

Università Carlo Cattaneo – LIUC

International Tax Law a.a. 2017/2018

Articles 10, 11 and 12 OECD MC

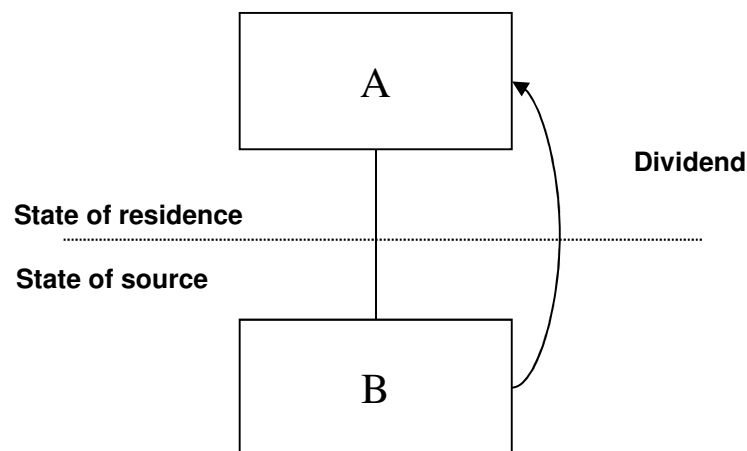
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Dividends – Distributive Rule

- Article 10(1) OECD MC

*“**Dividends paid** by a company which is a resident of a Contracting State to a resident of the other Contracting State **may be taxed** in that other State”*

- Art. 10(1) has a bilateral scope
- Art. 10(1) does not limit the taxing right of the State of residence of the payee



Dividends – Distributive Rule

- Article 10(2) OECD MC

*“However, such dividends **may also be taxed** in the Contracting State of which the company paying the dividends is a resident ...”*

- State of Source may tax
- Double taxation is avoided through the credit method by the State of residence (see Art. 23B and Article 23A(2) OECD MC).

“(...) where the State of residence prefers to make use of its right to tax such items of income, it cannot apply the exemption method to eliminate the double taxation since it would thus give up fully its right to tax the income concerned. For the State of residence, the application of the credit method would normally seem to give a satisfactory solution (...).” (Para. 47, OECD Commentary on Art. 23)

Dividends – Distributive Rule

- Article 10(2) OECD MC

“(...) if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;*
- b) 15 per cent of the gross amount of the dividends in all other cases.”*

- Limited taxing power of the State of source

Dividends (Definition)

- **Art. 10(3) OECD MC**

The term “dividends” includes:

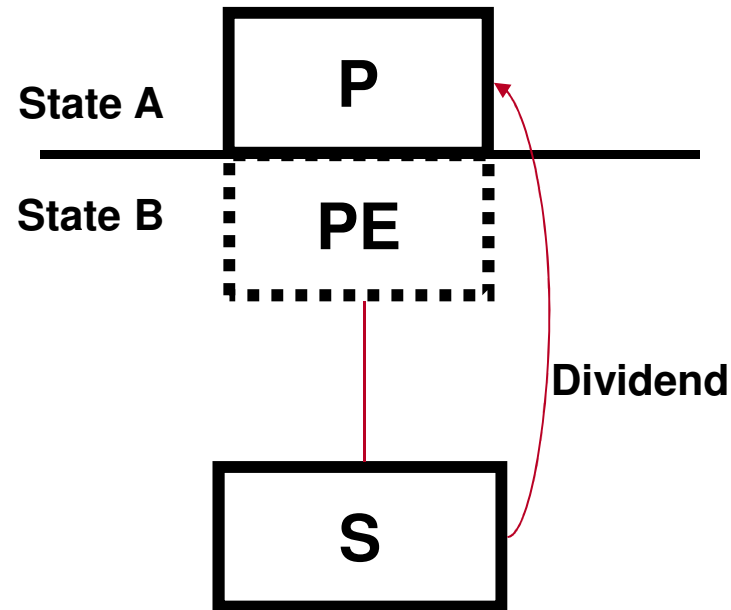
- income from shares,
 - “jouissance” shares or “jouissance” rights,
 - mining shares,
 - founders’ shares
 - other rights, not being debt-claims, participating in profits,
 - income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident”
- Nature of mere examples of the items listed (see Commentary at para. 23)

Dividends (PE Provision – Art. 10(4))

- Article 10(4) OECD MC

“The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.”

