

*LEAGUE OF NATIONS*  
*FISCAL COMMITTEE*

Model Bilateral Conventions  
for the Prevention of  
International  
Double Taxation  
and Fiscal Evasion

*SECOND REGIONAL TAX CONFERENCE*

*MEXICO, D.F., JULY 1943*

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*FISCAL COMMITTEE.*

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*SECOND REGIONAL TAX CONFERENCE*

*MEXICO, D.F., JULY 1943*

LEAGUE OF NATIONS, GENEVA

1945

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LEAGUE OF NATIONS  
FISCAL COMMITTEE

SECOND REGIONAL TAX CONFERENCE, MEXICO

REPORT ON THE WORK OF THE CONFERENCE

*INTRODUCTION*

The Second Regional Conference of the Fiscal Committee took place in México, D.F., from July 19 to 29, 1943.

The Secretary of Finance and Public Credit of Mexico, Mr. Eduardo Suárez, opened the first session of the conference and was elected as its honorary chairman.

The following persons attended the conference in a personal capacity, and not as representatives of their respective governments:

Mr. C. Fraser Elliott, Deputy Minister of National Revenue (Canada);

Mr. Mitchell B. Carroll, Counselor at Law, former Special Counsel, United States Treasury (United States of America), accompanied by:

Mr. Eldon P. King, Special Deputy Commissioner, Internal Revenue, and

Mr. William V. Whittington, Assistant Chief, Treaty Division, Department of State, observers;

Mr. Luciano Wiechers, Adviser of the Banco de México (Mexico), assisted by:

Mr. Enrique Ortiz, Director of Revenue, Ministry of Finance;

Mr. Gilberto Loyo, Chief, Department of Economic Investigations, Ministry of Finance;

Dr. Manuel Sánchez Sarto, Scientific Investigator, Department of Financial Studies, Ministry of Finance;

Mr. Raúl Martínez Ostos, Chief, Credit Department, Banco de México, and

*SECOND REGIONAL TAX CONFERENCE*

- Dr. Josué Sáenz, Director General of Statistics,  
Ministry of National Economy;
- Dr. Jesús Echeverri Duque, former Minister of Interior  
(Colombia);
- Dr. Vicente Grisanti, Director of International Politics,  
Ministry of Foreign Affairs (Venezuela), accom-  
panied by:
- Dr. Constantine E. McGuire, observer;
- Dr. Eduardo Riofrío Villagómez, Comptroller of the  
Caja de Seguros (Ecuador);
- Dr. Juan Lino Castillo, Technical Adviser and In-  
tendent, General Superintendency of Taxes  
(Peru);
- Dr. Vicente Mendoza López, former Minister of Fi-  
nance (Bolivia);
- Mr. Medardo Goytia, Assistant Director of Internal  
Taxes, former Minister of Lands and Colonization  
(Chile);
- Mr. Avelino C. Lerena, Administrative Director of  
Income Tax (Argentina);
- Dr. Mario La Gamma Acevedo, Adviser to the Minis-  
ter of Finance, Secretary of the Tax Legislation  
Committee (Uruguay).

In addition, the following observers assisted the Conference:

- Dr. Alfonso Carrillo, Ambassador of Guatemala in  
Mexico;
- Dr. Pedro Corpion Caula, First Secretary of the Em-  
bassy of Cuba in Mexico;
- Mr. Manuel J. Sierra, Delegate of the Pan-American  
Union.

Mr. Luciano Wiechers was elected chairman of the Conference.  
The Conference had before it the Draft Model Convention for  
the Prevention of Double Taxation of Income which had been  
prepared in June, 1940, by the First Regional Tax Conference  
in Mexico, as well as other documents submitted by various experts  
and the Secretariat of the League of Nations on the prevention

## REPORT

of double taxation of income, the prevention of double taxation of successions, the establishment of a reciprocal cooperation between national tax administrations for the assessment and collection of direct taxes and, finally, postwar fiscal problems.

After a general discussion, the Conference organized four sub-committees to deal respectively with the various items of the agenda, as follows:

Sub-committee I: Prevention of international double taxation of income, presided by Mr. C. Fraser Elliott;

Sub-committee II: Prevention of international double taxation of successions, presided by Dr. Juan Lino Castillo;

Sub-committee III: Administrative cooperation for the assessment and collection of direct taxes, presided by Mr. Avelino C. Lerena;

Sub-committee IV: General fiscal problems, presided by Dr. Jesús Echeverri Duque.

As the result of the discussions which took place in the meetings of the sub-committees and the plenary sessions of the Conference the three following model conventions, the text of which is reproduced hereafter, were prepared:

1. Model convention I for the prevention of international double taxation of income;
2. Model convention II for the prevention of international double taxation of successions;
3. Model convention III concerning cooperation between national tax administrations for assessment and collection of direct taxes.

These model conventions were drafted in the light of the work of the General Meeting of Government Experts on Double Taxation and Fiscal Evasion, which was organized by the League of Nations in 1928, the meetings of the Fiscal Committee from 1930 to 1939, as well as of the numerous bilateral conventions which were concluded during the period which preceded the present conflict.

The object of these models is to facilitate negotiations between States for the prevention of international double taxation and



## SECOND REGIONAL TAX CONFERENCE

fiscal evasion, taking especially into account the requirements of the reorganization of the international economy after the war. The preparation of these model conventions also served as a useful clearing ground for the exchange of ideas, thus facilitating initially the possibility of adoption of common solutions, through greater understanding of the various national viewpoints and ways of approach in relation to the several technical matters considered.

