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# Can Anyone Be Trusted to Enforce National Treatment Disciplines With Respect to Tax Measures?

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# FLORIDA TAX REVIEW

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## Can Anyone Be Trusted to Enforce National Treatment Disciplines With Respect to Tax Measures?

*by*

*Patricia A. Brown**

### Abstract

*Because the traditional non-discrimination article of tax treaties seemingly provides protection against only the most blatant discrimination against non-residents and non-nationals of a taxing State, governments may be emboldened to adopt "anti-abuse" rules that are in reality disguised trade barriers. On the other hand, trade disciplines in non-tax agreements may include protections against discriminatory taxes that non-specialist courts interpret in expansive ways, contrary to the wishes of tax authorities. An OECD project in the mid-2000s was an opportunity for governments to re-think the piecemeal nature of the traditional non-discrimination article in tax treaties and develop a coherent national treatment system that takes into account legitimate tax policy concerns. Instead, the project resulted in a mishmash of changes that largely blessed the various discriminatory practices that governments had adopted to that date. If tax authorities want to continue to play a leading role in developing international tax policy, they should consider whether a tax treaty approach that borrows concepts from non-tax*

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*agreements would better balance the interests of governments and taxpayers than the current version of Article 24 (and the Commentaries thereon).*


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## I. Introduction

Twenty years ago, one of the hot topics in tax circles was whether tax policy and trade disciplines could peacefully co-exist. Robert A. Green argued for "antilegalistic" resolution of tax disputes—as compared to trade disputes—in 1998.[1] Alvin Warren searched "in vain for a coherent norm" in the non-discrimination article.[2] Paul McDaniel made this the topic of his Tillinghast Lecture in 2003, concluding that normative tax rules are not in conflict with trade disciplines.[3] Yariv Brauner

1. Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 Yale J. Int'l Law 79 (1998).

2. Alvin C. Warren, Jr., *Income Tax Discrimination Against International Commerce*, 54 Tax L. Rev. 131, 131 (2001).

3. *See* Paul McDaniel, David R. Tillinghast Lecture, *Trade Agreements and Income Taxation: Interactions, Conflicts, and Resolutions*, 57 Tax Law Rev. 275 (2004).

offered his riposte to Professor McDaniel's lecture in 2005, arguing for an international tax organization in order to keep tax disputes out of the WTO.[4] Mary Bennett used her own 2005 Tillinghast Lecture[5] to compare litigation outcomes under the non-discrimination article of tax treaties with EU litigation with respect to tax matters. In 2007, the Organisation for Economic Cooperation and Development ("OECD") issued a public discussion draft with proposed changes to the Commentary on Article 24 (non-discrimination) of the OECD Model Tax Convention on Income and on Capital (the "OECD Model"), which were finalized and included in the 2008 Update to the OECD Model.[6] The OECD's work led, perhaps inevitably, to the choice of non-discrimination as one of the main topics at the 2008 International Fiscal Association Congress.[7] Wrapping up the decade (or so), Arthur Cockfield and Brian Arnold asked what trade could teach tax and essentially concluded, "Nothing."[8]

The OECD project that led to the 2008 changes to the Commentary was an opportunity for governments to re-think the piecemeal nature of the traditional non-discrimination article in tax treaties and develop a coherent national treatment system that takes into account legitimate tax policy concerns. Instead, the project resulted in a mishmash of changes that largely blessed the various discriminatory practices that governments had adopted to that date. But governments have gotten more creative, and the Base Erosion and Profit Shifting ("BEPS") project seems to have emboldened individual governments, who are adopting various "anti-abuse" rules that may be disguised trade barriers. The time seems ripe, therefore, to consider whether there may be a better process for developing such rules and whether there is a

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4. *See* Yariv Brauner, *International Trade and Tax Agreements May Be Coordinated, but Not Reconciled*, 25 Va. Tax Rev. 251 (2005).

5. Mary C. Bennett, David R. Tillinghast Lecture, *Nondiscrimination in International Tax Law: A Concept in Search of a Principle*, 59 Tax L. Rev. 439 (2006).

6. OECD, *The 2008 Update to the OECD Model Tax Convention* (2008).

7. *See* Luc Hinnekens & Philippe Hinnekens, *General Report, Non-Discrimination at the Crossroads of International Taxation*, 93a Cahiers de Droit Fiscal Int'l 15, 18–22 (2008).

8. *See generally* Arthur J. Cockfield & Brian J. Arnold, *What Can Trade Teach Tax? Examining Reform Options for Art. 24 (Non-Discrimination) of the OECD Model*, 2 World Tax J. 139 (2010).

substantive model that does a better job than the current version of Article 24 (and the Commentaries thereon).

Part II provides background, explaining how the non-discrimination article of tax treaties differs substantially from the rest of the treaty provisions. Part III sets out some of the alternative sources of national treatment obligations that may constrain governments' ability to discriminate against nationals of other jurisdictions. Part IV provides a case study that considers where tax policy leaves off and trade barriers arise. Part V considers the extent to which critiques of Article 24 are justified. Part VI sets out a suggested path towards a more coherent (and accessible) provision. Part VII provides some concluding thoughts.

## II. The Role of Article 24

### *A. What the Non-Discrimination Article Is Not*

Tax treaties, it is often said, are intended to avoid double taxation of the same income by two different jurisdictions. They do so primarily by allocating taxing rights between the Contracting States. In more recent years, there has been an increasing interest also in preventing double non-taxation.[9]

The parameters of the treaty itself support these goals. The tax treaty provides benefits only to "residents" of a Contracting State and defines a "resident" as a person who is liable to "comprehensive" taxation in the jurisdiction of which he claims to be a resident.[10] That is, the scope of the treaty is limited to persons who are likely to suffer double taxation. The "taxes covered" article is intended to ensure that the treaty

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9. The OECD report on *The Application of the OECD Model Tax Convention to Partnerships* (1999) included a long and somewhat controversial section on double non-taxation as a result of "conflicts of qualification" and resulted in the addition of Paragraph 4 to Article 23A. See Michael Lang, *2008 OECD Model: Conflicts of Qualification and Double Non-Taxation*, 63 Bull. for Int'l Tax'n, no. 5, 2009, at 204, which summarizes the development of the concept and its adoption by the OECD.

10. OECD, *Model Tax Convention on Income and Capital: Condensed Version* art. 1, para. 1; *id.* cmt. art. 1, para. 26 (2017) [hereinafter *OECD Model*].

applies to income taxes or taxes on capital—those taxes that will give rise to double taxation. Additions to the Introduction to the OECD Model in 2017 encourage governments to consider whether there are real risks of double taxation in the absence of a treaty (or the risk of creating opportunities for double non-taxation) before ever entering into a tax treaty relationship.[11]

The allocation of taxing rights between Contracting States serves the same goals. The distributive articles—starting with Income from Immovable Property in Article 6 and usually ending around Article 21 with Other Income—establish a series of rules that may allow one country (frequently referred to as the "source" country, but sometimes the "host" or "paying" country) to tax a resident of the other country if certain thresholds are met. In some cases, the non-resident country is provided an unlimited right to tax. In more cases, the non-resident country is prohibited from taxing. In still others, the non-resident country is permitted to tax but at a specified maximum rate or only if certain thresholds regarding in-State activity are met.

In general, if the non-resident State is provided the right to tax, then the resident State is required to relieve double taxation. The OECD Model Tax Convention specifies two methods for relieving double taxation. Under Article 23A, the residence State will exempt from taxation the income that may be taxed in the other State.[12] Alternatively, a Contracting State may choose the credit method of Article 23B, reducing the residence State tax dollar-for-dollar for the taxes paid to the other State. The OECD Model provides that even countries that generally use the exemption method for relieving double taxation may choose to retain their taxing rights with respect to items of income taxed on a

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11. *Id.* intro., paras. 15.1–.6.

12. Article 23A(3) allows for "exemption with progression" so that the marginal rate applicable to other non-exempt income takes into account the exempt income. *See OECD Model*, *supra* note 10, cmt. art. 23A & 23B, para. 14. For example, Individual *X* earns $100 from business activities in Country *S* and $100 from business activities in Country *R*, his State of residence. The marginal tax rate in Country *R* is 20% for the first $150 of income, but 30% for income in excess of $150. Under the Country *S*-Country *R* tax treaty, Country *R* must exempt the $100 earned in Country *S* from taxation, but it may apply the 30% rate to $50 of Individual *X*'s income.

withholding basis by the source State by using the credit method for withholding taxes.[13]

Although the formal structure of these provisions is quite consistent from treaty to treaty, the details can vary considerably. Capital importing countries (whether developed or developing) frequently argue for higher withholding rates on dividends, interest, royalties, and so-called "technical services" than the capital exporting countries (which will be required to relieve double taxation) would prefer. Countries that import goods and services may argue to expand taxing rights by changing the applicable thresholds for taxation.[14] Countries with close economic ties may tailor provisions to address specific instances of double taxation[15] or double non-taxation[16] that arise from differences in their tax systems.

Thus, the first 23 articles or so of the OECD Model and of most bilateral tax treaties consist of a highly negotiated set of rules allocating tax revenues between the two Contracting States, ensuring that taxpayers will not suffer double taxation because of the allocation of taxing rights, and attempting to mesh the tax systems of the two Contracting States so that income does not go completely untaxed. In its current form and as currently interpreted, Article 24 has little to do with any of that.

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13. *See OECD Model*, *supra* note 10, art. 23, para. 1; *id.* cmt. art. 23A & 23B, para. 47.

14. Compare, for example, Article 5 of the U.N. Model Double Taxation Convention between Developed and Developing Countries (2017) with Article 5 of the OECD Model.

