Tax Treaty Monitor **Prof. Dr Klaus Vogel**

In Cooperation with the IBFD's Tax Treaty Unit

Tax Treaty News

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I. DRAFT OF THE OECD MODEL'S 2002 UPDATE PUBLISHED

During the last decade, a remarkable change in the OECD's publication policy has occurred. The veil of secrecy covering the organization's internal discussions on the OECD Model Tax Convention, in particular its further development, was gradually lifted, first by seminars held in cooperation with IFA on the occasion of the IFA Congresses, subsequently by publishing discussion papers on highly topical subjects, such as the taxation of new financial instruments or of electronic commerce, to which comments were invited, and further by inviting members of the business community to committees (for example, Technical Advisory Groups or TAGs) to discuss such topics.

Now the OECD has taken another step, unheard of until now, in order to increase even more the transparency of its actions. Early in October 2001, it published the draft of the next update to the OECD Model which the Committee on Fiscal Affairs' Working Party No. 1 intends to discuss and adopt at its next meeting in February 2002 (the update can be found at www.oecd.org/pdf/M00018000/M00018559.pdf).

Though the introductory remarks to the draft update warn the reader that some drafting modifications and additional changes to the OECD Model may occur, it is highly useful for the adherents of tax treaty law to know so early what will probably come up in the near future. Further, experts will have a chance to make suggestions and observations to Working Party No. 1. According to prior experience, we may expect that the (amended) draft will be adopted by the Working Party next February and by the Committee on Fiscal Affairs in March and that the new version of the OECD Model will be published sometime between August and October 2002. (June 2002 was mentioned at the IFA Congress in San Francisco in October, but this may be a bit too optimistic.)

II. CROSS-BORDER COLLECTION OF TAXES

Like earlier updates, the present draft affects mainly the Commentaries and only to a small extent the OECD Model itself. The intended amendment to the OECD Model, however, is a far-reaching one. The former Arts. 27 to 30 will be renumbered 28 to 31 and, in a new Art. 27, the draft will introduce nothing less than a rule providing for the collection of taxes for another (the other contracting) state. Presupposing that the tax claim of a contracting state is enforceable under that state's law and that the taxpayer concerned cannot legally (by legal measures ?) prevent its collection, the other contracting state will be obliged, upon request, to collect that claim in accordance with its own laws as if the claim were its own.

The same will apply to measures of conservancy to ensure collection of the tax claim. The time limits will be those of the state requesting collection, but the general (non-tax) time limits of the collecting state will prevail. The priorities which the collecting state gives to tax claims – e.g. in cases of bankruptcy – will not apply. The procedure for making a request shall be settled by the competent authorities through mutual agreement. This, as the Commentary observes, shall include the documentation which must be enclosed in the request and the settlement of the costs incurred by the state requested to collect the other state's taxes.

It is not unlikely that states may be reluctant to oblige themselves so drastically. The Commentary on the new Art. 27 is aware of this possibility and expressly concedes that national law or policy may prevent such collection assistance or set limitations on it. The Commentary even warns (urges ?) states negotiating a tax treaty to consider the stance taken by their national law on assisting other states in collecting other states' taxes. According to the Commentary, the states should also consider whether the legal standards of the two states are similar (taxpayers' fundamental rights are explicitly mentioned in this context), whether assistance in the collection of taxes will provide balanced and reciprocal benefits to both states, whether the tax administrations of both states will be able to provide such assistance effectively, etc.

In view of all these considerations, we may expect that only a minority of states will agree on such comprehensive collection assistance as the new Art. 27 provides. The Commentary takes account of this by suggesting as an alternative a limited collection clause confined to cases of tax avoidance.

III. ELECTRONIC COMMERCE

The various discussions organized by the OECD and others on the application of double taxation treaties to electronic commerce have led to widely accepted results (though not accepted by all, see below), which now will be inserted into the Commentaries on Arts. 5 and 12 of the

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OECD Model. The new comments recognize that a web site is not a permanent establishment, but that a server may be if it is at the disposal of the enterprise in question (not just of an Internet service provider), if it is located at a certain place for a sufficient period of time and if, in addition, the operations performed by the server are not restricted to preparatory or auxiliary activities – in other words, only if the server carries on the core business of the enterprise.

Regarding the characterization of payments for digital products downloaded electronically, such as software, music or texts, the new comments distinguish between payments made by a customer to acquire the right to use the copyright in the downloaded product (e.g. to reproduce a copyrighted picture in order to put it on the cover of a book) and payments made by a customer to acquire the digitized data (e.g. for enjoying the music or reading the text). Payments of the first type constitute royalties; payments of the second type fall within Art. 7 or 13, as the case may be.

Unfortunately, at present, these views of the OECD are not recognized by all states. Only recently, a "High Powered Committee for Taxation of E-Commerce" in India delivered a report to the Central Board of Direct Taxes which, in many respects, disagrees with the OECD's contentions (see www.finmin.nic.in/fdrev.htm). In particular, the report rejects the concept of permanent establishment in general and characterizes most payments for downloading files from the Internet as royalties.

IV. OTHER AMENDMENTS TO THE COMMENTARIES

The draft update further includes in its Commentary on Art. 1 some additional examples of anti-avoidance clauses which the contracting states may choose if they consider the clauses to be desirable. In this respect, the OECD Model more and more departs from the intention of its original drafters to promote a unified tax treaty practice; instead, the OECD Model offers the member countries a diversified selection of formulas from which they are invited to help themselves. One of the new examples takes its inspiration from the long and complicated "limitation on benefits" clause of US provenance. The experience that the more complicated a rule is, the more possibilities of circumvention it provides, seems not to have been considered.

The Commentary on Art. 5 gives much more detailed guidance than before on the prerequisites for the existence of a permanent establishment. Moreover, the discussion of dependent and independent agents takes benefit from the excellent article by John Avery Jones and David Ward entitled "Agents as Permanent Establishments under the OECD Model Tax Convention", 33 *European Taxation* 5 (1993), at 154.

Finally, I should not forget to mention that the concept of "beneficial ownership", so intensively discussed in two recent monographs and on several IFA panels, receives an extended explanation in identical wording in the Commentaries on Arts. 10, 11 and 12.

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