

# Departures from the OECD Model and Commentaries

Reservations, observations and  
positions in EU law and tax treaties

# Tax Law

The main international sources of tax law are bilateral or multilateral treaties and on important source for the interpretation of the tax law is the OECD Model Tax Convention. The main international sources of tax law are bilateral or multilateral treaties and on important source for the interpretation of the tax law is the OECD Model Tax Convention.

Guglielmo Maisto / Series Editor

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# Departures from the OECD Model and Commentaries: Reservations, observations and positions in EU law and tax treaties

## Why this book?

Departures from the OECD Model and Commentaries, comprising the proceedings and working documents of an annual seminar held in Milan on 25 November 2013, is a detailed and comprehensive study of the reservations and observations made, and positions and alternative provisions taken in the OECD Model Convention and its Commentaries. The book begins by considering the role and evolution and the legal status of the reservations, observations, positions and alternative provisions in the OECD Model Convention, and by giving an analysis of their relevance in treaty negotiations. It then examines the role of the concepts enshrined in the OECD Model Convention in EU law and their relevance in the jurisprudence of the Court of Justice of the European Union. In addition, an analysis is made of the interaction between model conventions developed by certain OECD member countries and the OECD Model Convention. Lastly, a review of selected reservations, observations and positions is performed. Individual country surveys provide an in-depth analysis of the above issues from a national viewpoint in selected European and non-European jurisdictions including Australia, Austria, Belgium, China, Germany, Italy, the Netherlands, Spain and the United States.

This book is essential reading for all those dealing with tax treaty issues and EU tax law.

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## Revisiting and Reviewing “Reservations”, “Observations” and “Positions” to the OECD Model – Selected Provisions: OECD Member Countries

by Paolo Arginelli and Michael Dirkis<sup>1</sup>

### 8.1. Introduction

All OECD member countries have given undertakings to ensure that their bilateral income tax treaties conform to the OECD Model Tax Convention on Income and on Capital (OECD Model) as interpreted by the Commentary thereon.<sup>2</sup> In this respect, under the 2010 OECD Model<sup>3</sup> and its Commentary as they read on 18 July 2012, “all member countries are in agreement with the aims and the main provisions of the Model Convention.”<sup>4</sup>

Despite these undertakings, most of the 34 OECD member countries have expressed their disagreement either with some provisions of the OECD Model (reservation) or with the interpretation provided for in the OECD Commentary (observation).<sup>5</sup> As of July 2012, the OECD member countries have recorded 298 reservations and 76 observations<sup>6</sup> in respect of 24 articles of the OECD Model and the respective Commentaries. Such reservations

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2. See *Recommendation of the OECD Council concerning the Model Tax Convention on Income and on Capital, doc C(97) 195/final* (Adopted by the Council on 23 October 1997).

3. *OECD Model Double Taxation Convention on Income and Capital* (2010). Unless otherwise provided, references to the OECD Model and Commentary are to the 2010 OECD Model and Commentary as they read on 18 July 2012 respectively.

4. Para. 31, Introduction, *OECD Model*.

5. The OECD member countries that have not recorded any reservation or observation in the 2012 Commentary are Austria, Iceland, Israel and Estonia (the latter two, however, have become member countries after the last general revision of the OECD Model and Commentary, 22 July 2010).

6. Para. 30, Introduction, *OECD Model* sets out the purpose of observations. It states: “Observations on the Commentaries have sometimes been inserted at the request of member countries that are unable to concur in the interpretation given in the Commentary on the Article concerned. These observations thus do not express any disagreement with the text of the Convention, but usefully indicate the way in which those countries will apply the provisions of the Article in question.”

and observations generally do not concern departures explicitly authorized by the OECD, which indeed do not require any formal reservation or observation to be recorded, such as:

- variations in the rate of tax at source on dividends and interest;<sup>7</sup>
- the choice of the method for eliminating double taxation;<sup>8</sup>
- the adoption of optional articles or alternative/additional provisions that are mentioned in the OECD Commentary;<sup>9</sup> and
- the modification to the wording of a provision of the OECD Model in order to confirm or incorporate an interpretation of that provision put forward in the Commentary.<sup>10</sup>

This level of departure, in many respects, should not be a surprise as the OECD has noted that “it was thought necessary to leave in the Convention a certain degree of flexibility, compatible with the efficient implementation of the Model Convention.”<sup>11</sup>

The purpose of this chapter is twofold. First, it seeks to highlight this “flexibility” (i.e. the scope of the departures from the OECD Model and its Commentary) by means of broad statistical analyses on the reservations and observations recorded by the OECD member countries, as well as to investigate the possible causes and the (legal) effects thereof. Second, in light of this analysis, this chapter briefly explores the issues arising from the existence of observations and reservations raised in both the earlier chapters and the country reports.<sup>12</sup>

In order to achieve those goals, the chapter is divided into six sections, in addition to this Introduction. Section 8.2. diachronically describes the evolution of reservations and observations in the Commentary since 1963.