15. *See, e.g.*, Exchange of Notes Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, July 24, 2001, 2224 U.N.T.S. 280, 286 (paragraph referring to Article 24 (Relief from Double Taxation) and addressing conflicts between, in particular, the grantor trust rules of the United States and the settlor trust rules of the United Kingdom).

16. *See, e.g.*, Convention between the Kingdom of the Netherlands and the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, art. 18, June 5, 2001, 2205 U.N.T.S. 385 (as amended through 2009) (allowing the source State to tax pension income if the residence State does not tax such income fully).

Article 24, dealing with non-discrimination, may be the least negotiated provision of standard treaties. This is because it has nothing to do with the allocation of taxing rights and little to do with the relief of double taxation.[17] It is not limited to "residents" (with its carefully constructed definition intended to prevent double taxation and double non-taxation) or to the taxes covered by the rest of the treaty. Instead, it applies to "nationals" and to "taxes of every kind and description." Accordingly, the non-discrimination provisions of Article 24 are meant to limit one Contracting State's actions without regard to what the other Contracting State may do in terms of the affected taxpayer. In that sense, it appears very different from the rest of the provisions normally found in standard tax treaties.

### *B. What the Non-Discrimination Article Is*

In concept, the non-discrimination article represents a statement of principle. However, even some practitioners seem confused about what that principle is. To the extent that they think about it at all, the sense seems to be "Don't abuse foreigners (at least if they come from a tax treaty country)." They then become frustrated because Article 24 doesn't accomplish that because Article 24 doesn't say that. Instead, it lays out several distinct rules that, together, do not begin to add up to that general understanding.[18] Moreover, the individual rules include limitations that further erode their effectiveness. Any remaining vitality mostly has been stripped away by countries' unwillingness to apply the rules in any meaningful way. The rest of this section describes each paragraph, what it is meant to do, and some significant limitations.

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17. A tax that discriminates against a resident of the other State may shift taxation away from that other State, which still is required to relieve double taxation (unless the tax measure is found to be inconsistent with its treaty obligations). The shift by many countries toward relieving double taxation through exemption, rather than credit, systems may dull this effect. Moreover, if the relevant tax is not a covered tax within the meaning of Article 2 of the Convention, the residence State will have no obligation under Article 23, so that the entire burden of the discriminatory tax falls on the taxpayer.

18. *See* Niels Bammens & Frans Vanistendael, *Article 24: Non-Discrimination*, *in* GLOBAL TAX TREATY COMMENTARIES § 1.1.2.1 (2018).

*1. Article 24(1)*

The first paragraph of Article 24 is the closest thing to a general statement of principle found in the article. In the OECD Model it reads:

> Nationals of a Contracting State shall not be subjected 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 subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

According to those who have studied the history of Article 24, this paragraph was modeled on similar provisions in treaties of friendship, commerce, and navigation, and similar agreements,[19] which pre-dated modern tax treaties by almost 150 years.[20] The provision requires "national treatment"—that a State will not treat a national of the other State more harshly than it treats its own nationals.

For example, imagine that Province *Q* in Country *C* imposes a property tax on real estate located in the province at a rate of *x*% of the assessed value of the real estate each year. However, if the property is owned by an individual who is not a national of Country *C*, then the rate is *x.5%*. This would be a clear violation of Article 24(1). The property tax would be subject to the discipline of Article 24 because Article 24(6) provides that it applies to "taxes of every kind and description," not just the taxes on income and capital covered by Article 2. Note that, as described, the Province *Q* tax does not discriminate on the basis of residence. That is, a non-national of Country *C* who is living in the real property (and who therefore is a resident of Country *C*) would

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19. *See OECD Model*, *supra* note 10, cmt. art. 24, para. 6.

20. The first such treaty was signed in 1778 by France and the nascent United States. *See Treaty of Alliance with France*, Libr. Congress (Apr. 25, 2017), https://www.loc.gov/rr/program/bib/ourdocs/alliance.html.

nevertheless be subject to the higher rate.[21] Province *Q* could, however, provide a property tax break that results in lower taxation of residents than of non-residents (such as a "homestead exemption," popular in many U.S. states), as long as the break applies equally to nationals and non-nationals of Country *C*. That is because Paragraph 1 specifically refers to residence as a circumstance that may justify disparate treatment.

Such blatant discrimination may seem unlikely, almost laughable. However, in 2016, British Columbia enacted a 15% transfer tax on property purchased in the Vancouver area by persons who are not Canadian citizens or permanent residents.[22] The tax would fall afoul of Article 24(1)[23] because it applies to persons with work permits who would be taxable as residents in Canada.[24] However, Article 24 of the Canada-U.S. tax treaty applies to "all taxes imposed by a Contracting State" but

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21. In the OECD Model, *supra* note 10, Article 2 encompasses taxes imposed not only by the national government but also taxes imposed by political subdivisions or local authorities. Not all countries do so in their bilateral agreements. The United States, for example, does not cover state and local taxes in Article 2 (so the distributive rules do not apply with respect to state and local taxes) but generally does cover such taxes in the non-discrimination article.

22. Brian Hutchinson, *B.C. Government Scrambles to Appear Proactive with Surprise 'Citizenship' Tax on Vancouver Housing*, NAT'L POST (July 26, 2016, 8:00 PM), https://nationalpost.com/opinion/b-c-government-looks-to-rally-public-support-with-surprise-citizenship-tax-on-vancouver-housing. The local government's discriminatory purpose is made clear by photographs showing the provincial Premier holding a sign with the slogan "British Columbians First." Barry Appleton, *B.C. Just Violated NAFTA With Its Foreign Property Tax—and We Could All Pay for It*, FIN. POST (July 28, 2016), https://business.financialpost.com/opinion/barry-appleton-b-c-just-violated-nafta-with-its-foreign-property-tax-and-we-could-all-pay-for-it.

23. This is similar to Example 1 in the Commentary on Article 24, which found that a State would violate Article 24(1) if it provided an imputation credit for dividends paid to companies that are nationals and residents of that State by reason of incorporation but not to a company that is a resident of that State because it has its place of effective management therein but is not a national because it is incorporated elsewhere.

24. Dan Ferguson, *Langley Newcomer Frustrated by Foreign Investor Tax*," LANGLEY ADVANCE TIMES (Oct. 26, 2016), https://www.langleyadvancetimes.com/news/langley-newcomer-frustrated-by-foreign-investor-tax-with-video/amp/.

not to those imposed by political subdivisions or local authorities.[25] As a result, U.S. nationals appear to have challenged the law under the North American Free Trade Agreement, not the tax treaty.[26]

The reference to "residence" in Paragraph 1 has been used to justify a large number of provisions that discriminate between residents and non-residents of a Contracting State. These include rules affecting individuals, such as the denial to non-residents of relief for family responsibilities.[27] A Contracting State also is not required to extend privileges enjoyed by its own public bodies to public bodies of the other State.[28] Nor are they required to provide exemptions available to its own private non-profit entities to non-profit entities of the other Contracting State because the public benefits provided by the local non-profits are specific to that State.[29] At least the latter conclusion seems somewhat questionable. For example, if a non-profit that is organized in State *B* provided public benefits primarily in State *A*, would it be entitled to an exemption in State *A* under the logic of Paragraph 11 of the Commentary? Several cases decided under EU law make it clear that geographic limitations and public benefit can be addressed in a more nuanced manner. In *Staatssecretaris v. X*, the Netherlands provided certain tax benefits for maintaining historical property located in the Netherlands.[30] A resident of Belgium who lived in a castle in Belgium wished to deduct from his Netherlands income the costs incurred in maintaining the Belgian castle. His claim was denied. However, the Netherlands legislation explicitly allows the deduction to residents of other EU Member States who incur the costs with respect to a listed historic building located in

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25. Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, art. 24, U.S.-Can., Sept. 26, 1980, T.I.A.S. No. 11087 (as amended through 2007).

26. Katia Dmitrieva & Natalie Obiko Pearson, *Scuttled Sales, Legal Risks Mount from B.C. Tax on Foreign Buyers in Vancouver*, Seattle Times (Aug. 8, 2016, 3:59 PM), https://www.seattletimes.com/business/scuttled-home-purchases-legal-risks-mount-from-bcs-tax-on-foreign-buyers/.

27. *See OECD Model*, *supra* note 10, cmt. art. 24, para. 8.

28. *Id.* cmt. art. 24, para. 10.

29. *Id.* cmt. art. 24, para. 11. These long-standing statements were not modified in 2008 and seem to be intended to be illustrations of the principle that "in the same circumstances" need not refer only to an entity's tax situation.

30. Case C-87/13, 2014 EUR-Lex CELEX 62013CC0087 (Sep. 4, 2014).

the Netherlands. That is, the public benefit can be divorced from the residence of the taxpayer.[31]

The extensive additions to the Commentary made in 2008 sought to distinguish between cases where residence is relevant and where it is not. Example 4 posits a payroll tax that provides a lower rate for employers that are companies that are incorporated in State *A* than for other companies.[32] The example concludes that the residence of the employer has no relevance with respect to a payroll tax and therefore that the tax violates Article 24(1). A series of examples explore the effects of other provisions of a treaty. Example 1 concludes that a State would violate Article 24(1) if it provided an imputation credit for dividends paid to companies that are nationals and residents of that State by reason of incorporation but did not provide the credit to a company that is a resident of that State because it has its place of effective management therein but is not a national because it is incorporated elsewhere.[33] However, Example 2 explains that, if the tie-breaker rule of Article 4 prevented the company from being treated as a resident of State *A*, that same law would not violate Article 24(1) of that treaty.[34] In Example 5, the benefits of group consolidation in State *A* are denied to a company that is a resident of State *B* under the State *A*-State *B* treaty because, as a result of the treaty, State *A* is prevented from taxing the worldwide income of the company.[35]

The conclusions of Examples 1, 2, and 5 are not particularly surprising because they turn on whether the company is a resident of the taxing State (in the examples, State *A*). Example 3, on the other hand, is less straightforward. In that example, State *A*'s domestic law imposes a fixed tax equal to 3% of the value of immovable property located in the State, rather than taxing the net income from the property, if there

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31. The Netherlands does not limit its historic preservation to buildings, but also provides a waiver of the gift and inheritance tax with respect to properties that are "typical of the traditional Netherlands landscape." A Netherlands resident was denied a gift tax waiver with respect to a property located in the United Kingdom, which likewise was upheld by the ECJ. *See* Case C-133/13, Staatssecretaris v. Q, 2014 EUR-Lex CELEX 62013CJ0133 (Dec. 18, 2014).

