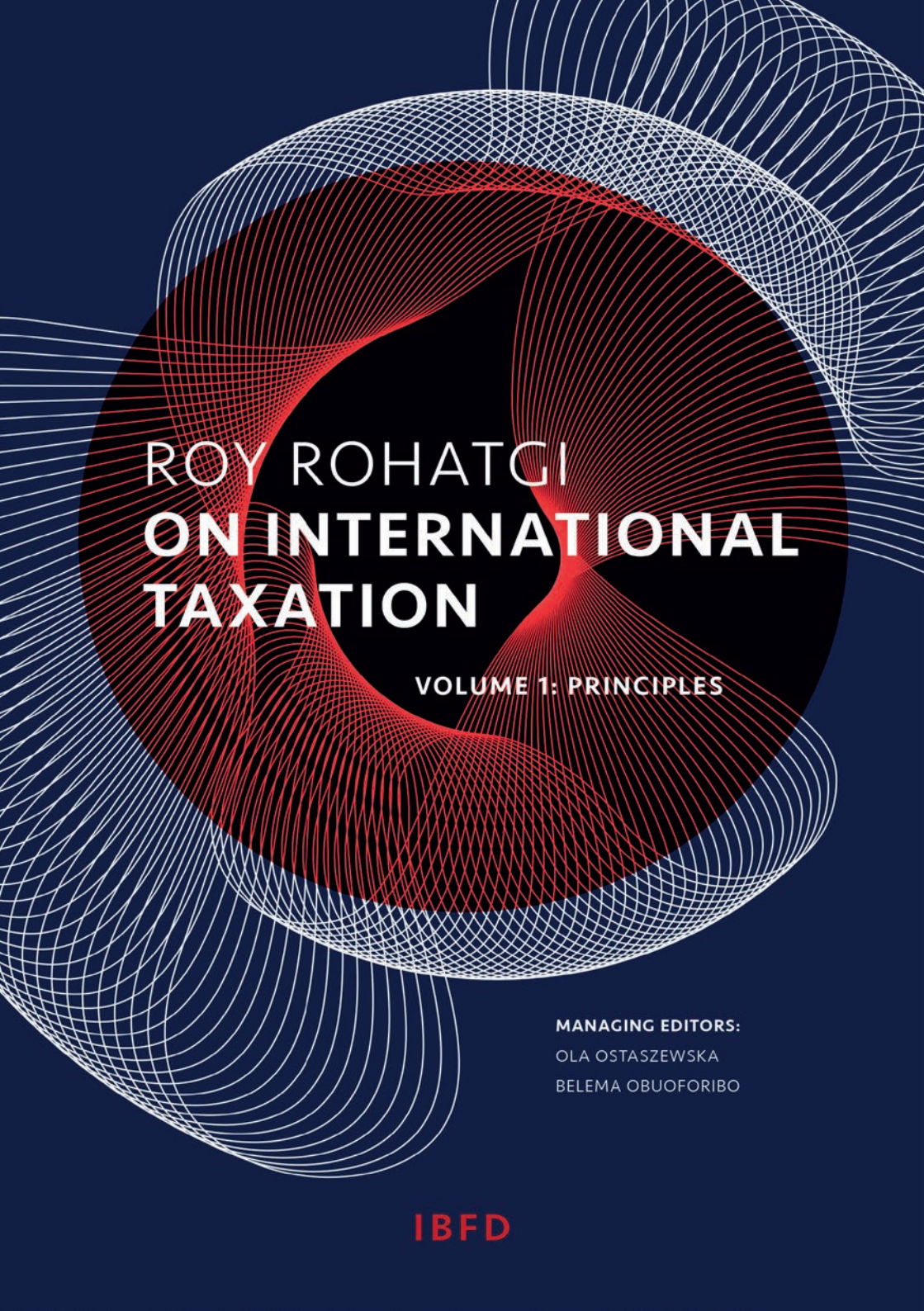

ROY ROHATGI ON INTERNATIONAL TAXATION

VOLUME 1: PRINCIPLES

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IBFD

Roy Rohatgi on International Taxation – Volume 1: Principles

Why this book?

