5 July 2007

Our ref: ICAEW Rep XX/07

Your ref:

Jeffrey Owens
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OECD
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FRANCE

By email; Jeffrey.owens@oecd.org

Dear Jeffrey

APPLICATION AND INTERPRETATION OF ARTICLE 24 (NON-DISCRIMINATION)
Public discussion draft – 3 May 2007

The Tax Faculty of the Institute of Chartered Accountants in England and Wales (‘the Tax Faculty’) is pleased to respond to your request for comments on the above public discussion draft produced by the OECD Working Group and the Group’s suggested amendments of the Model Commentary to Article 24.

However, we are concerned that the approach of the Working Group is unduly harsh, and would lead to a significant narrowing of the potential scope and therefore utility of Article 24.

Moreover, the draft frequently refers to the facts of actual national cases (without stating so) and then proceeds to advocate the opposite conclusion to that arrived at in the local decision without in our view adequate justification e.g. the Andritz case decided by the French Conseil d'Etat in favour of the taxpayer regarding the breach of the Austrian/French treaty non-discrimination article ownership paragraph triggered by the then French Thin Cap rules (and prior to Austria’s admission to the EU).

The proposed changes are also frequently at odds with EU law i.e. the EC treaty freedoms and ECJ case-law. We appreciate that reference is made to the potential relevance of EU law in the Appendix, but, whilst acknowledging that there are 11 Members of OECD who are not Members of the EU, it cannot be right for the Working Group to repeatedly advocate positions which, particularly where Member states' courts have (as in the UK) significant regard to the OECD Model Commentary, would lead to those 19 Member states who are Members of both OECD and the EU breaching the EC treaty by adopting positions contrary to one or more of that treaty's fundamental freedoms.
We also question whether this is the right time to seek to change the Model commentary on Article 24, given that this is to be a main topic at the International Fiscal Association Congress in Brussels in September next year.

The Chairman, Peter Cussons, of my Large Business and International Tax Committee which prepared the attached representation has sent a copy to Mike Williams at HM Treasury and a copy of Peter’s letter is also attached.

We would welcome the opportunity to discuss our views with the Working Group.

Yours sincerely

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TAXREP 48/07 – OECD Public Discussion Draft
on the Non-Discrimination article in the OECD
Model Convention

WRITTEN RESPONSE SUBMITTED ON 5 JULY 2007 BY THE
ICAEW TAX FACULTY RELATING TO THE PUBLIC
DISCUSSION DRAFT ON THE NON-DISCRIMINATION ARTICLE
IN THE OECD MODEL CONVENTION ISSUED BY OECD ON
3 MAY 2007

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The Tax Faculty of the Institute of Chartered Accountants in England and Wales

TAXREP 48/07

HMRC Consultation Framework
INTRODUCTION

1. The OECD Working Party 1 on Tax Conventions and Related Questions set up a Working Party to examine the interpretation and application of Article 24 (Non-Discrimination) of the OECD Model Convention. The Working Group examined practical issues that have arisen in the application of the Article with a view to proposing clarification of the Commentary on Article 24.

2. A public discussion draft was issued by OECD on 3 May 2007.

3. The present document represents the comments of the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) on the public discussion draft.

4. Paragraph references are to paragraphs of the discussion draft, or, where indicated, to cited paragraphs of the OECD Model Tax Treaty Commentary.

5. We note that Working Party No. 1 intends to consult later in 2007 on a more fundamental analysis of the non-discrimination issue which could lead to changes to the text of model Article 24. In these circumstances it seems inappropriate to prioritise changes to the Commentary on the existing text of the article.

6. We also note that there is no reference in the discussion draft to the similarly worded model Article 24 of the UN Model Treaty. We consider that a fundamental analysis of the issue should address discrimination in treaties that follow the UN Model as well as those that follow the OECD Model.

GENERAL COMMENTS

7. We have a number of overriding comments, and concerns, in relation to the public discussion draft.

8. Non-discrimination is an overarching principle that should underpin the relations between modern societies to ensure that citizens and business entities are treated fairly (without discrimination). This is a principle that runs through not only Human Rights Treaties but also Investment and Trade Agreements and it should also be present in Tax Treaties.

9. Sovereign States need to ensure that they secure equal rights for their citizens which means that the reciprocal State, in the case of a Double Taxation Convention, needs to accept a non discrimination article so that equal treatment can be achieved.