32. *OECD Model*, *supra* note 10, cmt. art. 24, para. 23.

33. *Id.* cmt. art. 24, para. 20.

34. *Id.* cmt. art. 24, para. 21.

35. *Id.* cmt. art. 24, para. 24. This conclusion is essentially reiterated in Paragraph 41 of the Commentary, relating to Article 24(3).

is no treaty between State *A* and the property owner's State of residence that provides for exchange of information. It concludes that the application of that law to a company that is incorporated in State *B* but that is treated as a resident of a third state that does not have a treaty with State *A* providing for information exchange does not violate Article 24(1) because residence matters.[36] The argument is that State *A* cannot access the information necessary to verify the net income from immovable property derived by the company that is incorporated in State *B* but is not a resident of State *B*. This somewhat ingenious example is presumably intended to demonstrate that residence can be relevant even in situations where the taxpayer is neither a national nor a resident of the State imposing the tax.[37] However, the example may overstate the legal significance of residence in the situation described. In the example, the State *A*-State *B* treaty is identical to the OECD Model. Therefore, Article 26(1) provides that "[t]he exchange of information is not restricted by Articles 1 and 2." This sentence is intended to ensure that a State may collect and exchange information of non-residents as well as with respect to taxes that are not the subject of the treaty. The fact that the company in Example 3 is not a resident of State *B* therefore does not present a <u>legal</u> barrier to information exchange that would allow State *A* to verify the amount of the company's taxable income from the property.[38]

### 2. *Article 24(3)*[39]

Article 24(3) appears to prevent a Contracting State from discriminating against a permanent establishment ("PE") of a resident of the other Contracting State. It reads:

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36. *Id.* cmt. art. 24, para. 22.

37. The example is also an argument in favor of anti-abuse rules that turn on the existence of information exchange provisions, an issue addressed in the WTO case between Panama and Argentina discussed below.

38. It is possible that there are practical barriers, although the company's incorporation in State *B* should provide it some leverage and access to relevant documents.

39. Article 24(2) prevents a Contracting State from discriminating against residents of the other Contracting State who are stateless persons, but only to the extent that the discrimination is not based on the fact that the stateless person is not a resident of the State whose measure is being considered. Effectively, Article 24(2) fills a small gap left by Paragraph 1's application to

> The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State 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. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

As the Commentary notes, Paragraph 3 is not concerned with nationality but with the situs of an enterprise.[40] By definition, the paragraph applies to a person who is not a resident of the host State but who is subject to taxation in the host State on business income attributable to the PE. Accordingly, the comparisons and limitations in Paragraph 1 do not apply. As a result, Paragraph 3 appears to provide substantially more robust protections than Paragraph 1.

The Commentary on Paragraph 3 sets out detailed guidance regarding what equal treatment means. It explains that the reason for such detailed guidance is the difficulty in defining "clearly and completely" the principle of equal treatment in the case of a PE, which is not a separate legal entity; if it were, all of the activities of that legal entity would be subject to the taxing jurisdiction of the host State.[41] Some of the guidance, however, seems equally as applicable to Paragraph 1 as to Paragraph 3.

The Commentary divides taxation measures into several categories, including measures relating to the assessment of tax (primarily the definition of the tax base), the treatment of dividends received by the PE, the structure and rate of tax, and certain issues involving withholding taxes, including those arising from triangular situations.

It would seem obvious that Paragraph 3 requires that a PE of a foreign enterprise not be subject to a higher tax rate than a similarly

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nationals, not residents. Stateless persons are not nationals of the other Contracting State, so Article 24(1) does not apply to them. Article 24(2) ensures that stateless persons are entitled to the same protections (or lack thereof) as nationals of the other Contracting State.

40. *OECD Model*, *supra* note 10, cmt. art. 24, para. 33.

41. *Id*. cmt. art. 24, para. 39.

situated enterprise of the host State. Surprisingly, despite the level of detail throughout this section of the Commentary, such a straightforward statement does not seem to exist. Paragraph 37 of the Commentary approaches the issue from the opposite direction, stating that the host State may take the legal structure of the taxpayer into account, so that a PE of an individual need not be taxed at the same rate of tax applicable to an enterprise carried on by a resident company. This seems to imply the converse, that the PE of a foreign company should be taxed at the same rate as a resident company, at least when companies in the host State are subject to tax at a single rate, not marginal rates.[42]

This issue was raised in *Royal Bank of Scotland v. Elliniko Dimosio*.[43] In the mid-90s, Greece's domestic law provided for differential tax rates based on several criteria, the results of which were that Greek resident companies engaged in a banking business were taxable at a rate of 35%, while non-Greek companies engaged in a banking business in Greece through PEs would be subject to tax at a rate of 40%. Thus, there were no complications from progressive rates as described in Paragraph 56 of the Commentary on Article 24; it should have been easy to conclude that the PE paragraph of the U.K.-Greece tax treaty[44]

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42. Paragraphs 55 to 58 of the Commentary on Article 24 deal with the application of marginal rates and exemption with progression when only a portion of a company's worldwide income is taxable in one of the Contracting States.

43. C-311/97, 1999 E.C.R. I-2652.

44. The relevant treaty pre-dated the 1963 Draft OECD Model, but still contained a robust non-discrimination article. In particular, the PE paragraph read:

> The enterprises of one of the territories, whether carried on by a company, a body of persons or by individuals alone or in partnership, shall not be subjected in the other territory, in respect of profits or capital attributable to their permanent establishments in that other territory, to any taxation which is other, higher or more burdensome than the taxation to which the enterprises of that other territory similarly carried on are or may be subjected in respect of the like profits or capital.

Convention Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of Greece for the

required that the same rate apply to the Bank of Scotland as applied to Greek banks. Although the taxpayer argued that the differential rates constituted a violation of Article XVI(2) of the tax treaty, the case instead was decided on the basis of the freedom of establishment of legal persons, Articles 52 and 58 of the EC Treaty (1957), legal authority with which the Court seemed much more comfortable.

With respect to the determination of the tax base, Paragraph 3 requires that a PE be allowed to deduct regular business expenses, to depreciate or expense assets under the same conditions as resident enterprises, and to establish reserves that are recognized for tax purposes, to the extent that those adjustments to income relate to income attributable to the PE and therefore taxable in that State.[45] Host State rules allowing the carrying back or forward of losses are also to be extended to the foreign State enterprise determining its host State taxable income attributable to the PE.[46] Permanent establishments should also be entitled to any special tax rules applicable to the taxation of capital gains.[47]

The Commentary also takes a strong position with respect to tax incentives intended to support economic development. Such incentives should be available to foreign entities that have PEs in the State providing the incentives and that therefore are subject to tax therein. The foreign entity must, however, satisfy the same conditions and requirements as resident enterprises.[48]

For example, Country *A* has enacted a regime that provides tax incentives for film production that occurs within Country *A*. The incentives are available, however, only to companies that are residents of Country *A*. That is, Company *D*, a resident of Country *U*, cannot qualify for the incentives even if it films in Country *A* for a sufficiently long period of time that it is treated as having a PE in Country *A* and pays taxes to Country *A* on the profits attributable to the PE. Such discrimination would violate Paragraph 3. It is not sufficient that Company *D* could qualify for the tax incentives by incorporating a subsidiary in Country *A*. Instead, Country *A* should extend the tax incentives to

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Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income art. 16, para. 2, June 25, 1953, 190 U.N.T.S. 281.

45. *OECD Model*, *supra* note 10, cmt. art. 24, para. 40.

46. *Id.*

47. *Id.*

48. *Id.* paras. 43–45.

foreign companies that conduct their film production activities through PEs taxable in Country *A*.[49]

The rules relating to withholding taxes are also relatively straightforward. If the host State imposes the withholding tax with respect to payments to residents (as a prepayment of tax) and non-residents (in accordance with the applicable provisions of the treaty), such withholding taxes may also be applied to a PE (which could claim a refund to the extent the withholding tax exceeded the net income tax due on the income attributable to the PE).[50] However, if the withholding tax is imposed on a gross basis and only with respect to non-residents, then it conflicts with Paragraph 3 of Article 24 (as well as Paragraph 4 of Articles 10 and 11 and Paragraph 3 of Article 12).[51]

The Commentary also provides that the host State should, in principle, allow a foreign tax credit for withholding taxes imposed on income that is attributable to the PE.[52] This gives rise to certain complications in triangular situations because the PE is not entitled to benefits under the host State's treaties with third countries (including any reductions in rates of withholding taxes on investment income). The Commentary includes reasonable suggestions for dealing with such issues.[53]

The Commentary (including the 2008 changes to the Commentary) is more restrictive when dealing with issues regarding corporate structure and similar issues. For example, Paragraph 41 of the Commentary explains that a host country of a PE is not required to consolidate the PE's profits with those of affiliated enterprises. Paragraph 59

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49. *See* Explanatory Memorandum, Taxation Laws Amendment (Film Incentives) Bill 2002 (Cth HR) para 1.9 (Austl.) ("The requirement that the company be either an Australian resident or a permanent establishment is consistent both with the non-binding obligation in the Australia-USA double tax treaty to avoid discrimination, and with the more general model non-discrimination clause in the OECD model treaty. There is no discrimination between production companies that have the same tax presence in Australia, wherever resident or wherever incorporated.").

