Chapter 3

Double Tax Treaties

3.1. Introduction

A significant role of a double tax agreement (DTA) between two or more countries is to remove the double taxation (discussed in chapter 2), which is an impediment to cross-border trade in goods and services, and the movement of capital and people between countries. Many countries have now entered into scores of comprehensive DTAs with other countries to assist in the avoidance of double taxation.

The second purpose of a DTA is the prevention of fiscal evasion, which can reduce a country’s tax base where a taxpayer has economic connections with more than one country.

In this general context, it is particularly important to know how DTAs come about and how they are used for the benefit of taxpayers, which embark upon transactions or economic events that have international tax ramifications, and for the benefit of tax administrations in different countries, which are charged with the responsibility of protecting their state’s tax base.

This chapter provides you with an understanding of the conceptual basis, and operation, of a DTA. We will:
- explain what DTAs are and why we need them;
- look at the history of the development of DTAs;
- examine the role of model DTAs; and
- distinguish between bilateral and multilateral DTAs.

You will need to refer to the OECD and UN model DTAs from this chapter onwards. You can access these models at:

OECD model DTA:

UN model DTA:
Chapter 3 - Double Tax Treaties

3.2. What is a double tax treaty?

A DTA is often referred to as a "double tax agreement", a "double tax treaty", a "double tax convention" or simply a "tax treaty". "Tax treaty" is defined in the *International Tax Glossary* as a "Term generally used to denote an agreement between two (or more) countries for the avoidance of double taxation." The definition goes on to say that:

In fact there are various types of tax treaty of which the most common are treaties for the avoidance of double taxation of income and capital (usually known as a comprehensive income tax treaty). Such treaties are also commonly expressed to be aimed at the prevention of fiscal evasion. In avoiding double taxation, such treaties also provide for the distribution between the treaty partners of the rights to tax, which may either be exclusive or shared between the treaty partners. (…)

3.3. Purpose of double tax treaties

From their inception the raison d'être of DTAs has been the avoidance of double taxation. The solution to that problem necessarily involves taxing income only once and that leads to consideration of which country will have the taxing right. More recently, DTAs have also developed into instruments to prevent tax evasion in a cross-border context.

3.3.1. Avoidance of juridical double taxation

Typically, a DTA is an agreement between the governments of two countries (a "bilateral" treaty) – or between more than two countries (a "multilateral" treaty) – with the objective of:

- avoiding double taxation, which would otherwise arise from an international transaction or event if each country imposed its own tax on the same income or capital;
- allocating the tax imposed between the governments that are parties to the DTA; and
- preventing the evasion of taxation on those international transactions or events.

---

Para. 7 of the OECD commentary on article 1 expands on the purpose of DTAs. DTAs are primarily concerned with the taxation of cross-border income. But they often extend to the taxation of capital, which is imposed by such means as wealth taxes or land taxes. In addition, but less common, are DTAs that are concerned specifically with the avoidance of double taxation by way of inheritance, estate and gift, and other taxes, e.g. the Germany–United States Estate, Inheritance, and Gift Tax Convention (1980), the France–United Kingdom Estate Tax Convention (1963) and DTAs that address a combination of double taxation of income and inheritance taxes, e.g. the CEAO Income and Inheritance Tax Convention (1984) between the member states of the West African Community (Communauté Économique de l’Afrique de l’Ouest), i.e. Burkina Faso, Ivory Coast, Mali, Mauritania, Niger and Senegal. Furthermore, certain DTAs concern themselves with only particular types of income; for example, income from shipping and air transport. An example of such a DTA is the Netherlands–Panama Shipping and Air Transport Agreement (1997).

3.3.2. Prevention of fiscal evasion

The OECD Committee on Fiscal Affairs has summarized the purposes of DTAs in the following way:

The principal purpose of double tax conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. It is also a purpose of tax conventions to prevent tax avoidance and evasion.20

Relief from double taxation is designed to benefit taxpayers. The mechanisms to achieve that relief under a DTA look to the allocation of taxing rights between the contracting states. However, you should not overlook that the second purpose of DTAs is to prevent fiscal avoidance and evasion. This purpose is set down for the benefit of tax administrations. The OECD model DTA (2010) addresses this anti-avoidance and evasion objective primarily in four articles:

- article 7 – Business profits;
- article 9 – Associated enterprises;
- article 26 – Exchange of information; and
- article 27 – Assistance in the collection of taxes.

