International

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Article 19(2): The Complexity of the OECD Model Can Be Reduced

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1. Introduction

The OECD Model Tax Convention contains a complex system for allocating taxing rights between the residence state and the source state. It is obvious that technically it would be possible to reduce the number of rules dramatically. It is also obvious, however, that the acceptance of the OECD Model depends to a certain extent on some complexity: contracting states have the impression that this complexity provides a fair system for sharing tax revenues. For this reason, the OECD Model has been a success story.

But the disadvantages of a complex system for allocating taxing rights between the contracting states are evident. The more different the rules, the more difficult it can be to draw the borderline between two different rules. And the more different the source criteria, the greater the possibility that very similar situations are covered by different rules and that the taxing rights are allocated differently. It is clear that a system that is too complex can create dissatisfaction. This can be illustrated by looking at the tax treatment of pensions in the OECD Model and by examining Art. 19(2) and the different treatment of pensions caused by this provision.

2. Methods of Allocating Taxing Rights

2.1. Art. 15 versus Arts. 16, 17 and 19(1) of the OECD Model

The OECD Model distinguishes between business (and before the 2000 changes to the OECD Model, independent personal services), on the one hand, and dependent personal services, on the other. From a policy point of view, it is not at all self-evident that the taxing rights with respect to income derived from services should be allocated according to different principles. In addition, it is difficult to draw the borderline between Art. 7 (Business profits) and Art. 15 (Income from employment) of the OECD Model. Although it seems possible to develop an autonomous interpretation of the concept of dependent services,[1] some authors tend to apply their own domestic law when interpreting Art. 15.[2]

Art. 15 does not cover every type of income from dependent services. Art. 16 (Directors' fees) of the OECD Model is a special provision in relation to Art. 15 which covers certain kinds of income from dependent services.[3] Income received by members of a supervisory board clearly falls under Art. 16. It is in dispute, however, whether Art. 16 also covers income received by board members who fulfil mainly management functions.[4]

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Rosenbloom, H. David, "US Source Rules: Building Blocks of Cross-Border Taxation", and Andersson, Krister, "An Economist's View on Source versus Residence Taxation – The Lisbon Objectives and Taxation in the European Union", both in the October 2006 issue of the *Bulletin*;

Kemmeren, Eric C.C.M., "Source of Income in Globalizing Economies: Overview of the Issues and a Plea for an Origin-Based Approach", and Halkyard, Andrew, "Source of Profits Rules in Hong Kong – Analysis of a 'Troublingly Successful System'", both in the November 2006 issue of the *Bulletin*; and

Easson, Alex, "Common Law Approaches to the Determination of the Source of Income: Pragmatism over Principle", and Mössner, Manfred, "Source versus Residence – an EU Perspective", in the December 2006 issue of the *Bulletin*.

The paper presented by Michael Lang at the seminar was based on a previous publication by him, "Public Sector Pensions and Tax Treaty Law", in *Regards Critiques et Perspectives sur le droit et la fiscalité, Liber Amicorum Cyrille David (2005)*, at 223.

1. See Lang and Zieseritsch, "Der Begriff der unselbständigen Arbeit nach Art 15 OECD-MA, in Gassner et al. (eds.), *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen* (2003), at 46.
2. See Loukota, H., "Grundsatz für die steuerliche Behandlung international tätiger Gastprofessoren", *SWI* 1998, at 456; and *Internationales Steuerfälle* (1989), marginal number 714 et seq.
3. Vogel and Lehner, *DBA* (4th ed., 2003), Art. 16, marginal number 4.
4. See Lang, "Grundsatzerkenntnis des VwGH zur DBA-Auslegung", *SWI* 1996, at 427; VwGH, 31 July 1996, 92/13/0172, *ÖStZB* 1997, at 235; Urtz, "Geschäftsführervergütungen nach dem neuen DBA Österreich–Deutschland", in Gassner, Lang and Lechner (eds.) *Das neue Doppelbesteuerungsabkommen Österreich–Deutschland* (1999), at 135; Toifl, "Die Besteuerung