50. *OECD Model*, *supra* note 10, cmt. art. 24, para. 64.

51. *See id.* cmt. art. 24, para. 65. Strangely, in Paragraph 66, the Commentary suggests addressing any difficulty arising from this interpretation through bilateral negotiations.

52. *Id.* cmt. art. 24, para. 67. Within the European Union, this result effectively is required by *Saint-Gobain*. Case 307/97, Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt, 1999 E.C.R. I-6161.

53. *OECD Model*, *supra* note 10, paras. 69–72.

similarly concludes that domestic measures intended to integrate the taxation of companies and shareholders are not within the scope of Article 24(3).[54]

The Commentary also adopts an interesting distinction between taxes imposed on the profits of the PE[55] and those taxes imposed on amounts deductible from the profits attributable to the PE.[56] The former, a branch profits tax, is not permitted while, according to the Commentary, the latter is permitted because imposed on the enterprise, not the PE. This distinction is one that U.S. tax authorities made soon after the branch profits tax and the branch level interest tax were enacted in 1986,[57] but it is not altogether convincing. With respect to interest actually paid to third parties (one component of the branch level interest tax), the tax is imposed at treaty rates on amounts borne by the PE, so it is consistent with Article 11 for the United States to impose that tax in treaties that provide for a positive withholding rate on interest. The "excess interest tax" imposed on the imputed payment treated as made to the head office of the enterprise (the difference between the interest deduction allowable and interest paid by the PE to third parties) is more similar to the branch profits tax as it is meant to mimic the withholding tax that would have been imposed if the PE were instead a separate legal entity. It seems that both taxes should be consistent with Paragraph 3 or neither should be.

Although this discussion of equal treatment is couched in terms of the treatment of PEs and Paragraph 3, much of it should apply with respect to Paragraph 1 as well. That is, is there any real question whether a national of a Contracting State that satisfies the comparability test should be subjected to the same tax rates, allowed the same deductions, and granted the same incentives as nationals of the host State under Paragraph 1? The OECD could have included a robust discussion of the principle of equal treatment in the Commentary on Paragraph 1 and then focused on the complications that arise in applying those principles to PEs in the Commentary on Paragraph 3. Instead, most of the discussion

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54. Although the conclusion may be sound, the reasoning—that Paragraph 3 does not apply to the taxpayer as a whole as evidenced by the reference to family allowances in the second sentence thereof—seems less than obvious.

55. *OECD Model*, *supra* note 10, cmt. art. 24, para. 60.

56. *Id.* cmt. art. 24, para. 61.

57. *See* I.R.C. § 884.

on Paragraph 1 is about the limits of equal treatment and constraints on comparability, which suggests that Paragraph 1 is even more limited than it is. This organizational oddity should be corrected.

*3. Article 24(4)*

Article 24(4) is intended to require parity with respect to deductible payments made to residents and non-residents. It reads:

> Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

Accordingly, if Company *S*, a resident of State *S*, pays $100 in interest to Company *B*, a bank that is also a resident of State *S*, and $100 in interest to Company *L*, a resident of State *O*, the $100 paid to Company *L* should be deductible under the same terms as the $100 paid to Company *B*.[58]

There is an important and necessary caveat to this requirement with respect to payments between related enterprises. If, for example, Company *L* is related to Company *S*, and the amount of interest paid to Company *L* is more than Company *S* would have paid to an unrelated party, then Country *S* is not required to allow the deduction. This is accomplished through the cross-reference in Paragraph 24(4) to Paragraph 6 of Article 11.[59]

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58. Similarly, in calculating capital taxes imposed on net value, the debt to Company *L* should be treated in the same way as the debt to Company *B*.

59. Paragraph 6 of Article 11 provides that the substantive rules limiting source State taxation in the rest of Article 11 apply only to the arm's

Given the recent importance placed on "base erosion and profit shifting" by the OECD,[60] it is somewhat startling to see that the Commentary on Article 24 includes only three paragraphs on Paragraph 4. Most of what has been written with respect to Article 24(4) discusses its application to domestic thin capitalization rules. The OECD Commentary reaches the anodyne but unhelpful conclusion that thin capitalization rules that discriminate between payments made to residents and non-residents are consistent with Article 24(4) if the rules are consistent with Article 9(1) or 11(6). Paragraph 3 of the Commentary on Article 9 refers to the arm's length standard, helpfully pointing out that the standard applies not only to the rate of interest charged but also to whether a loan should be recharacterized as equity.

The problem is that there is no single arm's length capital structure. A company's ideal debt-to-equity ratio depends on a number of factors, including the company's business model and its shareholders' relative risk tolerance. For this reason, countries' attempts to establish a single debt-equity ratio across industries generally failed.

In 1989, the United States enacted the earnings stripping rules of prior section 163(j), which established limits on the deductibility of interest paid to related foreign parties in certain circumstances.[61] The provision was more sophisticated (or simply more complicated, depending on the point of view) than some other countries' thin capitalization rules, as it incorporated not only a fixed ratio but also an income test. Nevertheless, when the same provision was included in pending legislation in 1986, Secretary of the Treasury Baker had objected on the grounds that the limits would violate U.S. non-discrimination obligations.[62]

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length amount of interest. Article 11 does not affect the deductibility of the interest; deductibility is addressed by Articles 9(1) and 24(4).

60. *See* OECD, *OECD/G20 Inclusive Framework on BEPS: Progress Report July 2018–May 2019* (2019), https://www.oecd.org/tax/beps/inclusive-framework-on-beps-progress-report-july-2018-may-2019.pdf; OECD, *Action Plan on Base Erosion and Profit Shifting* (2013). http://dx.doi.org/10.1787/9789264202719-en.

61. *See* Robert E. Culbertson & Jaime E. King, *U.S. Rules on Earnings Stripping: Background, Structure, and Treaty Interaction*, 29 Tax Notes Int'l 1161 (Mar. 24, 2003).

62. *Baker Says Tax Bill Should Not Override U.S. Tax Treaty Obligations*, 32 Tax Notes 448 (Aug. 4, 1986) (providing text of July 31, 1986,

Congress attempted to assuage those concerns by applying the limits not only when interest was paid to foreign related parties but also when interest was paid to related U.S. tax-exempt entities. The textual argument is that the deduction has to be allowed "under the same conditions." The Commentary of course does not provide guidance regarding the comparison that is to be made. Even Paragraph 3 of the Commentary, which points out that "for these paragraphs to apply, other relevant aspects must be the same," does not even mention Paragraph 4. Mary Bennett notes that "[m]ost respected commentators have argued that this defense is a sham, since the proper comparison is between the nonresident business entity lender and a comparable U.S. business entity lender,"[63] citing in particular to the 1992 ALI study on income tax treaties.[64] David Rosenbloom includes the earnings stripping rationale within a series of justifications for discriminatory measures that he describes as "jerry-rigged and disingenuous."[65]

The trend towards "interest barriers," which set an upper limit on the amount of deductible interest as a percentage of a measure like EBIDTA, without regard to the identity of the payee, takes some pressure off of Article 24(4). The 2017 changes to the "earnings stripping" rules of section 163(j) were a step towards greater compliance with Article 24(4) because they adopted the interest barrier approach rather than focusing on payments to related parties. At the same time, the United States took at least one giant step backwards. The enactment of the Base Erosion and Anti-Abuse Tax (the "BEAT") raises significant new non-discrimination issues. The BEAT constitutes an alternative

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letter to House Ways and Means Committee Chairman Dan Rostenkowski, D-Ill., from Treasury Secretary James A. Baker III).

63. Bennett, *supra* note 5, at 453.

64. ALI, Federal Income Tax Project, International Aspects of United States Income Taxation II 258–59 (1992). In their General Report in *Non-Discrimination at the Crossroads of International Taxation*, Luc Hinnekens and Philippe Hinnekens, *supra* note 7, at 32, cited Bennett's conclusion with apparent approval. *See also* Culbertson & King, *supra* note 61, at 1176 ("Thus, it is far from clear why a treaty resident fully taxable in the treaty jurisdiction should not be properly compared to a U.S. resident fully taxable in the United States, for purposes of determining that the payment to the treaty resident is being made 'under the same conditions' that would support equal deductibility in both circumstances.").

65. H. David Rosenbloom, *Toward a New Tax Policy Treaty for a New Decade*, 9 Am. J. Tax Pol'y 77, 91 (1991).

minimum tax calculated without regard to a number of otherwise deductible payments made to non-U.S. related persons.[66] The deductions are denied without regard to whether or not they meet the arm's length standard, so there may be many situations where the BEAT would impose a tax without meeting the requirements of the exceptions in Article 24(4).

*4. Article 24(5)*

Article 24(5) is intended to prevent discrimination on the basis of ownership by foreign persons. It 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-mentioned State are or may be subjected.