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7. Para. 27, Introduction, *OECD Model*.

8. *Id.*

9. Para. 31, Introduction, *OECD Model*. Similarly, “no observation is needed to indicate a country’s wish to modify the wording of an alternative or additional provision” (*id.* para. 30).

10. Para. 31, Introduction, *OECD Model*.

11. Para. 27, Introduction, *OECD Model*.

12. For a more detailed analysis of these issues, see G. Maisto, *The Observations on the OECD Commentaries in the Interpretation of Tax Treaties*, 59 Bull. Intl. Fiscal Docn. 1, p. 14 (2005); M. Lang & F. Brugger, *The Role of the OECD Commentary in Tax Treaty Interpretation*, 23 Australian Tax Forum 7, p. 101; D.A. Ward et al., *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model* (IBFD; IFA (Canadian Branch) 2005); A. Vega, ch. 2 of this volume. On the connected issue of the specific relevance of domestic law for the purpose of interpreting tax treaties, see P. Arginelli, *The Interpretation of Multilingual Tax Treaties* p. 448 et seq. and further references therein (Leiden University Press 2013).

Section 8.3. presents some general considerations about reservations and observations, which are helpful to appreciate the subsequent sections. Section 8.4. deals with the analysis of the statistical data concerning the 2010 OECD Model reservations and observations. Section 8.5. examines the reservations and observations recorded in connection with specific topics, which have been selected on the basis of the quantitative relevance of those reservations and observations. In that section, the authors discuss the possible causes and the effects of those departures and suggest viable solutions to their most evident drawbacks. Section 8.6.<sup>13</sup> deals with the second objective of the chapter, i.e. Paolo Arginelli briefly explores the problems that arise from the existence of observations and reservations in the application of the treaties, their continued relevance to treaty negotiation and the possible solutions to the issues emerging as a result thereof, including the role of domestic law concepts/definitions within tax treaties. Finally, section 8.7. draws some general conclusions on the matter.

## 8.2. Historical evolution of reservations and observations in the Commentary to the OECD Model

Although Maisto in his 2005 article on observations<sup>14</sup> noted that there were no observations in the OECD's 1963 Draft Double Taxation Convention on Income and on Capital,<sup>15</sup> there were therein 36 reservations<sup>16</sup> and two other categories of departures, these being:

- “special positions” (recognizing that the tax treatment of dividends specified in article 10 could not be applied by six member countries due to certain peculiarities of their national laws);<sup>17</sup> and

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13. This section was written by Paolo Arginelli, based in part on his doctoral thesis, *see Arginelli, supra* n. 12.

14. Maisto, *supra* n. 12, at 14.

15. *OECD Draft Double Taxation Convention on Income and Capital* (1963) [hereinafter *1963 OECD Draft*].

16. There were two in respect of article 2(1) (the United States and Canada), two in respect of article 4 (the United States and Ireland), one in respect of article 5(4) (Canada), 12 in respect of article 10 (the Netherlands, Spain, Italy (2), Portugal, France (2), Germany, Belgium (2), Turkey and Canada), four in respect of article 11 (Italy (2), Turkey and Canada); four in respect of article 12 (Austria, Italy, Turkey and Canada), four in respect of article 13 (Italy, the United States, Spain and Belgium), four by Canada in respect of articles 16, 18, 19 and 21, two in respect of article 24 (Ireland and Canada) and one in respect of article 26 (Switzerland).