Roy Rohatgi on International Taxation is an introductory text for practitioners and students of international tax law. For many years, this two-volume title has enjoyed a reputation as one of the leading handbooks in this complex area of taxation.With the latest rewrite of this seminal work, the authors provide in-depth treatment of the key topics in international tax, building up from detailed explanation of the basic concepts, all the way to solid analysis of the complex transactional issues. Volume 1, Principles, lays the foundation for this two-volume set. It examines international taxation through the prism of domestic law, explaining the conflicts of laws that give rise to issues seeking resolution in the international arena. This volume also introduces the reader to the world of tax treaties, crucially focusing on income and capital tax treaties, as well as on the main treaties that concern the administration and collection of taxes in the international sphere.

In its analysis of income and capital tax treaties, this book takes the OECD Model Convention as the starting point and enriches the discussion with examples from real-life treaties, as well as by contrasting provisions from other Model treaties. The book is rounded out by a generous analysis of jurisprudence from all over the world. What the reader gets is a thoroughly researched handbook, explaining the key principles of international taxation, buttressed with real-world practice and written with practical application in mind.

This volume is one of the first authoritative works to include analysis of the provisions of the updated OECD Model Convention (2017) and UN Model Convention (2017).

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List of Authors and Chapter Allocation

This book was written in its entirety by tax technical staff of IBFD. The following list gives the names of the authors, their roles at IBFD, and the chapters written by each author.

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Chapters 3, 15, 17 and 18.

Foreword

As the original author of *Basic International Taxation*, I am delighted to write the foreword to this third edition of Volume 1 of the book. The first edition was published as a single volume in 2001 by Kluwer Law International in the Netherlands. The second edition was published in two volumes in 2005 and 2008 by BNA International Inc. in the United Kingdom (hardcover) and in 2008 Taxmann Allied Services in India (paperback). This third edition, now updated in 2018 by the experts at IBFD, Amsterdam, the Netherlands will also be published in two volumes.

This latest edition is necessary to bring the book in line with today's requirements, both from a tax technical as well as a publishing aspect. The book will now include some of the content of Volume 3, which was intended to cover Current Issues in International Taxation, but which for personal reasons I was unable to finish. Furthermore, to meet the needs of today's readers, the book will be published in print as well as in electronic format.

The previous two editions were based on my own needs as a practising professional for a basic understanding of the various practical aspects of this subject, which is constantly evolving, both in content as well as application. Moreover, although this edition contains substantial changes to the original structure of the previous editions, there is no fundamental shift in content, presentation or in the approach used by me in the earlier editions. Most of the comments in the previous editions still apply. This first volume contains the same four sections on "Principles": (i) Domestic Tax Systems and International Conventions; (ii) Cross-border Taxation and International Conventions; (iii) Income and Capital Tax Treaties; and (iv) Interpretation and Application of Tax Treaties.

The work on Volume 2 dealing with "Practice" is expected to begin in 2019. Tax laws change, and tax practices evolve through new judicial decisions and interpretations provided by courts and revenue authorities in different countries, as well as by various international bodies, such as the OECD, the United Nations, the European Union and the International Fiscal Association, and research papers by international tax scholars and professionals. These changes take place continuously, and hence no single book can be relied upon solely. Nevertheless, the updates to Volume 1 and eventually Volume 2 should meet most of the needs of today's professionals and students of international taxation, regardless of their level of knowledge of the subject.

Finally, I would like to thank IBFD for providing me with their publications and access to their library in Amsterdam for my research to write this book. As much as I'd hoped to continue as the primary author of this book, time is not an ally. Hence, I am grateful to IBFD for undertaking to be the publishers of this book and, with their in-house research capability, to keep it updated for many more years to come.

Roy Rohatgi
September 2018

Preface

For many years, *Basic International Taxation* has enjoyed a reputation as a renowned primer on international taxation. In the days when international taxation occupied a niche status in many parts of the world, this two-volume book was a useful entry point for students and practitioners wishing to learn more about this field of taxation.

These days, international taxation has become mainstream. Even so, there remains a need for an introductory textbook, one that not only explains the salient principles, but also contains analyses grounded in the real-life practice of countries, as expressed in their tax treaty policy, legislation and jurisprudence. Such a book would combine a description of the relevant legal provisions with sound analysis of how these work in practice.

That is the basis for the long-awaited revision of this seminal work. It is also the basis for the collaboration between the original author (Roy Rohatgi) and IBFD.