The Conference requested the Secretary of the Fiscal Committee to prepare, in consultation with the chairmen of the various sub-committees, a commentary of the model conventions which have been drawn up. The commentary will not necessarily represent the views of the Conference or its members and it is occasioned by the fact that some of the features of the articles of the model conventions herewith are not regarded as wholly acceptable by some of the members of the Conference, but as they were generally accepted during the discussions, such provisions have been retained and inserted in the models as indicative of the terms in which they might be couched by Governments that adopt them, in actual fact, in any international convention.

The Conference considers that, when the governments have communicated to the Secretariat of the League of Nations their observations on this report, it might be appropriate that a new conference should take place in order to clarify, amend and complete, in so far as may be necessary, the conclusions and recommendations contained in this report.

With reference to general fiscal problems, the Conference took cognizance of a plan of study prepared by its fourth sub-committee on the tax problems which may arise after the war. The members of the sub-committee have been requested to pursue their work by correspondence, in order to enable the Secretariat to submit, as soon as possible, a detailed report on the subject to the Fiscal Committee.

I

*MODEL BILATERAL CONVENTION FOR THE  
PREVENTION OF THE DOUBLE  
TAXATION OF INCOME*

*Article I*

1. The present Convention is designed to prevent double taxation in the case of the taxpayers of the contracting States, whether nationals or not, as regards the following taxes:

A. With reference to State A:

1. ....
2. ....
3. ....

B. With reference to State B:

1. ....
2. ....
3. ....

2. It is mutually agreed that the present Convention shall apply also to any other tax, or increase of tax, imposed by either contracting State subsequent to the date of signature of this Convention upon substantially the same bases as the taxes enumerated in the preceding paragraph of this article.

*Article II*

Income from real property shall be taxable only in the State in which the property is situated.

*Article III*

1. Income from mortgages on real property shall be taxable only in the State where the property is situated.

2. Income from mortgages on sea and/or air vessels shall be taxable only in the State where such vessels are registered.

*Article IV*

1. Income from any industrial, commercial or agricultural business and from any other gainful activity shall be taxable only in the State where the business or activity is carried out.

#### MODEL CONVENTIONS

2. If an enterprise or an individual in one of the contracting States extend their activities to the other State, through isolated or occasional transactions, without possessing in that State a permanent establishment, the income derived from such activities shall be taxable only in the first State.

3. If an enterprise has a permanent establishment in each of the contracting States, each State shall tax that part of the income which is produced in its territory.

4. As regards agricultural and mining raw materials and other natural materials and products, the income which results from prices prevailing between independent persons or conforming to world market quotations shall be regarded as realized in the State in which such materials or products have been produced.

#### *Article V*

Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered in such State is taxable only in that State.

#### *Article VI*

1. Directors' percentages, attendance fees and other special remuneration paid to directors, managers and auditors of companies are taxable only in the State where the fiscal domicile of the enterprise is situated.

2. If, however, such remuneration is paid for services rendered in a permanent establishment situated in the other contracting State, it shall be taxable only in that State.

#### *Article VII*

1. Compensation for labour or personal services shall be taxable only in the contracting State in which such services are rendered.

2. A person having his fiscal domicile in one contracting State shall, however, be exempt from taxation in the other contracting State in respect of such compensation, if he is temporarily present within the latter State for a period or periods not exceeding a total of one hundred and eighty-three days during the calendar year, and shall remain taxable in the first State.

## DOUBLE TAXATION OF INCOME

3. If the person remains in the second State more than one hundred and eighty-three days, he shall be taxable therein in respect of compensation he earned during his stay there, but shall not be taxable in respect of such compensation in the first State.

4. Income derived by an accountant, an architect, a doctor, an engineer, a lawyer or other person engaged in the practice of a liberal profession shall be taxable only in the contracting State in which the person has a permanent establishment at, or from, which he renders services.

5. If any such person has a permanent establishment in both contracting States, he shall be taxable in each State only on the income received for services rendered therein.

### *Article VIII*

1. Salaries, wages and other remuneration paid by one of the contracting States, or by public bodies, institutions or services depending on it, to its nationals carrying out public functions in the other State shall be taxable only in the first State, provided that these functions are included within the normal field of activity of the State, as this field is defined by international usage.

2. Public pensions shall be taxable only in the State of the debtor entity.

### *Article IX*

Income from movable capital shall be taxable only in the contracting State where such capital is invested.

### *Article X*

1. Royalties from immovable property or in respect of the operation of a mine, a quarry, or other natural resource shall be taxable only in the contracting State in which such property, mine, quarry, or other natural resource is situated.

2. Royalties and amounts received as a consideration for the right to use a patent, a secret process or formula, a trademark or other analogous right shall be taxable only in the State where such right is exploited.

3. Royalties derived from one of the contracting States by an individual, corporation or other entity of the other contracting

*MODEL CONVENTIONS*

State, in consideration for the right to use a musical, artistic, literary, scientific or other cultural work or publication shall not be taxable in the former State.

*Article XI*

Private pensions and life annuities shall be taxable only in the State where the debtor has his fiscal domicile.

*Article XII*

Gains derived from the sale or exchange of real property shall be taxable only in the State in which the property is situated.

