

# Persons Entitled to Treaty Benefits



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Treaties and Addressing Base-Eroding Payments  
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## Scope of Treaty: Whose Benefit?



### Art 1 Persons Covered

This Convention shall apply to persons who are residents of one or both of the Contracting States.

- What is the effect of this provision? Could it limit the application of a substantive Article?
- Is there a difference between application of a treaty and entitlement to benefits? Or application to payments made by a person rather than payments received?
- Does a treaty really apply to “persons”? Or to activities of persons? or only to income or capital of persons?

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## Scope of Treaty: Whose Benefit?



- Treaties don't just grant benefits, they also impose obligations.
- Contrast taxpayer vs tax administration perspectives.
- Alternate title of presentation-  
“Treaty disadvantages imposed on tax administrations”
- Why would a government agree to such disadvantages?
- What are the competing purposes of tax treaties?

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## Treaty Purpose Relevant to Benefits

“[T]he purpose of bilateral treaties is to promote international trade, investment, and development” Com on Art 5 para 10



- Relevance of object and purpose of a treaty when interpreting its terms: Vienna Convention Art 31(1)
- How does this purpose relate to Art 1?
- Is the purpose to promote trade only between the Contracting States or is any trade good enough?
- Problem with narrow view: fragmentation of source of trade and investment and ownership of artificial entities
- Bilateral nature of treaties conflicts with globalisation

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## Who is a “Person”?



Art 3(1)(a) The term “person” includes an individual, a company and any other body of persons;

(b) The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes...

- Which country must treat the entity as a body corporate?
- How would you interpret “body of persons”?
- Is a partnership a “person” for the purposes of tax treaties?
- Contrast definition of “national” referring to “legal person, partnership or association”; Art 3(1)(f)

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## Why is “Person” important?



- Cannot be a resident unless a person; Art 4
- Referred to without reference to resident in Art 5(5), (6) & (7); Art 9(1); Art 11(5) & (6), Art 12 (5) & (6); Art 17(2); Art 24(1); Art 26; Art 27
- Related concepts:
  - “independent personal services” Arts 6, 10, 11, 12, 13, 21, 22
  - “personal activities” Art 17
  - “personal allowances” Art. 24(3)
  - “personal relations” Art 4
  - “personnel” Art 5(3)(b)
  - “sportsperson” Art 17
  - “stateless person” Art 24(2)

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## Who is a Resident?



Art 4(1)... “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature... [It] does not include any person who is liable to tax... only [on] income from sources in that State...

- “liable to tax” vs “subject to tax” (e.g. Art 1 Com paras 46, 56 referring to OECD) vs “payment of tax” (Art 23)
- consecutive vs concurrent residence
- the “place of management” requirement?
- the exclusion for source only taxation

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## Why is “Resident” Important?



- Definitions: Art 3 “enterprise of a Contracting State”; Art 5(8) “permanent establishment”
- Deriving income: Arts 6, 8, 10-21, 23 & 24(4)
- Making payments: Arts 10, 11, 12, 15(2), 16 & 18(2)
- Capital owned or allocated to: Arts 22, 23 & 24(4) & (5)
- Capital owed or allocated from: Art 13(5)
- Non-discrimination: Art 24(1), (2) & (3)
- Mutual agreement: Art 25

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## “Enterprise of a Contracting State”

- Definitions: Art 5(5), (6) & (7) “permanent establishment”
- Deriving income: Arts 7, 9(1), 13(2)
- Making payments: Art 24(4)
- Capital owned or allocated to: Arts 9(1) & 22(2)
- Capital owed or allocated from: Arts 9(1) & 24(4)



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## Residence: Tie-breakers

Art 4(2) Where... an individual is a resident of both Contracting States, then... he shall be deemed to be a resident only of ...



