, boats and aircraft shall never be considered as immovable property. No special provision has been included as regards income from indebtedness secured by immovable property, as the question is settled by Article 11 on the taxation of interest.

3. As indicated in paragraph 3 of the Article, the general rule applies irrespective of the form of exploitation of the immovable property. Paragraphs 3 and 4 also make it clear that the provisions of the Article apply not only to income from immovable property of industrial, commercial and other enterprises as well as to income from immovable property used for the performance of professional services.

4. It should be noted in this connection that the right to tax of the State of source has priority over other rights to tax and applies also where, in he case of a business undertaking or of non-industrial and non-commercial activities, income is only indirectly derived from immovable property. This does not prevent income from immovable property, when derived through a permanent establishment, from being treated as income of a business enterprise, but secures that income from immovable property will be taxed in the State in which the property is situated also in the case where such property is not part of a permanent establishment situated in that State. It should further be noted that the provisions of the Article do not prejudge the application of national laws as regards the manner in which income from immovable property is to be taxed.

COMMENTARY ON ARTICLE 7
CONCERNING THE TAXATION OF BUSINESS PROFITS

General Introduction

1. Article 7 on business profits is in many respects a continuation of, and a corollary to, Article 5 on the definition of the concept of permanent establishment. The permanent establishment criterion is commonly used in international double taxation Conventions to determine whether a particular kind of income shall or shall not be taxed in the country from which it originates but the criterion does not of itself provide a complete solution to the problem of the double taxation of business profits ; in order to prevent such double taxation it is necessary to supplement the definition of permanent establishment by adding to it an agreed set of rules of reference to which the profits made by the permanent establishment, or by an enterprise trading with a foreign member of the same group of enterprises, are to be calculated. To put the matter in a slightly different way, when an enterprise of a Contracting State carries on business in the other Contracting State the authorities of that second State have to ask themselves two questions before they levy tax on the profits of the enterprise ; the first question is whether the enterprise has a permanent establishment in their country ; if the answer is in the affirmative the second question is what, if any, are the profits on which that permanent establishment should pay tax. It is with the rules to be used in determining the answer to this second question that Article 7 is concerned. Rules for ascertaining the profits of an enterprise of a Contracting State which is trading with an enterprise of the other Contracting State when both enterprises are members of the same group of enterprises or are under the same effective control are dealt with in Article 9.

2. It should perhaps be said at this point that neither Article is strikingly novel or particularly detailed. The question of what criteria should be used in attributing profits to a permanent establishment, and of how to allocate profits from transactions between enterprises under common control, has had to be dealt with in a large number of European double taxation Conventions concluded since the war, and it is fair to say that the solutions adopted have generally conformed to a standard pattern. It is generally recognised that the essential principles on which this standard pattern is based are well founded, and it has been thought sufficient to restate them with some slight amendments and modifications primarily aimed at producing greater clarity. The two Articles incorporate a number of directives. They do not, nor in the nature of things could they be expected to, lay down a series of precise rules for dealing with every kind of problem that may arise when an enterprise of one State makes profits in another. Modern

commerce organises itself in an infinite variety of ways, and it would be quite impossible within the fairly narrow limits of an Article in a double taxation Convention to specify an exhaustive set of rules for dealing with every kind of problem that may arise. This, however, is a matter of relatively minor importance. If there is agreement on general lines. Special cases may require special consideration, but it should not be difficult to find an appropriate solution if the problem is approached within the framework of satisfactory rules based on agreed principles.

Paragraph 1

3. This paragraph is concerned with two questions. First, it restates the generally accepted principle of double taxation Conventions that an enterprise of one State shall not be taxed in the other State unless it carries on business in that other State through a permanent establishment situated therein. It is hardly necessary to argue here the merits of this principle. It is perhaps sufficient to say that it has come to be accepted in international fiscal matters that until an enterprise of one State sets up a permanent establishment in another State it should not properly be regarded as participating in the economic life of that other State to such an extent that it comes within the jurisdiction of that other State's taxing rights.

4. The second and more important point is that it is laid down — in the second sentence — that when an enterprise carries on business through a permanent establishment in another State that State may tax the profits of the enterprise but only so much of them as is attributable to the permanent establishment ; in other words that the right to tax does not extend to profits that the enterprise may derive from that State otherwise than through the permanent establishment. This is a question on which there may be differences of view. Some countries have taken the view that when a foreign enterprise has set up a permanent establishment within their territory it has brought itself within their fiscal jurisdiction to such a degree that they can properly tax all profits that the enterprise derives from their territory, whether the profits come from the permanent establishment or from other activities in that territory. But it is thought that it is preferable to adopt the principle contained in the second sentence of paragraph 1, namely that the test that business profits should not be taxed unless there is a permanent establishment is one that should properly be applied not to the enterprise itself but to its profits. To put the matter another way, the principle laid down in the second sentence of paragraph 1 is based on the view that in taxing the profits that a foreign enterprise derives from a particular country, the fiscal authorities of that country should look at the separate sources of profit that the enterprise derives from their country and should apply to each the permanent establishment test. This is of course without prejudice to other Articles.

5. On this matter, naturally, there is room for differences of view, and since it is an important question it may be useful to set out the arguments for each point of view.

6. Apart from the background question of fiscal jurisdiction, the main argument commonly put forward against the solution advocated above is

that there is a risk that it might facilitate avoidance of tax. This solution, the argument runs, might leave it open to an enterprise to set up in a particular country a permanent establishment which made no profits, was never intended to make profits, but existed solely to supervise a trade, perhaps of an extensive nature, that the enterprise carried on in that country through independent agents and the like. Moreover, the argument goes, although the whole of this trade might be directed and arranged by the permanent establishment, it might be difficult in practice to prove that that was the case. If the rates of tax are higher in that country than they are in the country in which the head office is situated, then the enterprise has a strong incentive to see that it pays as little tax as possible in the other territory; the main criticism of the solution advocated above is that it might conceivably provide the enterprise with a means of ensuring that result.

7. Apart again from the question of the proper extent of fiscal jurisdiction, the main argument in favour of this solution is that it is conducive to simple and efficient administration, and that it is more closely adapted to the way in which business is commonly transacted. The organisation of modern business is highly complex. In O.E.C.D. countries, there are a considerable number of companies each of which is engaged in a wide diversity of activities and is carrying on business extensively in many countries. Current trends of political thought in Europe seem likely to make such companies even more common in future than they are at present. It may be that such a company may have set up a permanent establishment in a second country and may be transacting a considerable amount of business through that permanent establishment in one particular kind of manufacture; that a different part of the same company may be selling quite different goods or manufactures in that second country through independent agents; and that the company may have perfectly genuine reasons for taking this course — reasons based, for example, either on the historical pattern of its business or on commercial convenience. Is it desirable that the fiscal authorities of the country should go so far as to insist on trying to search out the profit element of each of the transactions carried on through independent agents, with a view to aggregating that profit with the profits of the permanent establishment? Such an Article might interfere seriously with ordinary commercial processes, and so be out of keeping with the aims of the Convention.

8. It is no doubt true that evasion of tax could be practised by undisclosed channelling of profits away from a permanent establishment and that this may sometimes need to be watched, but it is necessary in considering this point to preserve a sense of proportion and to bear in mind what is said above. It is not, of course, sought in any way to sanction any such malpractice, or to shelter any concern thus evading tax from the consequences that would follow from detection by the fiscal authorities concerned. It is fully recognised that Contracting States should be free to use all methods at their disposal to fight fiscal evasion.

9. For the reasons given above, it is thought that the argument that the solution advocated might lead to increased avoidance of tax by foreign enterprises should not be given undue weight. Much more importance is

attached to the desirability of interfering as little as possible with existing business organisation and of refraining from inflicting demands for information on foreign enterprises, which are unnecessarily onerous.

Paragraph 2

10. This paragraph contains the central directive on which the allocation of profits to a permanent establishment is intended to be based. The paragraph incorporates the view, which is generally contained in bilateral Conventions that have been concluded since the war, that the profits to be attributed to a permanent establishment are those which that permanent establishment would have made if, instead of dealing with its head office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. Normally, this would be the same profit that one would expect to be reached by the ordinary processes of good business accountancy. In the great majority of cases, therefore, trading accounts of the permanent establishment — which are commonly available if only because a well-run business organisation is normally concerned to know what is the profitability of its various branches — will be used by the taxation authorities concerned to ascertain the profit properly attributable to that establishment. Exceptionally, there may be no separate accounts (see paragraphs 21 to 25 below). But where there are such accounts they will naturally form the starting point for any processes of adjustment in case adjustment is required to produce the amount of properly attributable profits. It should perhaps be emphasized that the directive contained in paragraph 2 is no justification for tax administrations to construct hypothetical profit figures in vacuo ; it is always necessary to start with the real facts of the situation as they appear from he business records of the permanent establishment and to adjust as may be shown to be necessary the profit figures which those facts produce.

11. Even where a permanent establishment is able to produce proper accounts which purport to show the profits arising from its activities, it may still be necessary for the taxation authorities of the country concerned to rectify those accounts, in accordance with the general directive laid down in paragraph 2. Adjustment of this kind may be necessary ; for example, because goods have been invoiced from the head office to the permanent establishment at prices which are not consistent with this directive, and profits have thus been diverted from the permanent establishment to the head office, or vice versa.

12. In such cases, it will usually be appropriate to substitute for the prices used ordinary market prices for the same or similar goods supplied on the same or similar conditions. (Clearly the price at which goods can be bought on open market terms varies with the quantity required and the period over which they will be supplied ; such factors would have to be taken into account in deciding the open market price to be used). It is perhaps only necessary to mention at this point that there may sometimes be perfectly good commercial reasons for an enterprise invoicing its goods at prices less than those prevailing in the ordinary market ; this may, for example, be a perfectly normal commercial method of establishing a competitive position in a new market and should not then be taken as evidence

of an attempt to divert profits from one country to another. Difficulties may also occur in the case of proprietary goods produced by an enterprise, all of which are sold through its permanent establishments; if in such circumstances there is no open market price and it is thought that the figures in the accounts are unsatisfactory it may be necessary to calculate the permanent establishment's profits by other methods, for example, by applying an average ratio of gross profit to the turnover of the permanent establishment and then deducting from the figure so obtained the proper amount of expenses incurred. Clearly many special problems of this kind may arise in individual cases but the general rule should always be that the profits attributed to a permanent establishment should be based on that establishment's accounts insofar as accounts are available which represent the real facts of the situation. If available accounts do not represent the real facts then new accounts will have to be constructed, or the original ones re-written, and for this purpose the figures to be used will be those prevailing in the open market.

Paragraph 3

13. This paragraph clarifies ,in relation to the expenses of a permanent establishment, the general directive laid down in paragraph 2. It is valuable to include paragraph 3 if only for the sake of removing doubts. The paragraph specifically recognises that in calculating the profits of a permanent establishment allowance is to be made for expenses, wherever incurred, that were incurred for the purposes of the permanent establishment. Clearly in some cases it will be necessary to estimate or to calculate by conventional means the amount of expenses to be taken into account. In the case, for example, of general administrative expenses incurred at the head office of the enterprise it may be appropriate to take into account a proportionate part based on the ratio that the permanent esablishment's turnover (or perhaps gross profits) bears to that of the enterprise as a whole. Subject to this, it is considered that the amount of expenses to be taken into account as incurred for the purposes of the permanent establishment should be the actual amount so incurred.

14. Apart from what may be regarded as ordinary expenses, there are some classes of payment between permanent establishments and head offices which give rise to special problems, and it is convenient to deal with them at this point. The next five paragraphs discuss three specific cases of this kind and give solutions for them. It should not, of course, be inferred that it is only in relation to the three classes of payments mentioned in these paragraphs that problems may arise; there may well be payments of other kinds to which similar considerations apply.

15. The first of these cases relates to interest, royalties and other similar payments made by a permanent establishment to its head office in return for money loaned, or patent rights conceded, by the latter to the permanent establishment. In such a case, it is considered that the payments should not be allowed as deductions in computing the permanent establishment's taxable profits. (Equally, such payments made to a permanent establishment by the head office should be excluded from the computation of the permanent establishment's taxable profits.) It is, however, recognised that

special considerations apply to payments of interest made by different parts of a financial enterprise (e.g. a bank) to each other on advances, etc., (as distinct from capital allotted to them), in view of the fact that making and receiving advances is narrowly related to the ordinary business of such enterprises. Furthermore, if an enterprise makes payments of interest, etc., to a third party and these payments in part relate to the activities of the permanent establishment, then a proportionate part of them should naturally be taken into account in calculating the permanent establishment's profits insofar as they can properly be regarded as expenses incurred for the purposes of the permanent establishment.

16. The second case relates to the performance of ancillary services by a permanent establishment on behalf of its head office (or vice versa). Consider, for example, the case of a large company with a varied business, part of which it carries on in another country through a permanent establishment. In addition, that permanent establishment advertises on behalf of its head office goods which that enterprise produces but which the permanent establishment itself does not handle. Clearly, in calculating for tax purposes the profits of the permanent establishment, the profits should be increased by the amount of the expense it has incurred on behalf of the head office (unless, of course, such an adjustment has already been made in drawing up the accounts of the permanent establishment). But if the permanent establishment and its head office were entirely separate and independent, the permanent establishment would ordinarily carry out services for the head office only if it were paid a commission as well as reimbursed the actual expenses incurred. It is, therefore, necessary to decide whether the calculation should be made on the basis of account being taken not only of any expenses borne by a permanent establishment by reason of services performed for the head office but also of a notional commission increasing the profits of the permanent establishment.

17. After careful consideration of this question, it is thought that in such circumstances the profits of the permanent establishment should not be increased by the addition of a "commission" figure. While, on one view, to include a commission figure in the profits of every permanent establishment that has performed services otherwise than for its own purposes could be looked at in theory as a consequential application of the fiction of separate enterprise, it would inevitably be found exceedingly cumbersome in practice. There would be scope for lengthy argument about, and usually no concrete basis for determining, the percentage to be used in calculating the amount of notional commission. In the great majority of cases the accounts of the permanent establishment would doubtless take into consideration the actuel expenses incurred; in other words they would not normally include any credit for commission. If as a general rule the "separate enterprise" test were to be applied to services performed by a permanent establishment on behalf of its head office and a notional "commission" profit were to be included in the profits of the permanent establishment, it would, therefore, be necessary in the great majority of cases first to settle how the "commission" element was to be calculated and then re-write the accounts of the permanent establishment. Considerations of practical administration weigh heavily against such a course. Therefore no "commission" element should in such cases be included in the profits of the permanent establish-

ment. Similarly, in the converse case where the head office undertakes services on behalf of the permanent establishment) no "commission" element should be deducted in determining the profits of the permanent establishment.

18. The third case is related to the question whether any part of the total profits of an enterprise should be deemed to arise from the exercise of good management. Consider the case of a company that has its head office in one country but carries on all its business through a permanent establishment situated in another country. In the extreme case it might well be that only the directors' meetings were held at the head office and that all other activities of the company, apart from purely formal legal activities, were carried on in the permanent establishment. In such a case there is something to be said for the view that at least part of the profits of the whole enterprise arose from the skilful management and business acumen of the directors and that part of the profits of the enterprise ought, therefore, to be attributed to the country in which the head office was situated. If the company has been managed by a managing agency, then that agency would doubtless have charged a fee for its services and the fee might well have been a simple percentage participation in the profits of the enterprise. But, once again, whatever the theoretical merits of such a course, practical considerations weigh heavily against it. In the kind of case quoted the expenses of management would, of course, be set against the profits of the permanent establishment in accordance with the provisions of paragraph 3, but when the matter is looked at as a whole, it is thought that it would not be right to go further by deducting and taking into account some national figure for "profits of management". In cases identical to the extreme case mentioned above, no account should therefore be taken in determining taxable profits of the permanent establishment of any notional figure such as profits of management.

19. It may be, of course, that countries where it has been customary to allocate some proportion of the total profits of an enterprise to the head office of the enterprise to represent the profits of good management will wish to continue to make such an allocation. Nothing in the recommendation made is designed to prevent this. Nevertheless it follows from what is said in paragraph 18 that a country in which a permanent establishment is situated is in no way required to deduct when calculating the profits attributable to that permanent establishment an amount intended to represent a proportionate part of the profits of management attributable to the head office.

20. It might well be that if the country in which the head office of an enterprise is situated allocates to the head office some percentage of the profits of the enterprise only in respect of good management, while the country in which the permanent establishment is situated does not, the resulting total of the amounts charged to tax in the two countries would be greater than it should be. In any such case the country in which the head office of the enterprise is situated should take the initiative in arranging for such adjustments to be made in computing the taxation liability in that country as may be necessary to ensure that any double taxation is eliminated.

21. It is usually found that there are, or there can be constructed, adequate accounts for each part or section of an enterprise so that profits and expenses, adjusted as may be necessary, can be allocated to a particular part of the enterprise with a considerable degree of precision. This method of allocation is, it is thought, to be preferred in general wherever it is reasonably practicable to adopt it. There are, however, circumstances in which this may not be the case, and paragraphs 2 and 3 are in no way intended to imply that other methods cannot properly be adopted where appropriate in order to arrive at the profits of a permanent establishment on a "separate enterprise" footing. It may well be, for example, that profits of insurance enterprises can most conveniently be ascertained by special methods of computation, e.g. by applying appropriate coefficients to gross premiums received from policy holders in the country concerned. Again, in the case of a relatively undeveloped enterprise operating on both sides of a land frontier, there may be no proper accounts for the permanent establishment nor means of constructing them. There may, too, be other cases where the affairs of the permanent establishment are so closely bound up with those of the head office that it would be impossible to disentangle them on any strict basis of branch accounts. Where it has been customary in such cases to estimate the arm's length profit of a permanent establishment by reference to suitable criteria, it may well be reasonable that that method should continue to be followed, notwithstanding that the estimate thus made may not achieve as high a degree of accurate measurement of the profit as adequate accounts. Even where such a course has not been customary, it may, exceptionally, be necessary for practical reasons to estimate the arm's length profits.

Paragraph 4

22. It has in some cases been the practice to determine the profits to be attributed to a permanent establishment not on the basis of separate accounts or by making an estimate of arm's length profit, but simply by apportioning the total profits of the enterprise by reference to various formulae. Such a method differs from those envisaged in paragraph 2 of the Article, since it contemplates not an attribution of profits on a separate enterprise footing, but an apportionment of total profits : and indeed it might produce a result in figures which would differ from that which would be arrived at by a computation based on separate accounts. Paragraph 4 makes it clear that such a method may continue to be employed by a Contracting State if it has been customary in that State to adopt it, even though the figure arrived at may at times differ to some extent from that which would be obtained from separate accounts, provided that the result can fairly be said to be in accordance with the principles embodied in the Article. It is considered, however, that a method of allocation which is based on apportioning total profits is generally not as appropriate as a method which has regard only to the activities of the permanent establishment, and should be used only where, exceptionally, it has as a matter of history been customary in the past and is accepted in the country concerned both by the taxation authorities and taxpayers generally there as being satisfactory.

23. It would not, it is thought, be appropriate within the framework

of this commentary to attempt to discuss at length the many various methods involving apportionment of total profits that have been adopted in particular fields for allocating profits. These methods have been well documented in treatises on international taxation. It may, however, not be out of place to summarise briefly some of the main types and to lay down some very general directive for their use.

24. The essential character of a method involving apportionment of total profits is that a proportionate part of the profits of the whole enterprise is allocated to a part thereof, all parts of the enterprise being assumed to have contributed on the basis of the criterion or criteria adopted to the profitability of the whole. The difference between one such method and another arises for the most part from the varying criteria used to determine what is the correct propotion of the total profits. It is fair to say that the criteria commonly used can be grouped into three main categories, namely those which are based on the receipts of the enterprise, its expenses or its capital structure. The first category covers allocation methods based on turnover or on commission, the second on wages and the third on the proportion of the total working capital of the enterprise allocated to each branch or part. It is not, of course, possible to say in vacuo that any of these methods is intrinsically more accurate than the others ; the appropriateness of any particular method will depend on the circumstances to which it is applied. In some enterprises, such as those providing services or producing proprietary articles with a high profit margin, net profits will depend very much on turnover. For insurance enterprises it may be appropriate to make an apportionment of total income by reference to premiums received from policy holders in each of the countries concerned. In the case of an enterprise manufacturing goods with a high cost raw material or labour content profits may be found to be related more closely to expenses. In the case of banking and financial concerns the proportion of total working capital may be the most relevant criterion. It is considered that the general aim of any method involving apportionment of total profits ought to be to produce figures of taxable profit that approximate as closely as possible to the figures that would have been produced on a separate accounts basis, and that it would not be desirable to attempt in this connection to lay down any specific directive other than that it should be the responsibility of the taxation authority, in consultation with the authorities of other countries concerned, to use the method which in the light of all the known facts seems most likely to produce that result.

