



NATIONALITY AND NON-DISCRIMINATION OF CORPORATIONS IN THE OECD MODEL CONVENTION

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Abstract

Recently, the tax planning of Multinational Enterprises (MNEs) dominates the international taxation debate and triggered the OECD BEPS Project. The tax base erosion prompted the adoption of unilateral tax measures to target the tax planning strategies adopted by MNEs. By nature, the unilateral tax measures provide a different treatment to foreign corporations and the nondiscrimination provision of the Article 24 of the OECD Model Convention shall be observed. The present paper is aimed to discuss the nondiscrimination provision of the OECD Model Convention regarding corporations.

Keywords

International taxation. Planning of multinational enterprises. BEPS.

NACIONALIDADE E NÃO-DISCRIMINAÇÃO DE EMPRESAS NA CONVENÇÃO MODELO DA OCDE

Resumo

Recentemente, o planejamento tributário das empresas multinacionais domina a agenda do Direito Tributário Internacional e motivou o Projeto BEPS da OCDE. A erosão da base tributária ocasionou a adoção de inúmeras medidas tributárias unilaterais para coibir certas estratégias de planejamento fiscal de multinacionais. Por natureza, as medidas tributárias unilaterais autorizam tratamento tributário diferenciado para corporações estrangeiras e devem observar o correspondente ao artigo 24 da Convenção Modelo da OCDE (Não Discriminação) nos acordos sobre bitributação existentes. O presente artigo tem por objetivo discutir os dispositivos do artigo 24 da Convenção Modelo da OCDE quando aplicáveis a corporações estrangeiras.

Palavras-chave

Tributação internacional. Planejamento de empresas multinacionais. BEPS.

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1. INTRODUCTION

In the recent years, Google, Starbucks, Amazon and Apple were under severe public scrutiny regarding the tax planning strategies that allowed the payment of low or no taxes in countries where they develop substantial commercial activities. In short, by shifting income, they paid less taxes or no taxes on certain jurisdictions eroding the countries' tax bases. When tax base erosion's debate goes beyond the limits of academic circles and makes headlines in the media, the adoption of unilateral international tax measures to avoid profit shifting is inevitable. The affected countries' response should be prompt. More than a loss of revenue issue, tax base erosion is political issue. The public perception of inequality and unfairness of the tax system damages the tax system integrity. It's worth to mention that the disputed multinationals' tax planning was consistent with international and domestic tax rules taking advantage of mismatches and loopholes, although aggressive in results.

If curbing profit shift improves tax fairness, on the down side, unilateral tax measures can negatively impact the free trade of goods and services and the free movement of persons through the imposition of discriminatory tax treatment on cross border transactions. Non-discrimination rules can be found in all types of economic treaties under diverse provisions. Thus, whether or not discriminatory tax measures are justifiable involves a net of different international regimes and treaties, i.e., tax, trade and BITs. In particular, rules and principles of non-discrimination should be observed when designing, applying and interpreting such measures in order to achieve the least restrictive result on free trade and freedom of movement.

The present paper will address the nationality non-discrimination under Article 24.1, first sentence of the OECD Model Convention focusing on the interpretation and application of this provision to foreign corporations that is applicable to MNEs.

2. THE HISTORY OF THE NONDISCRIMINATION IN TAX TREATIES

The nationality non-discrimination provision on tax treaties is rooted in the tradition of Friendship, Commerce and Navigation treaties and the rationale behind non-discrimination rules is to prevent the use of tax measures as obstacles to free trade of goods and services and free movement of persons.

The League of Nations developed two Draft Models of tax treaties—London Draft Model and Mexico Draft Model- and both adopted the expression "fiscal domicile" to define the subject entitled to the non-discriminatory treatment and "nationality" to determine the subjects for comparison purposes:

1943 League of Nations London Draft Model

Article XV

A taxpayer having his fiscal domicile in one of the contracting States shall not be subject in the other contracting State, in respect of income he derives from that State, to higher or other taxes than the taxes applicable in respect of the same income to a taxpayer having his fiscal domicile in the latter State, or having the nationality of that State.