*Article XIII*

The State where the taxpayer has his fiscal domicile shall retain the right to tax the entire income of the taxpayer whether derived from its territory or from that of the other contracting State, but shall deduct from its tax on such entire income the lesser of the two following amounts:

- A. The tax collected by the latter contracting State on the income which is taxable in its territory according to the preceding articles;
- B. The amount which represents the same proportion in comparison with the total tax on the income that is taxable in both States as the income taxable in the other State in comparison with the total income.

*Article XIV*

In the case of a taxpayer with a fiscal domicile in both contracting States, the tax, the collection of which under this Convention depends on fiscal domicile, shall be imposed in each of the contracting States in proportion to the period of stay during the preceding year or according to a proportion to be agreed by the competent administrations.

*Article XV*

A taxpayer having his fiscal domicile in one of the contracting States shall not be subject in the other contracting State, in respect of income he derives from that State, to higher or other

*DOUBLE TAXATION OF INCOME*

taxes than the taxes applicable in respect of the same income to a taxpayer having his fiscal domicile in the latter State, or having the nationality of that State.

*Article XVI*

1. When a taxpayer shows proof that the action of the tax administration of one of the contracting States has resulted in double taxation, he shall be entitled to lodge a claim with the tax administration of the State in which he has his fiscal domicile or of which he is a national.

2. Should the claim be admitted, the competent tax administration of that State shall consult directly with the competent authority of the other State, with a view to reaching an agreement for an equitable avoidance of double taxation.

*Article XVII*

As regards any special provisions which may be necessary for the application of the present Convention, more particularly in cases not expressly provided for, the competent authorities of the two contracting States may confer together and take the measures required in accordance with the spirit of this Convention.

*Article XVIII*

1. This Convention and the accompanying Protocol, which shall be considered to be an integral part of the Convention, shall be ratified and the instruments of ratification shall be exchanged at ..... as soon as possible.

2. This Convention and Protocol shall become effective on the first day of January 19... They shall continue effective for a period of three years from that date and indefinitely after that period. They may, however, be terminated by either of the Contracting States at the end of the three-year period or at any time thereafter, provided that at least six months prior notice of termination has been given, the termination to become effective on the first day of January following the expiration of the six-month period.

Done in duplicate, at ..... this ..... day of ....., 19.....

MODEL CONVENTIONS

PROTOCOL

On proceeding to sign the Convention for the prevention of double taxation of income concluded this day between . . . . . and . . . . . the undersigned Plenipotentiaries have agreed the following provisions which shall form an integral part of the said Convention.

*Article I*

The terms "taxpayer of a contracting State" and "enterprise of a contracting State" mean a taxpayer or an enterprise whose fiscal domicile is in the said State.

*Article II*

1. For the purpose of the present Convention the term "fiscal domicile" means, in the case of an individual or of an enterprise belonging to an individual, the place where the individual has his normal residence, the term "residence" being understood to mean permanent home.

2. Should a taxpayer possess a residence in both the contracting States, the competent administration shall determine, by common agreement, the place of his main residence, which shall be considered as his fiscal domicile. In order to determine, as between several residences, the main residence, the competent administration will take into account elements such as the duration, regularity, frequency of stays, the place where the family of the taxpayer is usually present, the proximity to the place where the party concerned carries out his occupation.

3. In the case of a taxpayer having a residence in both of the contracting States of which either can be considered as his main residence, Article XVII shall apply.

4. The fiscal domicile of partnerships, companies and other legal entities or *de facto* bodies shall be the State under the laws of which they were constituted.

*Article III*

Differences which arise concerning the nature of real property shall be settled in accordance with the legislation of the territory where the property is situated.

Article IV

The term "enterprise" includes any kind of enterprise whether it belongs to an individual, a partnership, a company or any other legal entity or *de facto* body.

Article V

1. The term "permanent establishment" includes head offices, branches, mines and oil-wells, plantations, factories, workshops, warehouses, offices, agencies, installations, professional premises and other fixed places of business having a productive character.

2. A building site (*chantier de construction*) constitutes a "permanent establishment" when it is destined to be used for a year at least or has been in existence for a year.

3. The fact that an enterprise established in one of the contracting States has business dealings in another contracting State through an agent of genuinely independent status (broker, commission agent, etc.) shall not be held to mean that the enterprise has a permanent establishment in the latter State.

4. When an enterprise of one of the contracting States regularly has business relations in the other State through an agent established there who is authorized to act on its behalf, it shall be deemed to have a permanent establishment in that State.

A permanent establishment shall, for instance, be deemed to exist when the agent:

- A. Is a duly accredited agent (*fondé de pouvoir*) and habitually enters into contracts for the enterprise for which he works; or
  - B. Is bound by an employment contract and habitually transacts business on behalf of the enterprise in return for remuneration from the enterprise; or
  - C. Is habitually in possession, for the purpose of sale, of a depot or stock of goods belonging to the enterprise.
5. As evidence of an employment contract under the terms of B above may be taken, moreover, the fact that the administrative expenses of the agent, in particular the rent of premises, are paid by the enterprise.



## MODEL CONVENTIONS

6. The fact that a broker places his services at the disposal of an enterprise in order to bring it into touch with customers does not in itself imply the existence of a permanent establishment for the enterprise, even if his work for the enterprise is, to a certain extent, continuous or is carried on at regular periods, and even if the goods sold have been temporarily placed in a warehouse. Similarly, the fact that a commission agent (*commissionnaire*) acts in his own name for one or more enterprises and receives a normal rate of commission does not constitute a permanent establishment for any such enterprise, even if the goods sold have been temporarily placed in a warehouse.