25. The use of any method which allocates to a part of an enterprise a proportion of the total profits of the whole does, of course, raise the question of the method to be used in computing the total profits of the enterprise. This may well be a matter which will be treated differently under the laws of different countries. This is not a problem which it would seem practicable to attempt to resolve by laying down any rigid rule. It is scarcely to be expected that it would be accepted that the profits to be apportioned should be the profits as they are computed under the laws of one particular country ; each country concerned would have to be given the right to compute the profits according to the provisions of its own law.

Paragraph 5

26. In paragraph 3 of Article 5 defining the concept of permanent establishment there are listed a number of examples of activities which, even though carried on at a fixed place of business, are not to be deemed to be included in the term "permanent establishment". In considering rules for the allocation of profits to a permanent establishment the most important of these examples is the activity mentioned in paragraph 5 of the present Article, i.e. the purchasing office.

27. This present paragraph is not, of course, concerned with the organisation established solely for purchasing; such an organisation is not a permanent establishment and the profits allocation provisions of this Article would not therefore come into play. The paragraph is concerned with a permanent establishment which although carrying on other business also carries on purchasing for its head office. In such a case the paragraph provides that the profits of the permanent establishment shall not be increased by adding to them a notional figure for profits from purchasing. It follows, of course, that any expenses that arise from the purchasing activities will also be excluded in calculating the taxable profits of the permanent establishment.

Paragraph 6

28. This paragraph is intended to lay down clearly that a method of allocation once used should not be changed merely because in a particular year some other method produces more favourable results. One of the purposes of a double taxation Convention is to give an enterprise of a Contracting State some degree of certainty about the tax treatment that will be accorded to its permanent establishment in the other Contracting State as well as to the part of it in its home State which is dealing with the permanent establishment; for this reason, paragraph 6 gives an assurance of continuous and consistent tax treatment.

Paragraph 7

29. Although it has not been found necessary in this Convention to define the term "profits", it should nevertheless be understood that the term when used in this Article and elsewhere in the Convention has a broad meaning including all income derived in carrying on an enterprise. Such a broad meaning corresponds to the use of the term made in the tax laws of most Member States.

30. This interpretation of the term "profits", however, may give rise to some uncertainty as to the application of the Convention. If the profits of an enterprise include categories of income which are treated separately in other Articles of the Convention, e.g. dividends, it may be asked whether the taxation of those profits is governed by the special Article on dividends etc. or by the provisions of the present Article.

31. To the extent that an application of the present Article and the special Article concerned would result in the same tax treatment, there is little practical significance to this question. Further, it should be noticed

that some of the special Articles contain specific provisions giving priority to a specific Article (cf. paragraphs 3 and 4 of Article 7, paragraph 4 of Articles 10 and 11 and paragraph 3 of Article 12).

32. It has seemed desirable, however, to lay down a rule of interpretation in order to clarify the field of application of the present Article in relation to the other Articles dealing with a specific category of income. In conformity with the practice generally adhered to in existing bilateral Conventions paragraph 7 of the present Article gives first preference to the special Articles on dividends, interest etc. It follows from the rule that the present Article will be applicable to industrial and commercial income which does not belong to categories of income covered by the special Articles and, in addition, to dividends, interest and royalties which under paragraph 4 of Articles 10 and 11 and paragraphs 3 of Article 12 fall within the present Article. It is understood that the items of income covered by the special Articles may, subject to the provisions of the Convention, be taxed either separately, or as industrial and commercial profits, in conformity with the tax laws of the Contracting States.

33. It is open to Contracting States to agree bilaterally upon special explanations or definitions concerning the term "profits" with a view to clarifying the distinction between this term and e.g. the concept of dividends. It may in particular be found appropriate to do so where in a Convention under negotiation a deviation has been made from the recommended definitions in the special Articles on dividends, interest and royalties. It may also be deemed desirable if the Contracting States wish to place on notice that, in agreement with the national tax laws of one or both of the States, the term "profits" includes special classes of receipt, such as income from the alienation or the letting of a business or of movable property used in a business. In this connection it may have to be considered whether it would be useful to include also additional rules for the allocation of such special profits.

COMMENTARY ON ARTICLE 8 CONCERNING THE TAXATION OF PROFITS FROM SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT

Paragraph 1

1. The object of paragraph 1 concerning profits from the operation of ships or aircraft in international traffic is to secure that such profits will be taxed in one State alone. Operation in international traffic means any operation of ships or aircraft which extends over more than one country, whatever the number of places of call in a particular country. The provision is based on the principle that the taxing power shall be left to the Contracting State in which the place of effective management of the enterprise is situated. This makes it unnecessary to devise detailed rules, e.g. for defining the profits covered, this being rather a question of application for which general principles of interpretation must be taken into account. It seems useful, however, to give a few examples and comments to clarify the question.

2. The profits covered consist in the first place of the profits obtained by the enterprise from the carriage of passengers or cargo. With this definition, however, the provision would be unduly restrictive, in view of the development of shipping and air transport, and for practical considerations also. The provision therefore covers other classes of profits as well, i.e. those which by reason of their nature or their close relationship with the profits directly obtained from transport may all be placed in a single category. Some of these classes of profits are mentioned in the following paragraphs.

3. Profits obtained by leasing a ship or an aircraft on charter fully equipped, manned and supplied must be treated like the profits from the carriage of passengers or cargo. Otherwise, a great deal of business of shipping or air transport would not come within the scope of the provision. The Article does not, however, apply to profits from a bare boat charter.

4. Shipping and air transport enterprises — particularly the latter — often engage in additional activities more or less closely connected with the direct operation of ships and aircraft. Although it would be out of the question to list here all the auxiliary activities which could properly be brought under the provision, nevertheless a few examples may usefully be given.

5. The provision covers, inter alia, the following activities :

a) the sale of passage tickets on behalf of other enterprises ;

b) the operation of a bus service connecting a town with its airport ;
c) advertising and commercial propaganda.

6. On the other hand, the provision does not cover a clearly separate activity, such as the keeping of a hotel as a separate business. The profits from such an establishment are in any case easily determinable. In certain cases, however, circumstances are such that the provision must apply even to a hotel business, e.g. the keeping of a hotel for no other purpose than to provide transit passengers with night accommodation, the cost of such a service being included in the price of the passage ticket. In such a case, the hotel is simply a kind of waiting room.

7. There is another activity which is excluded from the field of application of the provision, namely a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country.

8. Investment income of shipping, inland waterways or air transport enterprises (income from stocks, bonds, shares and loans is to be subjected to the treatment ordinarily applied to this class of income in general).

9. Since the Second World War, various forms of international co-operation have come into existence, particularly in air transport. In this field international co-operation is secured through pooling agreements or other Conventions of a similar kind which lay down certain rules for apportioning the receipts (or profits) from the joint business.

10. Generally speaking, participation in a pool, in a joint business or in an international operating agency does not appear to offer any special difficulties. If the provision recommended is applicable to any enterprise engaged in shipping, inland waterways transport or air transport, it follows that it must also extend to profits obtained through the type of co-operation described above ; indeed, such an interpretation results directly from the text of the provision.

Paragraph 2

11. The object of this paragraph is to apply the same treatment to transport on rivers, canals and lakes as to shipping and air transport in international traffic. The provision applies not only to inland waterways transport between two or more countries, but also to inland waterways transport carried on by an enterprise of one country between two points in another country.

12. The provision does not prevent specific taxation problems which may arise in connection with inland waterways transport, in particular between adjacent countries, from being settled specially by bilateral agreement.

Case of enterprises not exclusively engaged in shipping, inland waterways transport or air transport.

13. It follows from the wording of paragraphs 1 and 2 of the Article that enterprises not exclusively engaged in shipping, inland waterways transport or air transport nevertheless come within the provisions of these

paragraphs as regards profits arising to them from the operation of ships, boats or aircraft belonging to them.

14. If such an enterprise possesses in a foreign country permanent establishments exclusively concerned with the operation of its ships or aircraft, there is no reason to treat such establishments differently from the permanent establishments of enterprises engaged exclusively in shipping, inland waterways or air transport.

15. Nor does any difficulty arise in applying the provisions of paragraphs 1 and 2 if the enterprise possesses in another State a permanent establishment which is not exclusively engaged in a shipping, inland waterways transport or air transport. For if its goods are carried in its own ships to a permanent establishment belonging to it in a foreign country, it is right to say that none of the profit obtained by the enterprise through acting as its own carrier can properly be attributed to the permanent establishment. The same must be true even if the permanent establishment maintains installations for operating the ships or aircraft (e.g. consignment wharves) or incurs other costs in connection with the carriage of the enterprise's goods (e.g. staff costs). In this case, the permanent establishment's expenditure in respect of the operation of the ships, boats or aircraft should be attributed not to the permanent establishment but to the enterprise itself, since none of the profit obtained through the carrying benefits the permanent establishment.

16. In cases — which are probably purely theoretical — where the enterprise's ships or aircraft are operated by a permanent establishment which is not the place of effective management of the whole enterprise (e.g. ships or aircraft put into service by the permanent establishment and figuring on its balance sheet), then the effective management for the purposes of paragraphs 1 and 2 must be considered, as regards the operation of the ships or aircraft, as being in the Contracting State in which the permanent establishment is situated.

Paragraph 3

17. This paragraph deals with the particular case where the place of effective management of the enterprise is aboard a ship or a boat. In this case tax will only be charged by the State where the home harbour of the ship or boat is situated. It is provided that if the home harbour cannot be determined, tax will only be charged by the Contracting State of which the operator of the ship or boat is a resident.

COMMENTARY ON ARTICLE 9
ON THE TAXATION OF ASSOCIATED ENTERPRISES

This Article deals with associated enterprises (parent and subsidiary companies and companies under common control) and provides that in such cases the taxation authorities of a Contracting State may for the purpose of calculating tax liabilities re-write the accounts of the enterprises if as a result of the special relations between the enterprises the accounts do not show the true taxable profits arising in that country. It is evidenly appropriate that rectification should be sanctioned in such circumstances, and the Article seems to call for very little comment. It should perhaps be mentioned that the provisions of the Article apply only if special conditions have been made or imposed between the two enterprises. No re-writing of the accounts of associated enterprises is authorised if the transactions between such enterprises have taken place on normal open market commercial terms.

COMMENTARY ON ARTICLE 10 CONCERNING THE TAXATION OF DIVIDENDS

I. Preliminary Remarks

A. The Problems

1. By "dividends" is generally meant the distribution of profits to the shareholders or members by companies limited by shares[1], limited partnerships with share capital[2], limited liability companies[3] or other joint stock companies[4]. Under the laws of the O.E.C.D. Member countries, such joint stock companies are legal entities with a separate juridical personality distinct from all their shareholders or members. On this point, they differ from partnerships in so far as the latter do not have juridical personality in most countries.

2. The profits of a business carried on by a partnership are the partners' profits derived from their own exertions : for them they are industrial or commercial profits. So the partner is ordinarily taxed personally on his share of the partnership capital and partnership profits.

3. The position is different for the shareholder ; he is not a trader and the company's profits are not his ; so they cannot be attributed to him. He is personally taxable only on those profits which are distributed by the company (apart from the provisions in certain countries' laws relating to the taxation of undistributed profits in special cases). From the shareholders' standpoint, dividends are income from the capital which they have made available to the company as its shareholders.

B. Taxation of Companies Limited by Shares and of Dividends

4. The results of an enquiry made into the taxation of dividends as at 30th June, 1963, are summarised in the attached table which gives an overall picture of the situation at the time.

a) *Taxation of Resident Companies*

i) *Taxation of the company's profits*

5. In all the States, companies are taxed on their profits. The taxes

1. "Sociétés anonymes."
2. "Sociétés en commandite par actions."
3. "Sociétés à responsabilité limitée."
4. "Société de capitaux."

paid by companies are generally of a particular kind, that is, they are distinct from those paid by individuals.

6. In most of the States, a company's total profits are taxed uniformly. In taxing a company's profits, four States make a distinction according to whether the profits are distributed or not :

— Belgium : the rate of company tax in respect of distributed profits is always 30 per cent. The rate of company tax in respect of undistributed profits is generally 30 per cent also ; it is 25 per cent in respect of any profits placed to reserve and expenditure not allowed as business expenses, where these items of taxable income total not more than 1,000,000 Belgian Francs ; it is 35 per cent in respect of any excess of profits placed to reserve over 5 million Belgian Francs, but the surcharge of 5 per cent is repaid to the company if such profits are subsequently distributed.
— Germany : the rate of the company tax for distributed profits is lower than that for undistributed profits (15 per cent instead of 51 per cent).
— Greece : profits distributed by the company are not taxed at all.
— Iceland : profits distributed by the company to the amount of 10 per cent of its capital stock are not taxed.

In the Netherlands, the Government has introduced a Bill which proposes a rate on distributed profits of 30 per cent, while the rate on undistributed profits would remain at 45 per cent.

ii) *Taxation of the company's capital and reserves*

7. Six States (Austria, Germany, Italy, Luxembourg, Norway, and Switzerland) tax the capital and reserves of companies limited by shares.

b) *Taxation of Shareholders of a Resident Company*

i) *Taxes at the source*

8. Many States impose taxes at the source on dividends from resident companies. In most cases such taxes are borne by all the shareholders (Austria, Belgium, Germany, France, Italy, Luxembourg, the Netherlands, Portugal, Spain, Switzerland, Turkey) ; in Belgium the tax at the source is charged at the rate of 15 per cent on 85/70ths of the gross dividend declared, the object here being to take account of a tax credit allowed to the shareholder of 15/70ths of the dividend declared. In some cases the tax at the source is only payable by non-resident shareholders (Norway, Sweden) or non-resident alien shareholders (United States, Italy). Two States do not charge a tax at the source on dividends but make the company distributing the dividends pay taxes on its profits, leaving it the right to recover tax by deduction from dividends paid out of those profits to shareholders ; this is the case in the United Kingdom and the Republic of Ireland as regards their income taxes : Denmark does not tax non-resident shareholders at all. Italy imposes a tax at the source of 15 per cent. This tax will be definitively levied as tax on distributed profits in the case where the shareholder is not liable to the complementary tax ("imposta complementare") or to the Italian company tax ("imposta sulle società").

ii) *Taxation of resident shareholders*

9. In all the States dividends paid by resident companies are included in the taxable income of a resident shareholder, in some of the States as to their net amount, in the others as to their gross amount. Tax levied at the source by the same State is generally credited against the general income tax. Exceptions to this rule are : Spain as regards its "dividends tax" and Switzerland as regards its "coupon tax".

10. Some States give certain relief to resident shareholders :

— In the United Kingdom and the Republic of Ireland, the income tax paid by the company on its profits also counts as the shareholder's tax on its dividends he receives. The shareholder is entitled to have the personal allowances and reliefs he may claim taken into account in calculating his income tax on the dividends. This can result in a part of the tax paid by the company on its profits being refunded to the shareholder. The gross amount of the dividend is included in the shareholder's total income for the purposes of surtax.

— In certain States the recipient is not further liable on his dividends to tax already charged on the profits of the company paying the dividends. Thus in the United Kingdom and the Republic of Ireland, the profits tax is not charged again, the same holds good in Italy for the "imposta sul reddito di ricchezza mobile". In Belgium, dividends received by resident individuals, which have already borne company tax and tax at the source, are added as to 85/70ths of their gross amount to the shareholder's other taxable income and charged to personal income tax ; against the personal income tax are set off the tax charged at the source and the tax credit of 15 per cent referred to in paragraph 8 above. Dividends received by resident companies go to constitute their profits, but, on the principle "non bis in idem", the net dividend received is excluded from the taxable profits to the extent that it forms part of such profits and so escapes company tax, it is deemed, before all other income, to form part, of the distributed profits of the recipient company and when distributed is not charged to tax at the source.

— In most of the States the law gives preferential treatment, on one form or another, to holding companies.

— In Norway, companies are not taxed on dividends paid by resident companies. Resident individuals are neither liable to local income tax (varying from 16 to 19 per cent) nor to local capital tax (generally 4 per mille) on dividends paid by and shares held in resident companies.

iii) *Taxation of non-resident shareholders*

11. In seven States non-resident individuals who are shareholders of resident companies are liable to a graduated tax on total income : The United Kingdom and the Republic of Ireland (surtax), Greece (income tax), Iceland, Italy ("imposta complementare" or tax on distributed profits), the United States in the case of a non-resident alien shareholder whose

income from United States sources exceeds $15,400, and Spain if the income from Spanish sources exceeds 100,000 pesetas per year. In Belgium, such persons are liable to a graduated tax on their total income of Belgian origin, if they possess an establishment or dwelling in Belgium or receive there certain income in the capacity of a partner or director performing actual whole time service ; non-resident companies which are shareholders of resident companies are subject to a flat rate tax if they possess an establishment in Belgium. In both cases economic double taxation is avoided in the same manner as in the case of resident shareholders (see paragraph 10 above). In Greece and Iceland, non-resident companies which are shareholders of resident companies are liable to a flat rate tax.

c) *Taxation of Resident Shareholders in Respect of Dividends from a Non-Resident Company.*

12. Dividends paid to a shareholder resident in a State by a non-resident company are subject in that State to the general axes on income and profits. The following peculiarities should be mentioned :

- In Italy, individuals, as a rule, are taxed on foreign dividends only if these are remitted to Italy ("goduto in Italia"). Italy charges the "imposto sul reddito di ricchezza mobile" on certain foreign dividends only. Dividends received by companies are included in their taxable income for the purposes of the Italian Company tax ("imposta sulle società"). In any case a withholding tax of 15 per cent is imposed on the dividends paid by foreign companies when these dividends are paid by banks or credit institutes. This withholding tax is, however, credited if the beneficiary of the dividends is liable to the complementary tax ("imposta complementare") or to the Italian company tax ("imposta sulle società") ;
- Spain has, in addition, a tax at the source. It is charged on only so much of the dividends as corresponds to the proportion that the profits made in Spain bear to the total profits, furthermore, it is charged on the dividends from foreign sources actually paid in Spain ;
- In Belgium, dividends paid by foreign companies are charged on their entry into Belgium to a tax at the source or prelevy ("précompte mobilier") of 15 per cent. In the case of resident individuals this pre-levy is credited against the personal income tax, as also is a fixed quota of 15 per cent which is deemed to represent the foreign tax. In the case of resident companies double taxation is avoided in the same manner as in the case of dividends paid by resident companies (see paragraph 10 above) ;
- The United States and the United Kingdom give credit for foreign taxes against their own income taxes. Germany and Denmark only give credit for the tax charged on the dividends ;
- Portugal levies, in addition, a tax at the source on dividends actually paid in Portugal.

13. In some States the preferential treatment given to holding companies in respect of dividends arising in such States does not apply to dividends received from foreign companies.

COUNTRY	TAXATION OF PROFITS OF RESIDENT COMPANIES			TAXATION BORNE BY SHAREHOLDERS ON RESIDENT COMPANIES' DIVIDENDS								TAXATION BORNE BY RESIDENT SHAREHOLDERS ON NON-RESIDENT COMPANIES' DIVIDENDS			
				RESIDENT SHAREHOLDERS						NON-RESIDENT SHAREHOLDERS					
					INDIVIDUALS		COMPANIES								
	TOTAL	UNDISTRIBUTED	DISTRIBUTED	TAX AT THE SOURCE	GENERAL INCOME TAXES	CREDIT FOR 4 AGAINST 5	GENERAL INCOME TAXES	CREDIT FOR 4 AGAINST 7	PREFERENTIAL TREATMENT FOR HOLDINGS (a)	TAX AT THE SOURCE	OTHER TAXES	TAX AT THE SOURCE	GENERAL INCOME TAXES	CREDIT FOR FOREIGN TAXES	PREFERENTIAL TREATMENT FOR HOLDINGS
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Austria	×	—	—	17,7 %	×	×	×	×	25	17,7 %	—	—	×	—	—
Belgium	×	—	—	15 % of 85/70 th	×	×	×	—	(b)	15 % of 85/70 th	—	15 %	×	(f)	×
Denmark	×	—	—	—	×	—	×	—	25	—	—	—	×	×	×
France	×	—	—	24 %	×	×	×	×	20	24 %	—	24 %	×	—	×
Germany	—	51 %	15 %	25 %	×	×	×	×	25	25 %	—	—	×	×	—
Greece	—	×	—	25 %	×	—	×	—	—	25 %	×	—	×	—	—
Iceland	—	×	(f)	—	×	—	×	—	—	×	—	—	×	—	—
Ireland	×	—	—	(f)	(d)	—	(f)	—	—	(f)	(d)	—	×	—	—
Italy	×	—	—	15 %	(c)	×	(e)	×	—	15 %	(c)	15 %	(f)	×	—
Luxembourg	×	—	—	15 %	×	×	×	×	25	15 %	—	—	×	—	—
Netherlands	×	—	—	15 %	×	×	×	×	25	15 %	—	—	×	—	×
Norway	×	—	—	—	(f)	—	—	—	—	25 %	—	—	×	—	×
Portugal	×	—	—	×	×	×	×	—	—	×	×	—	×	—	—
Spain	×	—	—	8-30 %	×	—	×	—	—	8 30 %	—	×	×	—	—
Sweden	×	—	—	—	×	—	×	—	(b)	30 %	—	—	×	—	—
Switzerland	×	—	—	30 %	×	27 %	×	—	20	30 %	—	3 %	×	—	×
Turkey	×	—	—	×	×	×	×	×	(b)	×	—	—	×	×	×
United Kingdom	×	—	—	(f)	(d)	—	(f)	—	—	(f)	(d)	×	×	×	—
United States	×	—	—	—	×	—	×	—	(b)	30 %	(f)	—	×	×	—

NOTES: (a) For holdings of ... %.
(b) No minimum.
(c) "Impôt complémentaire".
(d) Surtax.
(e) "Imposta sulle società".
(f) See text.