The borderline between Arts. 15 and 17 (Artistes and sportsmen) of the OECD Model is also not entirely clear. If an artiste or athlete who is employed receives advertising or promotional fees, Art. 15 may be applicable if the advertising and promotional activities are not directly or indirectly linked to a certain performance.[5] Other authors argue that Art. 17 does not apply at all to promotional fees.[6]

The distinction between Arts. 15 and 19(1) (Government service) of the OECD Model is clear. Art. 19(1) applies if "salaries, wages and other similar remuneration [are] paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority". Income from dependent services rendered in the public sector is not covered by Art. 15, but Art. 19(3) provides an exception to this rule: if the services are rendered "in connection with a business carried on by a Contracting State or a political subdivision or a local authority", the income does not fall under Art. 19(1), but under Art. 15. The purpose of Art. 19(3) is clearly to treat employees who work in the public sector the same way as those who work in the private sector if the public sector is engaged in market activities.[7] What that means is not so clear. Helmut Loukota emphasizes that Art. 19 is inapplicable if the business activity is profitable.[8] Mike Waters, however, thinks that making a profit from such an activity does not necessarily mean that a business is carried on.[9]

2.2. Art. 15 versus Art. 18 of the OECD Model

Art. 15 of the OECD Model applies exclusively to remuneration paid for present employment. Remuneration for past employment falls under Art. 18 (Pensions) if Art. 19(2) does not apply. The borderline is sometimes difficult to draw, especially in cases of e.g. a severance payment designed to ease the burden on employees moving to another job or switching to another profession,[10] "golden handshake" payments or lump-sum payments.[11] At least in the past, however, there was often no need to distinguish between these two rules: pensioners were not very mobile and after retirement they often remained in the country in which they had worked. Therefore, the taxing rights remained with the residence state under Art. 18. This has recently changed. Individuals who were raised in one country and worked their whole business life in one country often move to another country after they retire.

These issues affect the balance between the contracting states in terms of tax revenues. In many countries, contributions to pension funds or other pension schemes are deductible by the employer or employee. Employees get a tax deferral because the part of an employee's income that is contributed to a pension arrangement is exempt from tax, as is the income earned in the arrangement. The pension benefits from these arrangements are taxable upon receipt. Other countries do not exempt contributions to pension schemes and consequently do not tax pension benefits.[12] If an employee changes his or her residence to a country where – for whatever reason – pension benefits are not taxed, the mismatch in the approaches adopted by the two countries results in no tax at all being payable on the relevant income. The former residence state is concerned about the loss of tax revenue if it grants a deduction for the pension contributions, but is not in a position to tax the pension benefits when the pensioner receives them. Many countries have already responded to these concerns by concluding tax treaties not in line with Art. 18 of the OECD Model.[13]

2.3. Art. 18 versus Art. 19(2) of the OECD Model

Art. 18 of the OECD Model does not cover all types of pensions. According to Art. 19: "pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority" fall under Art. 19(2). The taxing rights are either exclusively with that state or exclusively with the other contracting state "if the individual is a resident of, and a national of, that State".

von Geschäftsführern, Vorständen und Aufsichtsräten international tätiger Unternehmen", in Gassner and Lang (eds.), *FS 30 Jahre Steuerrecht* (1998), at 384.

5. Rief, "Künstler und Sportler", in Gassner, Lang and Lechner (eds.), *Aktuelle Entwicklungen im Internationalen Steuerrecht* (1994), at 278; Loydolt, "Künstler und Sportler im DBA-Recht", *SWI* 1996, at 392; Großmann, *Die Besteuerung des Künstlers und Sportlers im internationalen Verhältnis* (1992), at 113; Sandler, *The taxation of international entertainers and athletes* (1995), at 184; Para. 9 of the 2003 Commentary on Art. 17 of the OECD Model; Vogel, *DBA* (3rd ed., 1996), Art. 17, marginal number 20a.