1946 League of Nations Mexico Draft Model

Article XV

A taxpayer having his fiscal domicile in one of the contracting States shall not be subject in the other contracting State, in respect of income he derives from that State, to higher or other taxes than the taxes applicable in respect of the same income to a taxpayer having his fiscal domicile in the latter State, or having the nationality of that State.

3. THE ARTICLE 24 OF THE OECD MODEL CONVENTION

The article 24.1 of the OECD Model Convention provides that “nationals of a Contracting State shall not be subject in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subject”. The term “national” is used for both purposes: determining the subject entitled to non-discriminatory tax treatment and the subject for comparison in order to establish whether or not a different tax treatment for foreign taxpayers are discriminatory.

The text of article 24.1, first sentence of the OECD Model Convention was adopted by the UN Model Convention and the US Model Convention, thus, the same problems arise irrespective of the Model adopted by the Contracting States when negotiating a bilateral tax treaty.

The present paper will follow the general rule of interpretation of treaties under article 31.1 of Vienna Convention on the Law of Treaties¹, and each relevant word or expression of the first sentence of Article 24 of the OECD Model Convention will be discussed separately.

¹ Article 31.1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.

3.1. “Nationals of a contracting state ...”

Reflecting the traditional language of commerce treaties, article 24.1 of the OECD Model Convention prohibits discrimination based on nationality. The use of “nationality” as standard for determining when a taxpayer is entitled to the benefits of a tax treaty is not the default in OECD Model which predominately uses the word “residence” instead. Then, not surprisingly, interpreting and applying that provision is a difficult and sometimes confusing task. Furthermore, the term nationality is more likely to be applicable in the context of individuals than legal persons; thus, applying the concept to legal entities may be even more troublesome.² The Model Convention Commentaries justified the assimilation of companies with individuals under the same provision based on the closely resemblance between the “legal relationship created between the company and the State under whose law it is constituted” and the “relationship of nationality in the case of individuals”.

According to Article 3.1.g.(ii) of the OECD Model Convention, the nationality of a corporation should be determined by the national law of the Contracting States: “the term national, in relation to a Contracting State, means any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State.” Usually, the nationality of a company is defined either by its place of incorporation, its place of management and control, or both under national law. An additional problem posed is whether or not the discrimination is based solely in the nationality, solely in residence, or both, when the requirements for the determination of nationality and residence of a corporation are the same. Pursuant to the Commentaries of the OECD Model Convention, discrimination between residents and non-residents are consistent with the provision since it is a “crucial feature of domestic tax systems and of tax treaties”.³ Thus, if a discriminatory tax measure is based in residence, this measure may be considered consistent with Article 24.1, although the requirements for determining nationality and residence are the same.

3.1.1. Dual nationality

The same corporation may yet be considered as national of two or more jurisdictions as nationality is determined in reference to national law. For example, if State A considers as its national any corporation which is incorporated under its law, and State B considers as its national any corporation which place of management and control is within its territory, if Corporation X is

² The OECD Report on Application and Interpretation of Article 24 (Non-Discrimination), 2007, concluded that it is “unclear how the residence of a company can be distinguished from its nationality for purposes of paragraph 1 of Article 24.”, see p. 10.

³ Model Tax Convention on Income and on Capital Condensed Version (2014), p. 353

incorporated under the laws of State A but is managed in State B, Corporation X will be considered national of both States.

In the case of dual nationality, the OECD Commentaries clarifies that discriminatory tax treatment would be impossible because the taxpayer could benefit from the most favorable treatment. Nonetheless, JONES & ALL consider that “it is possible for discrimination to take place if there is a provision of State A’s law directed against State B nationals (or foreign nationals generally), regardless of whether or not they are nationals of State A”.⁴

3.2. “... nationals of that State in the same circumstances ...”