II. Solutions

A. Work of the International Organisations

14. In this matter of dividends, differences between taxation laws and conflicts of interests have an inhibiting effect that is not apparent in any other part of international fiscal law. Many States feel unable to relinquish the right to tax dividends paid by resident companies to non-resident shareholders, either because their taxation systems are based on the principle of territoriality, or because they fear that to do so would mean a loss of tax revenue.

15. The League of Nations took up the problems of international double taxation at a comparatively early date. A commission of four economists stated, in a report dated 5th April, 1923, that the right to tax movable property (including shares in companies and debt claims) should belong to the State of the taxpayer's residence. A second committee of seven taxation experts, in a report dated 7th February, 1925, formulated other proposals which the General Meeting of Government Experts on Double Taxation adopted in its report of 31st October, 1928, but not without modifying them on certain points and adding two further proposals, so that the proposals of the League of Nations in 1928 consisted of the following variants :

Variant A : Imposition of impersonal taxes by the State in which the enterprise has its effective place of management, and imposition of personal taxes exclusively in the State of the shareholder's residence ;

Variant B : Taxation exclusively in the State of the shareholder's residence ;

Variant C : Taxation in the State of the shareholder's residence, with a reservation in favour of taxes charged at the source in the other State ; it is recommended to the Contracting States that they should avoid or mitigate any resulting double taxation by arrangements for the full or part refund of the taxes levied in the State of source, or for giving credit for the taxes charged at the source against the taxes imposed in the State of the shareholder's residence.

16. From 1929 to 1939 no further solutions to the problem of dividend taxation were devised by the Fiscal Committee of the League of Nations. On the other hand, the drafts prepared at later conferences, in Mexico in 1943 and in London in 1946, contain provisions which differ essentially from the proposals contained in the 1928 draft. The Mexico and London drafts give the right to tax dividends to the State in which the capital is invested or in which the company has its fiscal domicile. It is only where a company has a "dominant participation" in the management or capital of the company paying the dividends that the London draft allows an exemption in the country where that company has its fiscal domicile. The proposals of the London and Mexico Model Convention regarding dividends have not been adopted by the O.E.C.D. Member countries.

B. The Conventions Concluded by the O.E.C.D. Member countries

17. The Conventions for the avoidance of double taxation concluded between O.E.C.D. Member countries contain the following solutions :

a) In a first category of Conventions, dividends are taxable only in the State of the recipient's residence (Convention between France and Sweden of 1936-1950).

b) Other Conventions provide for dividends to be taxed in the State of the recipient's residence ; but they contain an unlimited reservation in favour of taxes charged at the source in the other State (Convention concluded between Germany and Sweden in 1928).

c) In a third category, the right to tax dividends is conferred on the State of the recipient's residence ; a reservation is made in favour of taxes imposed at the source in the other State, but such taxes are not to be levied, or must be refunded fully or in part if the shareholder satisfies certain conditions (Conventions concluded by Switzerland with Sweden in 1948, with the Netherlands in 1951, with Austria in 1953, and with France in 1953).

d) In a last category, both States may tax dividends. But the State of the shareholder's residence undertakes to give credit for the tax levied in the State of source (which tax may or may not be limited to a certain rate) against its own taxes on the same income (Conventions concluded between Germany and Austria in 1954, between Sweden and Norway in 1947, by France with Norway in 1953 and with Germany in 1959, and by Italy with the United States in 1955, with Sweden in 1956, with France in 1958, and with the United Kingdom in 1960).

C. Solution Recommended by the Fiscal Committee of the O.E.C.D.

18. The solution recommended by the Committee is not new. It takes into account the work of the international organisations and the Conventions concluded up to now. The Committee has submitted a text which should be acceptable to the great majority of O.E.C.D. Member countries.

19. The Article states that dividends shall be taxable in the State of the shareholder's residence, but it confers a limited concurrent right to tax on the State of source.

20. The Article deals with the relationship between itself and the provisions of Article 7 concerning the taxation of business profits and it defines the term "dividends".

21. The Committee has confined itself to settling principles. Particular questions, in particular the manner in which the State of source must reduce its taxes, are not dealt with. Nor is the manner in which allowance is to be made for the peculiarities of certain countries' laws. There are too many possible solutions, so that it appears impossible to find a single formula which can satisfy all the States. There is still vast scope for bilateral negotiations without subtracting from the value of the proposed provisions.

III. Commentary on the Provisions of the Article

Paragraph 1

22. The first paragraph of the Article does not prescribe the principle of taxation of dividends exclusively in the State of the recipient's residence or exclusively in the State of which the company paying the dividends is a resident.

23. Taxation of dividends exclusively in the State of source is not acceptable as a general rule. Furthermore, there are some States which do not have taxation of dividends at the source, while as a general rule, all the States tax residents in respect of dividends they receive from non-resident companies.

24. On the other hand, taxation of dividends exclusively in the State of the recipient's residence is not feasible as a general rule. It would be more in keeping with the nature of dividends, which are investment income, but it would be unrealistic to suppose that there is any prospect of its being agreed that all taxation of dividends at the source should be relinquished.

25. For this reason, the first paragraph states simply that dividends may be taxed in the State of the recipient's residence.

Paragraph 2

26. Paragraph 2 reserves a right to tax to the State of source of the dividends, i.e. to the State of which the company paying the dividends is a resident ; this right to tax, however, is limited considerably. The rate of tax is limited to 15 per cent, which appears to be a reasonable maximum figure. A higher rate could hardly be justified since the State of source can already tax the company's profits.

27. On the other hand, a lower rate of 5 per cent is expressly provided in respect of dividends paid by subsidiary companies. If a company of one of the States owns directly a holding of at least 25 per cent in a company of the other State, it is reasonable that payments of profits by the subsidiary to the foreign parent company should be taxed less heavily, to facilitate international investment and to avoid recurrent taxation. The realisation of the latter intention depends, of course, on the fiscal treatment provided for parent companies in their State of residence. Some laws and Conventions already contain similar provisions. If a partnership is treated as a body corporate under the national law applying to it, the two Contracting States may agree to modify paragraph 2 *a*) in a way to give the benefits of the reduced rate provided for parent companies also to such partnerships.

28. The tax rates fixed by the Article for the tax in the State of source are maximum rates. The States may agree, in bilateral negotiations, on lower rates or even on taxation exclusively in the State of the recipient's residence. The reduction of rates provided for in paragraph 2 refers solely to the taxation of dividends and not to the taxation of the profits of the company paying the dividends.

29. The two Contracting States may also, in bilateral negotiations, agree to a holding percentage lower than that fixed in the Article.

30. Paragraph 2 says nothing about the mode of taxation. Each State is free to apply its own laws. The State of source may levy, not only taxes at the source, but also taxes charged by direct assessment.

31. Paragraph 2 does not settle procedural questions. Each State should be able to use the procedure provided in its own law. It can either forthwith limit its tax to the rates given in the Article or tax in full and make a repayment.

32. It has not been determined whether a relief in a State of source should be given only where the recipient is subject to tax in respect of the dividends in the State of residence. The formula chosen may be supplemented accordingly by bilateral agreement.

33. The Article says nothing on how the State of the recipient's residence should make allowance for the taxation in the State of source. This question is considered in the Articles 23(A) and 23(B) concerning methods of avoiding double taxation in the State of residence.

34. Attention is drawn generally to the following case : the recipient of the dividends arising in a Contracting State is a company resident in the other Contracting State ; all or part of its capital is held by shareholders resident outside that other State ; its practice is not to distribute its profits in the form of dividends ; and it enjoys preferential taxation treatment ("private investment company", "base company"). The question may arise whether in the case of such a company it is justifiable to allow in the State of source of the dividends the restriction of tax which is provided in paragraph 2 of the Article. It may be appropriate, when bilateral negotiations are being conducted, to agree upon special exceptions to the taxing rule laid down in this Article, in order to define the treatment applicable to such companies.

Paragraph 3

35. In view of the great differences between the laws of O.E.C.D. Member countries, it is impossible to define "dividends" fully and exhaustively. Consequently, the definition merely mentions examples which are to be found in the majority of the Member countries' laws and which, in any case, are not treated differently in them. The enumeration is followed up by a general formula. It is open to the Contracting States, through bilateral negotiations, to make allowance for the peculiarities of their laws and to agree to bring other distributions of profits within the Article.

36. The Article relates, basically, to distributions of profits the title to which is constituted by shares, that is holdings in a company limited by shares ("Société anonyme"). The Article assimilates to shares all securities issued by companies limited by shares which carry a right to participate in the profits without being debt claims ; such are, for example, "jouissance" shares or "jouissance" rights, founders' shares or other rights participating in profits. On the other hand, debt claims participating in profits do not

come into this category. Likewise, interest on convertible debentures is not dividend.

37. The laws of many of the States put participations in a "Société à responsabilité limitée" (limited liability company) on the same footing as shares. Again, distributions of profits by co-operative societies are generally regarded as dividends.

38. Distributions of profits by partnerships of individuals are not dividends. French law, however, makes certain exceptions to this principle.

39. Payments regarded as dividends may include not only distributions of profits by annual resolutions of general meetings of shareholders, but also other benefits in money or money's worth, such as bonus shares, bonuses, profits on a liquidation and disguised distributions of profits. The reliefs provided in the Article apply so long as the State of which the paying company is a resident taxes such benefits as dividends.

Paragraph 4

40. Certain States consider that dividends, interest and royalties arising from sources in their territory and payable to individuals or legal persons who are residents of other States fall outside the scope of the arrangement made to prevent them from being taxed both in the State of source and in the State of the recipient's residence when the recipient possesses a permanent establishment in the former State. Paragraph 4 of the Article is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". It does not stipulate that dividends arising to a resident of a Contracting State from a source situated in the territory of the other State must, by a kind of legal presumption, or fiction even, be related to a permanent establishment which that resident may happen to possess in the latter State, so that the said State would not be obliged to limit its taxation in such a case. The paragraph merely provides that in the State of source the dividends are taxable as part of the profits of the permanent establishment there owned by the recipient residing in the other State, if they are paid in respect of holdings forming part of the assets of the permanent establishment or otherwise effectively connected with that establishment. In that case, paragraph 4 relieves the State of source of the dividends from any limitations under the Article. The foregoing explanations accord with those in the Commentaries on Article 7 on the taxation of business profits.

Paragraph 5

41. The Article deals only with dividends paid by a company resident in one of the States to a resident of the other State. Certain States, however, tax not only dividends paid by companies resident in them but even distributions by non-resident companies of profits arising in them. Each State, of course, is entitled to tax profits arising in its territory which are made by non-resident companies, to the extent provided in the Convention (in particular in Article 7 concerning the taxation of business profits). The shareholders of such companies should not be taxed as well at any rate

unless they are resident in the State and so naturally subject to its fiscal sovereignty.

42. Paragraph 5 adopts a provision already contained in a number of Conventions. It rules out extraterritorial taxation of dividends and further provides that non-resident companies are not to be subjected to special taxes on undistributed profits.

IV. Special Position of Certain Countries due to Peculiarities of the National Tax Laws

A. General

43. Certain laws seek to avoid or mitigate economic double taxation, that is the simultaneous taxation of the company's profits in its hands and of the distributed profits in the hands of the shareholder. There are various ways of achieving this :

- — the shareholder is not taxed in respect of the dividends paid to him by the company, the company having already been taxed in respect of the profits distributed ; the tax paid by the company is allowed to be recovered from the shareholder (United Kingdom, Ireland : see C below) ;
- — the shareholder pays the bulk or the whole of the tax on the profits distributed, while in respect of those same profits the company either pays a considerably reduced tax or is even exempted from tax (Germany, Greece and proposed legislation in the Netherlands : see D below) ;
- — part of the tax paid by the company on its distributed profits is credited against the tax payable by the shareholder (Belgium : see B below).

44. In the first case, the tax is paid by the company and is then regarded as borne by the shareholder ; such treatment of the tax confers a dual character on it. The tax falls on the company's profits but enters into the computation of the shareholder's tax liability as well. This dual character becomes particularly apparent when the tax is charged only on the profits distributed. The above observation still applies even in the case where, besides the tax paid by the company and then regarded as borne by the shareholder, the recipient of the dividend, if an individual, has to pay other taxes (United Kingdom and Republic of Ireland : surtax).

45. In the second case, the taxation in question comes within the Article on the taxation of dividends. However, the reduction of such tax as provided in the present Article would cause difficulties for Germany, the Netherlands and Greece, owing to the peculiarities of their national tax laws.

B. Belgium

46. In Belgium, the company distributing the dividends is normally charged to company tax on its distributed profits. In the hands of a shareholder who is an individual the dividends are charged to personal income

tax, but the shareholder has a tax credit equal to one-half of the tax paid by the company. In the hands of a company the net amount of the dividends received is excluded from the taxable profits to the extent that it forms part of such profits and so escapes company tax. As the share holder receives a tax credit equal to half of the amount of the company tax, Belgium considers that this tax credit should not be taken into consideration with regard to the 15 per cent limit and that the base taxable at the rate of 15 per cent should include this tax credit ("impôt de distribution" calculated at 15 per cent on 85/70 ths of the dividend paid).

C. United Kingdom, Ireland

47. The United Kingdom and Ireland could not envisage the repayment to non-resident shareholders of the tax charged on the company, with a view to reducing the tax indirectly borne by them to the amount provided for in the Article. In bilateral Conventions the United Kingdom and the Republic of Ireland commonly give up surtax payable by non-resident shareholders. The United Kingdom and the Republic of Ireland are further prepared to give non-resident individuals the relief provided in Section 227 of the United Kingdom's Income Tax Act, 1952, and Section 8 of the Republic of Ireland's Finance Act, 1935, respectively (proportionate personal allowances). Non-resident bodies corporate which are shareholders of companies resident in the United Kingdom or in Ireland cannot, however, obtain relief in respect of taxes indirectly borne by them.

D. Germany, Greece and Iceland

48. The solution proposed in paragraph 2 of the Article is based on the hypothesis that the purpose of a double taxation Convention is not to prevent the economic double taxation that occurs when a State taxes not only in the hands of the company its total industrial or commercial profits, but also, in addition, the profits distributed as dividends in the hands of the shareholder. If a State mitigates or abolishes such double taxation by charging on the company only a very low tax or no tax at all in respect of the part of profits to be distributed (because it fully taxes the profit distribution in the hands of resident shareholders), it must have the right to tax, at a higher rate than those mentioned in paragraph 2, the dividends received by a non-resident shareholder. The imposition of a higher tax at the source would thus be compensation for the fact that the distributed profits have not been taxed, or have been taxed at a reduced rate, in the hands of the company. In this case, it may also be necessary to charge a higher tax at the source than those mentioned in paragraph 2 in order to ensure that non-resident shareholders (or certain categories of shareholders, e.g. non-resident parent companies) are not in a more favourable tax position than resident shareholders. A number of States which have concluded Conventions with these countries have taken this peculiarity in their laws into account.

E. Appreciation of the Position

49. Different views may be taken as to the exact nature of taxes (in the United Kingdom and Ireland) which, though not levied directly on the

shareholder, are regarded as borne by him. Whatever these views may be, however, States negotiating double taxation Conventions with the United Kingdom or Ireland should have the opportunity to decide, in each particular case, whether they are prepared to reduce their own taxes to the rate specified in the present Article, taking into account the other concessions which these two countries can offer.

50. With regard to the position in Belgium, Germany, Greece and Iceland, the Committee considers that a final settlement should be reached through bilateral negotiations.

V. Reservation on the Article

Paragraph 2, sub-paragraph a) *(Holdings)*

51. The Netherlands has entered a reservation respecting the rate of 5 per cent, since it considers that transfers of profits within a group of enterprises should be entirely exempted from tax at the source.

52. Spain and Italy have a reservation concerning the percentage envisaged for the holding (25 per cent). They can only agree to a rate of tax of 5 per cent for a direct holding of at least 51 per cent.

53. Portugal has a reservation regarding the rate of tax of 5 per cent. It can only accept in the Article itself a rate of 10 per cent, but might consider reducing this percentage in bilateral negotiations.

54. France wishes to retain its freedom of judgement, both as regards the limit on the tax and the determination of the minimum percentage for the holding.

55. Germany enters a reservation concerning the application of sub-paragraph *a*) in certain cases where it does not seem necessary to reduce its tax at the source below 15 per cent in order to avoid substantial recurrent taxation.

56. Belgium has a reservation on sub-paragraph *a*) because, as regards the treatment of subsidiaries, it has not up to now made any special concession in the case of holdings of less than 90 per cent. Belgium's Conventions with the United Kingdom and Sweden contain a special (fairly complicated) solution for the benefit of subsidiaries controller as to at least 90 per cent ; where a British or Swedish company owns at least 90 per cent of the share capital of a Belgian company, the total charge to the "taxe mobilière" and the "contribution nationale de crise" in respect of the dividends distributed to the parent company is restricted to a sum equal to the additional "taxes professionnelles" which would have been payable had there been no distribution of dividends. In addition, owing to the changes introduced by the new Law of 20th November, 1962, Belgium wishes to retain its freedom of action with regard to the treatment of holdings (parent companies and subsidiaries).

Paragraph 2, sub-paragraphs a) *and* b)

57. Turkey cannot accept a rate of tax which is lower than 20 per cent.

58. Canada reserves its position on the second paragraph of this Article.

Paragraph 3

59. With respect to paragraph 3 of the Article, Belgium in view of the fact that the income tax reform Law of 20th November, 1962, excludes liquidation bonuses from the category of income from movable property and subjects them to special levy in lieu of company tax, reserves its position as regards :

a) the special levy imposed by the new law in the case of the redemption of their shares or stock by companies limited by shares and limited partnerships with share capital or by any companies, associations establishments or bodies constituted in Belgium otherwise than in one of the forms specified in the Commercial Code ;

b) the special levy imposed by the same law in the case of the division of the assets of such legal persons as are mentioned in sub-paragraph *a*) above or of partnerships of individuals not opting for their profits to be charged to personal income tax in the name of the partners.

This reservation is dictated by the consideration that these special levies on the company, etc., are really in the nature of a composition satisfying all personal taxes that would be due from the shareholders or partners on the capital gains or distributions of profits in question. Belgium considers that the limitations provided for in the case of distribution taxes on dividends do not apply to these special levies.

Paragraph 4

60. Italy reserves the right to subject dividends to the taxes imposed by its law whenever the recipient thereof has a permanent establishment in Italy, even if the holding on which the dividends are paid is not effectively connected with such permanent establishment.

Paragraph 5

61. France cannot adhere without a reservation to the provisions of this paragraph owing to the structure of its fiscal law which provides that permanent establishments in France of foreign companies are to be taxed under the same conditions as French companies.

COMMENTARY ON ARTICLE 11
CONCERNING THE TAXATION OF INTEREST

I. Preliminary Remarks

A. Definition of Interest for the purposes of this report

1. "Interest" is generally taken to mean remuneration on money lent, being remuneration coming within the category of "income from movable capital" (revenus de capitaux mobiliers). Such remuneration includes, in particular, interest on and all other income — to which certain taxation laws assimilate prizes and redemption premiums — from :

- — bonds or debentures, whether or not secured on immovable property and whether or not carrying a right to participate in profits, which are negotiable securities just as company shares are, being issued in representation of collective loans, offered to the public in equal fractions and ordinarily redeemable at long term or by drawing lots, and quoted on a Stock Exchange or capable of being so quoted;
- — government securities ;
- — indebtedness or debt claims of every kind (whether secured by mortgage, preferential or unsecured) ;
- — notes of indebtedness, deposits, security lodged in money and other rights which can be assimilated to debt claims or loans.