Assume that Country *R* imposes a corporate tax of 25% on resident companies engaged in the banking business and owned by Country *R* residents. However, companies resident in Country *R* and engaged in the banking business that are owned by foreign persons are subject to corporate tax at a rate of 29%. If Company *S* is a wholly owned subsidiary of Company *T*, a resident of Country *T*, the differential tax rates should be a violation of Article 24(5) of the Country *R*-Country *T* tax treaty. Similarly, if the rate differential depends on whether the banking company was publicly traded in Country *R*, Article 24(5) would still be

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66. It has been argued that the BEAT does not deny a deduction but rather denies "the benefit" of the deduction because the BEAT is imposed at a rate of 10% rather than 21%. See Reuven S. Avi-Yonah, *Beat It: Tax Reform and Tax Treaties* (Univ. Mich. Pub. Law Research Paper, No. 587, 2018), https://ssrn.com/abstract=3096879. This argument conflates the BEAT with the corporate income tax, when in fact the BEAT is a separate tax that should be analyzed separately. See H. David Rosenbloom & Fadi Shaheen, *The BEAT and the Treaties*, 92 Tax Notes Int'l 53 (Oct. 1, 2018).

violated because a wholly owned subsidiary of a foreign company could not qualify for the lower rate of tax.

The Commentary states that Article 24(5), like 24(3) and 24(4), does not require the granting of various group reliefs. In addition, the Commentary states that a Contracting State may provide that dividends paid from one resident company to another are not subject to withholding tax, while dividends paid to a company that is a resident of the other Contracting State are subject to withholding tax. The argument is that the difference in treatment is due not to the ownership by the non-resident, but because dividends paid by that non-resident company would not be subject to withholding taxes imposed by the host State.[67]

Many of the cases that seem to most bother non-discrimination skeptics arise under this paragraph. For example, in *Square D Co. v. Commissioner*,[68] the taxpayer, the U.S. subsidiary of a French company, challenged the application of U.S. regulations that deferred a deduction for interest paid to a foreign related person until the interest actually was paid.[69] The court found that the provision did not depend on the ownership of the U.S. company but on the identity of the recipient.[70] Therefore, there was no violation of the equivalent in the U.S.-France treaty of Article 24(5). In this case, the court was almost certainly right—the regulation does not relate to ownership. The taxpayer would have had a better argument under Article 24(4), but the treaty didn't include that provision.

A more difficult case is *American Air Liquide, Inc. v. Commissioner*, also decided under the U.S.-France treaty.[71] In this case, the taxpayer received royalties from its French parent company that were treated as passive income for U.S. foreign tax credit purposes. The taxpayer sought to apply a look-through that a U.S. company would apply with respect to royalties received from its controlled foreign corporations. The court compared royalties received by the subsidiary to any other royalties received by a U.S. company from a foreign company that is not a controlled foreign corporation and denied look-through treatment.[72]

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67. *See OECD Model*, *supra* note 10, cmt. art. 24, para. 78.
68. 438 F.3d 739 (7th Cir. 2006).
69. *Id*. at 741.
70. *Id*. at 748.
71. 45 F.App'x. 721 (9th Cir. 2002).
72. *Id*. at 724.

Again, as a technical matter, the result is defensible. It also demonstrates the limits of Article 24(5).

A third case that is frequently cited for the proposition that U.S. courts are reluctant to find discrimination is *UnionBanCal Corp. v. Commissioner*.[73] It involved the specific problem of transactions between members of a controlled group. When a U.S. company sells an asset to another member of the controlled group at a loss, the loss is not recognized until the asset or the selling company leaves the group. In *UnionBankCal*, the loss sale was from a U.S. company to its U.K. parent. The remedy in the U.S. context is for the transferee to increase its basis in the asset when the transferor leaves the group, thus preserving the loss.[74] The United Kingdom's rules, not surprisingly, did not track the United States' highly technical rules in this regard.

It is hard to see this case as a matter of discrimination. It is really a failure to mesh the tax systems of the two countries in situations when an asset leaves the taxing jurisdiction of one State and becomes subject to the taxing jurisdiction of another. Peter Wattel argues that this "exercise in parallel" of taxing jurisdiction does not constitute discrimination.[75] Both the OECD and the European Union recently have blessed "exit taxes," which will give rise to similar problems. The OECD Model includes no provisions intended to address double taxation that arises from timing mismatches.[76] This should be addressed in a comprehensive way, but separately from the work on non-discrimination.

### *5. Relationship Between Paragraphs of Article 24*

As noted above, Article 24 does not provide a single, easily stated principle. Instead, it consists of separate rules with significant limitations.

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73. 305 F.3d 976 (9th Cir. 2002).

74. *Id.* at 986.

75. *See* Peter J. Wattel, *Non-Discrimination* à la Cour*: The ECJ's (Lack of) Comparability Analysis in Direct Tax Cases*, 55 Eur. Tax'n 542, 549 (2015).

76. The Canada-U.S. treaty, *supra* note 25, includes several provisions in Article XIII that deal with specific timing mismatches. Several other treaties include less extensive provisions. Since the United States enacted I.R.C.§ 877A, its own exit tax, it has added a "basis bump" provision in Article 13(7) of the 2016 U.S. Model Tax Convention on Income.

Those rules also have no cumulative effect. It has been suggested,[77] for example, that the BEAT applies to companies that are part of U.S. corporate groups in order to comply with the non-discrimination rules of U.S. treaties. Even if that were the motivation, it would only have satisfied concerns under Article 24(5). The BEAT is still problematic under Article 24(4). This relationship is explained with respect to more traditional thin capitalization rules in Paragraph 79 of the Commentary on Article 24.

This structure, and the limitations on the application of each individual rule, cause Article 24 to reach only the most blatant examples of discrimination. Arguably, this was the intention of the tax authorities who drafted the original version of Article 24 and those who "negotiated" the substantial revision of the Commentary in 2008. If tax authorities cannot be trusted to establish and comply with meaningful national treatment disciplines, perhaps the task should be turned over to others.

## III. Other Sources of National Treatment Obligations

### *A. Treaties of Friendship, Commerce, and Navigation*

The United States signed the first so-called FCN treaty in 1778 with France during the American Revolution.[78] It entered into a number of such treaties in the mid-1800s, primarily with countries in Latin America. Another wave of treaties entered into force after World War II, including an FCN with Germany. The provisions of that treaty relevant to taxes provide:

> Article XI
>
> 1. Nationals of either Party residing within the territories of the other Party, and nationals and companies of either Party engaged in trade or other gainful pursuit or in scientific, educational, religious or philanthropic

77. Treaties and the TCJA: A Disturbance in the Force?, Panel, American Bar Association Tax Section Meeting (May 11, 2018) (audience question from Kimberly S. Blanchard, partner, Weil, Gotshal & Manges LLP) (confirmation on file with *Florida Tax Review*).

78. *See supra* note 20.

activities within the territories of the other Party, shall not be subject to the payment of taxes, fees or charge imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, within the territories of such other Party, more burdensome than those borne in like situations by nationals and companies of such other Party.

2. With respect to nationals of either Party who are neither resident nor engaged in trade or other gainful pursuit within the territories of the other Party, and with respect to companies of either Party which are not engaged in trade or other gainful pursuit within the territories of the other Party, it shall be the aim of such other Party to apply in general the principle set forth in paragraph 1 of the present Article.

3. Nationals and companies of either Party shall in no case be subject, within the territories of the other Party, to the payment of taxes, fees or charges imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, more burdensome than those borne in like situations by nationals, residents and companies of any third country.

4. In the case of companies and of nonresident nationals of either Party engaged in trade or other gainful pursuit, within the territories of the other Party, such other Party shall not impose or apply any tax, fee or charge upon any income, capital or other basis in excess of that reasonably allocable or apportionable to its territories, nor grant deductions and exemptions less than those reasonably allocable or apportionable to its territories. A comparable rule shall apply also in the case of companies organized and operated exclusively for scientific, educational, religious or philanthropic purpose.

5. Each Party reserves the right to: (*a*) extend specific tax advantages on the basis of reciprocity; (*b*) accord

> special tax advantages by virtue of agreements for the avoidance of double taxation or the mutual protection of revenue; and (*c*) apply special provisions in allowing, to nonresidents, exemptions of a personal nature in connection with income and inheritance taxes.[79]

FCN treaties were general treaties covering a variety of topics. They eventually fell out of favor as the United States began negotiating more specialized agreements. Still, the U.S. State Department's January 1, 2019, version of Treaties in Force states that FCN treaties with dozens of countries remain in force and therefore at least theoretically could provide some measure of national treatment protection to nationals and companies of the parties.[80]

### *B. General Agreement on Trade in Services*

While there are relatively few direct taxation measures that discriminate against particular goods, the extension of trade disciplines to services by the adoption of the General Agreement on Trade in Services (the "GATS") in 1994 implicated a number of provisions of countries' domestic laws.[81] The GATS subjects to national treatment disciplines not only taxes on services but also those on service providers.[82] Accordingly, it applies such disciplines more broadly to foreign direct investment and,

79. Treaty of Friendship, Commerce and Navigation, U.S.-Ger., Oct. 29, 1954, 7 U.S.T. 1840.

80. U.S. Dep't of State, Treaties in Force: A List of Treaties and Other International Agreements of the United States in Force on January 1, 2019, https://www.state.gov/wp-content/uploads/2019/05/2019-TIF-Bilaterals-web-version.pdf.

81. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183 [hereinafter GATS] (entered into force 1 January 1995).