10. We are concerned that many of the detailed proposals in the public discussion draft seek to negate decisions that have sought to strike down discrimination where it is has been found to exist, for example decisions by the European Court of Justice in respect of the tax systems of EU Member States. The discussion draft also seeks to negate decisions of the courts of individual countries such as the UK, France and Germany in relation to judgments which have also sought to strike down discrimination.
11. To the extent that the changes occur in the Commentary then this will present a problem in those countries, such as the UK, where the Commentary is considered to be extremely influential by, for instance, the UK courts.

12. We note that 19 of the 30 Member Countries of OECD are EU Member States and we do not believe that it is appropriate to put forward changes to the Non Discrimination Article or the Commentary that would run contrary to the relevant decisions of the ECJ in respect of the EU Treaty.

13. We suggest that if individual countries do not want to introduce a general Non Discrimination article into particular double tax conventions then they should be free not to do so and then introduce specific provision when they want to promote equality of treatment. The alternative would be to introduce a non discrimination article with a clear indication when it would be acceptable to introduce exceptions, for instance in relation to personal allowances the availability of which is restricted under many existing bilateral agreements.

14. We are aware that one of the two key topics at the 2008 Congress of the International Fiscal Association (IFA) is non discrimination. The individual country reports, which will be prepared for the Congress, will provide invaluable evidence of discrimination, and non discrimination, at the present time in a very considerable number of countries and we would have thought it sensible for the OECD to defer any firm recommendations in this area, and changes to the non discrimination article and commentary, until the IFA ‘evidence’ is available.

15. We consider that the Working Group should articulate a view in relation to the position in certain dualist Member States, such as the UK, where case law (NEC Semiconductors Limited, now known as Boake Allen Limited) has indicated that, under domestic law, there is no “relevant incorporation” of aspects of treaty non-discrimination undertakings given by the UK reciprocally as a matter of international law. Accordingly, where the court finds that the UK has levied tax contrary to a tax treaty non-discrimination article the taxpayer has no remedy in UK law. In these circumstances a non-UK resident taxpayer is unable to enforce a treaty right, even where a UK taxpayer in equivalent circumstances facing discriminatory taxation by another state in breach of Article 24 can enforce his treaty rights in that other state.

16. The language used in the relevant UK statute provisions incorporating income tax (and other) treaties into UK domestic law has long been considered to be inadequate to give full effect to typical non-discrimination articles (see, for example, the House of Commons Select Committee on Statutory Instruments First Report of Session 1993-94). Despite continued assurances that the UK Government takes its treaty obligations very seriously, to date the Government has not announced any proposals to introduce legislation to remedy this situation.¹

¹ ICAEW Tax Faculty does, however, acknowledge that in treaty negotiations where the UK is unable to persuade the treaty partner to expressly restrict the scope of the Non Discrimination Article to taxes covered by the Treaty, notwithstanding that the Non Discrimination Article may refer to “all taxes”, the UK makes it clear that under domestic law taxes other than corporation and income tax will not be protected by the Non Discrimination Article.
17. We consider that this is unacceptable, in that OECD Member States should honour the treaty or contractual undertakings they make, in the same way as nationals (whether individuals or corporates) should.

DETAILED COMMENTS

Section A - General Issues (Paragraph A1)

18. As a preliminary observation on the general approach adopted in the Commentary, we suggest that it would be helpful to articulate more clearly the distinction between discrimination by the source state and discrimination by the residence state.

Relationship with other Articles of the Convention

19. We consider that the converse should also be stated. In other words, where another Article in the Convention is silent on a particular point, it cannot be inferred that no right of redress exists under the Non-discrimination Article. This point has been the subject of litigation in the UK in the UBS case (HMRC v UBS [2007] EWCA 119, 21 February 2007), where the UK Court of Appeal has, in our view questionably, held that a reason for UBS’s claim (to repayment of UK tax credits on UK dividend income, by reference to brought forward tax losses of the UK permanent establishment of the Swiss resident bank) failing is because Article 10 (dividends) of the UK/Swiss Tax Treaty does not expressly extend the domestic (former) right of repayment under Section 243 ICTA 1988 to UK permanent establishments of Swiss resident companies.

20. We understand that UBS has been refused permission to appeal the Court of Appeal decision to the UK House of Lords.

Covert or Indirect Discrimination

21. Paragraph A-1 and paragraph 6 with the proposed new paragraph 1 of the OECD Model Commentary on Article 24 rehearses the Working Group’s view that “the Article should not be unduly extended to cover so-called “indirect” discrimination”.

22. It seems tenuous, to say the least, to suggest that different treatment of residents and non-residents, which is a fundamental feature of most systems of direct taxation can never amount to discrimination on grounds of nationality for the purposes of Article 24. The key issue is surely that comparable situations should not be treated differently and different situations should not be treated in the same way unless such treatment is objectively justified.