B. International double taxation of interest

2. Unlike dividends, interest does not suffer economic double taxation, that is, it is not taxed both in the hands of the debtor and in the hands of the creditor. Unless it is provided to the contrary by the contract, payment of the tax charged on interest falls on the recipient. If it happens that the debtor undertakes to bear any tax chargeable at the source, this is as though he had agreed to pay his creditor additional interest corresponding to such tax. Subject to the remarks made later (paragraph 17), the debtor may nevertheless show the interest paid and any tax so borne in his enterprise's general expense.

3. But, like dividends, interest on bonds or debentures or loans usually attracts tax charged by deduction at the source when the interest is paid. This method is, in fact, commonly used for practical reasons, as the tax charged at the source can constitute an advance of the tax payable by the recipient in respect of his total income or profits. If in such a case the recipient is a resident of the country which practises deduction at the source, any double taxation he suffers is remedied by internal measures. But the position is different if he is a resident of another country : he is

then liable to be taxed twice on the interest, first by the State of source and then by the State in which he resides. It is clear that his double charge of tax can reduce considerably the interest on the money lent and so hamper the movement of capital and the development of international investment.

C. How can double taxation of interest be avoided?

4. There is no point in re-opening doctrinal arguments on the respective merits of taxing interest in the State of source or in the State of the recipient's residence, according to whether the tax is impersonal or personal; or in considering whether the theoretically ideal solution would not be for the right to tax to be the privilege of the State of the creditor's residence, on the principle that movable property is intimately associated with the person of its owner and that tax on the income that it produces should properly be borne by the owner. Very detailed studies were made on this subject in the League of Nations. These resulted in the elaboration of different, not to say conflicting, proposals as to the taxation of interest.

5. The fact is that countries which export capital and countries in which it is invested have apparently opposed interests. The former are naturally inclined to advocate that income from exported capital should be taxed in the State of the recipient's residence, and the latter in the State of source of the income.

6. Although the State in which the capital is invested may be entitled to tax income paid as interest on capital coming from another State, on the ground that the income results from the use of such capital and has its source in its territory, it would be exorbitant for it to claim that it alone had the right to tax it. The State exporting the capital can no less justifiably maintain that if the payment of the interest on the capital is made possible by the use of the capital, it is also, and primarily, due to the very existence of the capital, so that it too is justified in calling upon the owners of the capital — the recipients of the interest — to participate in the public expenses, by reason of their possession of such income.

7. Thus it is clear that both solutions — that which would give an exclusive right to tax to the country of source of the interest and that which would reserve it to the country of the creditor's residence — are too rigid.

D. Solutions adopted in the bilateral Conventions already concluded for the purpose of avoiding double taxation

8. In the Conventions concluded between them the O.E.C.D. Member countries have adopted various methods for avoiding double taxation of interest.

9. Sometimes taxation is reserved exclusively to the State of source (cf. Convention concluded in 1957, between Italy and the Netherlands, Art. 8), or to the State of the recipient's residence (cf. Denmark-Netherlands, 1957, Art. 10; France-Norway, 1953, Art. 9; Denmark-France, 1957, Arts. 8 and 9; France-Netherlands, 1949, and Additional Agreement of 1952, Arts. 8 and 9; France-Sweden, 1936, and Additional Agreement of 1950, Arts. 8 and 9; Netherlands-Sweden, 1952, Art. 10).

10. Sometimes taxation is shared between the State of the recipient's residence and the State of source (cf. Denmark-Switzerland, 1957, Arts. 2 and 9 ; Norway-Switzerland, 1956, Arts. 2 and 9 ; France-Switzerland, 1953, Art. 10 ; United States-France, 1956, Art. 6 A (new) of the Convention of 1939, and Art. 14 ; France-Germany, 1959, Art. 10. para. 1).

11. In other cases the tax in the State of source is to be levied at the ordinary rate and credit given for it against the tax payable in the State of the recipient's residence (cf. Belgium-France, 1931, Art. 6 ; Italy-Sweden, 1956, Art. 9).

12. Finally, special treatment is applied to income from indebtedness secured by mortgage of immovable property, the taxation of which is often reserved to the State of the mortgaged property's situs (Netherlands-United Kingdom, 1948, Art. 8 ; Netherlands-Switzerland, 1951, Art. 3).

E. Solution adopted by the Fiscal Committee of O.E.C.D.

13. The Fiscal Committee's discussions first of all showed that all the O.E.C.D. Member countries tax interest arising abroad to their residents, two-thirds of them tax interest arising in their territories to non-residents and one-third do not tax interest at the source at all.

14. The discussions further showed that a formula reserving the exclusive taxation of interest to one State, whether the State of the recipient's residence or the State of source, could not be sure of receiving general approval. Some countries stated that their preference was for taxation in the State of residence, others for taxation in the State of source. A number of countries which practise taxation at the source considered that they would be able to give up the right to tax at the source if certain conditions were concurrently present ; but they at once made it clear that they could not be bound by a text which left them no discretion in this respect.

15. The Fiscal Committee therefore has been obliged to turn towards a compromise solution, first laying down the principle that interest shall be taxed in the State of residence — particularly as this is the practice in the generality of the Member states — but leaving the State of source the right to impose a tax if its laws so provide, it being implicit in this right that the State of source is free to give up all taxation on interest paid to non-residents. Its exercise of this right will however be limited by a ceiling which its tax cannot exceed but, it goes without saying, the Contracting States can agree to adopt an even lower rate of taxation in the State of source. The sacrifice that the latter would accept in such conditions will be matched by a similar sacrifice for the State of residence, since it will have to take into account the tax levied in the State of source in order to prevent the double taxation that the interest would suffer if the State of residence imposed on itself no restriction in the exercise of its right (on this subject see Articles 23 (A) and 23 (B) on methods of avoiding double taxation in the State of residence of the recipient of the income).

16. Views were divided on the determination of the ceiling of the tax levied in the State of source. A very large majority, however, was found

for a rate of 10 per cent. The reservations entered by some Member countries are indicated in Section III of this commentary.

F. Deductibility of interest for the purposes of the payer's tax

17. Certain countries do not allow interest paid to be deducted for the purposes of the payer's tax unless the recipient also resides in the same State or is taxable in that State. Otherwise they forbid the deduction. The Fiscal Committee considers it desirable that the deduction in question should also be allowed in cases where the interest is paid by a resident of a Contracting State to a resident of the other State, the case of fraud being, of course, reserved ; it considers that the deduction should not be forbidden simply because the tax payable by the recipient of such interest is reduced in the State of source in application of the proposed Article. Any other method of procedure might cancel out the beneficial effects of the measures taken to avoid double taxation.

II. Commentary on the Article

Paragraph 1

18. This paragraph lays down the principle that interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in the latter. In doing so, it does not stipulate an exclusive right to tax in favour of the State of residence, but simply repeats the rule deriving from the generality of tax laws which include the right to tax income of this kind in the State of the recipient's residence.

Paragraph 2

19. Paragraph 2 reserves a right to tax interest to the State in which the interest arises ; but it limits the exercise of that right by determining a ceiling for the tax, which may not exceed 10 per cent. This rate may be considered a reasonable maximum if it is remembered that the State of source is already entitled to tax profits or income produced on its territory by investments financed out of borrowed capital. The two Contracting States may agree through bilateral negotiations upon a lower tax or even on exclusive taxation in the State of the recipient's residence (see on this point the reservation entered by Italy which is recorded in Section III).

20. Paragraph 2 of the Article lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own law and, in particular, to levy the tax either by deduction at source or by individual assessment.

21. It does not specify whether the relief in the State of source should be conditional upon the interest being subject to tax in the State of residence. It has already been stated that taxation in the State of residence is the general rule. There is, however, nothing to prevent the formula proposed in paragraph 2 from being supplemented in this respect by means of bilateral negotiations.

22. Moreover, the Article contains no provisions concerning any obligation on the State of the Recipient's residence to take account of the tax in the State of source of the interest. This question is dealt with in Articles 23(A) and 23(B) concerning method of avoiding double taxation in the former State.

23. Attention is drawn generally to the following case : the recipient of interest arising in a Contracting State is a company resident in the other Contracting State ; all or part of its capital is held by shareholders resident outside that other State ; its practice is not to distribute its profits in the form of dividends ; and it enjoys preferential taxation treatment ("private investment company", "base company"). The question may arise whether, in the case of such a company, it is justifiable to allow in the State of source the restriction of tax which is provided in paragraph 2 of the Article. It may be appropriate, when bilateral negotiations are being conducted, to agree upon special exceptions to the taxing rule laid down in this Article, in order to define the treatment applicable to such companies.

Paragraph 3

24. This paragraph specifies the meaning to be attached to the term "interest" for the application of the taxation treatment defined by the Article. In particular, the term designates income from bonds or debentures, whether or not secured by mortgage and whether or not carrying a right to participate in profits, and debt claims of all kinds, including mortgages. Bonds or debentures which participate in profits are nonetheless regarded as loan securities if the contract of issue by its general character constitutes evidence of a loan at interest. It is also recognised that mortgage interest comes within the category of income from movable capital ("revenus de capitaux mobiliers"), although certain countries assimilate it to income from immovable capital.

25. In any case, the Article does not give a complete and exhaustive list of the various kinds of interest. Such a list might not be fully in harmony with the various States' laws, which may differ among themselves in their interpretation of the concept of interest. It therefore seems preferable to include in a general formula all income which is assimilated by those laws to remuneration on money lent. This applies in particular to interest derived from cash deposits and security lodged in money.

26. Finally, the question arose whether annuities ought to be assimilated to interest ; it was decided that they ought not to be. On the one hand, annuities granted in consideration of past employment are referred to in Article 18 and are subject to the rules governing pensions. On the other hand, although it is true that instalments of purchased annuities include an interest element on the purchase capital as well as return of capital, such instalments thus constituting "fruits civils" which accrue from day to day, it would be difficult for many countries to make a distinction between the element representing income from capital and the element representing a return of capital in order merely to tax the income element under the same category as income from movable capital. Taxation laws often contain special provisions classifying annuities in the category of salaries, wages and pensions, and taxing them accordingly.

Paragraph 4

27. Certain States consider that dividends, interest and royalties arising from sources in their territory and payable to individuals or legal persons who are residents of other States fall outside the scope of the arrangement made to prevent them from being taxed both in the State of source and in the State of the recipient's residence when the recipient possesses a permanent establishment in the former State. Paragraph 4 of the Article is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". It does not stipulate that interest arising to a resident of a Contracting State from a source situated in the territory of the other State must, by a kind of legal presumption, or fiction even, be related to a permanent establishment which that resident may happen to possess in the latter State, so that the said State would not be obliged to limit its taxation in such a case. The paragraph merely provides that in the State of source the interest is taxable as part of the profits of the permanent establishment there owned by the recipient residing in the other State, if it is paid in respect of debt claims forming part of the assets of the permanent establishment or otherwise effectively connected with that establishment. In that case, paragraph 4 relieves the State of source of the interest from any limitation under the Article. The foregoing explanations accord with those in the Commentaries on Article 7 on the taxation of business profits.

Paragraph 5

28. This paragraph lays down the principle that the State of source of the interest is the State in which the payer of the interest resides, who may, moreover, be that State itself or one of its political subdivisions. It provides, however, for an exception to this rule in the case of interest-bearing loans which have an obvious economic link with a permanent establishment owned in the other Contracting State by the payer of the interest. If the loan was contracted for the requirements of that establishment and the interest is borne by the latter, the paragraph determines that the source of the interest is in the Contracting State in which the permanent establishment is situated, leaving aside the place of residence of the owner of the permanent establishment, even where he resides in a third State.

29. Paragraph 5 provides no solution for the case, which it excludes from its provisions, where both the recipient and the payer are indeed residents of the Contracting States, but the loan was borrowed for the requirements of a permanent establishment owned by the payer in a third State and the interest is borne by that establishment. As paragraph 5 of the Article now stands, therefore, only its first sentence will apply in such a case. The interest will be deemed to arise in the Contracting State where the payer resides, and not in the third State in whose territory is situated the permanent establishment for the account of which the loan was effected and by which the interest is payable. Thus the interest will be taxed both in the Contracting State where the payer resides and in the Contracting State where the recipient resides. But, although double taxation will be avoided between these two States by the arrangements provided in the Ar-

ticle, it will not be avoided between them and the third State if the latter taxes the interest on the loan at the source when it is borne by the permanent establishment in its territory.

30. It has not, however, been considered possible to refer to such a case in a bilateral Convention and provide for it a solution consisting, for example, in obliging the Contracting State of the payer's residence to relinquish its tax at the source in favour of the third State in which is situated the permanent establishment for the account of which the loan was effected and by which the interest is borne. The risk of double taxation just referred to can only be fully avoided through a bilateral Convention containing a similar provision to that in paragraph 5 of the proposed Article, between the Contracting State where the payer of the interest resides and the third State in which the permanent establishment paying the interest is situated, or through a multilateral Convention containing such a provision.

31. Moreover, in the case — not settled in paragraph 5 of the Article — where whichever of the two Contracting States is that of the payer's residence and the third State in which is situated the permanent establishment for the account of which the loan is effected and by which the interest is borne, together claim the right to tax the interest at the source, there would be nothing to prevent those two States — together with, where appropriate, the State of the recipient's residence — from concerting measures to avoid the double taxation that would result from such claims. The proper remedy, it must be said again, would be the establishment between these different States of bilateral Conventions, or a multilateral Convention, containing a provision similar to that in paragraph 5 of the Article.

32. It goes without saying that if two Contracting States agree in bilateral negotiations to reserve to the State where the recipient of the income resides the exclusive right to tax such income, then ipso facto there is no value in inserting in the Convention which fixes their relations that provision in paragraph 5 of the Article which defines the State of source of such income. But it is equally obvious that double taxation would not be fully avoided in such a case if the payer of the interest owned, in a third State which charged its tax at the source on the interest, a permanent establishment for the account of which the loan had been borrowed and which bore the interest payable on them. The case would then be just the same as is contemplated in paragraphs 29 to 31 above.

Paragraph 6

33. The purpose of this paragraph is to restrict the operation of the provisions concerning the taxation of interest in cases where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the interest paid exceeds the amount which would have been agreed upon by the payer and the recipient had they stipulated at arm's length. It provides that in such a case the provisions of the Article apply only to that last-mentioned amount and that the excess part of the interest shall remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

34. It is clear from the text that for this clause to apply the interest held excessive must be due to a special relationship between the payer and the recipient or between either of them and some other person. There may be cited as examples cases where interest is paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interests with him. These examples, moreover, are similar or analogous to the cases contemplated by Article 9 on the taxation of associated enterprises.

35. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the interest.

36. With regard to the taxation treatment to be applied to the excess part of the interest, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income in which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention for the avoidance of double taxation.

37. It goes without saying that should the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

III. Reservations on the Article

Paragraphs 1 and 2

38. In view of the special structure of its taxation system, Italy is unable to accept paragraphs 1 and 2 of the Article insofar as it applies to that country. However, in its bilateral Conventions for the avoidance of double taxation, Italy could possibly agree to the non-application of the progressive complementary tax on total income ("imposta complementare progressiva sul reddito complessivo") to interest arising from Italian sources to persons resident in the other Contracting State and, where such interest is not exempt from the tax on income from movable property ("imposta sui redditi di ricchezza mobile"), of the tax on bonds and debentures ("imposta sulle obbligazioni") as well.

Paragraph 2

39. Turkey cannot accept a rate of tax which is lower than 20 per cent.

40. Canada reserves its position on the second paragraph of this Article.

Paragraph 4

41. Italy reserves the right to subject interest to the taxes imposed by its law whenever the recipient thereof has a permanent establishment in Italy, even if the indebtedness in respect of which the interest is paid is not effectively connected with such permanent establishment.

COMMENTARY ON ARTICLE 12 CONCERNING TAXATION OF ROYALTIES

I. Preliminary Remarks

A. General Observations

1. In principle, royalties in respect of licences to use patents and similar property and similar payments are income to the recipient from a letting. The letting may be granted in connection with an industrial or commercial enterprise (e.g. the use of literary copyright granted by a publisher) or an independent profession (e.g. use of a patent granted by the inventor) or quite independently of any activity of the grantor (e.g. use of a patent granted by the inventor's heirs).

2. The Model Conventions drawn up by the Fiscal Committee of the League of Nations in 1928 did not contain any specific rules about the taxation of such royalties and similar payments. These could thus only be taxed in the State in which the grantor resided, unless they were obtained in connection with a permanent establishment maintained by the grantor in the other State, the concept of "permanent establishment" including here a fixed place of business used for the performance of professional services.

3. The Model Convention drafted in Mexico in 1943 by the Fiscal Committee of the League of Nations does contain a special provision on the taxation of royalties and similar payments (Article X). In this Model Convention, a distinction was made between royalties and amounts received as a consideration for the right to use :

a) a patent, a secret process or formula, a trade mark or other analogous right ; and
b) a musical, artistic, literary, scientific or other cultural work.

4. In case *a*), the royalties and other payments were only taxable in the State where the right or property was used. In case *b*), the right to tax rested solely with the State of which the grantor — in this case the grantor of the work — was a resident, unless the royalties were obtained in connection with a permanent establishment maintained by the grantor in the other State, the concept of "permanent establishment" here again including a fixed place of business used for the performance of professional services.

5. On this question of the taxation of patent royalties and similar payments, the Model Convention drafted in London in 1946 by the Fiscal Committee of the League of Nations shows the following departure from the Mexico text :

a) as regards both the rights mentioned in paragraph 3(*a*) and those mentioned in paragraph 3(*b*), the right to tax always rests with the State of residence of the grantor, and

b) where an enterprise of one of the Contracting States pays royalties to an enterprise of the other Contracting State and there is a particularly close economic connection between the two enterprises, then the royalties can be subjected to tax in the State where the rights in question are used.

6. A study of more recent Conventions has revealed that the principles in the London draft have been adopted by most O.E.C.D. Member countries :

a) the right to tax patent royalties and similar payments is conferred in principle, therefore, on the State of the grantor's residence ;

b) where patent royalties and similar payments are derived in connection with a permanent establishment situated in one of the States and forming part of an industrial or commercial enterprise carried on in the other State by the grantor, or are derived in connection with professional services performed by the grantor in one of the States and the grantor is a resident of the other State, then they are treated in accordance with the rules applicable under the Convention to income from an industrial or commercial enterprise or to income from the performance of professional services, respectively.

7. In addition to the rules in the London Model Convention drawn up by the League of Nations, more recent Conventions between O.E.C.D. Member countries contain special provisions regarding :

a) rents in respect of cinematograph films. In most Conventions, these are treated like patent royalties and other similar payments; in some cases, however, they are considered as industrial or commercial income ;

b) payments for the use of scientific or industrial equipment. These are treated like patent royalties and the like ;

c) royalties representing more than an adequate consideration. In this case, the royalty stipulated differs from the amount that would normally be agreed in the same circumstances, this being a device to prevent income from being taxed by a particular State. The State in which the rights are used has the right to tax so much of the royalty or other payment as exceeds an adequate consideration.

8. In the light of the above considerations, the Fiscal Committee has prepared the Article on the direct taxation of patent royalties and similar payments.

B. Deductibility of Royalties for the Purposes of the Payer's Tax

9. Certain countries do not allow royalties paid to be deducted for the purposes of the payer's tax unless the recipient also resides in the same State or is taxable in that State. Otherwise they forbid the deduction. The Fiscal Committee considers it desirable that the deduction in question should also be allowed in cases where the royalties are paid by a resident

of a Contracting State to a resident of the other State, the case of fraud being, of course, reserved ; it considers that the deduction should not be forbidden simply because the tax payable by the recipient of such royalties is not levied in the State of source in application of the proposed Article. Any other method of procedure might cancel out the beneficial effects of the measures taken to avoid double taxation.

II. Commentary on the Draft Article

Paragraph 1

10. The first paragraph follows the Model Conventions drafted in London in 1946 by the Fiscal Committee of the League of Nations and the solutions adopted in many Conventions between O.E.C.D. Member countries, in adopting the principle of exclusive taxation of royalties in the State of the recipient's residence. The only exception to this principle is that made in the cases dealt with by paragraph 3.

11. Paragraph 1 does not state whether or not exemptions in the State of source must be conditional upon the royalties being subject to tax in the State of residence. This question can be determined either way by bilateral negotiations.