82. *See* Hugh J. Ault & Jacques Sasseville, *Taxation and Non-Discrimination: A Reconsideration*, 22 World Tax J. 101, 119 (2010) ("The view of the tax officials was that if these agreements are too broadly drafted and if tax laws and treaties are not carefully taken into account, the obligations imposed by these agreements may inadvertently have an impact on legitimate tax measures and upset the reasonable expectations and needs of taxpayers and tax authorities. Trade and investment officials, however, argued that taxation may be, and sometimes is, used to discriminate against foreign

therefore, direct taxes.[83] For this reason, tax authorities sought to ensure that the GATS carves out from such disciplines a number of common tax measures. The relevant provision reads:

> Article XIV: General Exceptions
>
> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> (a) necessary to protect public morals or to maintain public order;
>
> (b) necessary to protect human, animal or plant life or health;
>
> (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:
>
> (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
>
> (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
>
> (iii) safety;

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investment or products and that the general non-discrimination rules of these agreements should apply to all forms of discrimination.").

83. Michael Daly, *WTO Report*, *Non-Discrimination at the Crossroads of International Taxation*, 93a Cahiers de Droit Fiscal Int'l 73, 79 (2008).

> (d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;
>
> (e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.[84]

Article XVII imposes national treatment disciplines with respect to the provision of services. Article II is the most-favored nation provision, which requires (with some exceptions) that any concession provided by a member to another member must be provided to all members of the WTO.

WTO members are not given free rein to decide what measures are "aimed at ensuring the equitable of effective imposition or collection of direct taxes." A footnote explains what is covered in subparagraph (d) (and therefore potentially allowed notwithstanding a conflict with national treatment requirements):

> Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:
>
> (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
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> (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or

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84. GATS, *supra* note 81, art. XIV (footnotes omitted).

(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.

Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.[85]

Conclusion of the GATS entailed negotiation over specific commitments with respect to sectors and the modes in which services are provided. Countries were also permitted to take exceptions for existing provisions that were in conflict with national treatment requirements, but they are not permitted to take any action to make such non-compliance worse.[86]

A recent WTO case brought by Panama against Argentina involved the application of the GATS to tax measures, along with certain related measures. These measures were applied to countries on a

85. *Id.* art. XIV(d) n.6.
86. *Id.* art. XXI.

so-called "black list" comprised of countries that were uncooperative in terms of exchanging information for tax purposes with Argentina. In very simplified terms, Panama argued that Argentina's measures, which included differential withholding rates and transfer pricing rules for payments to countries on the black list, violated the most-favored nation and national treatment obligations of the GATS because of their effect on the ability of Panamanian companies to provide financial services to Argentina.[87] An initial panel decision concluded that certain of the measures violated the most-favored nation requirements of Article II(1) and, further, that they did not fall within the exemption in GATS Article XIV.[88]

The interesting part was that Argentina's measures were "provisionally" justified under GATS Article XIV(c) (ensuring compliance with GATS-compliant laws and regulations) but failed because the measures were "arbitrary."[89] The Appellate Body decision did not reach this question because it found that the eight measures at issue did not violate the most-favored nation provision.[90] The Panama-Argentina case leaves open questions regarding how the WTO will deal with anti-tax abuse measures. The use of the "arbitrary" standard suggests that a future panel could find that an anti-tax abuse measure meets the specific requirements of Article XIV(d) but still is not protected by Article XIV because it is not sufficiently tailored to the particular abuse.

### *C. The "Four Freedoms"*

Although the Member States of the European Union are not subject to a single "national treatment" standard, the "four freedoms" serve a similar function. These are (1) free movement of capital; (2) freedom to provide services; (3) freedom of establishment; and (4) free movement

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87. *See* Tom Miles, *Argentina Wins WTO Appeal in Case Targeting Panama Tax Practices*, Reuters (Apr. 14, 2016, 1:55 P.M.), https://www.reuters.com/article/us-argentina-panama-wto-idUSKCN0XB2D4.

88. Panel Report, *Argentina—Measures Relating to Trade in Goods and Services*, WTO Doc. WT/DS453/R (Sept. 30, 2015).

89. *See id.* ¶ 7.560.

90. Appellate Body Report, *Argentina—Measures Relating to Trade in Goods and Services*, ¶7, WTO Doc. WT/DS453/AB/R (Apr. 14, 2016).

of persons.[91] Member States have not ceded competence over direct taxation matters to the European Commission, but they may be forced to withdraw domestic tax measures that infringe on one of those freedoms.[92] So, for example, a Belgian rule that allowed a tax deduction for contributions to a pension fund organized in Belgium, but not for contributions to a pension fund organized in other countries, was found to violate Article 56 of the Treaty on the Functioning of the European Union, which comprises the freedom to provide services.[93]

It is useful to consider EU jurisprudence with respect to the four freedoms because it is the richest body of law regarding discrimination through tax measures. However, within the European Union there is a political imperative to create a "single market," which does not exist in the tax treaty context. As a result, it may not be appropriate to treat every tax measure that is found to violate one of the four freedoms when applied to residents of another EU Member State as also a violation of the non-discrimination provision of a tax treaty with a non-EU member. For example, it is likely that many countries would take the position that a tax treaty would not require them to allow a deduction for cross-border pension contributions, as described previously, in the absence of a specific provision in the treaty to that effect.

In recent years, EU Member States have become increasingly concerned about the abuse of directives and tax treaties. Following on the BEPS project, the European Union adopted the Anti-Tax Avoidance Directive ("ATAD"). The ATAD includes several specific anti-abuse rules, but also adopts a general anti-abuse rule that, while similar to the

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91. Richard Lyal, *EU Report*, *Non-Discrimination at the Crossroads of International Taxation*, 93a Cahiers de Droit Fiscal Int'l 55 (2008).

92. *See* Case C-311/97, Royal Bank of Scotland v. Elliniko Dimosio, 1999 E.C.R. I-2652 (citing Case C-279/93 Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225, paras. 21 & 26; Case C-80/94, Wielockx v. Inspecteur der Directe Belastingen, 1995 E.C.R. I-2493, para. 16; Case C-107/94, Asscher v. Staatssecretaris van Financiën, 1996 E.C.R. I-3089, para. 36; Case C-250/95, Futura Participations & Singer v. Administration des Contributions, 1997 E.C.R. I-2471, para. 19).

93. C-296/12, European Comm'n v. Kingdom of Belgium, 2014 EUR-Lex CELEX 62012CJ0296 (Jan. 23, 2014).

principal purpose test that is one of the BEPS minimum standards,[94] differs in certain respects. It reads:

> Article 6
>
> General anti-abuse rule
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> 1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
>
> 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
>
> 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.[95]

Although the General Anti-Abuse Rule is not yet in force universally, it is similar in certain respects to anti-abuse rules found, for example, in the Parent-Subsidiary Directive.[96] Several recent cases suggest that courts will not simply accept tax authorities' assurances that a rule is necessary to prevent abuse.

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94. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6—2015 Final Report* 55 (2015), http://dx.doi.org/10.1787/9789264241695-en.

95. Council Directive 2016/1164 of 12 July 2016 Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market, 2016 O.J. (L. 193) 1, 11.

96. Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation in the Case of Parent Companies and Subsidiaries of Different Member States, 2011 O.J. (L. 345) 8.

For example, *Deister Holding and Juhler Holding* involved a German substance and anti-treaty shopping rule that was based on predetermined criteria.[97] Under the rule, a holding company would not be entitled to the elimination of the German withholding tax under the Parent-Subsidiary Directive unless the holding company met one of three criteria, one of which was that it earn at least 10% of its income from its own economic activities (separate from its activities as a holding company). The Court of Justice of the European Union ("ECJ") held that an irrebuttable presumption of abuse is not allowed, but that tax authorities must undertake an individual examination of the whole operation in order to determine whether a particular structure is artificial.[98]

The ECJ reached a similar conclusion in *Eqiom SAS*.[99] In that case, a French anti-treaty shopping rule created a presumption of abuse that applied whenever dividends were distributed by a French resident subsidiary to a non-resident parent company controlled directly or indirectly by one or more residents of non-EU states. This presumption also was not in line with EU law because it was considered "disproportionate" and an unjustified restriction to the freedom of establishment.[100]

## IV. Case Study—Reinsurance and the BEAT

The concept of insurance is familiar to many people, although it is probably considered a necessary evil. It is likely that a much smaller number are aware of the concept of reinsurance, the process by which insurance companies can transfer and spread risks to other companies. The number of people who have ever thought about the U.S. taxation of reinsurance, as a percentage of the population, is probably vanishingly small.

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97. *See* Case C-504/16, Deister Holding AG & Juhler Holding A/S v. Bundeszentralamt für Steuern, 2017 EUR-Lex CELEX 62016CJ0504 (Dec. 20, 2017).

98. Jakob Bundgaard et al., *When Are Domestic Anti-Avoidance Rules in Breach of Primary and Secondary EU Law? Comments Based on Recent ECJ Decisions*, 58 Eur. Tax'n. 130, 135 (2018).

99. *See* Case C-6/16, Eqiom SAS, previously Holcim France SAS Enka SA v. Ministre des Finances et des Comptes Publics, 2017 EUR-Lex CELEX 62016CC0006 (Jan. 19, 2017).

100. Robert J. Danon, *Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups*, 72 Bull. for Int'l Tax'n, no. 1, 2018, at 31, 46.

And yet, for two decades, a fierce public relations battle has been fought between U.S-based insurance companies and foreign reinsurance companies. The complaint was that some U.S-based companies had "inverted"—replaced a U.S. parent company with a non-U.S. parent company—and thereafter would be able to avoid future U.S. taxation of profits from their property and casualty business.