7. A permanent establishment shall not be deemed to exist in the case of commercial travellers not coming under any of the preceding categories.

8. The fact that a parent company, the fiscal domicile of which is one of the contracting States, has a subsidiary in the other State does not mean that the parent company has a permanent establishment in that State, regardless of the fiscal obligations of the subsidiary toward the State in which it is situated.

### Article VI

The allocation of the income of the enterprises mentioned in Article IV of the Convention shall be effected in the following manner:

1. In respect of industrial, commercial and agricultural enterprises in general and for other independent activities:

A. If an enterprise with its fiscal domicile in one contracting State has a permanent establishment in the other contracting State, there shall be attributed to each permanent establishment the net business income which it might be expected to derive, if it were an independent enterprise engaged in the same or similar activities, under the same or similar conditions. Such net income will, in principle, be determined on the basis of the separate accounts pertaining to such establishment. According to the provisions of this Convention, such income shall be taxed in accordance with the legislation and agreements of the State in which such establishment is situated.

*DOUBLE TAXATION OF INCOME*

- B. The fiscal authorities of the contracting States shall, when necessary, in execution of the preceding section, rectify the accounts produced, especially to correct errors or omissions, or to re-establish the prices or remunerations entered in the books at the value which would prevail between independent persons dealing at arm's length. If the accounts of the permanent establishment in one contracting State are rectified as a result of such verification, a corresponding rectification shall be made in the accounts of the establishment in the other contracting State with which the dealings in question have been effected.
- C. If an establishment does not produce an accounting showing its own operations, or if the accounting produced does not correspond to the normal usages of the trade in the country where the establishment is situated, or if the rectifications provided for in the preceding section cannot be effected, or if the taxpayer agrees, the fiscal authorities may determine, in a presumptive manner, the business income by applying a percentage to the gross receipts of that establishment. This percentage is fixed in accordance with the nature of the transactions in which the establishment is engaged and by comparison with the results obtained by similar enterprises operating in the country. Where the activities of the permanent establishment are in the nature of those of a genuinely independent commission agent or broker, the income may be determined on the basis of the customary commission received for such services.
- D. If the methods of determination described in the preceding sections are found to be inapplicable, the net business income of the permanent establishment may be determined by a computation based on the total income derived by the enterprise from the activities in which such establishment has participated. This determination is made by applying to the total income coefficients based on a comparison of gross receipts, assets, number of hours worked or other appropriate factors, provided such factors are so selected as to ensure results approaching as closely as possible those which would be reflected by a separate accounting.

*MODEL CONVENTIONS*

2. In determining the net income on the basis of the separate accounting of a permanent establishment, a properly apportioned part of the general expenses of the head office of the enterprise may be deducted.

3. In respect of banking and financial enterprises, the allocation of the income shall be effected in conformity with the principles laid down in paragraph 1 of the present Article, provided that when a permanent establishment of the enterprise is in the position of a creditor or debtor in relation to another permanent establishment of the enterprise, the following provisions shall apply:

- A. If a permanent establishment in one State (creditor establishment) supplies funds, whether in the form of an advance, loan, overdraft, deposit, or otherwise, to a permanent establishment in the second State (debtor establishment), interest shall be deemed to accrue as income to the creditor establishment and as a deduction from gross income to the debtor establishment for tax purposes, and it shall be computed at the inter-bank rate for similar transactions in the currency used;
- B. The interest corresponding to the permanent capital allotted to the debtor establishment, whether in the form of an advance, loan, overdraft, deposit or otherwise shall be, however, excluded from the interest accruing as income to the creditor establishment and deductible from gross income by the debtor establishment.

4. The net income of insurance enterprises shall be determined in conformity with the principles laid down in paragraph 1 of the present Article. If, however, these principles are not applicable in a given case, the net taxable income of a permanent establishment belonging to an insurance enterprise may be assessed, either by applying, to the gross premiums received as a result of the activity of the permanent establishment, coefficients computed on the basis of the total income of a representative national enterprise of the particular category of insurance concerned, or by apportioning the income according to the ratio existing between the gross premiums relating to the permanent establishment and the total gross premiums received by the enterprise.

## DOUBLE TAXATION OF INCOME

5. In cases where the foregoing rules do not result in a fair allocation of income, the competent authorities may consult to agree upon a method that will prevent double taxation.

### *Article VII*

When an enterprise of one contracting State has a dominant participation in the management or capital of an enterprise of another contracting State, or when both enterprises are owned or controlled by the same interests, and, as the result of such situation, there exist in their commercial or financial relations conditions different from those which would have existed between independent enterprises, any item of profit or loss which should normally have appeared in the accounts of one enterprise, but which has been, in this manner, diverted to the other enterprise, shall be entered in the accounts of such former enterprise, subject to the rights of appeal allowed under the laws of the State of such enterprise.

### *Article VIII*

The provisions of Article IV of the Convention shall not apply to pedlars, inland shipping, touring shows and other similar occupations, which shall be taxable in accordance with the legislation of the country where these occupations are carried on and concerning which the competent administrations may, if necessary, agree special provisions.

### *Article IX*

For the purposes of Article IX of the Convention, the term "income from movable capital" includes income from public funds, obligations, loans, deposits, whether fixed or on current account, income from shares and similar participations in companies, as well as income from sleeping partner shares or shares of partners having no powers of management or personal liability in partnerships.