12. Attention is drawn generally to the following case : the recipient of royalties arising in a Contracting State is a company resident in the other Contracting State ; all or part of its capital is held by shareholders resident outside that other State ; its practice is not to distribute its profits in the form of dividends ; and it enjoys preferential taxation treatment ("private investment company", "base company"). The question may arise in the case of such a company whether it is justifiable to allow in the State of source the tax exemption which is provided by the Article. It may be appropriate, when bilateral negotiations are being conducted, to agree upon special exceptions to the taxing rule laid down in this Article, in order to define the treatment applicable to such companies.

Paragraph 2

13. Paragraph 2 contains a definition of the term "royalties". These relate, in general, to rights or property constituting the different forms of literary and artistic property, the elements of industrial and commercial property specified in the text and information concerning industrial, commercial or scientific experience.

14. The definition applies to payments for the use of, or the entitlement to use, rights of the kind mentioned, whether or not they have been, or are required to be, registered in a public register.

15. The definition covers both payments made under a licence and compensation which a person would be obliged to pay for fraudulently copying or infringing the right.

16. In accordance with the prevailing practice in the Convention between O.E.C.D. Member countries, rents in respect of cinematograph films

are also treated as royalties, whether such films are exhibited in cinemas or on the television.

17. It may, however, be agreed through bilateral negotiations that rents in respect of cinematograph films shall be treated as industrial and commercial profits and, in consequence, subjected to the provisions of Articles 5, 7 and 9.

18. It is further pointed out that variable or fixed payments for the working of mineral deposits, sources or other natural resources are governed by Article 6 on the taxation of income from immovable property and do not, therefore, fall within the present Article.

Paragraph 3

19. Certain States consider that dividends, interest and royalties arising from sources in their territory and payable to individuals or legal persons who are residents of other States fall outside the scope of the arrangement made to prevent them from being taxed both in the State of source and in the State of the recipient's residence when the recipient possesses a permanent establishment in the former State. Paragraph 3 of the Article is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". It does not stipulate that royalties arising to a resident of a Contracting State from a source situated in the territory of the other State must, by a kind of legal presumption, or fiction even, be related to a permanent establishment which that resident may happen to possess in the latter State, so that the said State would not be obliged to limit its taxation in such a case. The paragraph merely provides that in the State of source the royalties are taxable as part of the profits of the permanent establishment there owned by the recipient residing in the other State, if they are paid in respect of rights or property forming part of the assets of the permanent establishment or otherwise effectively connected with that establishment. In that case, paragraph 3 relieves the State of source of the royalties from any limitations under the Article. The foregoing explanations accord with those in the Commentaries on Article 7 on the taxation of business profits.

Paragraph 4

20. The purpose of this paragraph is to restrict the operation of the provisions concerning the taxation of royalties in cases where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the royalties paid exceeds the amount which would have been agreed upon by the payer and the recipient had they stipulated at arm's length. It provides that in such a case the provisions of the Article apply only to that last-mentioned amount and that the excess part of the royalty shall remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

21. It is clear from the text that for this clause to apply the payment held excessive must be due to a special relationship between the payer and the recipient or between both of them and some other person. There may

be cited as examples cases where royalties are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him. These examples, moreover, are similar or analogous to the cases contemplated by Article 9 on the taxation of associated enterprises.

22. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the royalty.

23. With regard to the taxation treatment to be applied to the excess part of the royalty, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income in which it should be classified for the purpose of applying the provisions of the tax laws of the States concerned and the provisions of the Convention for the avoidance of double taxation.

24. It goes without saying that should the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

III. Special Derogation in Favour of Certain Countries

25. The following Member countries, Greece, Luxembourg, Portugal and Spain consider that they are unable to relinquish all taxation at the source as regards royalties arising in their territories and paid to residents of another State. They are prepared, however, to limit their tax at the source on such royalties to a maximum of 5 per cent of the gross amount of the royalties.

26. The other Member countries, for their part, declare that they are prepared to allow such States, by bilateral Conventions and subject to reciprocity, a limited right to tax as described above.

27. Whenever use is made of the above derogation in a bilateral Convention, the Contracting States are recommended to model the special clause giving a limited right to tax to the State of source on the formulas employed in paragraphs 1 and 2 of the Article on the taxation of interest. In such a case it will also be necessary to define the State of source. For this purpose, the formula employed in paragraph 5 of the Article on the taxation of interest will serve as a model.

IV. Reservations on the Article

Paragraph 1

28. Austria is unable to accept a provision which would preclude it, in bilateral Conventions for the avoidance of double taxation, from stipulating a clause conferring on it the right to tax royalties at a rate up to 10 per cent.

29. Turkey cannot accept a rate of tax which is lower than 20 per cent.

Paragraphs 1 and 2

30. Canada reserves its position on paragraphs 1 and 2 of this Article. However the Canadian authorities would be prepared to provide an exemption from tax for copyright royalties and other like payments made in respect of the production or reproduction of any literary, dramatic, musical or artistic work (but not including rents or royalties in respect of motion picture films, including films or video tapes for use in connection with television) derived from sources within one of the Contracting States by a resident of the other Contracting State.

Paragraph 3

31. Italy reserves the right to subject royalties and profits from the alienation of rights or property giving rise to royalties to the taxes imposed by its law whenever the recipient thereof has a permanent establishment in Italy, even if the rights or property in respect of which the royalties are paid is not effectively connected with such permanent establishment.

COMMENTARY ON ARTICLE 13
CONCERNING THE TAXATION OF CAPITAL GAINS

I. Preliminary Remarks

1. A comparison of the tax laws of the O.E.C.D. Member countries shows that the taxation of capital gains varies considerably from country to country :

— in some States capital gains are not deemed to be taxable income ;
— in other States capital gains accrued to an enterprise are taxed, but capital gains made by an individual outside the course of his trade or business are not taxed ;
— even where capital gains made by an individual outside the course of his trade or business are taxed, such taxation often applies only in specified cases, e.g. profits from the sale of immovable property or speculative gains (where an asset was bought to be resold).

2. Moreover, the taxes applicable to capital gains vary from country to country. In some States capital gains are taxed as ordinary income and therefore added to the income from other sources. This applies especially to the capital gains made by the alienation of assets of an enterprise. In a number of States, however, capital gains are subjected to special taxes, such as taxes on profits from the alienation of immovable property, or capital gains taxes, or taxes on capital appreciation (increment taxes). Such taxes are levied on each capital gain or on the sum of the capital gains accrued during a year, mostly at special rates, which do not take into account the other income (or losses) of the taxpayer. It does not seem necessary to describe all those taxes.

3. Article 13 does not deal with the above mentioned questions. It is left to the domestic law of each Contracting State to decide whether capital gains should be taxed and, if they are taxable, how they are to be taxed. The Article can in no way be construed as giving a State the right to tax capital gains if such right is not provided for in its domestic law. The Article does not prescribe what kind of tax may be levied. It should be understood that the Article must apply to all kind of taxes levied by a Contracting State on capital gains. The wording of Article 2 on taxes covered by the Convention is large enough to achieve this aim and to include also special taxes on capital gains.

II. Commentary on the Article

General Remarks

4. It is justified to give the right to tax capital gains to the State which

is entitled to tax both the property and the income derived therefrom before such property was alienated. A gain from the alienation of an asset must be taxable in the same State without regard to the question whether such gain is a capital gain or a business profit. Accordingly, no distinction between capital gains and commercial profits is made nor is it necessary to have special provisions as to whether the Article on capital gains or Article 7 on the taxation of business profits should apply. It is however left to the domestic law of the taxing State to decide whether a tax on capital gains or on ordinary income must be levied. The Convention does not prejudice this question.

5. The Article does not give a detailed definition of capital gains. This is not necessary for the reasons mentioned above. The words "alienation of property" are used to cover in particular capital gains resulting from the sale or exchange of property and also from a partial alienation, the expropriation, the transfer to a company in exchange for stock, the sale of a right, the alienation free of charge and even the passing of property on death.

6. Most States taxing capital gains do so when an alienation of capital assets takes place. Some of them, however, tax only so-called realised capital gains. Under certain circumstances, though there is an alienation no realised capital gains is recognised for tax purposes (e.g. replacement of equipment). Whether or not there is a realisation has to be determined according to the applicable domestic tax law. No particular problems arise when the State which has the right to tax does not exercise it at the time the alienation takes places.

7. As a rule, appreciation in value not associated with the alienation of a capital asset is not taxed, since, as long as the owner still holds the asset in question, the capital gain exists only on paper. There are, however tax laws under which capital appreciation and revaluation of business assets are taxed even if there is no alienation.

8. Special circumstances may lead to the taxation of the capital appreciation of an asset that has not been alienated. Such taxation may occur if the value of a capital asset has increased in such a manner that the owner proceeds to the revaluation of this asset in his books. Such revaluation of assets in the books may also occur in the case of a devaluation of the national currency. A number of States levy special taxes on book profits, amounts put into reserve, an increase in the paid-up capital and other revaluations resulting from the adjustment of the book-value to the intrinsic value of a capital asset. These taxes on capital appreciation (increment taxes) are covered by the Convention according to Article 2 on taxes covered by the Convention.

9. Where capital appreciation and revaluation of business assets are taxed, the same principle should, as a rule, apply as in the case of the alienation of such assets. It is not found necessary to mention such cases expressly in the present Article or to lay down special rules. The rules of the present Article on the taxation of capital gains as well as the provisions of Article 6 on the taxation of income from immovable property. Article 7 on the taxation of business profits and Article 21 on the taxation of income

not expressly mentioned in the Convention seem to be sufficient. As a rule, the right to tax is conferred by the aforementioned provisions to the State of which the taxpayer is a resident, except that in the cases of immovable property or of movable property employed in a permanent establishment or pertaining to a fixed base, the prior right to tax belongs to the State where such property is situated. Special attention must be drawn, however, to the cases dealt with in paragraphs 13 to 17 below.

10. In some States the transfer of property from a permanent establishment situated in the territory of such State to a permanent establishment or the head office of the same enterprise situated in another State is assimilated to an alienation of property. The present Article does not prevent these States from taxing profits or gains deemed to arise in connection with such a transfer, it being assumed, however, that such taxation is in accordance with Article 7 concerning the taxation of business profits.

11. The Article does not discriminate as to the reason instrumental in producing the capital gain. Therefore all capital gains, those accruing over a long term, parallel to a steady improvement in economic conditions, as well as those accruing in a very short period (speculative gains) are covered. Also capital gains which are due to depreciation of the national currency are covered. It is, of course, left to each State to decide whether or not such gains should be taxed.

12. The Article does not determine how to compute a capital gain, this being left to the domestic law applicable. As a rule, capital gains are calculated by deducting the cost from the selling price. To arrive at cost all expenses incidental to the purchase and all expenditure for improvements are added to the purchase price. In some cases the cost after deduction of the depreciation allowances already granted by the tax authorities is taken into account. Some tax laws prescribe another base instead of cost, e.g. the value previously reported by the alienator of the asset for property tax purposes.

13. Special problems may arise when the basis for the taxation of capital gains is not uniform in the two Contracting States. The capital gain from the alienation of an asset computed in one State according to the rules mentioned in paragraph 12 above, may not necessarily coincide with the capital gain computed by the other State under the accounting rules used there. This may occur when one State has the right to tax capital gains because they pertain to property situated therein, while the other State has the right to tax because the enterprise is resident there.

14. The following example may illustrate this problem ; an enterprise of State A has bought immovable property situated in State B. The enterprise may have entered depreciation allowances in the books kept in State A. If such immovable property is sold at a price which is above cost, a capital gain may be realised and, in addition, the depreciation allowances granted earlier may be recovered. State B in which the immovable property is situated and where no books are kept does not have to take into account, when taxing the income from the immovable property, the depreciation allowances booked in State A. Neither can State B substitute the value of the immovable property shown in the books kept in State A for the cost

at the time of the alienation. State B cannot, therefore, tax the depreciation allowances realised in addition to the capital gain as mentioned above.

15. On the other hand, State A of which the alienator is a resident, cannot be obliged in all cases to exempt such book profits fully from its taxes under paragraph 1 of the present Article and Article 23(A) on the exemption method (there will be hardly any problems for States applying the tax credit method.) As far as such book profits are due to the realisation of the depreciation allowances which State A had granted previously and which had reduced the income or profits taxable in such State A that State cannot be prevented from taxing such book profits. The situation corresponds to that dealt with in paragraph 38 of the commentary to Article 23(A).

16. Further problems may arise in connection with profits due to changes of the rate of exchange between the currencies of State A and State B. After the devaluation of the national currency of State A, enterprises of such State A may, or may have to, increase the book value of the assets, including assets situated outside the State A. Besides, and apart from any devaluation of the national currency of a State, the usual fluctuations of the rate of exchange may give rise to so-called monetary gains or losses. Take for example an enterprise of State A having bought and sold immovable property situated in State B. If the cost and the selling price, both expressed in the currency of State B, are equal, there will be no capital gain in State B. When the value of the currency of State B has risen between the purchase and the sale of the asset in relation to the currency of State A, a profit will accrue to such enterprise expressed in the currency of State A. If the value of the currency of State B has fallen in the meantime, the alienator will sustain a loss which will not be recognised by State B. Such currency gains or losses may also arise in connection with claims and debts contracted in a foreign currency. If the balance-sheet of a permanent establishment situated in State B of an enterprise of State A shows claims and debts expressed in the currency of State B, the books of the permanent establishment do not show any gain or loss when repayments are made. Changes of the rate of exchange may be reflected, however, in the accounts of the head office. If the value of the currency of State B has risen (fallen) between the time the claim has originated and its repayment, the enterprise, as a whole, will realise a gain (sustain a loss). This is true also with respect to debts if between the time they have originated and their repayment, the currency of State B has fallen (risen) in value.

17. The provisions of the present Article on the taxation of capital gains do not answer all questions regarding the taxation of such currency gains. Such gains are in most cases not connected with an alienation of the asset ; they may often not even be determined by the State on which, for instance, according to the situation of the permanent establishment, the right to tax capital gains is conferred by the present Article. Accordingly, the question, as a rule, is not, whether the State in which the permanent establishment is situated has a right to tax, but whether the State of which the taxpayer is a resident must, if applying the exemption method, refrain from taxing such currency gains which, in many cases, cannot be shown but in the

books kept in the head office. The answer to that latter question depends not only on the present Article but also on Article 7 on the taxation of business profits and on Article 23(A) on the exemption method. It seems difficult to give one definite answer to all possible cases. The Fiscal Committee will examine the matter in a more detailed manner at a later stage. If in a given case different opinions of two States should result in an actual double taxation, the case could be settled under the mutual agreement procedure provided for by Article 25.

18. The Article is not intended to apply to prizes in a lottery or to bonuses on premium bonds.

19. The Article deals first with the gains from the alienation of property which may be taxed in the State where such property is situated (paragraph 1 and first sentence of paragraph 2). For all other capital gains paragraph 3 gives the right to tax to the State of which the alienator is a resident.

20. As capital gains are not taxed by all States, two States may find it reasonable to avoid only any actual double taxation of capital gains. The negotiating States are free to supplement their bilateral agreement in such a way that a State has to forego its right to tax conferred on it by the domestic law only if the State on which the right to tax is conferred by the Convention makes use thereof. In such a case, paragraph 3 of the Article should be supplemented accordingly. Besides, a modification of Article 23(A) on the exemption method as suggested in paragraph 33 of the Commentary to Articles 23(A) is needed.

Paragraph 1

21. Paragraph 1 states that gains from the alienation of immovable property may be taxed in the State in which it is situated. This rule is in accordance with the provisions of Article 6 on the taxation of income from immovable property and paragraph 1 of Article 22 on the taxation of capital. The rule applies also to immovable property forming part of the assets of an enterprise or used for performing professional services. For the definition of immovable property paragraph 1 refers to paragraph 2 of Article 6[1].

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1. Attention is drawn to the fact that for capital gains tax purposes (as well as for the purposes of other taxes such as taxes on the transfer of property) it is the practice in some countries to assimilate the alienation of all shares in a company, the exclusive or main aim of which is to hold immovable property, to the alienation of such immovable property. This point of view is not shared by all States ; some of them could object to the disregard of a distinct legal subject and therefore not apply paragraph 2 of Article 6. The State of which the shareholder is a resident may contend that the shares come within the scope of paragraph 3 of the Article which would mean that a capital gain realised from the sale of these shares would be taxable only in the State of the residence of the alienator. The different qualification of the same fact could result in a double taxation.

The same situation may prevail in other cases : in some countries (e.g. Norway) it is the practice to assimilate the sale of all shares in a company to the sale of the enterprises carried on by such company. Moreover, the tax laws of some countries provide for the taxation of gains from the alienation of shares in a company which is resident in the taxing State, if the alienator of the shares, even if not residing in the State, had a predominant position (material interest) therein. In such cases, each State could invoke paragraph 2 of Article 3 on definitions to justify its taxation.

Paragraph 2

22. Paragraph 2 deals with movable property forming part of the business assets employed in a permanent establishment of the enterprise or pertaining to a fixed base used for performing professional services. The term "movable property" means all property other than immovable property which is dealt with in paragraph 1. It includes also incorporeal property, such as goodwill, licences etc. Gains from the alienation of such assets may be taxed in the State in which the permanent establishment or fixed base is situated, which is in accordance with the rules for business or professional income (Articles 7 and 14).

23. An exception from the above mentioned general rule is provided for ships and aircraft operated in international traffic and for boats engaged in inland waterways transport and movable property pertaining to the operation of such ships, aircraft and boats. Gains from the alienation of such assets are taxable only in the State in which the effective place of management of the enterprise operating such ships, aircraft and boats is situated. This rule is in accordance with Article 8 on the taxation of income from shipping, inland waterways transport and air transport and with paragraph 3 of Article 22 on taxation of capital to which the second sentence of paragraph 2 of the present Article refers.

24. The paragraph makes clear that its rules apply when movable property of a permanent establishment or fixed base is alienated as well as when the permanent establishment as such (alone or together with the whole enterprise) or the fixed base as such is alienated. If the whole enterprise is alienated, then the rule applies to such gains which are deemed to result from the alienation of movable property employed in the permanent establishment. The rules of Article 7 should then apply mutatis mutandis without express reference thereto. For the transfer of property from a permanent establishment in one State to a permanent establishment (or the head office) in another State, see paragraph 10 above.

25. On the other hand, the first sentence of paragraph 2 may not always be applicable to capital gains from the alienation of a participation in an enterprise. The provision applies only to property which was owned by the alienator, either wholly or jointly with another person. Under the laws of some countries, capital assets of a partnership are considered to be owned

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Similar problems arise in connection with other provisions of a double taxation convention. They cannot be avoided as long as the terms used therein have not the same meaning in both States or are not defined by the Convention. The Draft Convention of O.E.C.D., like the existing bilateral Conventions does not provide for a solution of such a conflict which is due to different qualifications of facts by two States as long as they are not defined. In conformity with Article 25 on the mutual agreement procedure, however, the competent authorities have the possibility to avoid an actual double taxation. Besides, negotiating States are free to agree on special provisions dealing with such cases in their bilateral Conventions. They may for instance expressly exclude certain practices mentioned above. But they may also bilaterally agree to treat the sale of all shares in a company holding exclusively immovable property as the sale of the unmovable property itself. Moreover, they could arrange for a special clause dealing with capital gains from the alienation of shares in a company in which the alienator had a predominant position. But in such cases at least an actual double taxation should be avoided (see paragraph 20 above).

by the partners. Under some other laws, however, partnerships and other associations are treated as legal entities, distinct from their partners (members), which means that participation in such entities are dealt with in the same way as shares in a company. Capital gains from the alienation of such participations, like capital gains from the alienation of shares, are therefore only taxable in the State of residence of the alienator. Negotiating States may agree bilaterally on special rules governing the taxation of capital gains from the alienation of a participation in a partnership[1].

26. Certain States consider that all capital gains arising from sources in their territory should be subject to their taxes according to their domestic law, if the alienator has a permanent establishment within their territory. Paragraph 2 is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". The paragraph merely provides that gains from the alienation of assets forming part of the business property employed in a permanent establishment or of assets pertaining to a fixed base used for performing professional services may be taxed in the State of source. All other assets or property is taxable in the State of residence of the alienator under paragraph 3 of the Article. The foregoing explanations are in accordance with those in the Commentaries on Article 7 on the taxation of business profits.

Paragraph 3

27. As regards gains from the alienation of capital assets other than those listed in paragraphs 1 and 2, paragraph 3 of the Article provides that they are taxable only in the State of which the alienator of such assets is a resident. This is in accordance with the rules laid down in Article 22 on the taxation of capital.

28. The present Article does not provide for special rules for gains from the alienation of shares in a company or of securities, bonds, debentures and the like. Such gains are therefore, taxable only in the state of which the alienator is a resident[1].