17. Belgium, the United Kingdom, Ireland, Germany, Greece and Iceland.



- “certain special derogations” (recognizing that four states were unable to relinquish all taxation at source of royalties as required under article 12).<sup>18</sup>

In respect of the 1977 OECD Model,<sup>19</sup> the number of departures had grown to 132 reservations, 36 observations, 4 “special derogations”<sup>20</sup> and 13 “special positions”.<sup>21</sup> By 2005, the OECD member countries had entered 286 reservations and 69 observations in respect of the 2005 OECD Model and its Commentary.<sup>22</sup> There has been little change in the number of formal reservations and observation since July 2008, when there were 276 reservations and 84 observations in respect of the 2008 OECD Model and its Commentary.<sup>23</sup>

The problem with these purely numeric calculations as a basis for a comparison in the growth of reservations and observations is that not only have some categories of departures disappeared since 1963 (i.e. “special positions” and “certain special derogations”), but also the countries recording reservations observations have not remained static, either making new reservations and observations or withdrawing them.<sup>24</sup>

Against this background, the statistical analyses in section 8.4. provide a clearer picture of the scope of the departures from the 2010 OECD Model and its Commentary.

### **8.3. General considerations**

As previously mentioned, in the 2010 OECD Model there are 298 reservations and 76 observations posted by the 34 OECD member countries, which

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18. Greece, Luxembourg, Portugal and Spain.

19. *OECD Model Double Taxation Convention on Income and Capital* (11 April 1977).

20. These were for Greece in respect of articles 8, 13, 15 and 22.

21. The term “special positions” was not expressly used in relation to these countries (Austria, Belgium, Canada, Finland, France, Germany, Greece, Iceland, Ireland, Japan, Norway, Turkey and the United Kingdom) in the 1977 Commentary. As with the 1963 OECD Draft, the 1977 Commentary identifies the special features of each state’s domestic tax law that does not allow the tax treatment of dividends specified in article 10 to be applied.

22. *OECD Model Double Taxation Convention on Income and Capital* (15 July 2005).

23. See the 2008 Commentary.

24. For instance, with its entry into membership of the OECD, Chile alone added at least 11 reservations between 2008 and 2012.

makes an average of 8.8 reservations and 2.2 observations per country.<sup>25</sup> However, it should be noted in this respect that Austria, Estonia, Iceland and Israel have not entered any reservation or observation in the 2012 Commentary.

With regard to the Model articles, the analysis carried out has shown that six, out of the 30 articles of the OECD Model (excluding former article 14), are not subject to any reservation or observation.<sup>26</sup> The remainder have, on average, 12.4 reservations and 3.2 observations each.

Although it appears that reservations and observations are unevenly distributed between the different articles and the numbers and scope the reservations and observations posted by the various OECD member countries varies, in order to properly assess the statistical data discussed it is initially necessary to briefly highlight certain patterns that emerged in the course of the analysis.<sup>27</sup>

First, certain observations are drafted as if they were reservations and vice versa. This sometimes makes it difficult to grasp the real aim of the OECD member countries in respect of whether:

- they intend to interpret the OECD Model standard provisions included in their tax treaties differently from the way they are construed in the Commentary; or
- they reserve their right to negotiate treaty provisions different from those included in the OECD Model.

For instance, the observation in paragraph 68 of the Commentary to Article 10 provides: “Canada and the United Kingdom do not adhere to paragraph 24 above. Under their law, certain interest payments are treated as distributions, and are therefore included in the definition of dividends”. While Canada supports its observation with a twin reservation, according to which it reserves “the right to amplify the definition of dividends in paragraph 3 so as to cover certain interest payments which are treated as distributions” under its domestic law,<sup>28</sup> the United Kingdom does not. That notwithstanding, the

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25. If we exclude Iceland, Austria, Estonia and Israel, which have no reservations or observations recorded in the Commentary, from the computation of those average figures, the latter rise to 9.9 and 2.5 respectively.

26. These are articles 20 and 27 through 31.

27. A detailed analysis of the distribution of reservations and observations is made in section 8.4.

28. Para. 81 *OECD Model: Commentary on Article 10*.

United Kingdom, in order to treat certain interest payments as dividends under its treaties, often modifies the definitions encompassed in articles 10(3) and 11(3).<sup>29</sup>

Another example is represented by the two reservations recorded by Greece in the Commentary to Article 12, which read like observations.<sup>30</sup> Under paragraph 46.2, Greece states that it “does not adhere to the interpretation in the sixth dash of paragraph 11.4 and takes the view that all concerning payments are falling within the scope of the Article” and under paragraph 46.3, “Greece does not adhere to the interpretation in paragraphs 17.2 and 17.3 because the payments related to downloading of computer software ought to be considered as royalties even if those products are acquired for the personal or business use of the purchaser.”