This work is inspired by the original author's vision to teach international taxation to students and practitioners everywhere. His vision aligns clearly with that of IBFD: to spread knowledge of international taxation to every corner of the globe.

Working in tandem, we have produced this book, which is the first of a two-volume series and a relaunch of the original *Basic International Taxation*. IBFD's contribution includes a team of expert tax writers, researchers and editors. Drawing on IBFD's wealth of information on all the tax systems of the world, we have enriched this book with practical examples of country practice, set within a solid framework of commentary and analysis.

This first volume deals with the basic principles of international taxation. Volume 2 will address selected topics in international taxation, which will include transfer pricing, controlled foreign companies, selected anti-avoidance rules, and selected indirect taxes.

In recognition of the groundwork laid by the original author, this series has been renamed. Henceforth, *Roy Rohatgi on International Taxation* will continue the mission for which it was launched: to teach the principles of international taxation to students and practitioners across the globe. IBFD

is proud to take this series forward, and proud of this offering to the international tax world.

Belema R. Obuoforibo CTA ATT (Fellow)
Director, IBFD Knowledge Centre
IBFD, Amsterdam
25 July 2018

Sample Content

Introduction

1.1. General

Roy Rohatgi on International Taxation is a two-volume introductory text for students and practitioners of international tax law. The key mission of the series is to identify the crucial themes of international tax law and to explain them in an accessible manner, drawing upon examples from specific country practice, including domestic law provisions, treaty practice and court decisions.

Volume 1 provides an in-depth examination of the fundamental principles of international taxation, laying the groundwork for thorough analysis of specific practical issues, which are then dealt with in Volume 2.

This chapter sets out the structure of Volume 1, according to its constituent parts and chapters. It provides a synopsis of the entire book, showing the clear narrative built upon the structure.

The book is divided into four parts, as follows:

– Part 1: Domestic tax systems and international double taxation
– Part 2: Cross-border taxation and international conventions
– Part 3: Income and capital tax treaties
– Part 4: Interpretation and application of tax treaties

A thorough study of international taxation must have, as its starting point, a solid understanding of the relevant aspects of domestic tax law. Indeed, it is the conflict of domestic law provisions of two or more jurisdictions that gives rise to the double taxation that treaties are created to resolve.

This book proceeds from that premise. Part 1 is therefore devoted to a discussion of domestic tax systems and of their impact on international taxation. This part encompasses chapters 1 to 3.

Chapter 2 explains the key features of domestic tax systems that have an impact on international taxation. The main point here is an examination of the key bases upon which a sovereign state would, on its own terms, impose a charge to tax. The chapter examines both the residence and source

bases, highlighting the manner in which the application of these concepts could lead to double taxation.

Most states provide in their own domestic tax laws for relief from double taxation (so-called unilateral double tax relief). Where treaty relief is also available, domestic law rules may specify which relief (i.e. unilateral relief or treaty relief) should apply, and in what circumstances. Where treaty relief is not available, the taxpayer's only recourse would be to unilateral relief. Chapter 3 approaches double tax relief from the domestic tax law standpoint. (Treaty relief is addressed elsewhere in the book, with cross-referencing between both chapters, where appropriate.) Chapter 3 gives an in-depth explanation of the various methods of relief from both juridical double taxation and economic double taxation. It also highlights the main practical issues that may arise in the application of these rules.

1.2. Cross-border taxation and international conventions

Having set the reader up nicely for a foray into the world of international taxation, the book proceeds to part 2, which introduces the concept of the tax treaty. Chapter 4 explains what a tax treaty is, and the role it plays in international taxation. The chapter also explains the interaction of the tax treaty with the domestic legal framework. It highlights not just the role of a treaty in avoiding double taxation but also its role in preventing tax evasion and avoidance. As to the format that a treaty may take, chapter 5 introduces the main treaty models used by contracting states today: the OECD and UN Models for sure, these being the most predominantly used models, but also the United States Model Convention and the ILADT Model.

In explaining the concept of tax treaties, this book takes as its basis the OECD Model and its Commentaries. Where important deviations exist from both the OECD Model and Commentaries, these are also addressed in the book. Such deviations commonly exist in the specific treaties entered into by contracting states and tend to arise because such contracting states may have a different approach under domestic law, which they would naturally prefer to reflect in their tax treaties. Also, where relevant, the book addresses deviations (from the OECD Model) set out in other model treaties.