29. If shares are sold by a shareholder to the issuing company in connection with the liquidation of such company or the reduction of its paid-up capital, the difference between the selling price and the par-value of the shares may be treated by the State of which the company is a resident as a distribution of accumulated profits and not as a capital gain. The present Article is not intended to prevent the State of the residence of the company from taxing such distributions at the rates provided for in Article 10 on the taxation of dividends : such taxation is in accordance with the definition contained in paragraph 3 of Article 10 and with the interpretation given to this provision in paragraph 39 of the Commentary relating thereto. The same interpretation may apply if bonds or debentures are redeemed by the debtor at a price which is higher than the par-value or the value at which the bonds or debentures have been issued ; in such a case, the difference may represent interest and, therefore, be subjected to a limited tax in the State of source of the interest in accordance with Article II

1. As regards the special provisions relating to capital gains from the alienation of shares in a company, see footnote relating to paragraph 21 above.

on the taxation of interest (cf. also paragraphs 24 and 25 of the Commentary to Article 11).

III. Reservations on the Article

30. Italy reserves the right to subject capital gains from Italian sources to the taxes imposed by its law whenever the alienator has a permanent establishment in Italy, even if the property or assets alienated did not form part of the business property employed in such permanent establishment.

31. The United States, in accordance with its basic position, reserves the right to tax its citizens and corporations on gains from the alienation of property, wherever they may be resident or the property situated. In accordance with its law, the United States also reserves the right to tax non-resident aliens on the capital gains derived from the sale in the United States of personal (movable) property if such sale occurs while the non-resident is in the United States (or under certain other circumstances described in its law). Because "movable property" and "immovable property" are terms not used in United States law, the United States reserves the right to employ the terms "personal property" and "real property" in its bilateral negotiations.

32. Spain reserves the right to tax capital gains from the alienation of movable capital within its territory. This reserve takes into account that the Spanish exchange control regulations are far more liberal with regard to the repatriation of foreign capital or profits derived therefrom than with regard to investments of Spanish residents abroad. Moreover Spain should not be deprived of the right to tax capital gains as long as such taxation can be used as an instrument of economic policy.

33. With respect to paragraph 3 of the Article, Belgium, in view of the income tax reform law of 20th November, 1962, reserves its position as regards :

a) the special levy imposed by the new law in the case of the redemption of their shares or stock by companies limited by shares and limited partnerships with share capital or by any companies, associations, establishments or bodies constituted in Belgium otherwise than in one of the forms specified in the Commercial Code ;

b) the special levy imposed by the same law in the case of the division of the assets of such legal persons as are mentioned in sub-paragraph *a*) above or of partnerships of individuals not opting for their profits to be charged to personal income tax in the name of the partners.

This reservation is dictated by the consideration that these special levies on the company, etc., are really in the nature of a composition satisfying all personal taxes that would be due from the shareholders or partners on the capital gains or distributions of profits in question here. Belgium considers that the limitations provided for in the case of distribution taxes on dividends do not apply to these special levies.

COMMENTARY ON ARTICLE 14 CONCERNING THE TAXATION OF INDEPENDENT PERSONAL SERVICES

1. Article 14 is concerned with what are commonly known as professional services and with other independent activities of a similar character. This excludes industrial and commercial activities and also professional services performed in employment, e.g. a physician serving as a medical officer in a factory. It should, however, be observed that the Article does not concern performances by public entertainers and athletes working on their own account, all public entertainers coming under a special Article covering their activities whether independent or not (Article 17).

2. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. Difficulties of interpretation which might arise in special cases may be solved by mutual agreement between the competent authorities of the Contracting States concerned.

3. The provisions of Article 14 are similar to those customarily adopted for income from industrial or commercial activities. Nevertheless it was thought that the concept of permanent establishment should be reserved for commercial and industrial activities. The term "fixed base", which is to be found in various Conventions, has therefore been used. It has not been thought appropriate to try to define it, but it would cover, for instance, a physician's consulting room or the office of an architect or a lawyer. A person performing professional services would probably not as a rule have premises of this kind in any other State than that of his residence. But if there is in another State a centre of activity of a fixed or permanent character, then that State should be entitled to tax the person's activities.

COMMENTARY ON ARTICLE 15 CONCERNING THE TAXATION OF DEPENDENT PERSONAL SERVICES

1. The first paragraph of Article 15 establishes the general rule as to the taxation of income from employment (other than pensions), namely, that such income is taxable in the State where the employment is actually exercised. One consequence of this would be that a resident of a Contracting State who derived remuneration, in respect of an employment, from sources in the other State could not be taxed in that other State in respect of that remuneration merely because the results of his work were exploited in that other State.

2. The general rule is subject to exception only in the case of pensions (Article 18) and of remuneration and pensions in respect of certain governmental functions (Article 19). Remuneration of members of boards of directors of companies is the object of a special provision (Article 16).

3. The second paragraph of Article 15 contains, however, a general exception to the rule in paragraph 1. This exception, which concerns employment of short duration abroad, is mainly intended to facilitate the international movement of qualified personnel, as in the case of firms which sell capital goods and are responsible for installing and assembling them abroad. The three conditions prescribed in this paragraph must be satisfied concurrently for the remuneration to qualify for the exemption. The exemption is limited to the 183-day period which is stipulated in the Mexico and London Model Conventions of the League of Nations. The employer paying the remuneration must not be a resident of the State in which the employment is exercised. Furthermore, should the employer have in that State a permanent establishment (or a fixed base if he performs professional services or independent activities of a similar character), the exemption is given only on condition that the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State. It should be noted that, under the provisions of Article 17 the exemption does not apply to remuneration of public entertainers and athletes.

4. The object of the third paragraph of Article 15 is to apply to the remuneration of crews of ships or aircraft in international traffic, or of boats engaged in inland waterways transport, a rule which follows up to a certain extent the rule applied to the income from shipping, inland waterways transport and air transport — that is, to tax them in the Contracting State in which the place of effective management of the enterprise concerned is situated. This provision assumes that the internal law of that State

allows it to tax the remuneration of a person in the service of the enterprise concerned, irrespective of his fiscal domicile. It is understood that paragraph 3 of Article 8 concerning shipping, inland waterways transport and air transport, is applicable if the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat.

5. It should be noted that no special rule regarding the taxation of income of frontier workers is included as it would be more suitable for the problems created by local conditions to be solved directly between the countries concerned.

6. No special provision has been made regarding remuneration derived by visiting professors or students employed with a view to their acquiring practical experience. Most current Conventions contain rules of some kind or other concerning such cases, the main purpose of which is to facilitate cultural relations by providing for a limited tax exemption. Sometimes, tax exemption is already provided under national taxation laws. The absence of specific rules should not be interpreted as constituting an obstacle to the inclusion of such rules in bilateral Conventions whenever this is felt desirable.

COMMENTARY ON ARTICLE 16
CONCERNING THE TAXATION OF DIRECTORS' FEES

1. Article 16 relates to remuneration received by a resident of a Contracting State, whether an individual or a legal person, in the capacity of a member of a board of directors of a company which is a resident of the other Contracting State. Since it might sometimes be difficult to ascertain where the services are performed, the provision treats the services as performed in the country of residence of the company.

Reservation on the Article

2. Canada reserves its position with regard to this Article. When negotiating Conventions with other Member countries, the Canadian authorities would wish to have directors' fees included with remuneration and salary under Article 15.

COMMENTARY ON ARTICLE 17
CONCERNING THE TAXATION OF ARTISTES AND ATHLETES

1. The provisions of Article 17 relate to public entertainers and athletes and stipulate that they may be taxed in the State in which the activities are performed, whether these are of an independent or of a dependent nature. This provision is an exception, in the first case, to the rule laid down in Article 14, in the second case, to the rule laid down in paragraph 2 of Article 15.

2. This provision makes it possible to avoid the practical difficulties which often arise in taxing public entertainers and athletes performing abroad. Certain Conventions, however, provide for certain exceptions such as those contained in paragraph 2 of Article 15. Moreover, too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of Article 17 to independent activities by adding its provisions to those of Article 14 relating to professional services and other independent activities of a similar character. In such case, public entertainers and athletes performing for a salary or wages would automatically come within Article 15 and thus be entitled to the exemptions provided for in paragraph 2 of that Article.

COMMENTARY ON ARTICLE 18
CONCERNING THE TAXATION OF PENSIONS

1. According to the rule stipulated in Article 18, pensions in respect of private employment are taxable only in the country of residence of the recipient. The provision also covers widows' and orphans' pensions and other similar payments such as annuities paid in respect of past employment. It also applies to pensions in respect of services rendered to a State or a political subdivision or local authority thereof which are not covered by the provision of paragraph 1 of Article 19.

Reservation on the Article

2. Canada reserves its position on this Article for the purpose of preserving the right to tax certain lump sum payments, described in Section 31 A of the Income Tax Act of Canada, paid to persons formerly employed in Canada in respect of their employment in Canada.

COMMENTARY ON ARTICLE 19 CONCERNING THE TAXATION OF REMUNERATION IN RESPECT OF GOVERNMENTAL FUNCTIONS

1. Article 19 applies to remuneration in respect of governmental functions. The similar provisions which are frequently found in bilateral Convention were originally framed in order to conform with the rules of international courtesy and mutual respect between sovereign States (Cf. Mexico Model Convention, Commentary ad Article VIII). They were therefore rather limited in scope. The first paragraph of Article 19 lays down a general principle, the scope of which may be determined by the Contracting States by means of special provisions. It should be observed that the Article is not intended to restrict the operation of any rules originating from international law in the case of diplomatic and consular missions (see Art. 27) but deals with cases not covered by such rules.

2. It should be noted that the term "remuneration" used in Article 19 covers wages and salaries and pensions, to the exclusion of any other payments. The provisions of the Article apply to remuneration paid not only by a State but also by its political subdivisions and local authorities (member States, cantons, municipalities, etc...). Paragraph 1 of the Article does not apply if the services are performed in connection with trade or business carried on by the State, or one of its political subdivisions or local authorities, paying the remuneration. In such cases, the ordinary rule applies (Article 15 for wages and salaries, Article 16 for directors' fees and similar payments and Article 18 for pensions).

Reservation on the Article

3. Canada reserves its position on this Article. When negotiating Conventions with the Member countries, the Canadian authorities would wish to have pensions excluded from this article so that all pensions would be taxed only in the country where they are received.

COMMENTARY ON ARTICLE 20 ON THE TAXATION OF STUDENTS AND BUSINESS APPRENTICES ABROAD

The rule established in Article 20 concerns certain payments received by students or business apprentices for the purpose of their maintenance, education or training. The exemption provided for is already fairly well established in existing bilateral Conventions. All such payments received from sources outside the State in which the student or business apprentice concerned is staying shall be exempted from tax in that State.

COMMENTARY ON ARTICLE 21
CONCERNING INCOME NOT EXPRESSLY MENTIONED IN THE CONVENTION

1. The aim of the Article, which appears in the same or similar form in most Conventions for the avoidance of double taxation, is to provide a general rule relating to items of income not expressly mentioned in the preceding Articles of the Convention. The State of which the recipient is a resident is given the exclusive right to tax such items of income.

2. As the Article is drafted, this rule applies irrespective of whether the right to tax is in fact exercised. If the income arises in the other Contracting State, that State cannot therefore impose tax even if the income is not taxed in the first-mentioned State. In order to avoid non-taxation, the Contracting States can agree to limit the scope of the Article to items of income which are subject to tax in the Contracting States of which the recipient is a resident and modify the Article in this way.

Reservation on the Article

3. Canada reserves its position on this Article. The Canadian authorities, in negotiating Conventions with other Member countries, would wish to maintain the right to tax income paid by residents of Canada to non-residents of Canada in the form of income from a trust or estate, alimony, and certain payments from a registered retirement savings plan, as well as certain lump sum payments to former employees in Canada in respect of their employment in Canada as described in Section 31 A of the Income Tax Act.

COMMENTARY ON ARTICLE 22 CONCERNING THE TAXATION OF CAPITAL

1. The Article deals with taxes on capital, to the exclusion of taxes on estates and inheritances and on donations and of transfer duties. Taxes on capital to which the Article applies are those specified in Article 2 concerning taxes covered by the Convention.

2. Taxes on capital generally constitute supplementary taxation of income from capital. Consequently, taxes on capital can be levied, in principle, only by the State which is entitled to tax the income from the capital. However, it is not possible to refer purely and simply to the rules relating to the taxation of the income, for not all income is subject to taxation exclusively in one State.

3. The Article, therefore, enumerates first property and assets which may be taxed in the State in which they are situated. To this category belong immovable property, as defined in Article 6 on the taxation of income from immovable property, and movable property forming part of the business property employed in a permanent establishment of an enterprise, or pertaining to a fixed base used for the performance of professional services (paragraphs 1 and 2).

4. Ships and aircraft operated in international traffic and boats engaged in inland waterways transport and assets, other than immovable property, pertaining to the operation of such ships, aircraft and boats are taxable only in the State in which the effective place of management of the enterprise is situated (paragraph 3). This rule is based on the provisions of Article 8 on taxation of income from shipping, inland waterways transport and air transport. It is understood that paragraph 3 of Article 8 concerning shipping, inland waterways transport and air transport, is applicable if the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat. Immovable property pertaining to the operation of ships, aircraft and boats, may be taxed in the State in which they are situated, in accordance with the rule laid down in paragraph I.

5. As regards other elements of capital than those listed in paragraphs 1 to 3, the Article provides that they are taxable only in the State of which the person to whom they belong is a resident (paragraph 4).

6. If, following the application of paragraph 4 to elements of movable property under usufruct, double taxation subsists because of the disparity between national laws, the States concerned may resort to the mutual agreement procedure or settle the question by means of bilateral negotiations.

COMMENTARY ON ARTICLES 23(A) AND 23(B) CONCERNING THE METHODS FOR AVOIDANCE OF DOUBLE TAXATION

I. General observations

A. The Scope of the Articles

1. The Articles deal with the so-called juridical double taxation, where the same income or capital is taxable in the hands of the same person by more than one State.

2. This case has to be distinguished especially from the so-called economic double taxation, i.e. a taxation of the same income or capital in the hands of two different persons both chargeable to tax. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

3. International juridical double taxation may arise in three cases :

a) where each of two States under its domestic taxation law treats the same person as having his residence within its territory ;

b) where each of two States imposes tax on the same income or capital (limited tax liability in both States), e.g. where a permanent establishment in one State derives income from immovable property in another State, and neither State is the State of residence of the owner of the permanent establishment ;

c) where a person who has his residence in one State derives income from or owns capital in another State and both States impose tax on that income or capital.

4. The Articles do not deal with the first two cases. The conflict in case (*a*) may be solved in accordance with Article 4 on fiscal domicile. The conflict in case (*b*) is outside the scope of the Conventions, as this is confined by Article 1 on the personal scope of the Convention, to persons who are residents of one or both of the Contracting States. It can, however, be settled by applying the mutual agreement procedure.

5. The conflict in case (*c*) may be solved by a renunciation either by the State of residence or by the State of source. In this connection it is to be noted that, in a number of special Articles of the Convention, the allocation of the right to tax has been given either to the State of residence or to the State of source.

6. In the case where the State of source renounces its right to tax, the relevant Article states that the income and capital in question "shall be

taxable only" in the other State. Accordingly, no question of double taxation arises here.

7. In the case where the State of source does not renounce its right to tax, i.e. where the relevant Article states that the income or capital "may be taxed" in the State of source, the State of residence must give relief so as to avoid double taxation. Therefore, in the Articles submitted, the prior right of taxation in the State of source is implied, and the State of residence is left to provide the means by which double taxation is to be avoided.

B. Description of Methods for Avoidance of Double Taxation

8. A study of Convention concluded between O.E.C.D. Member countries shows that two leading principles are followed for the avoidance of double taxation. For purposes of simplicity only income tax is referred to in what follows, but the principles apply similarly to capital tax.

1. *The exemption system*

9. This system implies that the State to which the Convention has not given the right to tax a certain income shall leave out that income when determining the amount which is chargeable to income tax in that State.

10. The exemption system is found in two different forms :

a) The income in question may be left out altogether, so that the State concerned is not entitled to take that income into consideration when determining the rate of tax to be imposed on the rest of the income. Hereinafter this method is referred to as "full exemption".

b) The income in question is left out, but the State concerned retains the right to take that income into consideration when determining the rate of tax to be imposed on the rest of the income. Hereinafter this method is referred to as "exemption with progression".

11. Where the exemption system is adopted in Conventions, and the State of residence is not given the right to tax, it normally follows the form described under (*b*).

2. *The credit system*

12. The adoption of this system implies that the State applying it imposes tax on the basis of the taxpayer's total income including the income from another State, and then allows a deduction from its own tax for tax paid in that other State.

13. The credit system is found in different forms :

a) The deduction given by the State of residence may be restricted so that the deduction does not exceed that part of its own tax appropriate to the income from the other State. Hereinafter this method is referred to as "ordinary credit".

b) In some forms of the credit system the State of residence allows a deduction of the total amount of tax paid in the State of source. Hereinafter this method is referred to as "full credit".

c) Further variations of the credit system are possible, e.g. where the State of residence limits the deduction to an amount not exceeding the tax which it would itself have imposed on that income if the taxpayer had no other income.

14. Fundamentally the difference between the exemption system and the credit system is that the exemption system looks at income, the credit system at tax on income.

C. The functions and effects of the methods

15. An example in figures will facilitate the explanation of the effects of the various methods. Suppose the income to be 100,000, 80,000 being derived from one State (the State of residence) and 20,000 derived from the other State (the State of source). Assume that in the State of residence the rate of tax on an income of 100,000 is 35 per cent and that the rate of tax on an income of 80,000 is 30 per cent. Assume, too, that in the State of source the rate of tax is either : (*i*) 20 per cent or (*ii*) 40 per cent, so that the tax payable therein is (*i*) 20 per cent of 20,000 = 4,000 or (*ii*) 40 per cent of 20,000 = 8,000.

16. If the taxpayer's total income of 100,000 arises in the State of residence his tax would be 35,000. If he had an income of the same amount derived in the manner set out above, and, if there were no Convention between the State of residence and the State of source, the total amount of the tax would be, in case (*i*), 35,000 + 4,000 = 39,000 and, in case (*ii*), 35,000 + 8,000 = 43,000.

17. If a Convention were concluded between the two States, based on one of the following methods, the respective results in figures would be :

a) *Full exemption :*

The tax in the State of residence would be 30 per cent of 80,000 = 24,000. The total amount of tax payable would therefore be, in case (*i*), 24,000 + 4,000 = 28,000 and, in case (*ii*), 24,000 + 8,000 = 32,000.

b) *Exemption with progression :*

The tax in the State of residence would be 35 per cent of 80,000 = 28,000. The total amount of tax payable would therefore be, in case (*i*), 28,000 + 4,000 = 32,000 and, in case (*ii*), 28,000 + 8,000 = 36,000.

c) *Ordinary credit :*

The State of residence would compute tax on the total income at a rate of 35 per cent, i.e. 35,000. The amount of tax in the State of residence corresponding to the income from the State of source would be 35 per cent of 20,000 = 7,000 (maximum credit). In case (*i*) the tax in the State of source would be 4,000 and the State of residence would allow a deduction of this amount since the question of restriction does not arise. The tax in the State of residence would therefore be 35,000 — 4,000 = 31,000. The total amount of tax would be 31,000 + 4,000 = 35,000. In case (*ii*) the tax in the State of source would be 8,000 and the State of residence would allow a deduction of 7,000 only, that is the amount of the maximum credit.

The tax in the State of residence would therefore be 35,000 — 7,000=28,000. The total amount of tax would be 28,000 + 8,000 = 36,000.

d) *Full credit :*

The State of residence would compute tax on the total income at a rate of 35 per cent, i.e. 35,000. In case (*i*) the tax in the State of source would be 4,000 and the State of residence would allow a deduction of this amount. The tax in the State of residence would therefore be 35,000 — 4,000 = 31,000 and the total amount of tax would be 31,000 + 4,000 = 35,000. In case (*ii*) the tax in the State of source would be 8,000 and the State of residence would allow a deduction of this amount. The tax in the State of residence would, therefore, be 35,000 — 8,000 = 27,000. The total amount of tax would be 27,000 + 8,000 = 35,000.