Second, certain observations and reservations appear to be unnecessary clarifications of the relevant member countries’ perspective, which either do not depart from the interpretation set out in the Commentary or are in line with the alternative provisions explicitly allowed (and sometimes suggested) by the Commentary.

For example, in the Commentary to Article 9, Slovenia “reserves the right to specify in paragraph 2 that a correlative adjustment will be made only if it considers that the primary adjustment is justified.”<sup>31</sup> The redundancy of this reservation clearly emerges from the comparison with paragraph 6 of the Commentary to Article 9 of the OECD Model, according to which “an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm’s length.”

Similarly, in the Commentary to Article 15, Germany and Norway have reserved their right “to include an express reference in paragraph 2 to income earned by hired-out personnel of one Contracting State working in the other Contracting State, in order to clarify the understanding that the exception in paragraph 2 does not apply in situations of ‘international hiring-out

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29. See section 8.5.2.

30. Similarly, Greece’s four “special derogations” in respect of articles 8, 13, 15 and 22 of the 1977 OECD Model (previously mentioned) would have better been expressed as reservations.

31. Para. 19 *OECD Model: Commentary on Article 9*.

of labour’.”<sup>32</sup> However, this reservation appears outdated in light of the 2010 additions to the Commentary dealing with the application of article 15 of the OECD Model in the case of hiring-out of labour.<sup>33</sup>

Third, it is apparent that not all departures from the OECD Model that characterize the OECD member countries’ treaty practice are included in the Commentary as reservations. The same holds true with regard to the interpretations of OECD standard treaty provisions made by the tax authorities and the judiciaries of the OECD member countries, not all of which are (and could be) accurately reflected in the Commentary.

One of the most emblematic instances of this pattern is represented by the departures from the OECD Model that may often be found in Austria’s tax treaties. As previously mentioned, Austria has entered no reservation in the Commentary since 2009; that notwithstanding, it frequently includes provisions in its tax treaties that differ from those of the OECD Model, in particular with regard to passive income.<sup>34</sup> At the same time, since 1998, Austria has published a national model convention, which is regularly updated and which serves the same (ideal) purpose of the reservations recorded in the Commentary, i.e. making the other OECD member countries, as well as non-member countries, aware of the tax treaty policy and practice of the relevant member country.<sup>35</sup>

## 8.4. Statistical data analysis

The following analyses of the reservations and observations recorded in the Commentary seek to highlight the scope of the departures from the OECD Model and its Commentary (i.e. the “flexibility” of the OECD Model). The analysis is done on the basis of country, article, subject matter and convergence with other treaty models.

32. Para. 16 *OECD Model: Commentary on Article 15*.

33. See paras. 8.1 et seq. *OECD Model: Commentary on Article 15*.

34. See H. Jirousek, *Anmerkungen zur DBA-Politik Österreichs: eine Replik*, SWI 4, p. 157, cited in M. Wenzl, *Austria*, ch. 10 in this volume.

35. See Wenzl, *id.*

### 8.4.1. Analysis by country

The analysis of the statistical data arranged by OECD member countries produces some interesting figures.

First, when countries are ordered from highest to lowest in terms of the number of reservations and observations lodged, there appears to be no correlation between the size of a country’s economy and its propensity to record reservations and observations.<sup>36</sup> The G8 OECD member countries (i.e. the former G7)<sup>37</sup> are proportionally spread through the list. In particular, when the countries are classified into the top “5”, top “10” and top “20” in terms of the number of reservations and observations lodged the G8 OECD member countries are proportionally represented in each category.<sup>38</sup>

Second, the fact the United States ranks third with 22 reservations runs counter to the common belief that the United States influences so much of the work of the OECD in the tax field that the latter ends being a *longa manus* of the former. Although the influence of the United States on the work of the OECD is undeniable, the above data shows that the OECD Committee for Fiscal Affairs works on an actual consensus basis more than it is generally credited for and that even the leading member countries have to make frequent concessions to smaller economies.

Third, there is no common pattern among OECD member countries of recording reservations and observations (*see* Tables 2 and 3 of the Annex). While, on average, there are four reservations for each observation, there are countries that mainly record reservations and tend to avoid entering observations and countries that predominantly record observations.