6. Görl, *Die freien Berufe im Internationalen Steuerecht der Bundesrepublik Deutschland* (1983), at 161 et seq.; Schrettl, *Rechtsfragen der beschränkten Steuerpflicht* (1994), at 234; Artner, "Einkünfte von Künstlern aus der Überlassung von Namens- und Bildrechten", *SWI* 2001, at 253; Wassermeyer, "Der Künstlerbegriff im Abkommensrecht", *IStR* 1995, at 555.

7. Rodi, in Vogel and Lehner, supra note 3, Art. 19, marginal number 84; Baker, *Double Taxation Convention*, at 19 B.06.

8. Loukota, H., in Kolb, Lang, Loukota, Walburger, Waters and Wolff, "Employment Income Under Tax Treaty Law – Case Studies", *SWI* 2002, at 523.

9. Waters, in Kolb et al., supra note 8, at 525.

10. There are cases, especially in the Netherlands, in which severance payments were regarded as a pension (Supreme Court, 26 August 1981, *BNB* 1981/307) or as income from dependent personal services (Supreme Court, 10 February 1999, *BNB* 1999/153). On the other hand, the Administrative Tax Court of Denmark considered a golden handshake to fall under the "other income" article of the Denmark–Switzerland tax treaty; *Tax News Service* (1998), Nos. 51/52 at 432.

11. See BFH, *Bundessteuerblatt* II 757 (1973) regarding Germany's 1931 treaty with Switzerland; Vogel, *Klaus Vogel on Double Taxation Conventions* (3rd ed., 1997), Art. 18, marginal number 12; Schuch and Stefaner, "Abfertigungen und Abfindungen im DBA-Recht", in Gassner et al. (eds.), supra note 1, at 254; and Mössner, General Report on Subject II: International tax aspects of deferred remunerations", in *Cahiers de droit fiscal international*, Vol. LXXXVb (2000b), at 25, 55 et seq. (54th Congress of the International Fiscal Association, Munich, 2000).

12. Gutmann, "Tax Treatment of Pensions – A Comparative Analysis", 41 *European Taxation* 12 (2001), Supplement No. 1, at S-8, S-9; García Prats, "The Tax Treatment of Cross-Border Pensions from an EC Law Perspective", id. at S-12, S-20; Avery Jones, "A Framework for Evaluating the Commission's Tax Proposals for Occupational Pensions in the European Union", id. at S-27.

13. See Art. 18(2a) of the 1999 Netherlands–Portugal treaty, Art. 18(3) of the 1980 France–Mauritius treaty, Art. 18(2) of the 2001 Belgium–Netherlands treaty, Art. 18(3) of the 1988 Indonesia–Norway treaty, Art. 18(4) of the 1979 Indonesia–Canada treaty, Art. 18(2) of the 1990 Italy–Mauritius treaty, and Art. 18(2) of the 2000 Georgia–Italy treaty.

Art. 19(2) is drafted along the lines of Art. 19(1) of the OECD Model. The underlying principles of Arts. 19(1) and (2) are quite similar: the taxing rights are with the "state of funds" if the dependent services were rendered to this state or a subdivision or authority. Contrary to Art. 18, the taxing rights also remain with that state with respect to the pension benefits received by the employee after retirement. If the employee is a resident of the other contracting state, the taxing rights are – under certain conditions – with the residence state. Both Arts. 19(1)(b) and (2)(b) contain exceptions to the "state of funds" principle enshrined in Arts. 19(1)(a) and (2)(a).

There are, however, differences between Arts. 19(1)(b) and (2)(b). According to Art. 19(1)(b), the "other Contracting State" has the exclusive taxing rights if the services are rendered in that state, if the individual is a resident of that state, and if the individual is either also a national of that state or did not become a resident of that state solely for the purpose of rendering the services. According to Art. 19(2)(b), the "other Contracting State" may tax the pension if the individual is both a resident and a national of that state. Therefore, if a person is a resident and national of State A, but works for the government of State B in State B, State B has the exclusive taxing rights with respect to his or her employment income. After the person's retirement, State A has the exclusive taxing rights if the person maintains his or her residence in State A. On the other hand, if a person has always been a resident of State A, but a national of State B, and works for the government of State B in State A, State A has the exclusive right to tax his or her employment income. After the person's retirement, State A is not allowed to levy its income tax on his or her pension benefits since the person is a national of State B. The exclusive taxing rights are with State B.