TABLE I. TOTAL AMOUNT OF TAX IN THE DIFFERENT CASES ILLUSTRATED ABOVE

I. All income arising in the State of residence : ..... tax 35,000		
II. Income arising in two States, viz., 80,000 in the State of residence and 20,000 in the State of source.	Tax in State of source 4,000 (case i)	Tax in State of source 8,000 (case ii)
No Convention	39,000	43,000
a) Full exemption	28,000	32,000
b) Exemption with progression	32,000	36,000
c) Ordinary credit	35,000	36,000
d) Full credit	35,000	35,000

18. Under the exemption system the State of residence limits its charge of taxation to that part of the total income which, in accordance with the various Articles in a Convention, it has a right to tax. It will impose tax on that part of the income either at the rate of tax applicable to that amount of income (full exemption) or at the rate of tax applicable to the total income wherever it arises (exemption with progression). In either event, the level of the tax in the State of source would have no influence on the amount of tax given up by the State of residence.

19. Under the exemption system if the rate of tax in the State of source were the lower, the taxpayer would fare better than a taxpayer with the same total income arising solely in the State of residence. In the examples given, the tax in the case of full exemption would be 28,000 and, in the case of exemption with progression, 32,000, as compared with 35,000 if the total income arose solely in the State of residence.

20. If the rate of tax in the State of source were the higher, the result, in the case of exemption with progression, would be unfavourable for the taxpayer. In the examples given for case (*ii*) in paragraph 15, the figure would be 36,000, as compared with 35,000 if the total income arose in the State of residence. But in the case of full exemption, the result, in the example given, would be in the taxpayer's favour, i.e. 32,000, as compared with 35,000.

21. Under these forms of exemption the State of residence would give up tax as follows :

a) *Full exemption :*

11,000 irrespective of whether the tax in the State of source is 4,000 or 8,000.

b) *Exemption with progression :*

7,000 irrespective of whether the tax in the State of source is 4,000 or 8,000.

22. Under the credit system the State of residence retains its right to tax the total income of the taxpayer, but against the tax so imposed it allows a certain deduction. A characteristic of the credit systems described above is that the State of residence is never obliged to allow a deduction greater than the tax paid in the State of source.

23. Where the tax in the State of source is the lower, the taxpayer will always have to pay the same amount of tax as he would have had to pay if he were taxed solely in the State of residence. [In case (*i*) 35,000 — 4,000 + 4,000 = 35,000.]

24. Where the tax in the State of source is the higher, and where the deduction is limited to the appropriate part of the tax imposed in the State of residence, the taxpayer will not get a deduction for the whole amount of the tax paid in the State of source. In such an event the result would be less favourable for the taxpayer than if his whole income arose in the State of residence. [In case (*ii*) 35,000 — 7,000 + 8,000 = 36,000.]

25. If the tax in the State of source were the higher, and the State of residence were to allow full credit, the taxpayer would have to pay the same amount of tax as if he were taxed solely in the State of residence. [In case (*ii*) 35,000 — 8,000 + 8,000 = 35,000.]

26. Under the various forms of the credit system described above, the State of residence never gives up an amount of its tax greater than the tax levied in the State of source. This underlines a fundamental distinction between the credit and the exemption systems.

27. In the above-mentioned examples the State of residence gives up the following amounts of tax :

a) *Ordinary credit :*

Where the tax in the State of source is 4,000	4,000
Where the tax in the State of source is 8,000	7,000

b) *Full credit :*

Where the tax in the State of source is 4,000	4,000
Where the tax in the State of source is 8,000	8,000

28. A system where the State of residence gives up the part of its own tax appropriate to the income from the State of source — irrespective of the tax paid in the State of source — produces the same result as an exemption system with progression.

TABLE II. AMOUNT OF TAX GIVEN UP BY THE STATE OF RESIDENCE

	Tax in State of source 4,000 (case i)	Tax in State of source 8,000 (case ii)
No convention	0	0
a) Full exemption	11,000	11,000
b) Exemption with progression	7,000	7,000
c) Ordinary credit	4,000	7,000
d) Full credit	4,000	8,000

D. THE METHODS PROPOSED IN THE ARTICLES

29. In the Conventions concluded between O.E.C.D. Member countries both systems have been adopted. Some States have a preference for one system, some have a preference for the other. Theoretically a single system could be held to be more desirable, but, on account of the preferences referred to, each State has been left free to make its own choice. On the other hand, it has been found important to limit inside each system the number of methods to be employed.

30. In view of this limitation, the Articles have been drafted so that Member countries are left free to choose between two methods: the exemption method with progression [Article 23(A)] and the ordinary credit method [Article 23(B)]. If two Contracting States both adopt the same method, it will be sufficient if the relevant Article is inserted in the Convention. On the other hand, if the two Contracting States adopt different methods, the name of the State must be inserted each in the appropriate Article, according to the method adopted by that State.

31. Perhaps it may be of interest to add that, in particular circumstances, both methods could be combined with advantage. Thus it will be noted from paragraph 39 that paragraph 2 of Article 23(A) — the exemption Article — is drafted in accordance with the credit method, and from paragraphs 47 to 51 that the adoption of the exemption method, in respect of the type of income referred to therein, would obviate difficulties that arise under the credit method.

II. COMMENTS ON ARTICLE 23(A) (Exemption)

Paragraph 1

A. THE OBLIGATION OF THE STATE OF RESIDENCE TO GIVE EXEMPTION

32. In the Article it is laid down that the State of residence shall exempt from tax income and capital, which in accordance with the Convention "may be taxed" in the other State. The State of residence must accordingly give exemption whether or not the income or capital in question is actually taxed in the State of source. This is in accordance with most Conventions based on the exemption system between O.E.C.D. Member countries. It is regarded as the most practical method since it relieves the State of residence from undertaking onerous and time-consuming investigations of the actual taxation position in the State of source.

33. Exceptionally some negotiating States may find it reasonable in certain circumstances to deviate from the provision concerning the absolute obligation of the State of residence to give exemption. Such may be the case where one of the States adopts the credit method and the other State the exemption method. It may also be the case that the internal legislation of the State of source does not enable the fiscal authorities of that State to make use of a right to tax conferred on it by the Convention — e.g. where it does not impose capital tax. In such cases it is left to the negotiating States to agree upon the necessary modifications in the provision mentioned.

B. The Reservation of the Progression

34. In most of the Conventions concluded between O.E.C.D. Member countries on the basis of the exemption system the State of residence retains the right to take the amount of exempted income or capital into consideration when determining the rate of tax to be imposed on the rest of the income or capital. A similar provision therefore is inserted in the Article.

35. The provision concerning progression, proposed in the Article, relates only to the State of residence. A question arises, however, when a State of source which applies a progressive tax scale gives up the right to tax and the non-resident taxpayer derives other income from that State. Different principles may be applied by a State of source in determining its progression. Its internal tax law may provide for the calculation of the progression on the global income of the taxpayer or only on the total income arising to the taxpayer in the State of source.

36. The form of the Article does not prejudice the application by the State of source of the provisions of its national legislation concerning the progression. If two Contracting States wish to clarify whether, or to what extent, the State of source shall have the right to use a progression they are left free to do so in bilateral negotiations.

C. Alternative Formulation of the Article

37. An effect of the exemption system as it is drafted in the Article is that the taxable income or capital in the State of residence is reduced by the amount which the State of residence exempts. If in a particular State the amount of income as determined for income tax purposes is used as a measure for other purposes, e.g. social benefits, the application of the exemption system in the form proposed may have the effect that such benefits may be given to persons who ought not to receive them. To avoid such consequences, the Article may be altered so that the income in question is included in the taxable income in the State of residence. The State of residence must then in such cases give up that part of the total tax appropriate to the income concerned. This procedure would give the same result as the Article in the form proposed. States can be left free to make such modifications in the drafting of the Article. If a State wants to draft the Article as indicated above, paragraph 1 may be drafted as follows :

"Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraph 2, allow as a deduction from the income tax or capital tax that part of the income tax or capital tax, respectively, which is appropriate, as the case may be, to the income derived from or the capital owned in that other Contracting State."

D. Special Treatment of Losses

38. Where the State of residence allows as a deduction from the income it assesses the amount of a loss incurred in the other State, there should be no objection if, when profits are made subsequently in the other State, the exemption for the later years is restricted appropriately. States are left free in this respect and, if it is found necessary for clarification, can refer to such a restriction in the Article.

Paragraph 2

39. In Articles 10 and 11 the right to tax dividends and interest is divided between the State of residence and the State of source. Such is also the case with respect to royalties, as regards Greece, Luxembourg, Portugal and Spain. As a consequence double taxation in these cases cannot be expected to be avoided by the application of the exemption method since this method secures that the State of residence gives up its right to tax the income concerned, but the State of residence is left free to apply the exemption method if it wants to do so. For the State of residence the application of the credit method would normally seem to give a satisfactory solution. Consequently, the paragraph is drafted in accordance with the ordinary credit method. If, however, a given Contracting State has a special tax system (e.g. Switzerland) where the tax credit method is not yet applied and where it therefore would be difficult to apply such method as provided for by paragraph 2 of the Article, such Contracting State may, in bilateral negotiations, use other measures in order to alleviate the double taxation mentioned in such paragraph 2.

40. In the cases referred to in the previous paragraph certain maximum percentages are laid down for tax reserved to the State of source. In such cases the rate of tax in the State of residence will very often be higher than the rate in the State of source. Consequently, a limitation of the deduction in accordance with the ordinary credit method would have only a limited significance. If in such cases the Contracting States find it preferable to use the full credit method they can do so by deleting the second sentence of the paragraph.

III. Comments on Article 23(B) (Credit)

A. Methods

41. Article 23(B) which embodies the credit provision, follows the ordinary credit method : The State of residence allows, as a deduction from

its own tax on the income or capital of its resident, an amount equal to the tax paid in the other State on the income derived from, or capital owned in, that other State, but the deduction is restricted to the appropriate proportion of its own tax.

42. The ordinary credit method is intended to apply, inter alia, to dividends and interest where the State of source has a limited right to tax, but the possibility of a certain modification is referred to under paragraphs 39 and 40 above.

43. According to the Article the deduction, which the State of residence is to allow, shall not exceed that part of the income tax which is appropriate to the income derived from the State of source. If a resident of one State derives income of different kinds from the State of source and that State, according to its tax law, imposes tax only on one of these incomes, the maximum deduction which the State of residence is to allow will be that part of its tax which is appropriate only to that item of income which is taxed in the State of source. If a resident of one State, deriving income from another State, has a loss in his State of residence — less than the income from abroad — the total tax charged in the State of residence will be appropriate to the income from the State of source, and the maximum deduction which the State of residence is to allow will consequently be the tax charged in that State.

44. A modification of the credit method was requested by Italy. The Italian taxation system is based predominantly on the principle of the territoriality of the tax, that is to say, in principle, any income arising abroad is not taxable in Italy for the purposes of the impersonal or schedular taxes (i.e. tax on income from movable property, tax on income from built-up property, tax on income from land, etc.) but, when taxable, is charged to the progressive complementary tax or to the company tax. In view of that fact, Italy wishes to limit the credit to that part only of the tax paid abroad which exceeds the Italian impersonal or schedular tax not charged in Italy. It is agreed that Italy can be left free to apply the credit method with such modification.

B. Remarks concerning Tax on Capital

45. Capital taxes are included in the present Article. As paragraph 1 is drafted, credit is to be allowed for income tax only against income tax and for capital tax only against capital tax. Consequently, credit for or against capital tax will be given only if there is a capital tax in both Contracting States.

46. Under bilateral negotiations, two Contracting States may agree that a tax called a capital tax is of a nature closely related to income tax and may, therefore, wish to allow credit for it against income tax and vice versa. There will be cases where, because one State does not impose a capital tax or because both States impose capital taxes only on domestic assets, no double taxation of capital will arise. In such cases it is, of course understood that the reference to capital taxation may be deleted. Furthermore, negotiating States may find it desirable, regardless of the nature of the taxes included under the Convention, to allow credit for the total amount

of tax in the State of source against the total amount of tax in the State of residence. Where, however, a Convention includes both real capital taxes and capital taxes which are in their nature income taxes, the Contracting States may wish to allow credit against income tax only for the latter mentioned capital taxes. In such cases, Contracting States are free to alter the proposed Article so as to achieve the desired effect.

C. The Relation in Special Cases Between the Taxation in the State of Source and the Ordinary Credit Method

47. In certain cases a State, particularly a State which is commonly referred to as an industrially under-developed State, may for particular reasons give concessions to taxpayers, e.g. tax incentive reliefs to encourage industrial output. In a similar way, a State may wish to free from taxation certain kinds of income, e.g. pensions to war wounded soldiers.

48. When such a State concludes a Convention with a State which applies the exemption system, no restriction of the relief given to the taxpayers arises, because that other State must give exemption regardless of the amount of tax, if any, imposed in the State of source. But when the other State applies the credit system the concession is nullified, inasmuch as that other State will allow a deduction only of the tax paid in the State of source. Moreover, by reason of the concessions, that other State secures what may be called an uncovenanted gain for its own Exchequer.

49. Should the two Contracting States agree that the benefit of the concessions given to the taxpayers in the State of source are not to be nullified, a deviation from Article 23(A) paragraph 2, and Article 23(B) will be necessary.

50. One method of deviation might be that, where such "tax-spared" income is in question, the exemption method could, as pointed out in paragraph 48, be applied. Already, to cover special cases, a deviation from the exemption method, which embodies the credit method, has been proposed in paragraph 2 of Article 23(A), so that a deviation in this case from the credit method embodying the exemption method might be acceptable. Another deviation might be the adoption of what is called "matching credit". This method secures that the State of residence will allow as a deduction from its own tax an amount corresponding to the tax which would have been paid in the State of source if no concession had been granted by that State. In order that the system should give satisfactory results, it is necessary that the State of source should be able to notify to the State of residence the amount of tax that would have been paid if no relief had been granted.

51. Member States are left free to settle in such cases whether deviations are to be made from the ordinary credit method, and, if so, what form the deviations are to take, and what conditions are to be fulfilled before the deviations.

D. Special Credit with Respect to Dividends

52. Certain States wishing to apply the credit method allow in their

Conventions, in respect of dividends received from companies in other States, credit, not only for the amount of tax directly levied on the dividends in those other States, but also for that part of the companies' tax which is appropriate to the dividends. Member States applying this method are left free to do so.

COMMENTARY ON ARTICLE 24 CONCERNING TAX DISCRIMINATION ON GROUNDS OF NATIONALITY OR OTHER SIMILAR GROUNDS

Paragraph 1

1. This paragraph establishes the principle that for purposes of taxation discrimination on the grounds of nationality is forbidden, and that, subject to reciprocity, the nationals of a Contracting State may not be less favourably treated in the other Contracting State than nationals of the latter State in the same circumstances.

2. The expression "in the same circumstances" which appears in the text refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation law and regulations, in substantially similar circumstances both in law and in fact.

3. Consequently if one of the Contracting States, in giving relief from taxation on account of family responsibilities, distinguishes between its own nationals according to whether they reside in its territory or not, that State cannot be obliged to give nationals of the other State who do not reside in its territory the same treatment as it gives its resident nationals but it undertakes to extend to them the same treatment as is available to its non-resident nationals.

4. Likewise, the provisions of paragraph 1 are not to be construed as obliging a State which accords special taxation privileges to its own public bodies or services as such, to extend the same privileges to the public bodies and services of the other State.

5. Neither are they to be construed as obliging a State which accords special taxation privileges to private institutions not for profit whose activities are performed for purposes of public benefit, which are specific to that State, to extend the same privileges to similar institutions whose activities are not for its benefit.

6. To take the first of these two cases, if a State accords immunity from taxation to its own public bodies and services, this is justified because such bodies and services are integral parts of the State and at no time can their circumstances be comparable to those of the public bodies and services of the other State. Nevertheless, this reservation is not intended to apply to State corporations carrying on gainful undertakings. To the extent that these can be regarded as being on the same footing as private industrial and commercial undertakings, the provisions of paragraph 1 will apply to them.

7. As for the second case, if a State accord taxation privileges to certain private institutions not for profit, this is clearly justified by the very nature of these institutions' activities and by the benefit which that State and its nationals will derive from those activities.

8. Furthermore, paragraph 1 of the Article has been deliberately framed in a negative form. By providing that the nationals of one Contracting State may 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 the other Contracting State in the same circumstances are or may be subjected, this paragraph probably has the same mandatory force as if it enjoined the Contracting States to accord the same treatment to their respective nationals. But since the principal object of this clause is to forbid discrimination in one State against the nationals of the other, there is nothing to prevent the first State from granting, for special reasons of its own, certain concessions or facilities to foreigners which are not available to its own nationals. As it is worded, paragraph 1 of the Article would not prohibit this should the case ever arise.

9. Subject to the foregoing observations, the words "...shall not be subjected... to any taxation or any requirement connected therewith which is other or more burdensome..." mean that when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the same form for both, its basis of charge and method of assessment must be the same, its rate must be the same, and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals.

Paragraph 2

10. The purpose of paragraph 2 is more to specify the content of the expression "nationals" used in paragraph 1 than to define it. It merely stipulates in a customary formula that this expression applies to all individuals possessing the nationality of one of the Contracting States. It has not been judged necessary here to introduce into the text of the Article any considerations on the signification of the concept of nationality, any more than it seemed indispensable to make any special comment here on the meaning and application of the word. Obviously, in determining, in relation to individuals, what is meant by "the nationals of a Contracting State", reference must be made to the sense in which the term is usually employed and each State's particular rules on the acquisition or loss of nationality.

11. But paragraph 2 is more specific as to legal persons, partnerships and associations. By declaring that all legal persons, partnerships and associations deriving their status as such from the law in force in a Contracting State are considered to be nationals for the purposes of paragraph 1 of the Article, the provision disposes of a difficulty which often arises in determining the nationality of companies. In defining the nationality of companies, certain States have regard less to the law which governs the company than to the origin of the capital with which the company was

formed or the nationality of the individuals or legal persons controlling it. No ambiguity need be apprehended therefore.

12. Moreover, in view of the legal relationship created between the company and the State under whose law it is constituted, which from certain points of view is closely akin to the relationship of nationality in the case on individuals, it seems justifiable not to deal with legal persons, partnerships and associations in a special provision, but to bring them under the same term with individuals.

Paragraph 3

13. On 28th September, 1954, a number of States concluded a Convention relating to the status of stateless persons, under Article 29 of which stateless persons must be accorded national treatment. The signatories of the Convention include several O.E.C.D. Member countries. Such a provision, however, is mainly suitable for insertion in a multilateral Convention.

Paragraph 4

14. Strictly speaking, the type of discrimination which this paragraph is designed to end is discrimination based not on nationality, but on the actual situs of an enterprise. It therefore affects without distinction, and irrespective of their nationality, all residents of a Contracting State who have permanent establishments in the other Contracting State. In this Connection, while it is true that most Conventions for the avoidance of double taxation lay down the principle that, for the purpose of charging tax, a permanent establishment of an enterprise of a Contracting State in the other Contracting State must be regarded as an independent enterprise and treated as such, nevertheless the other State does not always extend to the permanent establishment the full benefit of the treatment it applies to its own enterprises. Thus, the permanent establishment may not be allowed the same depreciation facilities, or a proportion of the principal enterprise's overheads is not always allowed to be attributed to the permanent establishment, or any losses incurred by the permanent establishment are not allowed to be set off. The purpose of paragraph 4 is to put an end to these differences in treatment by stipulating that a permanent establishment which an enterprise of a Contracting State has in the other Contracting State must not be less favourably taxed by that other Contracting State than enterprises of that State carrying on the same activities.

15. This provision does not mean, however, that a Contracting State must give an individual residing in the other Contracting State, in connection with the taxation for which he is liable in the first Contracting State in respect of a permanent establishment owned by him therein, any personal allowances, reliefs and reductions on account of civil status or family responsibilities which it gives to its own residents. This reservation, moreover, is expressly contained in the text of the Article.

16. Furthermore, it seems indispensable to specify that the wording of the first sub-paragraph of paragraph 4 must be interpreted in the sense that it does not constitute discrimination to tax non-resident persons, for

reasons of practical convenience, differently from resident persons so long as this does not result in more burdensome taxation for the former than for the latter. In the negative form in which the provision has been framed it is the result alone that counts, it being permissible to adapt the taxation on the particular circumstances in which it is levied.

17. Finally, with regard to the use of the word "enterprise" in the first sub-paragraph of paragraph 4, the question was raised whether it would not be better to use the word "entrepreneur" instead which had the merit of designating both individuals and legal persons and of thus being applicable where it is not the enterprise itself that is taxed but the individual carrying on the enterprise. The word "enterprise" was finally selected.