U.S. rules regarding the calculation of reserves for property and casualty insurance companies are much stricter than those in other countries, so there can be a significant tax advantage to shifting the income out of the United States, often to Bermuda or Barbados. It is safe to say those two countries offer a hospitable tax environment. The U.S. subsidiaries of the inverted companies continued to issue policies to U.S. customers but then would transfer much of the risk (and much of the income) to their foreign related companies through "quota share" reinsurance treaties.[101]

The U.S. Internal Revenue Service and Treasury Department were aware of the inversions, both by insurance companies and other types of businesses. Regulations were issued to ensure that an inversion transaction would be a taxable event for shareholders.[102] Those regulations prevented some inversions, but another wave of inversions involved insurance companies whose stock prices had dropped, so that shareholders would be unlikely to recognize taxable gains. After this second wave, some U.S. insurers, led by Chubb and Hartford, began to lobby for measures that would increase U.S. taxation of foreign insurers writing insurance or reinsurance with respect to U.S. risks. The dispute became public with a front-page article in the New York Times.[103] While this story and related stories on tax havens led to a Pulitzer Prize for David Cay Johnston in 2001, the tax issue was not resolved so quickly.

At first, Chubb and Hartford proposed the simple solution of increasing the rate of the federal excise tax imposed on policies issued by foreign insurers with respect to U.S. risks. Such an increase would,

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101. Under such an agreement, the reinsurer agrees to accept a certain percentage of all risks written by the "ceding" company.

102. *See* U.S. Treas. Dep't, Office of Tax Policy, Corporate Inversion Transactions: Tax Policy Implications (2002).

103. David Cay Johnston & Joseph B. Treaster, *Bermuda Move Allows Insurers to Avoid Taxes*, N.Y. Times (Mar. 6, 2000), https://www.nytimes.com/2000/03/06/business/bermuda-move-allows-insurers-to-avoid-taxes.html.

however, have been a clear violation of the GATS. When becoming a party to the GATS, the United States had preserved its right to impose the federal insurance excise tax at current rates but not the right to increase the burden on foreign service providers. The proposal was a non-starter.

Over the course of the next 15 years or so, various proposals were floated. Some would have denied deductions for the reinsurance premiums paid to foreign reinsurers. All most likely would have violated the GATS because they were targeted directly at foreign insurers competing with U.S. insurers.

This obscure tax issue even spawned a pair of dueling websites. The website for the Coalition for Competitive Insurance Rates, the "leading voice for continued and increased competition within the insurance industry,"[104] described the various proposals as trade protectionism. The Coalition for American Insurance, in the meantime, was "working for a level playing field and tax fairness."[105] The Coalition for American Insurance even welcomed the BEAT, saying: "The Base Erosion and Anti-Abuse Tax (BEAT) is an important reform that will reduce the incentive to send U.S.-generated profits overseas."[106] The website for the Coalition for American Insurance has remained active since the 2017 tax law, posting stories about how insurance rates have not increased in the 11 months since the BEAT became law. The Coalition for Competitive Insurance Rates did not welcome the BEAT and the website has not been updated recently.

This raises several questions. Is the BEAT the "secret sauce" that shuts down the so-called "reinsurance loophole" without violating the GATS? If so, how is it different from the 20 years of proposals that preceded it? Or is the Coalition for Competitive Insurance Rates simply biding its time until a challenge is brought at the WTO? If such a challenge is brought, will the WTO be able to resolve the case in a way that does not unduly impinge on tax policy? Alternatively, should the U.S.

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104. *CCIR to Congress: Ax the Disaster Recovery Assistance Tax*, Coalition for Competitive Ins. Rates (Nov. 2, 2017), http://www.keepinsurancecompetitive.com/news-and-resources/2017/11/2/ccir-to-congress-ax-the-disaster-recovery-assistance-tax.html.

105. *Coalition: Positive News for Florida Insurance Consumers*, Coalition for Am. Ins. (June 8, 2018), www.coalitionforamericaninsurance.com/news/.

106. *Id.*

subsidiaries of foreign insurance groups bring a case under the non-discrimination articles of any relevant tax treaties?[107]

## V. Is It Really Incoherent, or Just Badly Drafted?

While the form of the non-discrimination article is quite different from the allocative provisions of tax treaties, its purpose is not substantially different. It is the purpose of tax treaties generally; they are "the primary means" to eliminate tax barriers to cross-border trade and investment.[108] In that respect, they can be compared to trade agreements, as both have "broadly similar goals, namely the removal of obstacles to the cross-border movement of goods, services, capital and labour (and also technology and tasks)."[109] Taxes can be a form of non-tariff measure, used to erect barriers against trade or cross-border investment.[110] The role of Article 24 therefore can be seen as preventing governments from erecting such barriers in ways that are not addressed by the distributive rules of Articles 6 to 21.

As described in Part II, such protections include prohibitions against discriminatory measures involving rates and the applicable tax base, the primary determinants of a taxpayer's level of taxation. What, then, explains the concern among U.S. academics over the lack of a "concept" or "principle" in the non-discrimination article?

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107. The U.S. tax treaty with Bermuda, which covers only certain insurance activities of Bermuda companies, does not have a robust non-discrimination article. Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on Behalf of the Government of Bermuda) Relating to the Taxation of Insurance Enterprises and Mutual Assistance in Tax Matters, July 11, 1986, Treaty Doc. 99-30. However, significant reinsurance activities are also conducted by companies resident in Barbados, Germany, and Switzerland. Those countries' tax treaties with the United States do contain non-discrimination articles that closely follow the OECD Model. *See United States Income Tax Treaties—A to Z*, IRS.Gov, https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-zn (last updated May 30, 2019) (links to treaty documents for Barbados, Germany, and Switzerland).

108. S. Exec. Rep. No. 114-1, at 27 (2016) (statement of Robert B. Stack, Former Deputy Assistant Sec'y, Int'l Tax Affairs, U.S. Treas. Dep't).

109. Daly, *supra* note 83, at 73–74.

110. *Id.* at 74.

First, there is historical context regarding the general application of trade rules to tax measures. Many articles were written within a few years of U.S. losses in the WTO with respect to the FSC/ETI dispute.[111] Although that dispute involved tax benefits for exports, not national treatment, there was some lingering bitterness over a case that condemned U.S. income tax benefits but allowed EU "border tax adjustments" that have a similar effect with respect to the value added tax. This may have affected negatively U.S. tax lawyers' view of trade disciplines generally.

Second, there is no doubt disappointment over U.S. jurisprudence with respect to the application of the non-discrimination article. As David Rosenbloom pointed out, Congress has adopted discriminatory provision after discriminatory provision, with various justifications that are flimsy at best.[112] Treasury and the Internal Revenue Service similarly claim that various provisions do not violate Article 24. The taxpayer's last hope, therefore, would be the courts but, as Lee Sheppard recently wrote regarding the BEAT, "[t]he nondiscrimination question would have to be decided in U.S. courts, and they don't care."[113] Hinnekens and Hinnekens reach the same conclusion, in slightly more polite terms.[114] Although, as discussed above, it is possible to conclude that there are reasonable grounds to reach the results in each case, Lee Sheppard's conclusion is not a stretch. This can only add to the general cynicism regarding the United States' commitment to its national treatment obligations.[115]

Finally, for some commentators, there may be a discomfort with, and fundamental misunderstanding of, tax treaties themselves.

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111. *See, e.g.,* David L. Brumbaugh, Cong. Research Serv., RL31660, A History of the Extraterritorial Income (ETI) and Foreign Sales Corporation (FSC) Export Tax-Benefit Controversy (2004).

112. Rosenbloom, *supra* note 65.

113. Lee A. Sheppard, *The Grim Reaper of Treaties?*, 94 Tax Notes Int'l 1269 (June 24, 2019).

114. Hinnekens & Hinnekens, *supra* note 7, at 39 ("[T]he tax authorities and courts of some jurisdictions interpret the provisions of Article 24 MC in a very restrictive manner so that the scope and impact of these provisions are even further reduced. This conclusion applies in particular to the UK and the USA.").

115. This includes the lack of challenge to the U.S. earnings stripping rules despite the apparent consensus among treaty experts that Congress's efforts to "comply" with U.S. non-discrimination obligations was a sham.

The discomfort may stem from the fact that tax treaties are not "pure" documents. They do not reflect either capital import neutrality or capital export neutrality. In fact, during treaty negotiations, invocation of one of those principles is likely to be met with a laughing invocation of the other, since the two are frequently in conflict. Rather, tax treaties reflect the conflicting interests of capital importing and capital exporting countries,[116] who reach a compromise that may leave each slightly unhappy. A treaty that reflects a compromise is unlikely to establish a principle.

Take, for example, the acceptance of gross-basis withholding taxes applied to non-residents of the source State, while residents of that State are subject to tax on a net basis. These withholding taxes are seen by trade lawyers as clear violations of the national treatment obligation.[117] They may also lead to excessive taxation (that is, taxation in excess of the tax that would have been paid in either Contracting State if the tax had been imposed on a net basis). Yet, these taxes are accepted not only in tax treaties but also in the GATS[118] and within the European Union.[119] Tax experts argue that withholding taxes on non-residents are justified by "administrative concerns related to the determination and collection of tax."[120] The concern is that the non-resident may have no other connections or assets in the source State, making it difficult to collect taxes that the non-resident does not pay voluntarily. Collecting the tax before income leaves the country therefore seems only prudent.[121]

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116. Even "capital importing" and "capital exporting" are not pure concepts. In any bilateral treaty negotiation, one country will be the capital importing country and one the capital exporting country (even if, with respect to other countries, their roles are different)—and those positions may switch from article to article.

117. Patricia A. Brown, *Withholding Taxes: Developing Sharper Instruments to Avoid Excessive Taxation of Income*, *in* New International Tax Cooperation Paradigm: Impact on Domestic Tax Regimes and the Cross-Border Allocation of Taxing Rights 19 (2017).

118. GATS, *supra* note 81, art. XIV fn. 6.

119. Case C-282/07, Belgian State v. Truck Center SA, 2008 E.C.R. I-10767 (discussed in Wattel, *supra* note 75, at 542, 545).