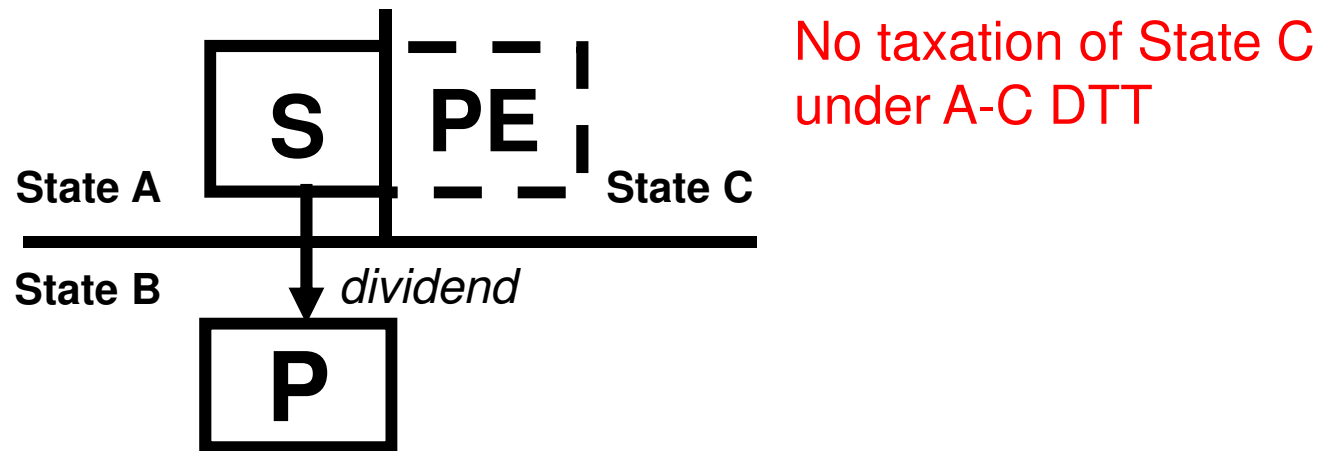
Dividends (PE Provision – Art. 10(4))



- Exception to the general rule of Article 10(1)-(2) OECD MC
- Shares (or other right) effectively connected to the PE (*e.g.*, banking sector)
- No “force of attraction” principle
- Article 7 applies
 - PE State may tax the dividends (as profits attributable to the PE)
 - State of residence may tax the dividends (as profits attributable to the PE) and shall eliminate double taxation through exemption or credit method

Dividends (Art. 10(5))

- Issue 1: extra-territorial taxation of dividend

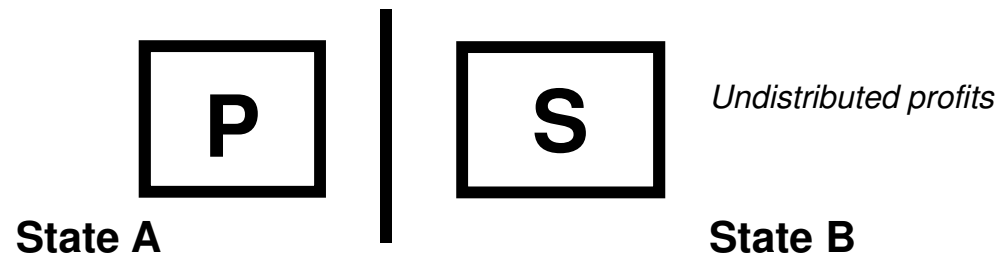


- Purpose of Art. 10(5)

“Paragraph 5 rules out the extra-territorial taxation of dividends, i.e. the practice by which States tax dividends distributed by a non-resident company solely because the corporate profits from which the distributions are made originated in their territory (for example, realised through a permanent establishment situated therein).”

Dividends (Art. 10(5))