### *Article X*

Students and apprentices from one contracting State residing in the other contracting State exclusively for the purpose of study or for acquiring business experience shall not be taxable by the latter State in respect of remittances received by them from within the former State for the purpose of their maintenance or studies.

## II

### *MODEL BILATERAL CONVENTION FOR THE PREVENTION OF THE DOUBLE TAXATION OF SUCCESSIONS*

#### *Article I*

1. The present convention, the purpose of which is to prevent the double taxation of successions, applies to all duties and taxes levied, by reason of death, on the estate, or on the transfer of, or the succession to, the estate, of a person who, at the time of his death, had his domicile in one of the two contracting States, whether or not he was a national of that State or the other State, and on the part of such estate that accrues to each heir or legatee.

2. The duties and taxes to which this Article refers are:

A. In the case of State A:

1. ....
2. ....
3. ....

B. In the case of State B:

1. ....
2. ....
3. ....

#### *Article II*

Real property, personal property accessory thereto and rights relating to, or secured by, real property which are included in the estate of a person who, at the time of his death, had his domicile in one of the two contracting States shall be subject to the duties and taxes described in Article I only in the State in which such property is situated.

#### *Article III*

Property appertaining to a commercial, industrial, mining, agricultural or other enterprise, including a maritime or an air navigation enterprise, left by a person who, at the time of his death, had his domicile in one of the contracting States shall be subject to the duties and taxes described in Article I in accordance with the following rules:

#### DOUBLE TAXATION OF SUCCESSIONS

- A. If the enterprise has a permanent establishment in one of the two States, the property shall be taxable only in that State;
- B. If the enterprise has a permanent establishment in both States, the property shall be taxable in each State to the extent to which such property belongs or relates to the establishment situated in that State.

#### *Article IV*

If a person who, at the time of his death, had his domicile in one of the contracting States leaves in the other contracting State property to which Articles II and III do not apply, the former State may apply the duties and taxes described in Article I of the present Convention to the entire estate, subject to the provisions of Article VI, and the latter State may apply such duties and taxes to the property situated in its territory, but only according to the rate which corresponds to the value of the latter property, without taking into account the property situated in the territory of the other State.

#### *Article V*

For the purposes of determining the net value of the property subject to the duties and taxes to which this Convention refers, the debts of the deceased shall be deducted according to the following rules:

- A. A debt secured by, or relating to, property to which Articles II and III apply shall be deducted from the value of the specific property by which it is secured, or to which it relates;
- B. If a debt to which rule A applies exceeds the value of the property by which it is secured or to which it relates, it shall be deducted from the value of the other property left by the deceased in the same country;
- C. If a debt to which rule A applies exceeds also the value of the property situated in the same country, the excess shall be deducted from the value of the property left by the deceased in the other country;

*MODEL CONVENTIONS*

- D. A general debt without specific guarantee will be deducted proportionately to the value of the property left by the deceased in each country.

*Article VI*

The State in which the deceased, at the time of his death, had his domicile shall retain the right to tax the entire estate, whether situated in its territory or that of the other contracting State, but shall deduct from the duties and taxes it applies to the entire estate the lesser of the two following amounts:

- A. The sum of the duties and taxes levied by the other contracting State on the property which is taxable in its territory, according to the preceding articles;
- B. The sum which represents the same proportion in comparison with the duties and taxes due in the State of domicile as the property taxable in the other State in comparison with the entire taxable estate of the deceased.

*Article VII*

As regards any special provisions which may be necessary for the application of the present Convention, more particularly in cases not expressly provided for, the competent authorities of the two contracting States may confer together and take the measures required in accordance with the spirit of this Convention.

*Article VIII*

1. This Convention and the accompanying Protocol, which shall be considered to be an integral part of the Convention, shall be ratified and the instruments of ratification shall be exchanged at ..... as soon as possible.

2. This Convention and Protocol shall become effective on the first day of January 19... They shall continue effective for a period of three years from that date and indefinitely after that period. They may, however, be terminated by either of the contracting States at the end of the three-year period or at any time thereafter, provided that at least six months prior notice of termination has been given, the termination to become effective on

DOUBLE TAXATION OF SUCCESSIONS

the first day of January following the expiration of the six-month period.

Done in duplicate, at ..... this ..... day of ..... 19..

PROTOCOL

On proceeding to sign the Convention concluded this day between the contracting States regarding the prevention of the double taxation of successions, the undersigned Plenipotentiaries have made the following joint declaration which shall form an integral part of the said Convention.

Article I

1. For the purposes of the foregoing Convention, the domicile of a person, at the time of his death, is the place where he then had his permanent residence with the manifest intention of retaining it.

2. If the deceased, at the time of his death, had no such domicile and was a national of both contracting States, he shall be regarded as having had his domicile in the country in which his family, social and economic interests were centered.

Article II

The question whether property is to be regarded as real or personal shall be settled in accordance with the laws of the State in which the property is situated.

Article III

The situation of personal property accessory to real property and of rights relating to, or secured by, real property shall be determined in accordance with the laws of the State in which the real property concerned is situated.

Article IV

1. The expression "commercial, industrial, mining, agricultural or other enterprise, including a maritime or an air navigation enterprise" and the expression "permanent establishment"



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have the same meaning for the purposes of the foregoing Convention as in Articles IV and V of the Protocol of the Model Bilateral Convention for the Prevention of the Double Taxation of Income.