The main countries that predominantly record reservations include the United States (22 reservations and 3 observations), Chile (22 reservations and 2 observations), Canada (18 reservations and 2 observations), Turkey (16 reservations and 2 observations), Australia (15 reservations and no observation), New Zealand (11 reservations and no observation) and Denmark (10 reservations and no observation).

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36. See Table 1 of the Annex.

37. The G8 OECD member countries represent  $\frac{7}{34}$  of the total OECD member countries, i.e. approximately  $\frac{1}{5}$  thereof. Such proportion rises to  $\frac{7}{32}$ , i.e. between  $\frac{1}{4}$  and  $\frac{1}{5}$ , if we exclude from the computation Israel and Estonia, which have become OECD member countries after the last revision of the OECD Model and Commentary (22 July 2010).

38. Respectively:  $\frac{1}{5}$ ;  $\frac{3}{10}$ ;  $\frac{6}{20}$ .

The main countries that predominantly record observations include Italy (6 reservations and 7 observations), Germany (5 reservations and 8 observations) and the Netherlands (1 reservation and 6 observations).

With regard to the application of tax treaties based on the OECD Model, the over-reliance on observations may lead to instances of double taxation and non-taxation. While reservations merely underscore the will of OECD member countries to discuss certain subjects in the course of negotiations,<sup>39</sup> observations speak out the interpretation of standard OECD Model provisions by the observing states, which contrasts with the generally agreed (by the other OECD member countries) interpretation recorded in the Commentary. Such a collision of interpretations may lead to instances of double taxation and non-taxation, due to the fact that the two contracting states apply the relevant tax treaty differently. This issue is dealt with in section 8.6.

#### 8.4.2. Analysis by article

The data analysis by article (*see* Table 4 of the Annex) shows a significant concentration of the reservations and observations within the Commentaries to certain articles. About 53% of the reservations and observations refer to just five articles (in descending order: 12, 5, 7, 8 and 13) and, if the analysis is extended to the first ten articles for total number of reservations and observations recorded, the percentage rises to 83%. The top two articles, i.e. 12 and 5, total 112 reservations and observations, which means about 30% of the whole.

If the analysis is carried out separately for reservations (*see* Table 5 of the Annex) and observations (*see* Table 6 of the Annex), it appears that while the distribution of the reservations substantially matches the distribution of reservations and observations (taken together), some of the articles that present the highest number of observations have not been subject to a significant amount of reservations. In particular, ten observations have been recorded in the Commentary to Article 1, while the text of that article is subject to just one reservation by the United States.<sup>40</sup> Although to a lesser extent, a similar pattern characterizes article 4.

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39. Obviously the potential treaty partner remains free to accept or reject the proposal to include those alternative or additional provisions in accordance with the principle of reciprocity (*see* para. 31, Introduction, *OECD Model*).

40. According to para. 28 *OECD Model: Commentary on Article 1*, the “United States reserves the right, with certain exceptions, to tax its citizens and residents, including certain former citizens and long-term residents, without regard to the Convention.”

Finally, a detailed analysis of the reservations and observations recorded in relation to each article reveals coexisting reservations and observations, often dealing with significantly different subject matters. For instance, in the Commentary on Article 1 there are observations concerning the application of tax treaties to partnerships, as well as observations dealing with the improper (abusive) use of tax treaties. Similarly, the Commentary on Article 5 includes reservations on the need for special provisions dealing with offshore hydrocarbon exploration and exploitation and related activities, reservations concerning service permanent establishments (PEs) and reservations dealing with the duration of construction PEs, as well as other subject matters. The Commentary on Article 12 encompasses reservations on the right to tax royalties at source, reservations on the right to include in the treaty definition of royalties income from the use of (and the right to use) industrial, commercial and scientific (ICS) equipment, as well as reservations on the definition of the source of royalties and on other matters.

In addition, the analysis has shown that certain topics are the subjects of reservations and observations in the Commentaries on different Articles of the OECD Model. For example, the issue of the qualification of an item of income as interest or as dividend for treaty purposes is the subject of reservations and observations in the Commentaries on both Articles 10 and 11. Similarly, the topic of offshore hydrocarbon exploration and exploitation and related activities has triggered reservations in connection with articles 5, 13 and 15.