- Issue 2: Taxation of undistributed profits in the State of Source

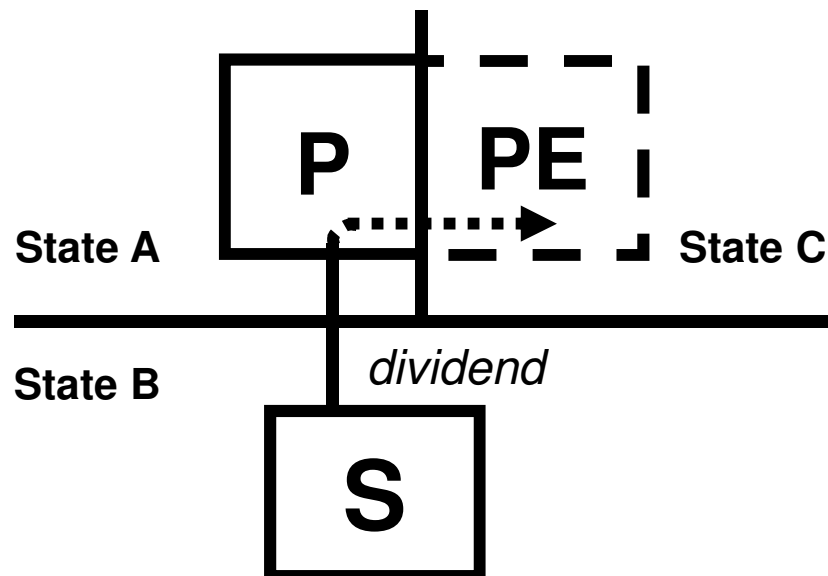


- Compatibility with CFC rules (see Comm., para. 37)
 - Art. 10(5) concerns taxation at source, *“it has no bearing on the taxation at residence under such legislation or rules”*
 - *“the paragraph concerns only the taxation of the company and not that of the shareholder”*
- Granting of tax credit for the withholding tax levied in the State of residence of the CFC upon profit distribution (See Comm. para. 39)

Dividends (Triangular case)

A parent company is resident in State A has a subsidiary resident in State B and a PE in State C. The participation in the subsidiary is attributable to the PE.

- State A taxes the dividend received by P
- State B taxes as source state
- State C taxes since the income is attributable to the PE



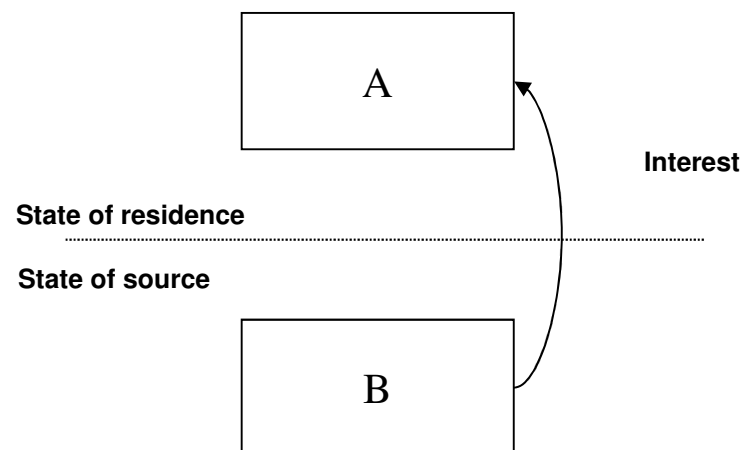
No Treaty protection unless non-discrimination provision of A-C DTT applies

Interest – Distributive Rule

- Article 11(1) OECD MC

“Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State”

- Art. 11(1) has a bilateral scope
- Art. 11(1) does not limit the taxing right of the State of residence of the payee



Interest – Distributive Rule

- Article 11(2) OECD MC

“However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation”
- Limited taxing power of the State of source
- Double taxation is avoided through the credit method by the State of residence (see Art. 23B and Article 23A(2) OECD MC).

Same as for dividends (see para. 47 OECD Commentary)

Interest (Definition)

- **Art. 11(3) OECD MC**

The term **“interest”** includes:

- **income from debt-claims of every kind**, whether or not secured by mortgage and **whether or not carrying a right to participate in the debtor’s profits**,
 - income from government securities
 - income from bonds or debentures,
 - premiums and prizes attaching to such securities, bonds or debentures
- Definition of Article 11(3) to be considered in principle exhaustive (See para. 21 OECD Commentary)

Interest (Definition)