20. OECD Commentary on Art. 1, Para. 7.
Articles 7 and 9 are concerned with adjustments to taxable income in the respective contracting states where a taxpayer engages in transfer pricing in transactions between those states. The primary objective of these articles is to ensure that arm's length prices are applied to transactions within different divisions of a multinational company (article 7) or between different companies in an multinational group (article 9). Article 7 is discussed in chapter 10 and article 9 is discussed in chapter 11.

The exchange of information article is intended to allow the tax administrations of the contracting states to obtain all the information that they require (but to which they may not have access domestically) to ensure that their taxing rights are preserved.

Similarly, article 27 is intended to facilitate the collection of tax to which a contracting state may be entitled, but is unable to access alone. Article 27 was introduced into the OECD model DTA in 2003 and the UN model DTA only in 2011. There is no counterpart in the US model DTA. Articles 26 and 27 are examined in detail in chapter 20.

Beyond DTAs, but still in the sphere of taxation, governments enter into treaties that have the objective of facilitating mutual assistance in the exchange of information or in the collection of taxes.21

3.4. History of double tax treaties

DTAs have been around for a long time. They first appeared in what is now Germany, as treaties between certain component states of Prussia. The first bilateral DTA was entered into by Prussia and Austria in 1899. A DTA was concluded by Hungary and Austria in 1909. However, few DTAs were entered into from then until the 1920s, when, after World War I, Germany embarked upon forming a number of DTAs with its neighbours.

3.4.1. League of Nations

Also at that time, the League of Nations began investigating the problems of juridical double taxation, in response to an appeal by the 1920 Brussels International Financial Conference. In 1923 a Report on Double Taxation,

21. These types of treaties are discussed in chapter 20.
prepared by an eminent group of fiscal economists at the time, was submitted to the League's Economic and Financial Commission. That report formed the basis of the first draft model DTA, published in 1928. This model favoured allocation of taxing rights on international transactions to a taxpayer's country of residence.

Since the first draft model published in 1928 there have been a number of model DTAs put forward by various international organizations to try to establish a model that will be accepted by all as the universal basis for all DTAs.

Because the 1928 model was not broad in scope, the League of Nations established its Fiscal Committee in 1929 to consider further developments of the model. The Fiscal Committee prepared a draft multilateral DTA on the allocation of income from industrial and commercial enterprises in 1933, revised in 1935; however, that model DTA was never adopted.

The Fiscal Committee continued its work over the following decade, culminating in regional conferences in 1940 and 1943 in Mexico City of representatives of countries in North and South America. The outcome of those conferences was a new draft DTA, commonly known as the "Mexico draft". The significant feature about that draft was its underlying premise: the primary taxing jurisdiction was to be the state of source of income, a position advantageous to developing countries. The Mexico draft was reviewed in London in 1946, the outcome of which was the "London draft", which changed the underlying premise of taxing international transactions back in favour of the state of residence of a taxpayer.

The principles of the Mexico and London draft models were followed during the period 1946-1955. During that period, over 70 bilateral DTAs were signed by various countries. However, these DTAs had several gaps and consequently were not fully accepted or unanimously followed. Nevertheless, the increasing economic interdependence of European countries highlighted the importance of measures for preventing double taxation, and DTAs with uniform principles, definitions, rules and methods became increasingly desirable.

The United Nations succeeded the League of Nations (in 1945), and the newly formed Economic and Social Council of the United Nations took over

22. Professors M. Bruins (Netherlands), M. Einaudi (Italy), E.R.A. Seligman (United States) and Sir Josiah Stamp (United Kingdom).
review and development of the League's London draft. The Council established a Fiscal Commission to do this; however, by 1954 the Commission had failed to take the initiative in significantly advancing work on developing the model DTA. This role was taken up by the Organisation for European Economic Cooperation (the OEEC). The OEEC established a Fiscal Committee in 1956, which worked on a draft model bilateral DTA, which was intended to be acceptable to all member countries and to eliminate the existing problems. From 1958-1961, the Fiscal Committee prepared interim reports in the course of preparing its new model DTA.

3.4.2. OECD model double tax treaty

In 1960, the OEEC transformed into the Organisation for Economic Co-operation and Development (the OECD). Nowadays, the OECD is the predominant body driving international development of DTAs. The problem, however, is that the OECD comprises only 34 members (relative to the size of the community of nations that is concerned with international tax matters), most of which are Western states and many of which are major industrial countries, i.e. developed countries or capital exporters. It is therefore unsurprising that the first draft OECD model DTA, published in 1963, reflects the interests of the OECD membership, allocating taxing rights in favour of the country of a taxpayer's residence, as exemplified in the League of Nation's London draft.