#### **8.4.3. Analysis by subject matter**

The analysis made in respect of the reservations recorded in the Commentary (*see* Table 7 of the Annex) shows that a significant number of OECD member countries find certain issues not adequately dealt with by the OECD Model. Among these issues, the most relevant appear to be:

- (i) the material scope of application of article 8 and, more specifically, the meaning of the expression “profits from the operation ... in international traffic”;
- (ii) the treaty qualification of certain items of income as dividends or interest (or, to a lesser extent, as capital gains);
- (iii) the taxation of profits from offshore hydrocarbon exploration and exploitation (and related) activities;
- (iv) the possibility to tax royalties at source and the connected need to establish where royalties are sourced for treaty purposes;

- (v) the definition of royalties and, in particular, the inclusion therein of income from the use (and the right to use) of ICS equipment; and
- (vi) the interaction between the treaty mutual agreement procedure and certain domestic rules of procedure.

On the other hand, the analysis made in respect of observations (*see* Table 8 of the Annex) shows that the major departures from the agreed interpretation of the OECD Model provisions are concerned with:

- the issue whether certain payments relating to software and intangible property qualify as royalties under the OECD Model;
  - (i) the application of tax treaties to partnerships' income;
  - (ii) the interaction between domestic CFC legislations and tax treaties;
  - (iii) the material scope of application of article 8 and, more specifically, the meaning of the expression “profits from the operation ... in international traffic”;
  - (iv) the treaty qualification of certain items of income as dividends or interest (or, to a lesser extent, as capital gains); and
  - (v) the interaction between domestic anti-abuse provisions and tax treaties.

The majority of these reservations and observations are examined in section 8.5.

#### 8.4.4. Reservations and other model conventions

Another interesting feature emerging from the data analysis is that a significant number of reservations appear in line with other model conventions. In particular, all reservations recorded by the United States conform to the 2006 US Model Income Tax Convention.

Even more noteworthy is the fact that about 30% of the other reservations (i.e. the reservations recorded by OECD member countries other than the United States) are consistent with the 2011 UN Model Double Taxation Convention between Developed and Developing Countries (hereinafter UN Model). The quantitatively most relevant of these reservations concern the following subject matters:



Subject of the reservation	Amount
Duration of construction PE: 6 months	15
Royalties: taxation at source	15
Royalties: inclusion of income from ICS equipment	15
Royalties: definition of source	9
Other income: taxation at source	7
Taxation of profits from services in the source state if they are performed therein for a substantive period of time	7

In summary, it could be suggested that these reservations and observations represent the actual tax treaty practice of the OECD member countries as accurately as a 16th century map might depict the coastline of South America.

## 8.5. Selected topics

As discussed above, the objective of this chapter is to explore the scope and possible causes of departures from the 2010 OECD Model by OECD member countries. This is done in the following examination.

### 8.5.1. Reservations and observations concerning shipping, inland waterways transport and air transport

There are 23 reservations and six observations concerning article 8. These numbers do not include the departures in respect of related provisions such as the definition of “international traffic” in article 3(e)(1),<sup>41</sup> the taxation of capital gains in article 13(3)<sup>42</sup> and the taxation of employment income in

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41. For example, Chile, Mexico and the United States have recorded reservations in respect of the definition of “international traffic” (see para. 15 *OECD Model: Commentary on Article 3*). Similarly, Turkey has lodged a reservation in respect of article 8 reserving the right in exceptional cases to apply the PE rule in taxation of profit from international transport (see para. 42 *OECD Model: Commentary on Article 8*).

42. For example, consistent with their reservation in article 8, Denmark, Norway and Sweden reserve the right to insert special provisions regarding capital gains derived by the air transport consortium SAS (para. 44 *OECD Model: Commentary on Article 13*) and the United States reserves the right to tax gains from the alienation of containers (id. para. 50).

article 15(3).<sup>43</sup> These totals also do not include the permissible alternative provisions included in the Commentary on Article 8, which provides for:

- the replacement of the criterion of the “place of effective management” with that of the “residence” of the enterprise;<sup>44</sup> or
- a hybrid approach where the state of effective management of the enterprise has the primary right to tax, while the state of residence eliminates double taxation in accordance with article 23.<sup>45</sup>

It is no surprise given its economic reliance on shipping that Greece’s two reservations and three observations to article 8 have consistently been the widest in scope among those recorded by OECD member countries.<sup>46</sup> In particular, one of Greece’s reservations provides that it “will retain its freedom of action with regard to the provisions in the Convention relating to profits from the operation of ships in international traffic.”<sup>47</sup>