The application of article 24.1, first sentence, requires some comparison to be made between national taxpayers and foreign taxpayers. The OECD Commentaries does not provide any guidance if the comparison should be made in relation to a specific taxpayer or a taxpayer in general. BMMENS⁵ explains that “the provision prohibits only the differential tax treatment that is based exclusively on the fact that the entity derives its status from the domestic law of another state and requires that all other relevant factors, including the residence of the entity, be the same”.

Besides, there is still the possibility that no comparable taxpayer is available to determine if the differential tax treatment is a discrimination based in nationality or not, in this case, no comparison should be made.

In *Commissioner of Inland Revenue v. United Dominions Trust Limited*, the taxpayer was a national and resident of United Kingdom received interest payments from a subsidiary national and resident of New Zealand. The interest income was taxed 5% more than the rate applicable to New Zealand resident company. Pursuant to New Zealand law, a corporation is deemed to be national from New Zealand if is incorporated in New Zealand or has its office center in New Zealand. Therefore, “in order to obtain a true comparison between the English company and a national in New Zealand it would be necessary notionally to envisage a company which is both a national of New Zealand and a resident in the United Kingdom”. Then, the decision

⁴ JONES, John F Avery & all, *THE NON-DISCRIMINATION ARTICLE IN TAX TREATIES – I*, *British Tax Review*, 1991-10, pp. 359 – 385.

⁵ BMMENS, Niels, *The Principle of Non-discrimination International and European Tax Law*, IBDF, Doctoral Series, Vol. 24, Netherlands, 2012, p. 75

found Article XIX (1) of New Zealand- UK treaty not applicable because a national New Zealand corporation will be necessarily a New Zealand resident and the comparison could not be made.⁶

The Commentaries of the OECD Model Convention clarifies that the same circumstances “refers to a taxpayer placed, from the point of view of the ordinary laws and regulations, in substantially similar circumstances both in law and fact”.⁷ Explaining the similar provision in the US Model Convention, GOLDBERG and GLICKLICH observe that “... in the same circumstances” should be thought of as referring to situations in which all the facts are identical except for the difference that is being tested, for example, resident versus nonresident, permanent establishment versus domestic corporation”.⁸

3.3. “... in particular with respect to residence ...”

This expression was included in the OECD Model Convention in 1992 as a response to a decision of the Cour de Cassation of France which considered a 3% tax on the value of immovable property owned by a non-resident that did not disclose their shareholders as indirect discrimination based on nationality.⁹ The Cour de Cassation decided that the concepts of nationality and residence were equivalent in the case of legal persons and, therefore, the imposition of such tax on non-residents was disallowed by article 24.1 of the France-Swiss Treaty.

In a prior case, the New Zealand Court of Appeal of Wellington in *Commissioner of Inland Revenue v. United Dominions Trust Limited* decided that, even though the terms nationality and residence are “somewhat artificial when applied to corporate bodies”, the language of the treaty recognized the “importance of the concept of residence as the source of taxing power and of the right of contracting parties to impose different rates or conditions of tax on companies according to residence”.¹⁰

The Commentaries follows the same orientation and explains that the expression “in particular with respect to residence” makes clear that the residence of the taxpayer is one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances.”¹¹

⁶ *Commissioner of Inland Revenue v. United Dominions Trust Limited*, New Zealand, Court of Appeal of Wellington, (1973), available at http://online.ibfd.org/kbase/#topic=doc&url=/collections/ttcls/html/cl_nz_1973-07-16_1-fulltext.html&WT.z_nav=Navigation&colid=4938

⁷ Model Tax Convention on Income and on Capital Condensed Version (2014), p. 350.

⁸ GOLDBERG, Sanford H. and GLICKLICH, Peter A., TREATY-BASED NONDISCRIMINATION: Now You See It Now You Don't, 1 Fla. Tax Rev. 51.