3. Splitting the Pension

3.1. Arts. 18 and 19(2) of the OECD Model

In modern times, employees increasingly do not have the same employer during their entire working life, and employees in the public sector often switch to the private sector, and vice versa. If they participated in one pension scheme while having different employers, part of their pension could be allocated to Art. 18 and part of it to Art. 19(2) of the OECD Model.

In November 2003, the OECD has published a discussion draft entitled "*Tax Treaty Issues Arising from Cross-Border Pensions*"[14] which assumed that social security pensions could fall under either Art. 18 or 19(2) depending on whether the services were rendered to a state or a subdivision or authority thereof, with the exception of services referred to in Art. 19(3). The OECD is correct in assuming that it could be necessary to draw a borderline between those provisions, but this is also true for pension schemes other than a mandatory social security system.

3.2. Art. 21 of the OECD Model

The authors of the OECD discussion draft further assumed that Art. 21 (Other income) of the OECD Model could also apply to social security payments: "This would be the case, for instance, of payments made to self-employed pensions as well as a pension purely based on resources, on age or disability which would be paid regardless of past employment or factors related to past employment (such as years of employment or contributions made during employment)."

Mike Waters pointed out that Art. 21 could also apply to payments for periods of maternal leave or unemployment.[15] This opinion is consistent with the approach developed in the OECD discussion draft mentioned above insofar as the pensions are paid regardless of past employment. If the payments are granted under the condition that the beneficiary was employed at least once for a certain period of time even if he or she became unemployed later, the income is related to past employment. In such a situation, the authors of the OECD discussion draft would not apply Art. 21, but as Ulrich Wolff pointed out,[16] other authors would not apply Art. 21 at all to pensions.

3.3. Criteria for splitting

After the applicable articles of the OECD Model have been identified, it must be determined how the income should be split between Arts. 18, 19(2) and 21. Helmut Loukota, Ulrich Wolff and Mike Waters have different opinions on this issue. Helmut Loukota's view is that the amount of employment income received by a pensioner during the period he or she was active is the relevant factor: if 60% of an employee's total employment income was earned in the private sector, 60% of his or her pension should fall under Art. 18.[17] Ulrich Wolff focuses on the time of employment as the basis for splitting the pension. If the same employee, who earned 60% of his or her total employment income in the private sector, worked ten years in the private sector and ten years in the public sector, 50% of his or her pension should be covered by Art. 18.[18] Mike Waters shares the view that the basis of apportionment could vary with the rules of the system, in particular, with the criteria for determining the amount of the pension. If only the periods of employment are taken into account in determining the amount of the pension, the apportionment might be made only on the basis of time. If only the pension contributions are taken into account, the apportionment might be made on the basis of the amounts contributed during the person's employment in the private sector, on the one hand, and during the person's employment with

14. See www.oecd.org/dataoecd/24/40/19239649.pdf.
15. Waters, supra note 9, at 527.
16. Wolff, in Kolb et al., supra note 8, at 527.
17. Loukota, supra note 8, at 524.
18. Wolff, supra note 16, at 527. The treatment in the Netherlands is similar to the treatment described, i.e. based on the number of years of employment in each sector; see Kosters, "An Analysis of the New Tax Treaty between Belgium and the Netherlands", 41 *European Taxation* 9 (2001), at 315, 321.

the state, on the other. If the periods of employment are taken into account along with the contributions to the scheme and the investment income of the scheme, the apportionment might be made on the basis of all these factors.[19] Although there are technical and administrative difficulties, the approach proposed by Mike Waters seems to be the most convincing: in order to identify the relevant factors for allocating the pension partly under Art. 18 and partly under Art. 19(2) of the OECD Model, it is necessary to identify the factors that are relevant for determining the amount of the pension.