2. In the case of an enterprise with a permanent establishment in each of the two contracting States, the apportionment of the assets and liabilities will be achieved through the application, by analogy, of the rules concerning the allocation of income that are expressed in Article VI of the Protocol of the Model Bilateral Convention for the Prevention of Double Taxation of Income.

*Article V*

For the purpose of Article IV of the foregoing Convention, personal property herein below mentioned shall be deemed to be situated:

- A. At the place where the property is situated, in the case of:
  - a. ....
  - b. ....
  - c. ....
  
- B. At the place where the property is registered for transfer purposes, as in the case of:
  - a. ....
  - b. ....
  - c. ....
  
- C. At the domicile of the debtor, in the case of property transferable only by notification to the debtor or endorsement, as in the case of:
  - a. ....
  - b. ....
  - c. ....

*Article VI*

The question whether a debt which is deductible according to Article V of the foregoing Convention is to be regarded as a *bona fide* debt shall be settled in accordance with the laws of the State in which such debt would be deducted.

*DOUBLE TAXATION OF SUCCESSIONS*

*Article VII*

A debt shall not be deducted from the value of inalienable property unless such property has been made inalienable by the will of the deceased.

*Article VIII*

The present Convention shall not affect such immunities as are at present, or may hereafter be, accorded to diplomatic, consular or foreign government officials in virtue of the general rules of international law or the internal legislation of either of the contracting States. Where, by reason of such immunities, the estate left by such an official is not subject to the duties and taxes to which the present Convention applies in the State in which they exercise their functions, the State which they serve shall be entitled to levy such duties and taxes.

### III

## **MODEL BILATERAL CONVENTION FOR THE ESTABLISHMENT OF RECIPROCAL ADMINISTRATIVE ASSISTANCE FOR THE ASSESSMENT AND COLLECTION OF DIRECT TAXES**

### *Article I*

With a view of assuring, in the interest of Governments and taxpayers, an effective and fair application of the taxes to which apply the conventions for the prevention of double taxation of income and successions, concluded this day by the contracting States, each of the contracting States undertakes, subject to reciprocity, to furnish on special request such information in matters of taxation as the competent authorities of each State have at their disposal or are in a position to obtain under their own laws and as may be of use to the competent authorities of the other State in the assessment of the above mentioned taxes and to lend assistance to the competent authorities of the other State in the collection of such taxes.

### *Article II*

The competent authorities of each of the contracting States shall be entitled to obtain through direct correspondence, from the competent authorities of the other contracting State, information concerning particular cases that is necessary for the assessment of the taxes to which the present Convention relates.

### *Article III*

In accordance with the preceding article, the competent authorities of each contracting State shall transmit, in concrete cases and on special request, to the competent authorities of the other State:

- A. The name and address of any individual, partnership, corporation or other entity having an address in the territory of the other State and deriving from sources within the territory of the former State rents, dividends, interests, royalties, income from trusts, wages, salaries, pen-

*RECIPROCAL ADMINISTRATIVE ASSISTANCE*

sions, annuities or other fixed or determinable periodical income, indicating the amount of such receipts in the case of each addressee;

- B. An extract of the inventories received by the competent authorities in the case of property passing on the decease of persons that had an address in the territory of the other State or the nationality of that State;
- C. Any particulars which the competent authorities may obtain from banks, insurance companies, or other financial institutions concerning assets and claims belonging to persons having an address in the territory of the other State;
- D. Any particulars which the competent authorities may obtain from inventories in the case of property passing on death concerning debts contracted to, or property passing to, persons having an address in the territory of the other State.

*Article IV*

1. The competent authorities of each of the contracting States shall be entitled to obtain, through direct correspondence, the assistance and support of the competent authorities of the other contracting State for the collection of the taxes to which the present Convention relates together with interest, costs, additions to taxes, and fines not being of a penal character, according to the laws of the State applied to, in the case of taxes that are definitely due according to the laws of the applying State.

2. In the case of a request for the enforcement of a tax, revenue claims of each of the contracting States which have been finally determined shall be accepted for enforcement by the other contracting State and collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes.

3. The request shall be accompanied by such documents as are required by the laws of the applying State to establish that the taxes are definitely due.

4. If a revenue claim is not definitely due, the State applied to may, on the request of the other contracting State, take such measures of conservancy as are authorized by the revenue laws of the former State.

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### Article V

Special requests for information and/or assistance for the enforcement of taxes under Articles II and IV of the present Convention may be refused in the following cases:

- A. If they involve the obligation to obtain or supply information which is not procurable under the legislation of the State applied to or that of the applying State;
- B. If they imply administrative or judicial action incompatible with the legislation and practice of either contracting State;
- C. If compliance involves violation of a professional, industrial or trade secret;
- D. If the request relates to a taxpayer who is a national of the State applied to;
- E. If, in the opinion of the State applied to, compliance with the request may compromise its security or sovereign rights.

### Article VI

When the competent authorities of one of the contracting States have requested from the authorities of the other State information to which this Convention applies, they shall observe secrecy as regards such information, in the same way and to the same extent as is done in the State that supplies it, and the competent authorities of the former State shall apply to its officials the administrative and penal sanctions that correspond, under its own laws, to the violation of such secrecy.

### Article VII

The competent authorities of the two contracting States may prescribe regulations necessary to interpret and carry out the provisions of this convention. With respect to the provisions of this convention relating to exchange of information, service of documents and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and reply, conversion of currency, disposition of amounts collected, minimum amounts subject to collection and related matters.