Chapters 6 and 7 go beyond models *simpliciter* and examine the application of particular classes of tax treaties. Chapter 6 addresses the main multilateral tax agreements. These include, from a mainstream perspective, the OECD Multilateral Instrument and, from a regional perspective, the

Nordic Convention, the Andean Pact and the CARICOM treaty. Chapter 7 examines the most significant treaties on administrative assistance. This chapter approaches the subject with three distinct categories: supranational agreements, multilateral agreements and bilateral agreements. Under the heading of supranational agreements, the chapter discusses the two main European Union Directives on the topic. While EU law is generally outside the scope of this volume, a discussion on administrative assistance in international taxation would be incomplete without mention of the EU law perspective. Its inclusion therefore rounds out the picture.

1.3. Income and capital tax treaties

Part 3 goes deeper into the subject of tax treaties and makes up a significant part of the book. Here the focus is on income and capital tax treaties, with the starting point being an analysis of the relevant provisions of the OECD Model and Commentaries. As stated in section 1.2., the book is enriched throughout by an examination of the key deviations (in country practice and treaty models) from the provisions of the OECD Model and Commentaries.

Part 3 can be divided into the following main categories:

– the structure of a tax treaty (chapter 8);
– the ambit of a tax treaty (chapters 9 and 10);
– treaty rules relating to particular types of income, i.e. the "distributive rules" (chapters 11 to 16);
– elimination of double taxation (chapter 17);
– provisions restricting entitlement to treaty benefits (chapter 18);
– prohibition of discrimination (chapter 19); and
– administrative provisions (chapter 20).

At this juncture, it is worth stating that international tax law extends beyond income and capital taxation, covering other direct taxes (such as inheritance tax and gift tax) and also including indirect taxes (such as VAT and customs). Some of these other topics are addressed in Volume 2 of this series.

1.3.1. The structure of a tax treaty

Chapter 8 gives an overview of the main structure of a tax treaty, taking the reader through all the provisions one would commonly find in a tax treaty. This provides a useful framework for the rest of part 3.

This book covers all the main provisions of the OECD Model (and, consequently, the provisions commonly found in standard income and capital tax treaties). In doing so, its authors have found it helpful to follow the structure laid down in the OECD Model. However, the book does not strictly bind itself to following this structure in all cases. The overriding aim is to adopt a structure that aids the reader in his journey through the text. Where this has meant deviating from the article-by-article approach, this course has been taken.[1]

1.3.2. The ambit of a tax treaty

So what exactly does a tax treaty cover? Who may avail of the benefits of a tax treaty, and which taxes come within its ambit? These two questions are dealt with in-depth in chapters 9 and 10. Chapter 9 deals with "persons covered" and "taxes covered". The discussion of "persons covered" sets the stage for a discussion of the term "resident of a Contracting State", which is then taken up fully in chapter 10.

A taxpayer may satisfy the definition of "person", and also that of "resident of a Contracting State", but may nevertheless be locked out of the tax treaty due to the operation of anti-avoidance rules within the treaty. The subject of certain anti-avoidance rules is picked up in detail in chapter 18.

Still on the subject of the scope of tax treaties: the OECD Model is reticent on several matters to do with the territorial scope of a tax treaty. This approach is also followed in this volume.

1.3.3. Treaty rules relating to particular types of income, i.e. the "distributive rules"

Having discussed entitlement to tax treaties, the book then goes on to examine the different types of income covered by the OECD Model.

Chapter 11 is a treatise in itself, dealing with active income of companies. In this regard, it covers the following topics: (i) business profits; (ii) profits from international shipping and air transport; and (iii) associated enter-

1. For example, the book does not contain a separate chapter devoted to article 3, Definitions. Rather the approach taken was to deal with the relevant parts of that article within the different chapters of the book that addressed those parts.

prises. The business profits section also includes an in-depth explanation of the concept of "permanent establishment". The chapter addresses the above three topics from the perspective of the OECD, UN and US Models, highlighting the variations in approach in all three Models.

Chapter 12 focuses on the active income of individuals, and, as such, includes the following topics: (i) income from employment; (ii) income from independent personal services; (iii) directors' fees; (iv) income from the personal activities of entertainers and sportspersons; (v) pensions; (vi) employment income and pensions from government service; and (vii) students. In keeping with the approach of the book, the OECD Model and Commentaries provide the starting point for analysis, as well as a useful reference point for deviations found in real-life country practice and in other model treaties.