The situation is somewhat more complex if the pensioner had experienced period(s) of unemployment or had been on maternal leave before retirement. Payments in connection with such periods would fall under Art. 21 of the OECD Model.[20] If the amount of the pension depends on (a) the period of maternal leave or unemployment, (b) the amount of contributions made during this period by the person himself or herself or by the government or someone else, (c) the amount of income the person received during this period, or (d) the investment income of the pension scheme relating to the contributions paid for that period, these factors should be taken into account in determining the amount of income that falls under Art. 21. If the amount of the pension is not less when the periods of unemployment and maternal leave are disregarded, Art. 21 should not apply at all. This approach is justified by the fact that Art. 21 is only kind of a "last resort" for income not covered by the other treaty articles and that the other articles have priority over Art. 21.[21]

4. Is the Special Treatment of Government Pensions Justified?

4.1. Discrimination of nationals?

Dividing a pension between different articles of the OECD Model is a challenge. The complexity demonstrated above is to a certain extent due to the fact that the OECD Model and most bilateral tax treaties contain a special provision for pensions paid for past dependent services rendered in the public sector. This leads to the question whether it is justified to treat pensions differently depending exclusively on the employer's legal qualification and not on the type or place of employment. One answer could refer to Art. 19(1) of the OECD Model, which also provides a different treatment for current employment income, but this answer would not be convincing. Art. 19(1) could be challenged the same way. In addition, as discussed above, Art. 19(1) is not based on the same principles as Art. 19(2). Some employees are taxed in the "state of funds" during their employment, but their pensions are taxed in the other contracting state without the employees changing their residence or nationality, and vice versa. There is no consistency between Arts. 19(1) and (2).

If a justification for a different treatment is sought, one should look at the rules that require a justification for treating taxpayers in the same situation differently. The fundamental freedoms enshrined in the EC Treaty could be viewed as rules that require equal treatment. In the late 1990s, the European Court of Justice (ECJ) was in a position to decide a case involving a different tax treatment caused by different tax treaty rules:[22] Mrs Gilly, a national of both France and Germany who resided in France and worked for a public school in Germany, invoked the free movement of workers.[23] Although the applicable provision was a provision of the France–Germany tax treaty which was essentially the same as Art. 19(1)(a) of the OECD Model, the ECJ's reasoning is also relevant to Art. 19(2):

> Although the criterion of nationality appears as such ... for the purpose of allocation of fiscal jurisdiction, such differentiation cannot be regarded as constituting discrimination prohibited under Article 48 of the Treaty. It flows, in the absence of any unifying or harmonizing measures adopted in the Community context under, in particular, the second indent of Article 220 of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation. Nor, in the allocation of fiscal jurisdiction, is it unreasonable for the Member States to base their agreements on international practice and the model convention drawn up by the OECD, Article 19(1)(a) of the 1994 version of which in particular provides for recourse to the paying state principle. According to the commentary on that article, that principle is justified by "the rules of international courtesy and mutual respect between sovereign States" and "is contained in so many of the existing conventions between OECD member countries that it can be said to be already internationally accepted".[24]

The ECJ has been heavily – and rightly – criticized for its decision in *Gilly*. The ECJ seems to accept every treatment that is different because of a provision of a bilateral tax treaty, especially if the provision is drafted along the lines of the OECD Model.[25] The reasoning in *Gilly* is not convincing. It is clear that discrimination cannot become acceptable just because it is caused by a rule enshrined in a bilateral treaty rather than by an ordinary domestic rule. Even if the bilateral treaty is modelled after the OECD Model, there is no reason to assume that