RECIPROCAL ADMINISTRATIVE ASSISTANCE

Article VIII

1. This Convention and the accompanying Protocol, which shall be considered to be an integral part of the Convention, shall be ratified and the instruments of ratification shall be exchanged at ..... as soon as possible.

2. This Convention and Protocol shall become effective on the first day of January 19... They shall continue effective for a period of three years from that date and indefinitely after that period. They may, however, be terminated by either of the contracting States at the end of the three-year period or at any time thereafter, provided that at least six months prior notice of termination has been given, the termination to become effective on the first day of January following the expiration of the six-month period.

Done in duplicate, at ..... this  
..... day of ..... 19...

PROTOCOL

On proceeding to sign the Convention concluded this day for the establishment of reciprocal administrative assistance in the case of direct taxes, the undersigned Plenipotentiaries, duly authorized by their respective governments for the purpose, have made the following joint declaration, which shall form an integral part of the said Convention.

Article I

As used in this Convention, the term "competent authorities" means the highest tax authorities of each of the contracting States or the duly authorized representatives of such authorities.

Article II

Reciprocity is deemed to exist as regards requests under Article III of the foregoing Convention. In the matter of other requests, reciprocity shall be deemed to exist when the request is accompanied by a declaration by the competent authorities who make the application, officially confirming that any similar request would be complied with in accordance with the laws of the applicant State.

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*Article III*

Information communicated under Article II shall be in the official language of the State by which they are communicated.

*Article IV*

1. Special requests for information shall specify: the authority making the request; the name, address and nationality of the person to whom the request relates; the taxation in respect of which the request is made and period or date in respect of which it is imposed.

2. Requests for the service of documents shall specify, in addition to the particulars mentioned in the first paragraph of this article: the address of the recipient; and the nature and purpose of the document for service.

3. Requests concerning the collection of taxes shall indicate in addition to the information mentioned in the first paragraph of this article: the amount of principal due and interest due and the date from which such interest begins to run; in the case of fiscal penalties, the nature and amount of such penalties; and any other information of a nature to facilitate or accelerate collection.

*Article V*

Requests to which Article IV refers shall be formulated in the official language of the applicant State and accompanied by a translation in the official language of the State applied to.

*Article VI*

The competent authorities of the State to which a request for the service of documents is made may limit their action in connection with the service of the document to merely handing it to the recipient, if the latter is willing to receive it.

*Article VII*

If the competent authorities of the applicant State so desire, the document may be served in the form prescribed in similar cases by the internal law of the State applied to.

RECIPROCAL ADMINISTRATIVE ASSISTANCE

*Article VIII.*

Requests for collection must be accompanied by a copy or official extract of the final decision or order by the competent authorities concerning the revenue claim in question and by a statement from the competent authorities to the effect that the revenue claim is final.

*Article IX*

No request for assistance for the collection of taxes shall be formulated when:

- A. There is a presumption that the amount due is in fact recoverable in the interested State;
- B. The amount due is less than .....

*Article X*

Assistance procedure shall be in the form for which the laws of the State applied to provide, as stipulated in the Convention. Nevertheless, any special forms of assistance not being incompatible with the laws of the State applied to may be adopted at the request of the applying State.

*Article XI*

Revenue claims for collection shall not receive preference over either public or private claims in the State applied to.

*Article XII*

The authorities of the State applied to shall take all such steps and employ all such means of action as they would be bound to take and employ in similar cases, when their own interests are involved, provided that no means of action shall be employed to which there is no corresponding means of action under the law of the applicant State. In doubtful cases, the competent authorities of the applicant State must certify that their national legislation empowers them to comply with a similar request from the State applied to.

*Article XIII*

The competent authorities of the State applied to shall inform, without delay, the competent authorities of the applicant State as



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to the action taken on the request, whether such action is complete or incomplete.

#### *Article XIV*

If a request cannot be complied with the competent authorities of the State applied to shall advise the competent authorities of the applicant State of the reasons which prevent complying with the request, and shall transmit to such authorities all information which may have a bearing on the case.

#### *Article XV*

The State applied to shall be responsible to the applying State for the sums collected on the latter's behalf by its officials or agents.

#### *Article XVI*

Collection shall always take place in the currency of the State applied to. To that effect, the competent authorities of the State applied to shall convert the amount for collection into their own currency at the last rate quoted between the two contracting States.

#### *Article XVII*

Amounts collected by the competent authorities of one State on behalf of the competent authorities of the other State shall be paid over immediately, after deduction of the costs under Article XVIII below, to the account of the Central Bank of the applying State with the Central Bank of the State applied to.

#### *Article XVIII*

No fees or costs shall be charged for action taken on requests for assistance. This provision shall, however, not apply, in the absence of any agreement to the contrary, to emoluments paid to witnesses, experts, agents of execution and to legal and judicial fees incurred in connection with the service of a document or the enforcement of a revenue claim. The revenue authorities shall notify one another as required of the probable amount of such costs, fees or charges. When relating to the collection of a revenue claim, the amount of such costs, fees and charges shall be retained

*RECIPROCAL ADMINISTRATIVE ASSISTANCE*

from the amount collected by the competent authorities of the State applied to.

*Article XIX*

The present Convention shall not apply to measures of conservancy in respect to taxes that have not yet been assessed.