23. Within the EU, for example, a Member State is generally obliged by Community law to treat residents of other Member States that derive the preponderant part of their income from activities in the first state as being entitled to the same reliefs and deductions as are available to residents of that state (see Schumacker, C-279/93, ECR 95 I 225).

24. In paragraph 3, page 29 of the Annex, the Working Group note, at very high level, the possible impact of European Community law on Article 24. Accordingly, as 19 out of the OECD’s current 30 members are member states of the European Union (and 21 of the 30 are European Economic Area members), we note that
The current European Court of Justice (ECJ) case law equates indirect and direct discrimination (since the judgement in Danner C-136/00, 3 October 2002). Therefore, we do not think it is adequate for the Working Group simply to advert to EU law as an “issue(s)” that require(s) a more fundamental analysis ...”.

25. The principle of primacy of Community law requires that provisions of EC law be applied rather than the provisions of a bilateral convention concluded with another Member State. In effect, it appears that the provisions of such bilateral conventions can be implemented only so long as their application does not reduce the effect of Community law (see the Advocate General’s opinion in Elisa, C-451/05, 28 April 2007). Given that this issue affects a clear majority of OECD members – a situation that will not change if all 5 of the states invited to seek membership on 16 May 2007 ultimately join the OECD – it surely deserves to be addressed by the OECD as a priority.

26. We also note that 23 of the 30 OECD members are parties to the European Convention on Human Rights (ECHR), Article 14 of which prohibits discrimination in the enjoyment of the rights and freedoms guaranteed by the ECHR on any ground including national or social origin. It is clear from the jurisprudence of the European Court of Human Rights (Darby v Sweden, Application No. 11581/85) that discrimination on the grounds of residence can give rise in certain circumstances to a breach of Article 14 in conjunction with Article 1/1 (right to the enjoyment of possessions).

Provisions Applicable to Groups of Companies (Paragraph A-2)

27. We assume that the heading should refer to groups, rather than group. In a similar vein, paragraph 9, second sentence should, presumably, read “BIAC pointed out that the use of group (consolidated) taxation concepts has substantially expanded ....”.

28. Likewise, in paragraph 10, the second sentence should read “This issue covers national provisions for groups of companies ....”.

29. More substantively, we would observe that, as regards paragraph 9 and BIAC’s observation that a host country PE should be permitted to join with other affiliated host country entities in whatever group relief is available in the host country (with which we would concur), EU law, in our view, requires this.

30. See, in particular, the judgement against Germany in the Saint-Gobain case, C-307/97, 21 September 1999 (albeit expressly in terms that a German PE of a French company should be entitled to domestic or tax treaty relief from economic double taxation on dividends in the same way that a German resident company would be)

Entitlement of a PE to Domestic Tax Grouping/Consolidation

31. We do not agree with the conclusion reached by the Working Group at paragraph 13. The wording of paragraph 3 of Article 24 of the OECD Model Tax Treaty is “the taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting States shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities”
32. The levying of taxation, in our strong opinion, encompasses all reliefs that would be available to a domestic enterprise, including eligibility for group relief or tax consolidation. Accordingly, insofar as, for example, a UK subsidiary of a US parent company would be eligible for (sideways) group relief with a second fellow UK subsidiary, so should a UK PE be so entitled (as indeed it is under current UK domestic tax legislation since FA 2000).

33. We would similarly reject the Working Group’s conclusion at paragraph 14 viz that “the new proposed Commentary should clarify that the paragraph is similarly limited to the taxation of the enterprise itself and generally excludes issues related to the taxation of the group to which the enterprise belongs”.

Ownership Paragraph

34. Paragraph 5 of Article 24 of the OECD Model reads “enterprises of a Contracting State the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-Member State are or may be subjected”.

35. The phraseology “any taxation or any requirement connected therewith” in our firmly held view, is sufficiently wide to encompass relations with a foreign parent company and, for example, eligibility of 2 locally resident sister-subsidiaries of a foreign treaty partner parent company to local tax grouping.

Foreign Incorporated, but Locally Managed Company, Not Eligible for Local Tax Grouping

36. We note the proposed new paragraphs 11.8 and 11.9. We understand that these mirror the facts in the January 2003 German Bundesfinanzhof decision, in which the German supreme tax court held that a US company, managed in Germany, was eligible for German Organschaft or tax grouping. We consider that any addition to the OECD Model Commentary should, therefore, at the very least, take account of the German supreme tax court decision, and articulate why the working group consider that that decision should not be followed.