19. Waters, supra note 9, at 525.
20. Id.
21. Avery Jones et al., "The Other Income Article of Income Tax Treaties", 44 *Bulletin for International Fiscal Documentation* 8/9 (1990), at 409; Wattel and Marres, "Characterization of Fictitious Income under OECD-Patterned Tax Treaties", 43 *European Taxation* 3 (2003), at 66, 69 et seq.; Lehner, in Vogel and Lehner, supra note 3, Art. 21, marginal number 11; Papotti and Saccardo, "Interaction of Articles 6, 7 and 21 of the OECD Model Convention", 56 *Bulletin for International Fiscal Documentation* 10 (2002), at 516.
22. ECJ, 12 May 1998, Case C-336/96, *Gilly*, [1998] ECR I-2793.
23. Id., Para. 22. Haunold, Tumpel and Widhalm, "EuGH: Doppelbesteuerungsabkommen und EG-Recht", *SWI* 1998, at 338.
24. *Gilly*, supra note 22, Para. 31; Para. 2 of the Commentary on Art. 19 of the OECD Model.
25. See Vogel, "Some observations regarding '*Gilly*'", and Vermeend, "Tax policy in Europe", *EC Tax Review* 1998/3, at 150 and 156, respectively; ECJ, 5 July 2005, Case C-376/03, *D*, [2005] ECR I-5821; Cordewener and Reimer, "The Future of the Most-Favoured-Nation Treatment in EC Tax Law – Did the ECJ Pull the Emergency Brake without Real Need? – Part 2", 46 *European Taxation* 7 (2006), at 291; Schuch, "Critical notes on the European Court of Justice's *D* case decision on most-favoured-nation treatment under tax treaties", *EC Tax Review* 2006/1, at 6; and Lang, "Das EuGH-Urteil in der Rechtssache *D*. – Gerät der Motor der Steuerharmonisierung ins Stottern?", *SWI* 2005, at 365.

the OECD Model is sacrosanct.[26] Distinguishing between public and private employers[27] or between employees who are residents of the same state but nationals of different states has nothing to do with "international courtesy" or "mutual respect between sovereign States". The argument that such a provision "is contained in so many of the existing conventions" and is therefore "already internationally accepted" is unusual, especially if other decisions of the ECJ are considered. The ECJ usually takes the position that a breach of European law is still a breach of European law even though not all the Member States have complied with the law.[28] The number of states breaking the law usually does not impress the ECJ or influence its decisions.

Although the ECJ's reasoning is not convincing, the result of its decision seems to make sense, at least if it is applied to Art. 19(2) of the OECD Model: if a national and resident of one contracting state is exempt from tax in the "state of funds", he or she is better off than a resident of the same state who is a national of the "state of funds", at least if one considers exclusively the tax burden in the "state of funds" or if one considers the overall tax burden and the tax rate is higher in the "state of funds". This means that, in the circumstances mentioned above, foreigners may get preferential treatment compared to nationals. According to the case law of the ECJ, this result does not constitute an infringement of the fundamental freedoms. If this situation is seen from the perspective of the residence state, the residence state has the exclusive taxing rights if the resident is also a national of that state, but it loses its taxing rights if the resident is not a national of that state. Again, foreigners are better off than nationals in the residence state.

4.2. Discrimination of the private sector?

In *Gilly*, the ECJ considered the worker, but not the employer, because the ECJ's examination is determined by the preliminary questions submitted by the national court. If Arts. 18 and 19(2) of the OECD Model are compared from the employer's viewpoint, public employers might benefit in specific situations: a private employer might conclude contracts with employees who are residents of the other contracting state. When they receive a pension, the taxing rights will stay with their residence state even if the pensioners are nationals of the state in which they rendered dependent services. Therefore, in the case of pensioners who are nationals of the employer's state but residents of the other contracting state, pensioners who were employed in the public sector benefit in their residence state since the only taxing rights are with the "state of funds". If the level of taxation in the residence state is higher than in the "state of funds", the employee's overall tax burden is higher if he or she used to work in the private sector. Taking this into account, the public sector might be seen as having an advantage finding employees who are residents of the other contracting state and nationals of the "state of funds" since their tax burden is lower – at least after retirement.