Chapters 13 and 14 cover the tax treaty provisions on the main items of passive income. For chapter 13, the focus is on dividends, interest and royalties, and for chapter 14, it is on income from immovable property.

Chapter 15 is devoted to the treaty rules on the allocation of taxing rights for capital gains. The chapter is enriched by a discussion of particular vexatious issues (such as the indirect transfer of shares) that have created much controversy in recent times.

Chapter 16 covers the standard catch-all provision, i.e. the "other income", explaining both the OECD Model provision and the important deviations therefrom.

1.3.4. Elimination of double taxation

Chapter 17 discusses the tax treaty provisions on double taxation relief. As such, it complements the discussion on unilateral double tax relief, which appears in chapter 3 of this book. While the standard OECD Model provision stipulates the types of double taxation methods that may be employed under the treaty, it is left to domestic law to spell out the precise mechanisms of the application of those methods. This chapter and chapter 3 address the interplay of both forms of double tax relief. A key benefit for the reader is that the subject is approached from the two perspectives, with a helpful dovetailing of the relevant issues.

1.3.5. Provisions restricting entitlement to treaty benefits

Chapter 18 zooms in on the provisions restricting entitlement to treaty benefits. It sets the scene with an analysis of the position that obtained before the changes wrought by the OECD Base Erosion and Profit Shifting (BEPS) Project. The chapter then explains the post-BEPS treaty anti-avoidance rules. In the context of incorporating these changes into existing treaties (i.e. treaties signed before the OECD Model was revised to include the post-BEPS anti-avoidance rules), the chapter addresses the role of the OECD Multilateral Instrument in effecting these changes. There is also a discussion on relevant provisions contained in the UN Model.

1.3.6. Prohibition of discrimination

Chapter 19 deals with non-discrimination, providing deep analysis of the OECD Model provisions, with relevant analytical contrast to the UN and US Models.

1.3.7. Administrative provisions

Part 3 is rounded out by a detailed discussion of the administrative provisions commonly found within tax treaties. These are all dealt with in chapter 20. First up is the mutual agreement procedure, containing an elucidation of the relevant procedural rules under the treaty. The chapter then moves on to exchange of information, explaining the operation of the treaty provisions and highlighting the practical challenges of compliance. The chapter concludes with a scrutiny of the provisions on assistance in the collection of taxes and the extent of the potency of these provisions.

1.4. Interpretation and application of tax treaties

Part 4 takes a step back from the substantive treaty provisions (e.g. scope, distributive rules and administrative issues) and centres on the issues around the operation of the tax treaty. On matters to do with the interpretation of a tax treaty, the book takes the Vienna Convention as the uncontested starting point, with chapter 21 exploring its key provisions. This sets the stage for the next line of inquiry: the precise status of the OECD

Commentaries. Chapter 22 takes up this discussion, explaining the various possible roles of the Commentaries in the interpretation of tax treaties.

Stepping away from the OECD Commentaries, part 4 moves on to the OECD Multilateral Instrument (MLI), with focus on its far-reaching impact on the existing tax treaty network. A particular challenge of the MLI is the way in which its provisions are given effect. In contrast to an amending protocol, the MLI does not directly amend the relevant tax treaty but merely sits above it, with its provisions being read into the tax treaty and the original treaty provisions being held, one might say, in abeyance. This approach creates problems of interpretation, and these are treated in chapter 23.

Chapter 24 reminds us that treaty law does not exist *in vacuo*. Private international law has its place due to the conflict of laws of different sovereign states. Tax treaty law is a clear example of this. This chapter therefore draws the reader to a place of contemplation: the interaction between domestic law and tax treaties. This pulls up issues such as the definition of terms contained in a tax treaty and, in the case of a term not defined within a treaty, when to rely upon a definition contained within the domestic law. This chapter also considers several other knotty issues: for example, the issue of static versus ambulatory interpretation, conflicts of qualification and treaty override.

Chapter 25 shows us the full life cycle of a tax treaty – from negotiation and initialling, all the way through to suspension and termination. The book concludes, in chapter 26, with a discussion of the various dispute resolution mechanisms under domestic law and tax treaties.

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