PEs and Entitlements as Regards Losses

37. We suggest that the opportunity should be taken to reword paragraph 24(c) of the OECD Model Commentary regarding the reference to a loss “brought out at the close of an accounting period”. It appears to us that a simple reference to a loss “in” an accounting period would suffice.

Proposed New Paragraph 24.1 to the OECD Model Commentary

38. As noted above, we do not agree. We consider it is clear from the wording of paragraph 3 that in referring to the levying of taxation, paragraph 3 encompasses rules that allow consolidation, transfer of losses or tax free transfers of property between companies under common ownership.

Proposed New Paragraph 57.2 as Regards Paragraph 5 of Article 24

39. We refer again to the relevance of EU law. As a matter of EU law, if a source Member State has a mechanism for relief of economic double taxation in an entirely domestic situation, e.g. no withholding tax on dividends paid by a locally
resident subsidiary to a locally resident parent company and exemption of that dividend in the hands of the parent company, then it must extend similar relief from economic double taxation cross border intra-EU, i.e. not levy withholding tax if, in practice, there is no credit for such withholding tax in the resident state (Denkavit, C-170/05, 14 December 2006).

**Section B - Issues Related to Paragraph 1 (the nationality clause)**

Para B-2 Interpretation of the term “in the same circumstances”

40. We do not agree with paragraph 26 of the Working Group discussion draft viz that “taxpayers with limited tax liability are usually not in the same circumstances as taxpayers with unlimited tax liability”.

41. Whether taxpayers with limited tax liability are in the same circumstances as taxpayers with unlimited tax liability is a question of fact as regards the relevant business operation.

42. Moreover, as a separate point, as a matter of EU law, it is clear that the fact that a resident of EU State A is subject only to limited tax liability in State B is not sufficient to render them non-comparable. See the judgement against Germany in the Stauffer case C-386/04, 14 September 2006.

43. Accordingly, we do not support the inclusion proposed at paragraph 28 of the new paragraph 4.1 to the Commentary.

Branch Level Interest Tax

44. Given that paragraph 3 of Article 24 is in terms of “the taxation levied on” a PE, we see no distinction, for these purposes, between a branch level interest tax, limiting deductions for interest incurred by a PE, and a supplementary corporation tax charge on a PE, in excess of the rate applicable to locally resident subsidiaries.

**Section C - Issues Related to Paragraph 3 (taxation of permanent establishments)**

Proposed New Paragraph 40 of the OECD Model Commentary

45. We consider that this paragraph should be extended to deal with branch level dividend withholding tax, i.e. to stipulate that this would be prohibited.

C-2. Comparable circumstances for purposes of paragraph 3

Charitable Activities

46. We cannot understand how the OECD Working Group can make comments which, on any view, are in breach of EU law. Specifically, paragraph 43 includes the sentence “similarly if a country restricted the preferential treatment of charitable activities to activities taking place in the country, the fact that such treatment would not apply to organisations that carry on charitable activities outside the country would not violate paragraph 3.”

47. This is contrary to the principles enunciated by the ECJ in the Stauffer case cited above.
48. We consider that charitable activities carried on in State B by a charity resident in State A must be of public benefit to State B and should be eligible for the same tax reliefs as are available to a charity resident in State B carrying on the same activities.

49. We also note that many OECD members grant tax relief to domestic charities that provide aid outside their home state, in particular to victims of disasters and to people in less developed countries, and that such policies are consistent with those of OECD governments that provide similar aid at an intergovernmental level.

50. Accordingly, we do not support the inclusion referred to at paragraph 46 of new paragraph 28.1 in the OECD Model Commentary.

Existing Paragraph 28 of the OECD Model Commentary

51. We would add that the restriction of tax advantages attaching to activities the exercise of which is reserved, on grounds of national interest, defence etc, to domestic enterprises is likely to be contrary to EU law, as being disproportionate.

C-3. Application of paragraph 3 to specific domestic provisions

Entitlement of Permanent Establishments to a Participation Exemption or Indirect Tax Credit Regime

52. We note, in relation to the discussion at paragraphs 53 to 57 of the discussion draft, that this is dealt with in the ECJ’s judgement against Germany cited above in the Saint Gobain case.

Extension to Permanent Establishments of the benefit of tax credit provisions in tax treaties with third countries

53. The proposed amendments to paragraphs 51 and 52 of the Commentary imply that source state taxation of royalties is now the exception to the general rule. While that goal may be supported by many OECD members, we doubt whether it can be said to have been achieved in the bilateral treaties concluded to date.