The question could arise whether this is in accordance with the fundamental freedoms of the EC Treaty, especially the freedom of services. Of course, the different treatment of private and public-sector employees as such does not violate the freedom of services. However, a private enterprise that seeks access to the market of another EU Member State and wants to employ residents of that Member State could argue that it has a disadvantage compared to a public enterprise because public-sector employees who are residents of another contracting state and work there may not be taxed in that state if they are nationals of the state of the public employer. For a private employer, employees who both work and reside in the other contracting state are taxed there even if they are nationals of the employer's state. This different treatment also applies if the employees have retired. Since the other contracting state must refrain from taxing public-sector employees, imposing tax on private-sector employees could be seen as an unjustified restriction. This does not necessarily mean that every imposition of tax in a cross-border situation is a violation of the freedoms. The fact that, in a specific cross-border situation (public employer), no tax is levied in a contracting state raises the question whether it is justified to levy tax in another cross-border situation. There, however, a problem could arise only if private and public employers who are in a comparable situation are treated differently. Therefore, the interpretation of Art. 19(3) of the OECD Model is decisive: if this provision can be interpreted so as to exclude from the application of Arts. 19(1) and (2) all situations where the public sector is engaged in market activities,[29] the problem seems to be solved.

Another question is whether treating private and public enterprises differently can constitute an infringement of the "state aid" provision of the EC Treaty. Art. 87(1) of the EC Treaty provides:

> any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.

As explained above, a private enterprise that seeks access to another Member State's market and employs residents

26. Lang, "The Binding Effect of the EC Fundamental Freedoms on Tax Treaties", in Gassner, *Tax Treaties and EC Law* (1997), at 24; Hinnekens, "Compatibility of Bilateral Tax Treaties with European Community Law. The Rules", *EC Tax Review* 1994/4, at 158; Lehner, "The Influence of EU Law on Tax Treaties from a German Perspective", 54 *Bulletin for International Fiscal Documentation* 8/9 (2000), at 461, 463 et seq.; Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why *Schumacker*, *Asscher*, *Gilly* and *Gschwind* Do Not Suffice", 40 *European Taxation* 6 (2000), at 210, 213; Dautzenberg, "Vereinbarkeit von Doppelbesteuerungsabkommen und EG-Vertrag am Beispiel der Besteuerung der Arbeitnehmereinkünfte", *DB* 1997, at 1354.

27. Wassermeyer, in Debatin and Wassermeyer, *DBA* (98th Supplement, 2006), Art. 19, marginal number 1; Rodi, supra note 7, Art. 19, marginal number 7.

28. See ECJ, 17 October 1996, Case C-283/94, *Denkavit International BV*, [1994] ECR I-05063, Para. 51.

29. See the different views of Waters (in Waters, supra note 9) and H. Loukota (in H. Loukota, supra note 8).

of that state who are nationals of the private enterprises's state could be in a worse situation than a public enterprise employing the same individuals. For employers, the employees' tax burden is often a burden since employees consider and negotiate their net income. Public enterprises could be considered as "certain undertakings".[30] Therefore, giving advantages to the public sector[31] could lead to an infringement of Art. 87 of the EC Treaty. Again, such problems can be solved if Art. 19(3) of the OECD Model ensures that all public entities engaged in market activities are excluded from the application of Arts. 19(1) and (2).

4.3. Principle of equality

The principle of equality is enshrined in Art. 14 of the European Convention on Human Rights and in most constitutions. It is not possible to analyse whether treating public-sector workers/pensioners differently from private-sector workers/pensioners is in accordance with the principle of equality. An answer can be given only after considering the specific context of the constitution which contains the provision for equality. This context may vary from constitution to constitution, but the rationale for the principle of equality is often very similar: individuals who are in a comparable situation must be treated alike unless there is an acceptable and appropriate justification for a different treatment.

Pensioners who had been employed in the private sector and those who had been employed in the public sector are often in a comparable situation. Is there really a conceptual difference between professors at state-run universities and those at private universities that justifies treating the pensions received by the former differently from the pensions received by the latter? The main reason for the special rule for pensions in Art. 19(2) of the OECD Model is historical: according to the principle of sovereignty, taxpayers who receive remuneration or a pension from one state should not be taxed on that remuneration or pension by another state.[32] Today, there is increasing doubt whether this justification is still acceptable.[33] Even if it is, one could question whether applying this principle in the tax treaty context is appropriate because Art. 19(2) works only if the taxpayer is also a national of the paying state but is taxed in the residence state in other circumstances. In the author's opinion, these questions might be raised in more and more states, and courts will have to respond sooner or later.

5. Conclusion

Art. 19 of the OECD Model is the cause of many difficulties concerning how to draw the borderline between Art. 19 and the other articles of the OECD Model. One question in particular that is not easy to answer is: In which circumstances are services "rendered in connection with a business carried on by a State" (Art. 19(3))? It is also difficult to derive the relevant criteria from the context of the OECD Model for splitting a pension that is paid partly for services rendered in the private sector and partly for services rendered in the public sector. These are practical interpretation issues.

In addition, the question arises whether there is a justification for treating public-sector pensions differently from private-sector pensions. The fundamental freedoms, the state aid rules and the constitutional provisions on equality require an appropriate justification. It is doubtful whether the principle of sovereignty is still sufficient. Therefore, there are many arguments in favour of deleting Art. 19 of the OECD Model, or deleting at least Art. 19(2). Such ideas were discussed at the 1997 IFA Congress, but they have thus far not had any effect on the OECD Model. More and more states, however, extend Art. 18 of the OECD Model to pensions referred to in Art. 19 in order to achieve a uniform treatment. The OECD Committee on Fiscal Affairs and its Working Party No. 1 should react by deleting Art. 19 of the OECD Model. The discussion of Art. 19 can serve as an example showing that the complexity of the OECD Model can be reduced.

30. See Lang, "Die Besteuerung von Körperschaften des öffentlichen Rechts aus dem Blickwinkel des gemeinschaftsrechtlichen Beihilfenrechts", in *FS Wiesner* (Linde, 2004), at 239; Lang and Riedl, "Verdeckte Ausschüttung an Körperschaften des öffentlichen Rechts", in Gröhs et al. (eds.), *Ausgliederung* (2003), at 297; and Ross, "State Aids and National Courts: Definitions and Other Problems – A Case of Premature Emancipation?", 37 *Common Market Law Review* (2000), at 406: "... it remains very difficult for a Member State to convince the Court of Justice that a measure is general and not selective in nature".

See also ECJ, 17 June 1999, Case C-75/97, *Belgium v. Commission*, [1999] ECR I-03671, where the ECJ observed that reduced social security contributions for employers in special sectors of industry satisfy the certainty element. In C-6 and 11/69, *Commission v. France*, [1969] ECR 523, Advocate-General Romer went a step further and stated that "measures which do not apply to all the undertakings in a Member State" met the certainty element.

31. Winter, "Re(de)fining the notion of state aid in article 87(1) of the EC Treaty", 41 *Common Market Law Review* 488 (2004). See ECJ, 2 July 1974, C-173/73, *Italy v. Commission*, [1974] ECR 709, Paras. 12 and 17; ECJ, 15 March 1994, Case C-387/92, *Banco Exterior de España*, [1994] ECR I-877, Para. 14; and Commission, "State aid probes into Italian direct tax incentives in favour of newly listed companies and of companies participating in trade fairs abroad", Ref. IP/04/354, date: 16/03/2004, available at europa.eu.int/comm/taxation_customs/index_en.htm.

32. See Spitaler, "Die Fortschritte der internationalen Ausgleichung der Systeme der direkten Steuern sei 1939", *StuW* 1948, at 7; and Hemetsberger-Koller, "Der wirtschaftspolitische Hintergrund des Doppelbesteuerungsabkommens zwischen Österreich-Ungarn und Preußen 1899", in Gassner et al (eds.), *Die Zukunft des Internationalen Steuerrechts* (1999), at 26.

33. Debatin and Wassermeyer, supra note 27, Art. 19, marginal number 7.