Paragraph 5

18. Paragraph 5 forbids a State to give different treatment to two enterprises residing on its territory, the capital of one of which is wholly or partly owned or controller, directly or indirectly, by one or more residents of the other Contracting State. This provision, and the discrimination which it puts an end to, relates to the taxation only of enterprises and not of the persons owning or controlling their capital. Its object therefore is to ensure equal treatment for taxpayers residing in the same State, and not to subject foreign captal, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital. Paragraph 5 has no connection with nationality as defined in paragraph 2 and in no way does it purport to introduce into the Article a new concept of "nationality of capital".

Paragraph 6

19. This paragraph states that the word "taxation" used in the preceding paragraphs of the Article means taxes of every kind and description levied by, or on behalf of the State, its political subdivisions or local authorities. It does not call for any special comment.

Reservation on the Article

20. Canada reserves its position on this Article.

21. Ireland reserves the right not to grant to companies incorporated or managed and controlled outside Ireland certain temporary tax reliefs available to Irish companies on mining profits ; and the right to impose a higher rate of Stamp Duty on acquisitions of agricultural land by aliens than that payable by nationals.

COMMENTARY ON ARTICLE 25
CONCERNING THE MUTUAL AGREEMENT PROCEDURE

1. In the Article are set out the rules governing the mutual agreement procedure to be followed where differences of opinion or other difficulties arise as to the application of the Convention. The Article also embodies some general rules regarding the exchange of views between the competent authorities concerned on the interpretation or the application of the Convention.

Paragraphs 1 and 2

2. The rules laid down in paragraphs 1 and 2 provide for the elimination in a particular case of taxation which does not accord with the Convention. The provisions of paragraph 1 establish a right for the taxpayer concerned to address himself to the competent authority of the Contracting State of which he is a resident. The taxpayer may use this right whether or not he has exhausted all the legal remedies open to him according to the national tax laws of both States. Neither is it a prerequisite for the use of this right that the actions concerned have already resulted in incorrect taxation ; the evident risk of such taxation as a consequence of the measures already taken would be sufficient.

3. The competent authority of the Contracting State of which the taxpayer is a resident will, of course, subject his application to a careful examination and ask for all evidence available. As a result of such an examination the authority may find that the matter can be solved without recourse to the mutual agreement procedure. On the other hand, although adjustments might be required in the State of residence only, an exchange of views as well as of information with the competent authority of the other Contracting State may be useful, e.g. to obtain support for a certain interpretation of the Convention.

4. In paragraph 2 it is laid down that in case the State of residence is not itself able to arrive at an appropriate solution, the competent authority of that State shall communicate with the competent authority of the other State with a view to reaching an agreement regarding the taxation in dispute. Among the cases in which this procedure could be applied might be mentioned the case where one Contracting State which, in the particular case, is considered by the other State to have no right to tax under the Convention, taxes income not being subject to tax under the laws of that other Contracting State. Other examples are the case of the application of non-discrimination clauses and the case of difficulties arising in the allocation of profits among associated enterprises.

5. No time-limit is specified in the Article for presenting claims under paragraph 1. Any time-limit that may be fixed upon bilaterally should be reasonably generous.

Paragraph 3

6. The provisions of paragraph 3 invite the competent authorities to resolve general difficulties of interpretation or application by means of mutual agreement and enable the authorities to enter into such agreement, if possible.

7. In the second sentence of paragraph 3, a possibility is indicated for the competent authorities to deal also with such cases of double taxation as do not come within the scope of the provisions of the Convention. Of special interest in this connection is the case of a resident of a third State having permanent establishments in both Contracting States. It is, of course, desirable that the consultations concerned should result in the effective elimination of the double taxation in question.

Paragraph 4

8. This paragraph provides that the competent authorities of the Contracting States may communicate with each other directly. It would thus not be necessary to go through diplomatic channels. As suggested by the second sentence of paragraph 4, the setting up of a Commission may in certain cases be advisable. When dealing with a particular case, it might be found of value to allow the taxpayer to make representations in writing or orally. If agreed upon unanimously, this procedure should be open to the Commission.

9. As the provisions embodied in this Convention as well as the Commentaries annexed thereto are the result of a close international joint work within the Fiscal Committee, a possibility near at hand would be to call upon the Fiscal Committee to give an opinion on the correct understanding of the provisions where special difficulties of interpretation arise as to particular points. Such a practice, which would be in line with the mandate and aims of the Fiscal Committee with regard to the progressive elaboration of uniform law for the avoidance of double taxation, might well make a valuable contribution to arriving at a desirable uniformity in the application of the provisions.

10. In future, when a multilateral Convention may have been agreed upon, it might be useful to consider more precise rules on such an international consultative procedure.

COMMENTARY ON ARTICLE 26 CONCERNING EXCHANGE OF INFORMATION

I. General Observations

1. The application of a Convention for the avoidance of double taxation implies a co-operation between the tax administrations of the two Contracting States which may be more or less close according to the circumstances. An obvious instance is the administrative assistance in particular cases for purposes of ascertaining the facts in relation to which the national tax legislation and the rules of the Convention are to be applied. The present Article embodies the rules according to which information may be exchanged with a view to laying the proper basis for a taxation under the Convention.

2. The matter of administrative assistance for the purpose of tax collection is not dealt with in the Article. This matter often forms the subject of a separate bilateral agreement between the Contracting States; alternatively, the provisions on assistance in the field of tax collection may be introduced in the double taxation Convention, whenever this is found preferable.

II. Commentary on the Draft Article

Paragraph 1

3. The main rule concerning the exchange of information is contained in the first sentence of the paragraph. It is stipulated that the competent authorities of the Contracting States shall exchange such information as is necessary in order to secure the correct application of the articles of the Convention and also of the internal laws of the Contracting States concerning taxes covered by the Convention. In order to keep the exchange of information within the framework of the Convention, a limitation to the compulsory exchange of information is set so that information should be given only insofar as the national tax in question is covered by the Convention and the taxation under the national tax law concerned is in accordance with the Convention.

4. The following examples may illustrate the principle dealt with in paragraph 3 above. Thus, when applying the provisions of Article 12 on the taxation of royalties the competent authority of the State where the recipient is resident may find it necessary to request information from the competent authority of the State where the payer is resident, concerning the amount of royalty transmitted by the payer to the recipient. And vice

versa, in determining the taxation of the payer, the competent authority of the State of the payer's residence may have occasion to inquire, officially, about the identity of the recipient and if there exist between the payer and the recipient special relations which may be of relevance for the tax treatment. For this purpose, certain information is sometimes also of importance, such as information on prices quoted between two enterprises situated in two different Contracting States or between a permanent establishment in one country and its head office in another country. Generally, the exchange of information in this field will be needed with a view to properly allocating taxable profits between two associated enterprises or adjusting the amounts of profits shown in the accounts of a permanent establishment and in the accounts of its head office. As a further typical example reference may be made to the information necessary for the application of Articles 23(A) and 23(B) on the methods for the avoidance of double taxation.

5. As was indicated in paragraph 3 above, the obligation to furnish information does not extend to the case where the national tax law concerned is not covered by or is contrary to the Convention. An illustration may be cited in this connection e.g. information for the purposes of the imposition of an extra-ordinary tax on capital appreciation with respect to which a given Convention is not applicable.

6. It should be noticed that the main rule on exchange of information is applicable in many cases where information is required for the prevention of fiscal fraud or fiscal evasion. The Contracting States should be free, however, to agree bilaterally on special provisions intended to prevent fiscal fraud or evasion of tax.

7. The rule laid down in paragraph 1 of the Article presupposes that information shall be exchanged only on application. Obviously, the regular sources of information available to the responsible tax authority under the internal taxation procedure should be relied upon in the first place. Assistance under the present Article would therefore normally be requested when, in a particular case, the information obtained from the regularly available sources is insufficient or is in need of corroboration. In general, requests for assistance from the authorities of the co-Contracting State would have to be restricted to particulars which are required in connection with the examination of specific tax cases. Wide-ranging requests for information, concerning for example all payments of royalty made from one Contracting State to residents of the requiring State might, if the information is at all available, entail administrative difficulties and should be subjected to special agreements between the Contracting States.

8. A number of existing Conventions provide for a scheme of regular and automatic exchange of certain categories of information for taxation purposes. Such an arrangement may be adopted bilaterally by Member countries ; it will then be necessary to list the items of information which shall be transmitted by the competent authorities.

9. The obligation to treat as secret the information which is received under the present Article applies to all authorities of the Contracting State, including those which are empowered with the jurisdiction of disputes as

to tax liabilities. In this connection, and to the extent required or permitted by the constitutional procedures and judicial organisation of certain States, special measures may be taken to safeguard the secrecy of such information if it is used in the course of court proceedings. Of course, the Contracting States are free to agree bilaterally that such information may be used in public court proceedings. To this end, the last sentence of paragraph 1 of the Article may be drafted as follows :

> "Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment, *including judicial determination,* or collection of the taxes which are the subject of this Convention."

Paragraph 2

10. This paragraph embodies certain limitations to the main rule. In the first place, the paragraph contains the clarification that a Contracting State is not bound to go beyond its own internal laws and administrative practice in putting information at the disposal of another Contracting State. In this connection, the internal provisions concerning tax secrecy should not be interpreted as constituting an obstacle to the exchange of information under the present Article. As was mentioned above, the authorities of a Contracting State are obliged to observe secrecy with regard to information received under this Article.

11. Furthermore, since the main rule on exchange of information is based on the general principle of reciprocity, a Contracting State is not obliged to carry out administrative measures that are not permitted under the laws or practice of the requiring State or to supply items of information that are not obtainable under the laws or in the normal course of administration of the requiring State. It follows that a Contracting State cannot take advantage of the information system of the other Contracting State if it is wider than its own system. On the other side, if the structure of the information systems of two Contracting States is very different, the conditions under sub-paragraphs *a*) and *b*) will allow the Contracting States to exchange very little information or perhaps none at all. In such a case, the Contracting States may find it appropriate to modify the principle of reciprocity by means of an understanding reached on the basis of Article 25 on mutual agreement procedure.

12. Information is deemed to be obtainable in the normal course of administration if it is in the possession of the tax authorities or can be obtained by them in the normal procedure of tax determination, but not if it cannot be obtained without special investigations or special examination of the business accounts kept by the taxpayer or other persons.

13. In addition to the limitations referred to above, sub-paragraph *c*) of paragraph 2 contains a reservation concerning the disclosure of certain secret information. Already under the internal laws of many Member States the access to or the supplying of certain information is prohibited and it has been considered desirable to make explicit mention in the Article of this kind of limitation. It is open to Contracting States to add further dispensations from the obligation to supply information to the

items listed in sub-paragraph *c*), for example information protected by provisions on banker's discretion. It has been felt necessary also to prescribe a limitation with regard to information which concerns the vital interests of the State itself. To this end, it is stipulated that Contracting States do not have to supply information the disclosure of which would be contrary to public policy (ordre public).

III. Reservation on the Article

14. Under the Swiss concept a taxation Convention aims at avoiding international double taxation ; the information necessary for the correct application and for the prevention of an abuse of such a Convention can be exchanged already within the existing framework of its provisions on the mutual agreement procedure, the reduction of taxes withheld at the source etc. Switzerland considers a particular provision on the exchange of information as unnecessary since even such an express clause could not, according to the purpose of the Convention, provide for more than for an exchange of information necessary for the correct application and prevention of an abuse of the Convention. Accordingly Switzerland has an express reservation on the Article on the exchange of information.

COMMENTARY ON ARTICLE 27
CONCERNING DIPLOMATIC AND CONSULAR PRIVILEGES

1. The aim of the provision is to secure that members of diplomatic or consular representations shall, under the provisions of a double taxation Convention, receive no less favourable treatment than that to which they are entitled under international law or under special international treaties.

2. The simultaneous application of the provisions of a double taxation Convention and of diplomatic and consular privileges conferred by virtue of the general rules of international law, or under a special international treaty may under certain circumstances, have the result of discharging, in both Contracting States, tax that would otherwise have been due. As an illustration, it may be mentioned that e.g. a diplomatic agent who is accredited by State A to State B and derives royalties or dividends from sources in State A will not, owing to international law, be subject to tax in State B in respect of this income and may also, depending upon the provisions of the bilateral Convention between the two States, be entitled as a resident of State B to an exemption from, or a reduction of, the tax imposed on the income in State A. In order to avoid tax reliefs that are not intended, the Contracting States should be free to adopt bilaterally an additional provision which may be drafted on the following lines :

> "Insofar as, due to fiscal privileges granted to diplomatic or consular officials under the general rules of international law or under the provisions of special international treaties, income or capital are not subject to tax in the receiving State, the right to tax shall be reserved to the sending State."

It should be remarked, however, that also without the inclusion of the additional clause the sending State, by the rules laid down in Article 19 on taxation of remuneration of governmental functions, always retains the right to tax the salaries and other emoluments paid to the diplomatic and consular officials in their capacity as such.

3. In many Member countries, the internal legislation contains provisions to the effect that diplomatic and consular agents while abroad shall for tax purposes be deemed to be residents of the sending State. In the bilateral relations between Member countries in which provisions of this kind are operative internally, a further step may be taken by including in the Convention specific rules that establish, for purposes of the Convention, the sending State as the State of residence of the members of the diplomatic and consular missions of the Contracting States. The special provision suggested here could be drafted as follows :

> "For the purposes of this Convention, persons who are members

of a diplomatic or consular mission of a Contracting State in the other Contracting State or in a third State and who are nationals of the sending State, shall be deemed to be residents of the sending State if they are submitted therein to the same obligations in respect of taxes on income and capital as are residents of that State."

4. Regarding the diplomatic and consular agents of a third State accredited to a Contracting State, it results from the rule suggested in the foregoing paragraph that they should be excluded from the benefits available under the double taxation Conventions concluded by the receiving State. Such a solution also finds strong support from the consideration that, where this category is concerned, there is normally no question of double taxation involved, since in the receiving State these officials are entitled to the fiscal privileges granted under the general rules of international law. This latter consideration also holds true of the officials of intergovernmental organisations established in a Member State, as these officials usually benefit from certain fiscal privileges either under the Convention or Treaty establishing the organisation or under a special international Treaty between the organisation and the country in which it is established.

As a safeguard against undesirable tax reliefs the following provision could be added to this Article by bilateral agreement :

"This Convention shall not apply to International Organisations, to organs or officials thereof and to persons who are members of a diplomatic or consular mission of a third State, being present in a Contracting State and not treated in either Contracting State as residents in respect of taxes on income and capital."

5. Although honorary consular officers cannot derive from the provisions of the Article any privileges to which they are not entitled under the general rules of international law — there commonly exists only tax exemption for payments received as consideration for expenses honorary consuls have on behalf of the sending State — the Contracting States should be free to exclude, by bilateral agreement, expressly honorary consular officers from the application of the Article.

COMMENTARY ON ARTICLE 28 CONCERNING THE TERRITORIAL EXTENSION OF THE CONVENTION

1. Certain double taxation Conventions state to what territories they apply. Some of them also provide that their provisions may be extended to other territories, and define when and how this may be done. A clause of this kind is of particular value to States which have territories overseas or are responsible for the international relations of other States or territories, especially as it recognises that the extension may be effected by an exchange of diplomatic notes. It is also of value when the provisions of the Convention are to be extended to a part of the territory of a Contracting State which was, by special provision, excluded from the application of the Convention. The Article, which provides that the extension may also be effected in any other manner in accordance with the constitutional procedure of the States, is drafted in a form acceptable from the constitutional point of view of all Member countries affected by the provision in question. The only prior condition for the extension of a Convention to any States or territories is that they must impose taxes substantially similar in character to those to which the Convention applies.

2. The Article provides that the Convention may be extended either in its entirety or with any necessary modifications, that the extension takes effect from such date and subject to such conditions as may be agreed between the Contracting States, and, finally, that the termination of the Convention automatically terminates its application to any States or territories to which it has been extended, unless otherwise agreed by the Contracting States.

COMMENTARY ON ARTICLE 29 and 30 CONCERNING THE ENTRY INTO FORCE AND THE TERMINATION OF THE CONVENTION

1. The present provisions on the procedure for entry into force, ratification, denunciation and termination are drafted for bilateral Conventions and correspond to the rules usually contained in international treaties.

2. In the case of some Contracting States, constitutional requirements may necessitate an additional provision in the first paragraph of the Article on entry into force indicating the authorities which have to give their consent to the ratification.

3. No provisions have been drafted as to the date on which the Convention shall have effect or cease to have effect, since such provisions would largely depend on the national laws of the Contracting States concerned. Some of the States assess tax on the income received during the current year, others on the income received during the previous year, others again have a fiscal year which differs from the calendar year. Furthermore, some Conventions provide, as regards taxes levied by deduction at the source, a date for the application or termination of the Convention which differs from the date applying to taxes levied by assessment.

4. As it is of advantage that the Convention should remain in force at least for a certain period, the Article on denunciation provides that notice of termination can only be given after a certain year—to be fixed by bilateral agreement. It is open to the Contracting States to decide upon the earliest year during which such notice can be given or even to agree not to fix any such year, if they so desire.

APPENDIX

APPENDIX

RECOMMENDATION OF THE COUNCIL
concerning the avoidance of double taxation
(Adopted by the Council on 30th July, 1963)

THE COUNCIL

Having regard to Article 5 *b*) of the Convention on the Organisation for Economic Co-operation and Development of 14th December, 1960 ;

Having regard to the Recommendation of the Council of the Organisation for European Economic Co-operation of 3rd July, 1959, concerning the Avoidance of Double Taxation, as amended on 19th July, 1960, and 7th July, 1961, and approved by the Council on 30th September, 1961 [C (59) 147 (Final) ; C (60) 157 (Final) ; C (61) 97 (Final) ; OECD/C (61) 5] ;

Having regard to the Report of the Fiscal Committee on the Draft Convention for the Avoidance of Double Taxation with respect to Taxes on Income and Capital between the Member countries of the O.E.C.D. of 6th July, 1963, and, in particular, to paragraphs 5, 48, 51, 53, 54 and 62-66, as well as the Commentaries on the Articles of the Draft Convention contained in that Report [C (63) 87] ;

Having regard to the desirability of removing the obstacles that double taxation presents to the free movement of goods, services, capital and manpower between the Member countries of the O.E.C.D. and of concluding Conventions between them for that purpose ;

Having also regard to the need for harmonizing existing bilateral Conventions on uniform principles, with uniform définitions, rules and methods, and of agreeing on a common interpretation, and of extending the existing network of such Conventions to all Member countries ;

I. RECOMMENDS TO THE GOVERNMENTS OF MEMBER COUNTRIES :

1. To pursue their efforts to conclude bilateral Conventions for the avoidance of double taxation with respect to taxes on income and on capital with Member countries with whom they have not concluded such Conventions, and to revise such existing Conventions between them which may no longer be in keeping with present circumstances.

2. When concluding or revising bilateral Conventions between them, to conform to the Draft Convention, set out in the Annex hereto (hereinafter referred to as the "Draft Convention"), as interpreted by the Commentaries in the Report of the Fiscal Committee hereinbefore referred to and having regard to the derogations and reservations contained in those Commentaries and in the said Report.

II. RECOMMENDS TO THE GOVERNMENTS OF MEMBER COUNTRIES WHICH ARE ALSO MEMBERS OF REGIONAL GROUPINGS :

To examine, as and when appropriate, the feasibility of concluding within such groupings multilateral Conventions based upon the Draft Convention.

III. REQUESTS :

1. The Governments of Member countries to notify the Organisation of the text of any new or revised bilateral double taxation Convention which they may conclude between them and, where appropriate, the reasons why the provisions of the Draft Convention have not been adopted in any such Convention.

2. The Governments of Member countries who are also members of regional groupings to notify the Organisation in due time of the results of their examination of the Recommendation in Section II above, and of any difficulties encountered with regard to the provisions of the Draft Convention.

IV. INSTRUCTS THE FISCAL COMMITTEE :

1. To seek solutions to the problems mentioned in §§ 53 and 54 of the Report of the Fiscal Committee, to consider the desirability of providing for recourse to arbitration, and to report to the Council before 1st July, 1965.

2. To prepare and submit to the Council before 1st July, 1965, a Draft Convention for the avoidance of double taxation with respect to taxes on estates and inheritances.

3. To report to the Council before 1st July, 1965, on the programme of work contemplated regarding the study of the problems of double taxation with respect to indirect taxes.

4. To examine the information submitted in conformity with the Recommendation in Section III above, and to report to the Council as and when appropriate.

5. To report to the Council, as and when appropriate, on the feasibility of concluding a Multilateral Convention for the avoidance of double taxation with respect to taxes on income and capital among all Member countries of the O.E.C.D.

V. DECIDES :

The Recommendation of the Council of the Organisation for European Economic Co-operation of 3rd July, 1959, as amended, referred to above, will hereby be repealed.

NOTE. The Annex referred to in the Recommendation contains the text of the Draft Convention.