120. Ault & Sasseville, *supra* note 82, at 115.

121. The ECJ seems to take a similar view, adding

> While resident recipient companies are directly subject to the supervision of the [source State] taxing authorities,

A truly neutral provision would ensure that income is taxed only on a net basis regardless of which Contracting State is taxing it. The fact that tax treaties do not require such treatment makes it difficult to see a unifying principle. In fact, Articles 6 through 21 may be seen as a series of articles intended to ameliorate the effects of neutrality-busting gross-basis withholding taxes. Article 24 then emerges as a residual article intended to eliminate all other discriminatory measures that might create unjustified barriers to cross-border trade and investment.

Within the European Union, a Member State may attempt to salvage a measure that is found to be discriminatory by establishing a justification for that measure (in which case the next issue is whether the measure is "proportional").[122] This three-step process may make each step less fraught because the result does not depend entirely on the comparability analysis. That is, even if a non-resident were found to be comparable, a government can argue that providing equivalent treatment would give rise to an abuse.

The non-discrimination article of tax treaties would benefit from the addition of such an anti-abuse concept. Currently, the only hint at such an "out" is in Paragraph 4, where deductions may be denied if payments are not at arm's length. As noted earlier, however, the concept of arm's length conditions is problematic in the case of establishing a debt-equity ratio. Moreover, the arm's length exceptions in Paragraph 4 do not address other types of transactions that might concern governments, such as hybrid transactions. Accordingly, it may be appropriate to provide a general exception from the national treatment obligations of Article 24 for measures intended to address abusive transactions, similar to the approach of the GATS. This approach would allow consideration of whether the overall transaction results in double non-taxation. If double non-taxation is specifically addressed, then governments should be willing to interpret current Paragraph 4 as applying not only when the recipient is a resident of the State allowing the deduction but also for a

> which can ensure compulsory recovery of taxes, that is not the case with regard to non-resident recipient companies inasmuch as, in their case, recovery of the tax requires the assistance of the tax authorities of the other Member State.

*Truck Center*, Case C-282/07, para. 48.

122. Lyal, *supra* note 91, at 68.

comparably situated taxable resident of the other Contracting State.[123] Adding an explicit anti-abuse test could also relieve some pressure on the comparability test which, in Paragraph 1, effectively denies all protection to persons who are residents of the other Contracting State.

Some additional well-deserved hostility to the non-discrimination article no doubt arises from the difficulty of sorting out the relationships between the different paragraphs. There are overlaps and gaps that make it difficult to figure out which paragraph or paragraphs (if any) apply to a particular situation. This lack of coherence results from the historical development of the article, which apparently consisted of governments imagining different types of discrimination and proposing paragraphs to address them. Drafters of national treatment obligations in other types of agreements have the benefit of a relatively clean slate and have in some cases produced more rational, or at least better drafted, provisions that could inform the drafting of a reorganized non-discrimination article.

For example, Paragraphs 1 and 3, which guard against so-called "direct" discrimination, should be combined into a single paragraph. In determining whether a measure imposed by a State is discriminatory, the test should clearly distinguish between persons who are subject to tax in that State on a net basis from those that are not.

This effectively is how the paragraphs work together with respect to business enterprises. If a company that is incorporated in a different State is also a resident of the taxing State, it is covered by Paragraph 1. To the extent that company is a resident of another State, it is covered by Paragraph 3 with respect to the income that is taxable in that State.

The current structure of Article 24 does not, however, provide such continuity of treatment with respect to individuals. An individual who is a resident of one Contracting State and a resident of the other Contracting State is protected by Paragraph 1 with respect to taxes imposed by that other State. However, if he is not a resident of that other State, his protections are diminished. The Commentary makes clear that an individual who is taxable in the host State on income attributable to a PE is not entitled to the local rate applicable to companies[124] but

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123. In his critique of *Schumacker*, Peter Wattel argues that "the only comparison criterion that makes sense for direct taxation purposes, is: subject to tax or *not* subject to tax (or, as the case may be, *to what extent* subject to tax)?" Wattel, *supra* note 75, at 548–49.

124. *OECD Model*, *supra* note 10, cmt. art. 24, para. 37.

does not add the obvious corollary that he should be subject to tax at the rate applicable to income earned by residents of that State. Moreover, the treaty itself allows a Contracting State to deny the benefits of family allowances, etc., to that individual in their entirety, without regard to the portion of that individual's income that might be taxable in that State.[125] It is also not clear whether an individual who is subject to tax in the host State on income from employment, for example, is protected from discrimination with respect to rates or tax base.

At least some of those protections exist as between the separate States of the United States.[126] Within the European Union, such discrimination with respect to tax rates or tax base presumably would not be permitted on the basis of freedom of establishment of individuals with respect to business income. However, *Schumacker* provides protection with respect to family allowances only in limited cases.[127] A provision promoting neutrality would allow such family allowances in the host State and the residence State in the same proportion as the individual is subject to net taxation in each.[128]

The provision on taxes in the Germany-United States FCN treaty accomplishes much of this,[129] although it allows States to "apply special provisions" for personal exemptions relating to income and inheritance taxes. The provision does not, however, specifically address anti-abuse measures. Accordingly, it would need to be modified to achieve a balanced position that would be acceptable to governments in a post-BEPS world.

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125. The Commentary notes that this limitation is based on concerns that such an individual might be able to claim such allowances in two States. *OECD Model*, *supra* note 10, cmt. art. 24, para. 36.

126. *See* Ruth Mason, *Common Markets, Common Tax Problems*, 8 Fla. Tax Rev. 599, 617 (2007).

127. *Id.* at 618.

128. As noted above, a treaty providing true neutral treatment would ensure that an individual subject to tax in the State in which he provides services through the application of Articles 15 to 20 would be taxed on a net basis, but this discussion assumes that such drastic revision of the OECD Model or individual bilateral treaties is not likely.

129. The article also includes a most-favored national provision which presumably would not be acceptable to many governments but that in any case is rendered largely ineffective through a carve-out for benefits provided by tax treaties and other reciprocal benefits (such as a reciprocal exemption for income from international shipping and air transport).

## VI. A Possible First Draft

Experience suggests that it is unlikely that tax authorities will voluntarily agree on a coherent set of national treatment principles that limit their ability to draft broad discriminatory measures in the name of combatting "abuse." For that reason, an international tax organization does not seem the best forum for drafting a new version of Article 24 (which is sorely needed). While the Appellate Body in the Panama-Argentina dispute took a judicious approach that left open the question of which anti-tax haven measures would pass muster under the GATS, the ECJ has shown less patience with broad "anti-abuse" measures that are not tailored to the abuse they purport to combat. There is substantial danger, therefore, that continued failure by tax authorities to develop real and enforceable non-discrimination standards may lead to further incoherence as non-specialty courts or arbitrators shed their self-restraint.

It seems advisable to give the OECD one last opportunity to get this right. It is, after all, the one organization that has relevant expertise not only in tax matters but also trade and investment matters. The peer review process successfully adopted by the Global Forum on Transparency and Exchange of Information for Tax Purposes could serve as a model for the work. However, given the history of the 2008 changes to the Commentary on Article 24, it seems imperative that business be invited to participate in that process from the beginning, not after the fact, to limit governments' ability to give themselves license to do anything in the name of combatting abuse.

It is easy for discussions of non-discrimination to become highly theoretical. The following proposed version of Article 24 is intended to begin a more practical discussion. By abandoning the current version of Article 24 (and borrowing heavily from non-tax agreements), it will allow negotiators to consider whether they agree with the principles laid out in the article, rather than attempting to explain how the article already embodies the principles on which they agree.

> Article 24
>
> Non-Discrimination
>
> 1. (a) Nationals of either Contracting State that are residents of the other Contracting State or engaged in trade or other gainful pursuit therein, shall not be

subjected in that other State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which similar nationals of that other State are or may be subjected. If such national is subject to taxation in that State on only a portion of its income, each of the Contracting States:

(i) may take account of that person's worldwide income in determining the appropriate rate of tax applicable to the income taxable in that State; and

(ii) shall provide, on a proportional basis, the same personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

(b) With respect to nationals of either Contracting State who are neither resident nor engaged in trade or other gainful pursuit within the other Contracting State, it shall be the aim of such other State to apply in general the principle set forth in subparagraph (a) in respect of taxes other than those described in Article 2.

(c) This paragraph shall also apply to stateless persons who are residents of one of the Contracting States and, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. Interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of

> determining the taxable capital of such enterprise, be deductible under the same conditions as if they have been contracted to a resident of the first-mentioned State.
>
> 3. 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 other requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.
>
> 4. The preceding paragraphs shall not:
>
> (a) require a Contracting State to allow a deduction with respect to transactions between associated enterprises or other related parties if such transactions would not have occurred on the same terms (or at all) between persons who were not so associated; or
>
> (b) prevent a Contracting State from applying rules intended to prevent double non-taxation or to impose a tax charge upon a person or asset ceasing to be subject to the taxing jurisdiction of that Contracting State.
>
> 5. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

## VII. Conclusion

The non-discrimination article is neither elegant nor, in its current form, fit for purpose. Government concerns that the article would be read too expansively led to changes that made it too narrow in some respects. At the same time, taxpayers sometimes expect the article to do too much, including dealing with timing issues that should be addressed through

the competent authority process or, if they are pervasive, addressed in the distributive articles of the Convention. While a re-write of the non-discrimination article may be too much to expect, engaging in the exercise may lead to a consensus on the principles, which in turn may allow the adoption of smaller fixes (such as the addition of an anti-abuse exception) that achieve similar goals.