It became apparent in the early 1970s that the 1963 draft model required work as international fiscal relations increased, tax systems became more complicated and new business sectors and organizations were emerging. The OECD's Committee on Fiscal Affairs began revising the model based on the experience gained by newly negotiated DTAs and the practical application of them. After that revision, which was not fundamental to underlying premise of the 1963 draft model, the final version of the first OECD model DTA was published in 1977. This model became the standard for bilateral DTA negotiations between states, and it was particularly appropriate as a model for DTAs between two or more developed countries.

The OECD claims that the extension and harmonization of bilateral agreements between member countries accelerated after the introduction of the 1963 model. The 179 conventions concluded by 1977, which largely

23. The main exceptions being Chile, the Czech Republic, Estonia, Hungary, Mexico, Poland, the Slovak Republic, Slovenia and Turkey.
followed the model, provided testimony to progress in ending double taxation. Furthermore, non-member countries also adopted the model both in agreements with OECD member countries and other countries. In addition, the OECD model commentary, which explains how each article of the OECD model DTA is intended to be interpreted and applied, facilitated common interpretation.

Given the premise upon which the OECD model DTA is written, and the interests of the members of the OECD, which the model served, it is not unexpected that developing countries (being capital importing countries) were not satisfied with it. In fact, while substantial progress had been made in eliminating double taxation since the OECD model DTA had been employed, only a relatively small number of agreements had been entered into between developing and developed countries. Where one country, which is a party to a DTA, is a developing country, DTAs based on the OECD model can produce a one-sided result as overall the source country gives up the tax revenue where double taxation would otherwise occur. This results from the fact that where developing countries trade with developed countries, (net) income is usually always flowing from the developing country to the developed country. So, generally, the developing country will be the net loser.

McIntyre explains the disenchantment of developing countries with the OECD model DTA this way:

The widespread success of the OECD model in the 1970s provoked a reaction from developing countries. Those countries, being outside of the OECD, were excluded from effective participation in the design of the model. Under the League of Nations, the developed countries were a dominant force in designing a model convention. Only in the Mexico draft were the interests of the developing countries given high prominence. Still, the developing countries were represented in the process of approving model conventions. With the capture of the model treaty process by the OECD, the participation by developing countries ended. They were disenfranchised at a time when the number of developing countries was increasing markedly, due in large part to the collapse of colonialism in Africa and Asia after World War II. 24

3.4.3. UN model double tax treaty

The response of the developing countries was recourse to the United Nations to develop a model DTA, which reflected their interests. An Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries was established in 1968 by direction of the UN Economic and Social Council (in 1967). That ad hoc group, to become known in 1980 as the Ad Hoc Group of Experts on International Cooperation in Tax Matters, was made up of tax officials and other tax experts from 20 developed and developing countries, who were to consider ways and means for facilitating the bilateral tax agreements between developed and developing countries. Several countries were involved along with many international organizations including the International Monetary Fund, the International Fiscal Affairs Association, the OECD, the Organization of American States and the International Chamber of Commerce. Government officials were to act in their individual capacities, rather than as formal representatives of their governments.

Through a long and arduous process, the Fiscal and Financial Branch of the Department of International Economic and Social Affairs of the UN Secretariat published a Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, based on guidelines previously devised by the Ad Hoc Group of Experts. This manual was followed in 1980 by the UN first model DTA, the United Nations Model Double Tax Convention between Developed and Developing Countries. To a large extent, the UN model DTA followed the OECD's 1977 model. However, it did grant greater taxing rights to source states, i.e. the capital importing and developing countries, particularly with respect to the taxation of business income and passive investment income.

The UN model was accompanied by a commentary which, where appropriate, reproduced the 1977 OECD model commentary. The OECD commentary was used in order to take advantage of the accumulated technical expertise embodied in that work, but also in acknowledging the widespread use of that model by the OECD member countries, not only amongst themselves, but also with non-member countries including some developing countries.

The United Nations envisaged that its model would not only lead to bilateral agreements with, and between, developing countries, but also ultimately to a worldwide multilateral convention for the elimination of double taxation.
The UN model DTA has been widely embraced by most developing countries. Some of its provisions are also included in DTAs of developed countries as well, particularly if they are also capital importing countries. Kosters (2004) points out that "after the collapse of the Eastern bloc, the newly independent states and the other Eastern European economies in transition also inserted many provisions from the UN Model in their national models."


3.5. Status of OECD and UN model double tax treaties

There are two primary factors that led to the development of the model DTAs. First, there was disagreement between countries as to the appropriate provisions to be inserted in bilateral DTAs as a policy matter. Second, there was ambiguity of language selected in bilateral DTAs to achieve the desired result.