C-4. Paragraph 3 and transfer pricing rules

Proposed New Paragraph 24.2 to the OECD Model Commentary

54. We cannot support the inclusion of this paragraph, as again, it is contrary to EU law. See, for example, decisions of the ECJ in the Re X & Y case, C-436/00, 21 November 2002 and the de Lasteyrie du Saillant and N cases (C-9/02, 11 March 2004 and C-470/04, 7 September 2006).

55. Moreover, the proposed new paragraph 24.2 contains no discussion of the difference between a dealing within a single legal person, which is not a transaction, and an actual transfer of an asset between two legal persons, which is a transaction.

Section D - Issues Related to Paragraph 4 (deduction of expenses of permanent establishments)

56. In relation to paragraph 74 of the discussion draft and proposed new paragraph 56.1 to the Commentary, we have concerns that non-resident taxpayers
frequently encounter significant delays in securing repayments of tax to which they are entitled under the relevant treaty. While it is not unreasonable for tax authorities to impose additional information requirements in connection with payments to non-residents, we consider that such procedures should be open and transparently fair so as to enable non-residents to exercise their treaty rights to repayment within a reasonable period of time. In this connection, we note that the UK has recently adopted a policy of addressing thin capitalisation issues separately from treaty applications to apply a reduced rate of withholding tax on interest payments; this approach serves, inter alia, to facilitate the processing of such applications in a timely manner.

Section E - Issues Related to Paragraph 5 (ownership of permanent establishments)

E-1 Thin Capitalisation Rules
57. We welcome the proposed wider wording of paragraph 56 of the Model Commentary viz that disallowance only of cross-border interest (even if not re-characterised as a dividend) is contrary to paragraph 4. However, regarding paragraph 5 there is no reference to the recent judgement of the ECJ substantially against the UK in the Thin Cap GLO case, C-524/04, 13 March 2007. This makes it clear that an EU Member State cannot apply thin capitalisation provisions against another Member State, even where the level of debt is arguably greater than arm’s length, unless that situation is a “purely artificial arrangement”, designed solely to avoid national tax otherwise properly due.

58. Again, we cannot understand how the Working Group can put forward a proposal that ignores EU law binding on almost two thirds of OECD Members, as regards the applicability of domestic thin capitalisation provisions with other EU Member States.

59. We would also have expected the Working Group to refer to the French Conseil d’Etat decision in favour of the taxpayer on the Andritz case, where the French Supreme Court held that application of the then French thin cap rules against the French Subsidiary of an Austrian parent was prohibited by the ownership paragraph of the non-discrimination article of the Austrian/French tax treaty.

E-2 Interpretation of the term ‘Other Similar Enterprises’
60. We note and support the Working Group’s conclusions at paragraph 88 that “the comparator for the purposes of paragraph 5 was a domestic enterprise owned by residents”. However, we do not agree that there is “no need to clarify this issue in the Commentary as long as there was no practical reason to do so”.

61. The Working Group will, doubtless, be aware of the NEC Semiconductors Limited/Boake Allen Limited UK case referred to above, in respect of which the House of Lords’ judgement was given on 23 May 2007. The stance taken by the Working Group has, so far, been endorsed by the UK courts (High Court, Court of Appeal and House of Lords), and we believe that it would be very helpful to the international business community for the Working Group’s views on the appropriate comparator (a domestic enterprise owned by a local resident’s) to be included in the revised OECD Model Commentary.
Section F - Issues Related to Paragraph 6 (application of Article 24 to taxes not covered by the relevant treaty)

62. We note that the UK (as well as Greece, Ireland and Luxembourg) has reserved the right to restrict the application of Article 24 to taxes covered by the relevant treaty. Although the UK generally exercises this right, it has not always done so. However, a taxpayer seeking to enforce in the UK courts an Article 24 right involving a tax not covered by the treaty would have to show that the right has been incorporated into UK domestic law. As noted above, that will not necessarily be the case.

Annex - Issues that require a more fundamental analysis of the issue of non-discrimination and taxation

Section 2 - Application of provisions of non-tax agreements to taxation and relationship between Article 24 and such other agreements

63. While we support efforts to clarify the relationship between non-discrimination provisions in tax treaties to similar provisions in other treaties, we note that such work may be of limited practical benefit to UK tax payers. In the few cases where tax has not been carved out of the scope of the non-discrimination provisions of the numerous commercial and investment protection treaties concluded by the UK, it is likely that the taxpayer would not be able to enforce a treaty right because almost none of these treaties has been incorporated into UK domestic law.

ICAEW Tax Faculty
5 July 2007
WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (‘ICAEW’) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute.