2. State practice in the conclusion of DTCs

2.1. Conventions in international law

21 At the conclusion of a DTC, the two parties to the convention accept an **international law obligation**. They commit themselves to relinquishing, completely or partially, the imposition of taxes in specific situations. The convention is subject to the rules of public international law.

22 The contracting states are free to decide the manner in which they will give up taxing rights. For example, they may change domestic law so that only the transactions set out in the DTC regarding the imposition of taxes remain. Often, however, the conventions are **directly applicable** as domestic law. In this case, the DTC rules override the otherwise applicable domestic tax rules.

2.2. The importance of model conventions

23 Every DTC is negotiated separately. Nevertheless, many of the existing DTCs throughout the world resemble each other. This can be traced to the model tax conventions developed by international organizations. These **model tax conventions are** usually the starting point for bilateral negotiations. The parties to the convention only need to negotiate those points upon which they wish to deviate from the model tax convention.

24 The **work of the League of Nations** contributed to the development of standardized model tax conventions. In the years between World Wars I and II the League of Nations produced several model tax conventions which gained importance in the negotiations of bilateral tax conventions between states and left their mark on the later work of other international organizations.

25 The OEEC, and later the **OECD**, continued the work of the League of Nations. In 1963, 1977 and 1992, the OECD published model tax conventions in the area of taxes on income and on capital (cf. m.no. 30 et seq.). These agreements were further developed in 1994, 1995, 1997, 2000, 2002, 2005, 2008 and 2010. In 1966 and in 1982, model tax conventions in the area of inheritance taxes were published (cf. m.no. 540 et seq.).

26 The United Nations published an independent UN Model in 1980; revised and updated versions were subsequently published in 2001 and 2011.

27 In most respects, the **UN Model** follows the OECD Model and deviations exist only with respect to certain issues. Major differences can be found in Art. 5 (permanent establishment), Art. 7 (business profits), Art. 9 (associated enterprises), Art. 10 (dividends), Art. 11 (interest), Art. 12 (royalties), Art. 13 (capital gains) and Art. 21 (other income). Since the UN Model is based on the interests of developing countries, these differences mostly try to ensure that the source country retains certain taxing rights.

Example

28 *The OECD Model provides that royalties are taxed exclusively in the state of the recipient's residence, to the exclusion of the source state (Art. 12 OECD Model, cf. m.no. 305 et seq.). According to the UN Model, royalties may also be taxed in the state in which they arise. The UN Model does not establish a tax rate for the source state but leaves this question open. The rate is to be established in bilateral negotiations. The UN Model's principle regarding source taxation for royalties considers the situation of the developing countries: know-how is provided primarily by entrepreneurs of developed countries to enterprises in developing countries. Only rarely does the opposite occur. Thus, developing countries want to retain the right to tax remuneration paid in return for know-how.*

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2.3. The importance of the OECD Model

29 The OECD Models have had considerable influence in international tax law. They influenced other model tax conventions and many states use the OECD Model as a basis for their **DTC negotiations**.

30 In the area of taxes on income and on capital, the first OECD Model Tax Convention was published, along with a Commentary, in 1963. It was developed by the OECD Committee on Fiscal Affairs. The OECD Council recommended to the Member countries to make use of the Model and the Commentary: The Council thereby recommended that Member countries should continue with their efforts to enter into bilateral tax conventions, that they should adopt the OECD Model as a basis for their negotiations and that they should continue to notify the Committee on Fiscal Affairs of their reservations on articles and observations on the Commentary. Non-Member countries are invited to express their divergent views in the positions to the OECD Model (cf. m.no. 34).

31 In **1977**, a revised OECD Model was published by the OECD Committee on Fiscal Affairs. This revision took practical experience with negotiating DTCs into account. In particular, the Commentary was considerably amended and expanded.

32 In **1992**, the OECD Model was again revised. The OECD Committee on Fiscal Affairs decided to publish the OECD Model in a loose-leaf version, the idea being that in future, the Model would be subject to continuous revision. Amendments followed in **1994, 1995, 1997, 2000, 2002, 2005, 2008 and 2010**.

33 Along with these amendments to the OECD Model, the OECD Committee on Fiscal Affairs also amended the accompanying **Commentary**. “Reports” that had been published by the OECD Committee on Fiscal Affairs concerning numerous questions were thereby included in the Commentary. Hence, in practice, the importance of the Commentary increased significantly (cf. m.no. 83 et seq.).

2.4. Bilateral peculiarities

34 States that use the OECD Model as a basis for negotiations usually deviate from the model on some points. This is because most states cannot agree with all the rules of the OECD Model. Many OECD Member countries have entered reservations on specific rules of the OECD Model. The contracting states furthermore try to take into consideration their **own economic interests** as well as the **peculiarities of their law and social systems**.

Example

35 *In the OECD Model, the PE concept is used to determine the right of a contracting state to tax the profits of an enterprise of the other contracting state. Sometimes, however, it is questionable whether certain activities constitute a PE in a contracting state. Therefore, considering the special problems in applying Art. 5 OECD Model to certain activities, Denmark reserved the right to insert in a special article relating to offshore hydrocarbon exploration and exploitation and related activities: The DTC between Denmark and Slovenia (concluded in 2001), for example, constitutes that such activities are deemed to be a PE.*

36 Numerous states also use the OECD Model as a basis for their **own model tax conventions** and incorporate their own deviations. They use these deviating models during their bilateral negotiations.

Example

37 *The United States is concerned about the improper use of a DTC. In order to prevent abuse, the United States attaches great importance to restrictions on the entitlement to the benefits of the DTC. Given this concern as well as other issues, the United States published its own Model Tax Convention in 1996 and issued a new version of this model in 2006. The United States uses this model in its bilateral negotiations. Thus, many DTCs concluded by the United States in recent years contain many similarities (cf. Avi-Yonah/ Tittle, BFIT 2007, 224).*

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38 Model tax conventions are also published by countries that generally agree with the OECD Model standards but want to make clear the policy principles followed by their own treaty negotiators. For example, in 2007, Belgium published its own Draft Standard Model Convention and related Protocol although, at that time, it had made only seven reservations on the OECD Model and two observations on the Commentary. The **Belgian Model** officially sets forth the policy principles that the Belgian negotiators will follow in negotiating tax treaties and is presented as such to countries that want to enter into treaty negotiations with Belgium (cf. De Broe, BFIT 2008, 322 et seq.).

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