The aim of a model DTA is to provide some guidance to countries wishing to enter into a bilateral or multilateral DTA and, ideally, to minimize the complexity and compliance costs of tax laws. The models have been developed through multilateral discussions on the basis that members would, as far as possible, follow the model. There is, however, no binding requirement or obligation to do so. Model DTAs are not enforceable.

Therefore, a model DTA is just that: a model on which real DTAs negotiated between countries can be based. In a sense, the models are the starting points for the countries' negotiations. The models are in no sense mandatory instruments to be applied by members of the OECD or United Nations (although the intention of the models' authors is that their model will be followed to a large extent). The commentaries to the models make it clear that many articles envisage that each country is free to apply its own domestic legislation and techniques in practice (e.g. particular methods of allowing foreign tax credits) and may deviate from the model in the light of a country's particular circumstances. For example, article 13(4) of the

---


Chapter 3 - Double Tax Treaties

OECD model DTA provides that capital "[g]ains derived by a resident of a Contracting State [Country R] from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State [Country S] may be taxed in [Country S]." However, the OECD commentary recognizes that:

... some States consider that [Article 13(4)] should not apply to gains derived from the alienation of shares of companies that are listed on an approved stock exchange of one of the States, to gains derived from the alienation of shares in the course of a corporate reorganisation or where the immovable property from which the shares derive their value is immovable property (such as a mine or hotel) in which a business is carried on. States wishing to provide for one or more of these exceptions are free to do so.27

In fact, many countries specifically reserve the right to deviate from a model at the time that the model provision is "agreed upon". All of the 34 OECD member states reserve their right in at least one of their DTAs to tax royalties at source, although article 12(1) of the OECD model DTA confers that right upon only the country of residence of the beneficial owner of the royalty income.28

3.6. Other model double tax treaties

There are other model DTAs besides those put forward by the OECD and the United Nations. In most cases, those other models are the basis on which a country, or a group of countries, formulates its DTAs.

3.6.1. US model double tax treaty

The United States has its own model DTA, the United States Model Income Tax Convention (2006), which is the basis of US bilateral DTAs. It reflects the interests of the United States as a capital exporting country and consequently ensures that the United States, being a country that taxes its citizens on their worldwide income, preserves its taxing rights as a country of "residence", sometimes to the detriment of the country of source of the income. This perspective is particularly evident in:

- the model’s general subservience to US domestic law (e.g. articles 1(4) and 18(8));

- the embracing of all US citizens as tax residents of the United States (which is also part of US domestic law);
- the broad notion of business profits;
- the taxation of:
  - profits of shipping and air transport operators;
  - dividends paid by US regulated investment companies and real estate investment trusts;
  - artistes and sportspersons;
  - social security payments, annuities, alimony and child support payments;
- the limitation on benefits available under US DTAs;
- the mechanism of credit relief for double taxation; and
- exchange of information and administrative assistance.

3.6.2. Other models

Other countries also have their own model DTAs on which they base their bilateral DTAs. They include Belgium (2007), the Netherlands (1998) and Russia (2010). Like the US model DTA, these models alert (potential) DTA partners of the countries’ positions on matters to be addressed in DTAs in which they propose to enter.

Multilateral model DTAs include the Andean Community Income and Capital Model Tax Treaty (1971), the Intra-ASEAN Model Double Tax Convention on Income (1987) (South East Asian countries), the SADC Model Tax Agreement on Income (2011) (Southern African countries), and the ILATD Multilateral Model Tax Convention for Latin America (2012). A model DTA has also been developed for signatories to the Cartagena Agreement for adoption in bilateral DTAs with countries outside the Andean Community.

3.7. Multilateral double tax treaties

Some groups of countries with common regional social and economic interests have entered into actual multilateral DTAs. Article 220 of the Treaty of

---

29. The *Standard Agreement to Avoid Double Taxation between Member Countries and States Outside the Subregion*, Commission of the Cartagena Agreement, Decision 40, Annex II. The Andean Subregional Integration Agreement (1971) between Bolivia, Colombia, Ecuador, Peru and Venezuela is typically referred to as the “Cartagena Agreement”. Venezuela withdrew from the Andean Pact in 2006.
Chapter 3 - Double Tax Treaties

Rome (1957), which created the European Economic Community (now the European Union), allows for the conclusion of a multilateral DTA between the Member States of the European Union. This has not yet come to fruition and, given the diversity of views of taxation (amongst other) matters between the Member States, does not look likely to occur in the foreseeable future.30

3.7.1. Nordic Convention

Probably the best example in practice of a multilateral DTA is the Convention between the Nordic Countries (1996), which is a DTA between Denmark, the Faroe Islands, Finland, Iceland, Norway and Sweden. This multilateral DTA is based largely on the provisions of the OECD model. Because of the economic importance of extractive natural resources in the region, the Nordic Convention contains particular provisions concerning the presence of a permanent establishment (PE) in a contracting state, and a unique article governing activities in connection with surveying, exploration for, and exploitation of, hydrocarbon deposits (article 21).