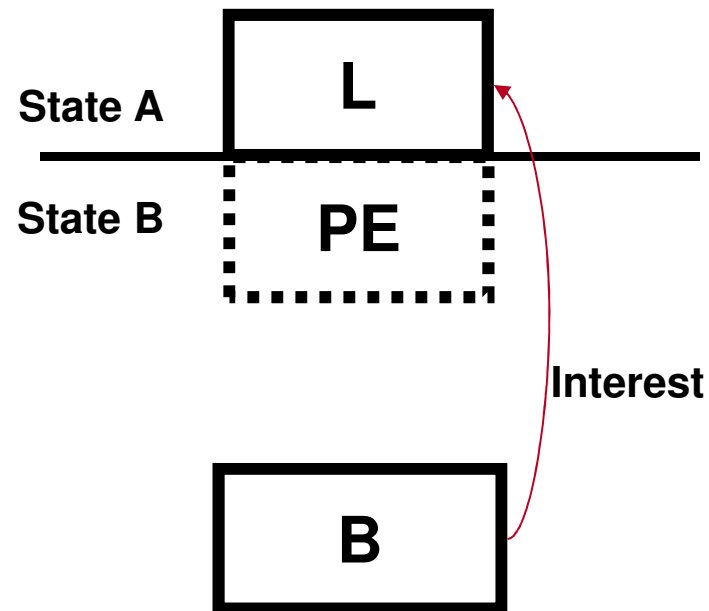
- Commentary, Para. 19 : “**Interest on participating bonds** should not normally be considered as a **dividend** ... the interest on such bonds should be considered as a dividend **if the loan effectively shares the risks run by the debtor company** ... it should be noted that the term "interest" as used in Article 11 does not include items of income which are dealt with under Article 10.”

Interest – PE provision

- Article 11(4) OECD MC

“The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply”

Interest - PE Provision



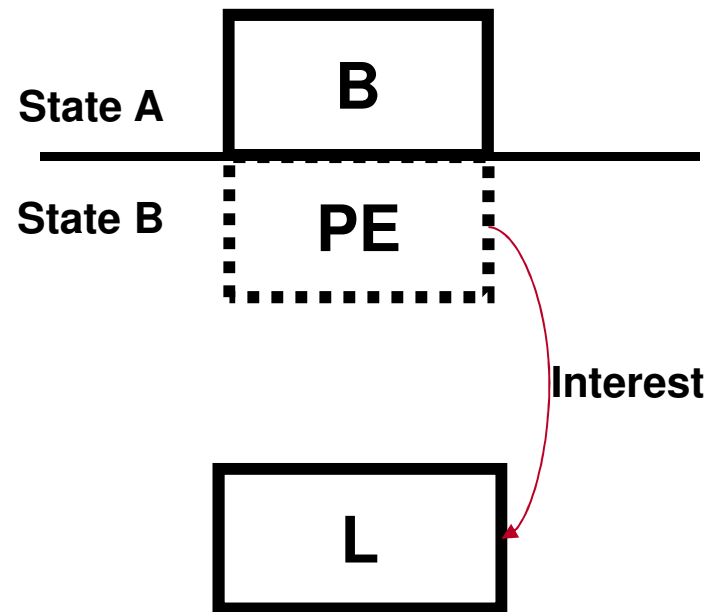
- Exception to the general rule of Article 11(1)-(2) OECD MC
- Debt-claims part of the assets of the PE, reference to 2010 Report on Attribution of Profits to PE
- No “force of attraction” principle
- Article 7 applies
 - PE State may tax the interest (as profits attributable to the PE)
 - State of residence may tax the interest (as profits attributable to the PE) and shall eliminate double taxation through exemption or credit method

Interest – Sourcing provision

- Article 11(5) OECD MC

“Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated”

Interest – sourcing provision



Article 11(5) OECD MC

Commentary at para. 27: interest should be considered linked to a PE if:

1. contracted by the management of the PE, used for the requirements of the PE and paid directly to the creditors;
2. Contracted by the headquarter for the purposes of the PE. The interest is served by the headquarter but ultimately borne by the PE

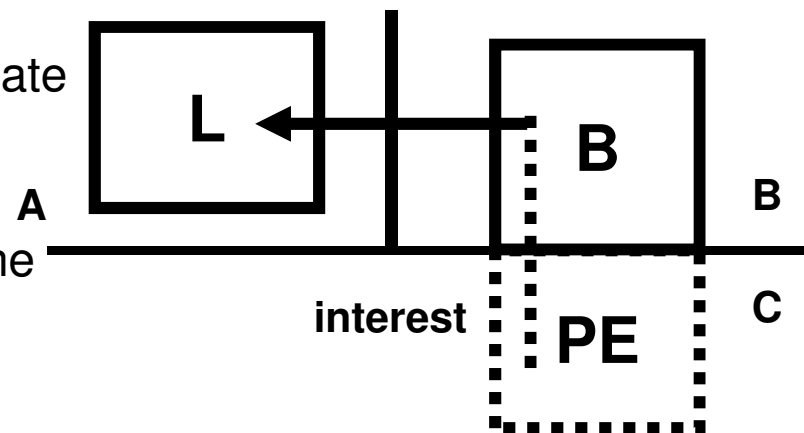
It should not be considered linked to the PE if the loan is contracted by the headquarter and used for several PE in different countries