The most common departure recorded by member countries, however, concerns the use of the permissible alternative provisions that use the “residence” of the enterprise rather than the “place of effective management” as the criterion to allocate the primary taxing right. Spain, for example, has employed the residence of the enterprise as the relevant connecting factor in approximately one third of its tax treaties.<sup>48</sup>

43. For example, Denmark, Norway and Sweden reserve the right to insert special provisions regarding remuneration derived in respect of an employment exercised aboard an aircraft operated in international traffic by the air transport consortium Scandinavian Airlines System (SAS) (see para. 15 *OECD Model: Commentary on Article 15*). Although Australia has not lodged a reservation under most Australian treaties, the taxing rights in respect of employment income are allocated to the country where the operator of the ship or airline is “resident”, not the country where the “place of effective management” is located, and in the tax treaty with New Zealand (article 14(3)), in order to reduce compliance costs for air crew, income derived by crew members from employment exercised aboard a ship or aircraft operated in international traffic is taxable only in the country of which the crew member is a resident (see M. Dirkis & M. Burch, *Australia*, ch. 9, sec. 9.2.2.15. in this volume).

44. Para. 2 *OECD Model: Commentary on Article 8*.

45. Para. 3 *OECD Model: Commentary on Article 8*. The UN Model provides for two alternative articles in this respect: article 8 (alternative A) corresponds to article 8 of the OECD Model (with the “place of effective management” as the relevant connecting factor), while article 8 (alternative B) provides for the “place of effective management” as the relevant connecting factor for aircraft profits (article 8(1)), but allows for source taxation of shipping profits (article 8(2)).

46. The reservations are recorded at paras. 32 and 35 *OECD Model: Commentary on Article 8* and the observations at paras. 28.1, 29 and 30 thereof.

47. Para. 35 *OECD Model: Commentary on Article 8*.

48. See I.G.F. Villavicencio, *Spain*, ch. 16, sec. 16.1.1.1.2.3. in this volume.

A second common departure is in respect of the taxation of profits arising from inland waterways. As some countries:

- have few inland waterways (e.g. Spain);<sup>49</sup> or
- their inland waterways are contained within their sovereign territory (e.g. Australia, New Zealand and the United Kingdom); or
- their treaty practice is to deal with those profits under other provisions (e.g. Belgium and Germany),<sup>50</sup>

they either formally<sup>51</sup> or informally<sup>52</sup> depart from article 8(2) of the OECD Model.

The third common departure from article 8 of the OECD Model is in respect of profits from the transportation of passengers or cargo taken on at one place in a state and discharged in a different place within the same state, as well as of other “inland traffic”.<sup>53</sup> These departures are aimed at retaining traditional source taxing right.<sup>54</sup> However, given the availability of alternative wording of the definition of “international traffic” in the OECD Commentary, which effectively permits source taxation of profits from the transportation of passengers and cargo taken on at one place in a state and

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49. See Villavicencio, *id.*, at sec. 16.1.1.1.3.4.

50. See J. Bossuyt & F. Debelva, *Belgium*, ch. 11, secs. 11.2.7. and 11.3.2., and C. Schmidt, *Germany*, ch. 13, sec. 13.4.2.4., in this volume.

51. Belgium, Canada, Chile, Greece, Mexico, Slovenia, Turkey, the United Kingdom and the United States reserve the right not to extend the scope of the article to cover inland transportation in bilateral conventions (paras. 32 and 43 *OECD Model: Commentary on Article 8*). Germany, Greece and Turkey also have recorded an observation in respect of article 8(2) whereby they reserve their position as to income from inland transportation of passengers or cargo and from container services (para. 29 *OECD Model: Commentary on Article 8*).

52. Australia and Spain have no formal reservations in respect of inland waterways; rather the departure is reflected in their tax treaty practice through the definition of “international traffic” in article 3(1) or the non-adoption of article 8(2). See Dirkis & Burch, *Australia*, sec. 9.2.2.8. and Villavicencio, *Spain*, sec. 16.1.1.1.3.4. in this volume. However, Spain usually includes a provision dealing with road and train transport (*id.*).

53. See paras. 31 and 38 *OECD Model: Commentary on Article 8* concerning Australia, Canada, Hungary, Mexico and New Zealand. New Zealand also reserves (*id.* at para. 31) the right to tax as profits from internal traffic the profits from other coastal and continental shelf activities (Australia removed a similar reservation in 2010). Turkey also reserves (*id.* at para. 42) the right to broaden the scope of the article to cover transport by road vehicle.