⁹ Cour de Cassation, Assemblée plénière, du 21 décembre 1990, 88-15.7400, publié au bulletin.

¹⁰ *Commissioner of Inland Revenue v. United Dominions Trust Limited* (1973).

¹¹ Model Tax Convention on Income and Capital Condensed Version (2014), p. 351.

3.4. "...shall not be subject ... to any taxation or requirement connected therewith which is other or more burdensome..."

The non-discrimination rule determines that no different tax or requirement connected therewith or more burdensome tax treatment should not be imposed upon a taxpayer of another State by the other State.

3.4.1. Similar Treatment

The nationality non-discrimination provision requires "no more burdensome" treatment; thus, the tax treatment of foreign taxpayers is not required to be equal to the tax treatment of national taxpayers, but similar. However, the costs of compliance with tax rules should be the same both to foreign and national taxpayers.

According to the Commentaries, the expression "... shall not be subject ... to any taxation or any requirement connected therewith which is other or more burdensome..." means that, where the same circumstances prevails among nationals and foreigners, the imposition of a tax "must be in the same form as regards both the basis of charge and the method of assessment, its rate must be the same and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals."

3.4.2. Justified discrimination

Nevertheless, some differential tax treatment based on the nationality of the taxpayer may be justified for administrative reasons, i.e., different methods of tax assessment and collection. The higher burden imposed on tax administration to collect information about a foreign taxpayer and, eventually, find assets in the case of forfeit. Thus, Article 24 of the Model Convention is aimed "to balance the need to prevent unjustified discrimination with the need to take account of these legitimate distinctions".¹²

GOLDBERG and GLICKLICH pointed that "it is difficult articulate a consistent and rational standard to apply to determine when proscribed discrimination is present".¹³

Some examples of justified differential tax treatment between foreign and national taxpayers can be found in GATS, that enumerates some discriminatory tax measures aimed at ensuring the equitable or effective imposition or collection of direct taxes are listed and considered justified for the purposes

¹² Model Tax Convention on Income and on Capital Full (2010), C(24)-1.

¹³ Idem, footnote 7.

of applying the general exception to the National Treatment provision in article XVII, footnote 6:

- (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
- (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
- (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
- (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
- (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
- (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

Although the above footnote is not part of the OECD Commentaries or any other tax treaty, it could provide some guidance about the issue based on the fact that 160 countries agreed upon it. Moreover, the measures described above are considered as justified inconsistencies with national treatment rules under GATS, which are analogous to non-discrimination provisions on bilateral tax treaties. Basically, the measures enumerated in the above footnote are adopted by tax jurisdictions in order to prevent tax base erosion and equalize administrative burdens incurred on assessing and collecting taxes from foreign taxpayers to those costs incurred in regard to national taxpayers.

4. CONCLUSION

The taxation of foreign taxpayers entails more complexities and burdens to tax administrations than the taxation of national taxpayers; therefore, it is usual to accord different tax treatment to foreign corporations in order to preserve the ability to tax and tax liability.

In order to prevent unjustified discriminatory tax treatment to foreign taxpayers, the OECD Model Tax Convention has a set of rules based on national treatment principle embodied on article 24. The paragraph 1 of article 24 provides a non-discrimination rule based on the nationality of the taxpayer.

The interpretation and application of this provision has proved to be troublesome, mainly regarding corporations, because nationality is one of the criterion for determining residence while differential treatment based on residence is considered a “crucial feature of tax systems”. Not surprisingly, national courts have reached distinct conclusions in similar cases, i.e., Cour de Cassation of France and Court of Appeal of Wellington, New Zealand.

Clearly, the use of the word “nationality” in the draft of non-discrimination provisions in tax treaties raised extra complexity to the interpretation and application of article 24.1 of the Model Convention and does not effectively grants protection against unjustified discriminatory tax measures to the foreign taxpayer.

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* **Recebido em 29 nov. 2016.**