Interest – sourcing provision

Para. 28 of the Commentary

• *“Paragraph 5 provides no solution for the case, which it excludes from its provisions, where both the beneficiary and the payer are indeed residents of the Contracting States, but the loan was borrowed for the requirements of a permanent establishment owned by the payer in a third State and the interest is borne by that establishment.”*

- Interest is deemed to arise in the State of residence of the payer (first sentence of Art. 10(5))
- Double taxation avoided between the Contracting States (A and B)...
- ... but not with the third State (C)



Interest – Arm’s length limitation

- Article 11(6) OECD MC

“Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention”

Interest - Arm's length limitation – Art. 11(6)

- Art. 11 **does not apply** to the interest that exceeds the arm's length amount
 - The rule applies only when the excessive interest is agreed by reason of a **special relationship** between the **payer and the beneficial owner** or between the both of them and some other person
 - The excessive interest will be in turn qualified differently for treaty purposes (see Commentary at para. 35)

Royalties

- Article 12(1) OECD MC

“Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State”
- Exclusive taxation in the State of residence
- In most treaties, limited taxation at source is allowed (see also UN MC and all Italian treaties)

Royalty - definition

Art. 12(2) OECD MC

The term "royalties" means "*payments of any kind received as a consideration for the use of, or the right to use*":

- any copyright of literary, artistic or scientific work including cinematograph films,
- any patent, trade mark, design or model, plan, secret formula or process,
- information concerning industrial, commercial or scientific experience

OECD Commentary at para. 8:

- Not necessary that the asset is registered in a public register
- Includes also payments due for "*fraudulently copying or infringing the rights*"

Deviating Royalty Definition

Article 12, paragraph 3, UN Model

OECD definition plus:

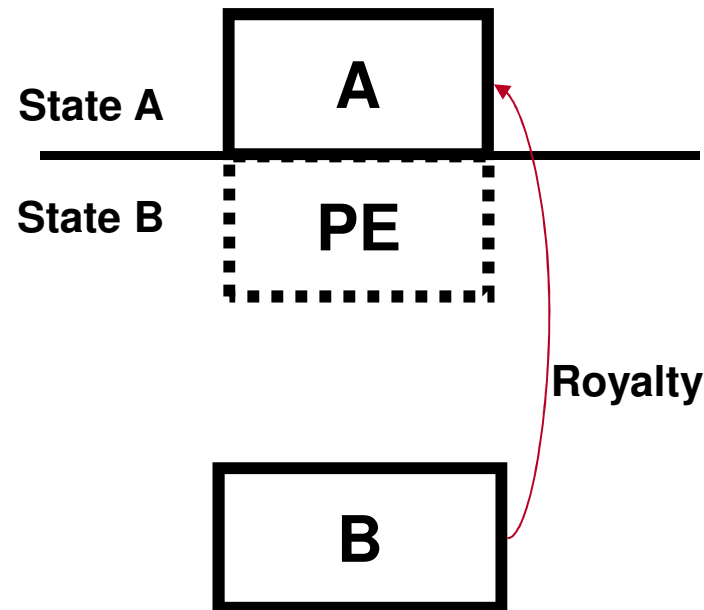
- or films or tapes used for radio and television broadcasting;
- or for the use of, or the right to use, industrial, commercial or scientific equipment.

Royalties – PE provision

- Article 12(3) OECD MC

“The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply”

Royalties- PE Provision (Art. 12(3))



- Exception to the general rule of Article 12(1) OECD MC
- Right or property connected to the PE
- No force of attraction
- Article 7 applies
 - PE State may tax the royalties (as profits attributable to the PE)
 - State of residence may tax the royalties (as profits attributable to the PE) and shall eliminate double taxation through exemption or credit method

Royalty (Arm's length limitation – Art. 12(4))

- Art. 12 **does not apply** to the royalties that exceed the arm's length amount
 - The rule applies only when the excessive interest is agreed by reason of a **special relationship** between the **payer and the beneficial owner** or between the both of them and some other person
 - The excessive interest will be in turn qualified differently for treaty purposes

The **beneficial ownership** requirement

- Requirement common to Articles 10, 11 and 12 OECD MC
- 2014 changes to the OECD Commentary
 - “Beneficial owner” is a concept *“to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country”* (para. 12.1)
 - *“(…) In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the “beneficial owner” because that recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person”* (para. 12.4)