54. For example, New Zealand’s and Australia’s reservations reflect the domestic ship charterer source rules provided for in the Land and Income Tax Assessment Act 1891 (NZ), Schedule C(1) and adopted into the colony of New South Wales in 1895 by the Land and Income Taxation Assessment Act 1895 (NSW) sec. 24 (see Dirkis & Burch, *Australia*, sec. 9.2.2.8. in this volume.

discharged in a different place within the same state (by excluding such case from the definition of “international traffic”), the continuation of a formal reservation has now become unnecessary.<sup>55</sup>

Finally, there are other minor departures. These reservations are in respect of:

- the leasing of ships and aircraft;<sup>56</sup>
- income from the use, maintenance or rental of containers used in international travel;<sup>57</sup>
- the profits derived by the air transport consortium Scandinavian Airlines System (SAS);<sup>58</sup> and
- accommodation.<sup>59</sup>

These reservations reflect the importance of these activities to those economies (e.g. the reservations by Ireland and the United States in respect of leasing of ships and aircraft reflect the importance of these leasing activities in those economies, while the reservations by Denmark, Norway and Sweden are the consequence of their joint air transport consortium and its economic significance for those countries).

55. See para. 6.2 *OECD Model: Commentary on Article 3*.

56. While the United States and Ireland reserve the right to include within the scope of article 8 income from the rental of ships and aircraft either if the ships or aircrafts are operated in international traffic by the lessee or if the rental income is incidental to profits from the operation of ships or aircraft in international traffic (paras. 39 and 41 *OECD Model: Commentary on Article 8*), the Slovak Republic and Greece – by reservation and observation respectively – preserve their right to tax under article 12 profits from the leasing of ships and aircraft (paras. 40 and 30 *OECD Model: Commentary on Article 8*).

57. Para. 39 *OECD Model: Commentary on Article 8*.

58. Denmark, Norway and Sweden reserve the right to insert special provisions regarding profits derived by the air transport consortium SAS (para. 33 *OECD Model: Commentary on Article 8*).

59. Mexico reserves the right to tax at source profits derived from the provision of accommodation (para. 36 *OECD Model: Commentary on Article 8*). The continued necessity for this reservation must be questioned as it was made in response to para. 11 *OECD Model: Commentary on Article 8* (1977), which was deleted in 2005.

### 8.5.2. Reservations and observations on the qualification of certain items of income as dividends, interest, or capital gains

The 2012 Commentary includes 19 reservations and four observations,<sup>60</sup> which concern three neighbouring issues.

The first issue arises from the fact that under the domestic tax law of several states, certain items of income from debt claims (and financial instruments other than shares) are subject to the same (or similar) tax treatment as income from shares. In such cases, it is not unusual that those states are willing to maintain such domestic law assimilation under their tax treaties.

However, the definition of “dividends” under article 10(3) of the OECD Model may constitute a barrier to the pursuit of that goal, due to the fact that those items of income cannot easily qualify as income from “other rights, not being debt-claims”, or as income from “other corporate rights”, as required by the above-mentioned definition. As reasonably put forward by some distinguished scholars, the term “income from other corporate rights” does not seem to include income from debt claims.<sup>61</sup> For it to apply “not only must the income be treated as a distribution for tax purposes, but also the income must derive from a membership right at least in non-tax law, but possibly in tax law.”<sup>62</sup>

Similarly, the definition of “interest” in article 11(3) of the OECD Model, which refers to “income from debt-claims of every kind,... whether or not carrying a right to participate in the debtor’s profits”, appears capable of preventing the treaty qualification as dividends of income from debt claims participating in profits that is assimilated to income from shares under domestic law.

In order to avoid that the wording of article 10 (and 11) might lead to a bifurcation between the domestic law and the treaty qualifications of dividend income, some OECD member countries have recorded ad hoc reservations and observations in the Commentary on Article 10 (and 11) and are used to departing from the text of that article(s) when concluding their tax

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60. These are: 9 reservations and 2 observations to the Commentary on Article 10; 9 reservations and 2 observations to the Commentary on Article 11; 1 reservation to the Commentary on Article 13.

61. J.F. Avery Jones et al., *The Definitions of Dividends and Interest in the OECD Model: Something Lost in Translation?*, 1 World Tax J., sec. 3.3. (2009), Journals IBFD.

62. Id.

## Notes



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