3.7.2. CARICOM Agreement

A solely source based multilateral DTA can be found in the CARICOM Income Tax Agreement (1994), entered into by 11 of the 14 member countries of the Caribbean Community, viz. Antigua and Barbuda, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.31 The unique feature of this multilateral DTA is that it is premised on exclusivity of the source state’s right to tax and prohibition against the taxpayer’s state of residence levying tax on a worldwide income basis (at least in respect of income derived from other treaty partner states). On this basis, double taxation does not arise (income being taxed in the country of source only, and not in the country of residence), thus obviating the need for an article in the DTA to relieve the impost of juridical double taxation.

30. To date, the only multilateral convention based on article 220 of the Treaty of Rome is the EC Arbitration Convention (1990).
31. The Bahamas, Barbados and Suriname being the three members of the Caribbean Community that are not signatories to the CARICOM Agreement.
3.7.3. Other multilateral double tax treaties

Other multilateral DTAs include:
- the Administrative Assistance Convention (1964) between the three Benelux countries;
- the Income Tax Convention (1957) between Chad, Gabon, Middle Congo, Ubangi-Shari and French Equatorial Africa;
- the Income from Movable Capital Tax Agreement (1961) between Dohomey, Ivory Coast, Niger and Upper Volta;
- the League of Nations Motor Vehicle Convention and Final Protocol (concerning the taxation of foreign motor vehicles) (1931) between 44 members of the League of Nations;
- the Successions Duties Agreement (1994) between Basutoland, Bechuanaland, South Africa and Swaziland;
- the Arab Economic Union Council Income and Capital Tax Treaty (1973);
- the Arab Maghreb Union Income Tax Treaty (1990);
- the Bolivia–Colombia–Ecuador–Peru Income and Capital Tax Treaty (Andean Community) (2004);
- the South Asian Association for Regional Cooperation (SAARC) Agreement (2005); and

The relative positions of some of the model DTAs and multilateral DTAs discussed above can be illustrated on a spectrum between those DTAs that most favour capital exporting countries (and are therefore reflecting the interests of the country of residence of the income earner) and those that most favour capital importing countries (and therefore reflect the interests of the country of source of the income):
3.8. Conclusion

In this chapter we have identified what a DTA is and discussed its primary purpose and evolution. We have seen how the OECD model DTA has developed from the original pronouncements by the League of Nations to become the pre-eminent international guide for the negotiation of real DTAs between contracting states.

However, we have also brought to light the major shortcoming of the OECD model DTA, which is primarily in relation to capital importing developing countries, and how the UN model DTA has been designed to ameliorate that deficiency. We have recognized other bilateral and multilateral model DTAs and actual multilateral DTAs.

Finally, we discussed the other main purpose of DTAs: to prevent fiscal evasion and avoidance by enterprises operating internationally, which have the ability to manipulate profits between tax jurisdictions to minimize their worldwide income tax liabilities.

The key concepts covered in this chapter were:
- DTA;
- model DTAs;
- OECD model DTA;
- UN model DTA;
- US model DTA;
- bilateral DTAs;
- multilateral DTAs;
- Nordic Convention; and
- CARICOM Agreement.

Review questions

1. We typically think of DTAs as instruments to avoid double taxation of income derived offshore. Are DTAs intended to achieve anything else? If so, what?

2. What are the main purposes of DTAs? How are they achieved?

3. What brought about the advent of the OECD model DTA?
4. Why were the early model DTAs disadvantageous to developing countries? What was the response of the developing countries?

5. Why do individual countries develop and publish their own model DTAs?

6. How do bilateral DTAs differ from multilateral DTAs?

7. What is unique about the CARICOM Agreement?

8. The OECD model DTA states that:
   – profits from shipping operations are taxable only in the contracting state in which the place of effective management of the shipping enterprise is situated (article 8(1));
   – royalties that arise in a contracting state are taxable only in the contracting state of which the beneficial owner is a resident (article 12(1));
   – pensions paid to a resident of a contracting state in consideration of past employment are taxable only in that state (article 18); and
   – income not otherwise dealt with under the OECD model DTA is taxable only in the state of residence of the recipient.

What are the international tax policy reasons for a country reserving its position on these articles?