(3) Where... a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

- Relevant for all purposes identified in slides 8 & 9?
- Manipulation of residence of artificial entities based on current tests including effective management.
- Fragmentation of corporate ownership and mobility of capital leading to treaty shopping
- OECD proposes replacing Art 4(3); BEPS Action 6 report

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## Beneficial Owner



- Limits on source state taxation under Arts 10(2), 11(2) & 12(2) only apply where the “beneficial owner” of the income is a resident of the other Contracting State
- Does not challenge “person” or “resident” so much as is a special income allocation rule for treaty purposes
- What does “beneficial ownership” mean?
  - Domestic vs. international meaning; Art 3(2) “context otherwise requires”
  - Relevance of Commentary in determining meaning
- Dislocation with other Articles, e.g. taxation of dividends looks to the beneficial owner but taxation of gains on the shares does not

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## Beneficial Owner



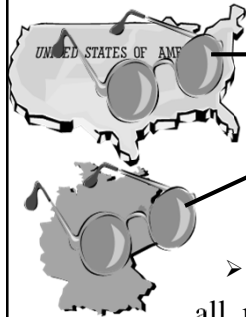
Commentary on Art 10 para 13 citing (old) OECD Com on Art 10 para 12... The term "beneficial owner" is not used in a narrow technical sense... it should be understood in its context and in light of the object and purposes of the Convention...

para 12.1... inconsistent with the object and purpose... for the State of source to grant relief... where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons... a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator...

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## Hybrid Entities



- Countries do not agree which entities have separate tax personality and so do not agree who makes and who receives a payment
- Result: expenses may be recognised twice or not at all, receipts may be recognised twice or not at all
- Part of larger issue of allocating payments and assets to persons
- A “hybrid” entity is recognised by one country as a tax entity (Germany) but another country views it as transparent (USA)
- Hybrids are often used in triangular situations but also in bilateral situations

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## Hybrids & Treaty Benefits



- Is a hybrid a “person”
- Who’s opinion matters?
- Is a hybrid a “resident”? Is it “liable to tax”?
- Is the hybrid’s owner a “resident” if the source state considers it receives payments that it is not taxable on?
- In the case of dividends, interest and royalties, who is the beneficial owner?
- Can Art 24(4) & (5) protect a hybrid from targeted anti-abuse rules?
- Treaty interaction with general anti-abuse doctrines and GAARs

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## Hybrids: OECD Report

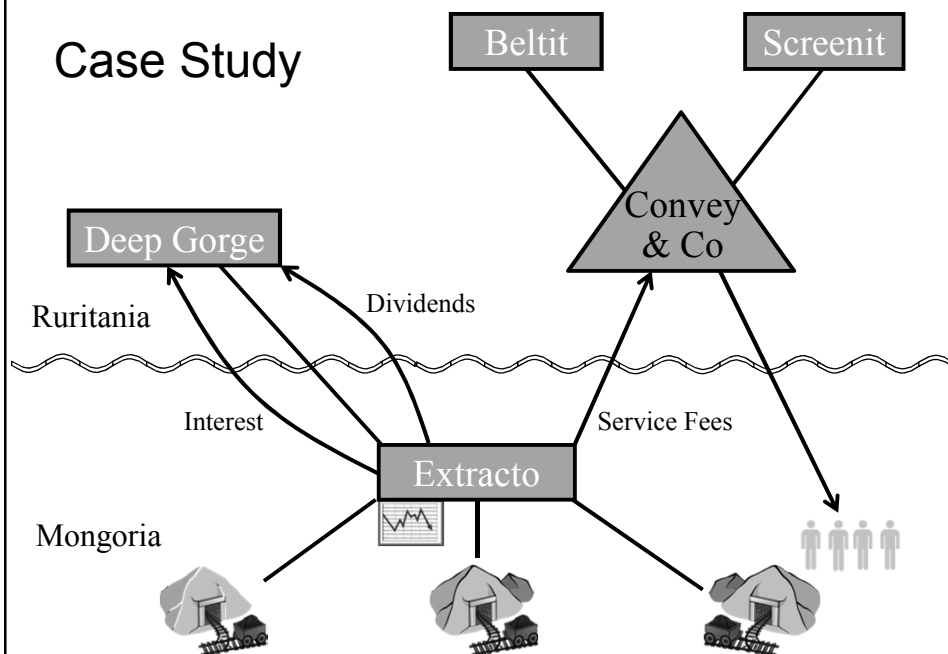


- Proposes changes to domestic law to prevent deduction / no income and double deduction outcomes
- Primary and defensive rules – need to know other country's tax law
- Main focus “related party” and “structured arrangements”
- No motive test – automatic application by requiring declaration in tax return
- Rules do not cover low tax rates, only tax base issues
- Adds Art. 1(2) on partly transparent entities

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## Case Study



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