The beneficial ownership requirement

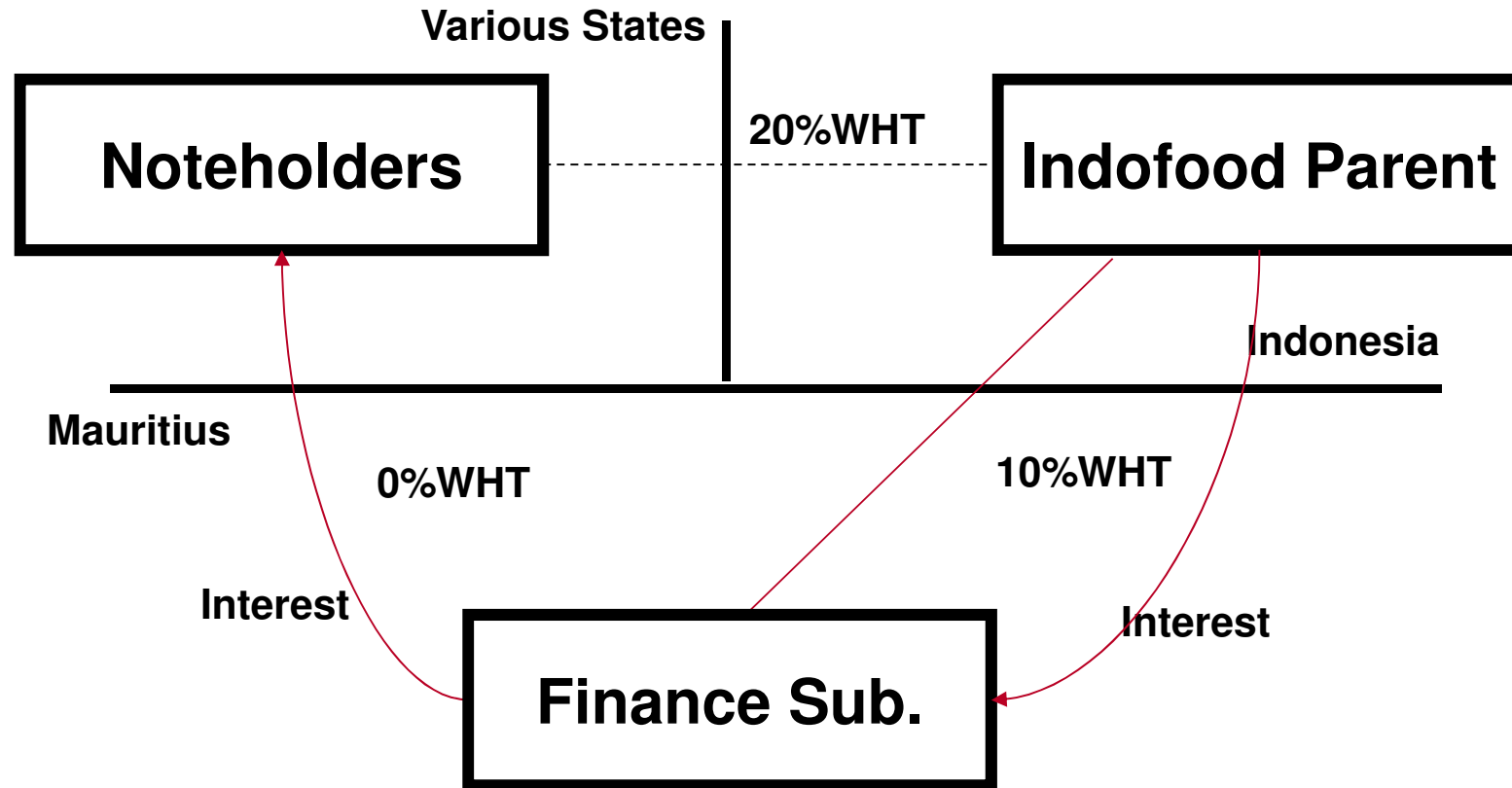
- 2014 changes to the OECD Commentary
 - Coordination with other anti-avoidance provisions

“Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases” (para. 12.5)

Case Law on Beneficial Owner

Indofood International Finance Ltd. vs. JP Morgan Chase Bank

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Case Law on Beneficial Owner

Indofood International Finance Ltd. vs. JP Morgan Chase Bank

- The structure proposed by the Trustee