*Article XX*

Over and above the measures of assistance for which the present Convention provides, the competent revenue authorities of the two contracting States may concert together for the exchange of information other than that for which provision is made and also for the purpose of the assessment of the taxes to which the present Convention relates.

COMMENTARY ON THE MODEL BILATERAL CON-  
VENTIONS PREPARED BY THE SECOND  
REGIONAL TAX CONFERENCE IN  
MEXICO, D.F., JULY 1943

*FOREWORD*

Subject to the required adaptation to the tax legislation and administrative practice of individual countries, the model bilateral tax conventions prepared by the Second Regional Tax Conference in Mexico, July, 1943, are intended to serve as a starting point for bilateral treaty negotiations between states and as a guide to officials engaged in such negotiations. They follow the same general pattern as the model tax conventions which the Fiscal Committee has prepared in the past.

When discussing the services that such models could render in bilateral tax treaty negotiations, the Fiscal Committee stated in 1935 that:

“The existence of model draft treaties of this kind has proved of real use in such circumstances in helping to solve many of the technical difficulties which arise in such negotiations. This procedure has the dual merit that, on the one hand, in so far as the model constitutes the basis of bilateral agreements, it creates automatically a uniformity of practice and legislation, while, on the other hand, inasmuch as it may be modified in any bilateral agreement reached, it is sufficiently elastic to be adapted to the different conditions obtaining in different countries or pairs of countries.”<sup>1</sup>

The three model conventions prepared in Mexico in July, 1943, result from discussions which referred in particular to the tax relations between capital-importing and capital-exporting countries. They tend to assure a reciprocity and equivalence in the sacrifice of revenue implied for each country by the removal of double taxation in their mutual economic and financial intercourse. They suggest convenient rules for the equitable treatment of taxpayers coming under the jurisdiction of both of the negotiating

<sup>1</sup> League of Nations, Fiscal Committee. Report to the Council on the Fifth Session of the Committee, Geneva, June, 1935. C. 252. M. 124. 1935. II. A.

*COMMENTARY*

states. They are, however, not intended to cover questions of purely internal tax legislation and administration which, except for occasional stipulations as to tax rates, are generally left out of tax treaties.

The present model conventions should not be taken as an expression of the views of the Fiscal Committee of the League, to whose consideration they still have to be submitted. They represent only a result of discussions that took place at the Mexico Second Regional Tax Conference. The attitude of the Conference in this respect is stated in the following passage of its report:

“some of the features of the articles of the model Conventions herewith are not regarded as wholly acceptable by some of the members of the Conference, but as they were generally accepted during the discussion, such provisions have been retained and inserted in the models as indicative of the terms in which they might be couched by governments that adopt them, in actual fact, in any international convention.”

Moreover, it is clear that the present commentary does not necessarily represent in all its parts the views of the Conference or its members.

# I. MODEL BILATERAL CONVENTION FOR THE PREVENTION OF THE DOUBLE TAXATION OF INCOME

## *Introduction*

The model bilateral convention for the prevention of double taxation of income prepared by the Second Regional Tax Conference in Mexico, 1943, is a redraft of the model conventions contained in the "Report of the General Meeting of Government Experts on Double Taxation and Tax Evasion", Geneva, 1928,<sup>1</sup> and it embodies most of the provisions of the "Draft Convention for the Allocation of Business Income Between States for the Purposes of Taxation", prepared by the Fiscal Committee in 1935.<sup>2</sup> It takes into account, moreover, the draft plurilateral treaties on income taxation prepared by the Fiscal Committee in 1931<sup>3</sup> and the experience gained as a result of the numerous tax treaties concluded in the 'thirties in which the influence of the work of the Fiscal Committee is noticeable.<sup>4</sup> The discussions which led to the present draft were based on tentative drafts prepared by a subcommittee of the Fiscal Committee which met at The Hague in April, 1940, and the First Regional Tax Conference which took place in Mexico in July, 1940.

The model convention on income tax deals mainly with the prevention of international double taxation of income, but its provisions are intended to avoid at the same time the extraterritorial and discriminatory taxation of foreigners. International double or multiple taxation arises when the taxes of two or more countries overlap in such a manner that persons liable to tax in more than one country bear a higher tax burden than they would if they were subject to only one tax jurisdiction. The additional burden so incurred must of course be due not merely to differences in tax

<sup>1</sup> Document C. 562. M. 178. 1928. II.

<sup>2</sup> League of Nations, Fiscal Committee. *Report on the Fifth Session*, Geneva, June, 1935, C. 252. M. 124. 1935. II. A.

<sup>3</sup> League of Nations, Fiscal Committee. *Report on the Third Session*, Geneva, June, 1931, C. 418. M. 171. 1931. II. A.

<sup>4</sup> Many of these conventions are reproduced in League of Nations, *Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion*, Vols. I to VI. Geneva, 1931-1936. Vol. VII in preparation.

rates in the various countries concerned, but to the circumstance that each tax jurisdiction claims to tax the same person on account of the same wealth or facts, or rather imposes taxes having the same incidence and basis without regard to the claims of the other tax jurisdictions concerned.

The cases of international double taxation that may arise in connection with income tax fall into three classes. The first and most important category includes the cases due to the coexistence of personal and impersonal tax liability. Tax liability is said to be personal when it is based on the personal status of the taxpayer himself: *e.g.*, his nationality, domicile, residence. Impersonal tax liability exists when a state claims to tax income earned or received within its territory without respect to the personal status of the recipient. Any person who is taxable in one country on account of his personal status and who receives income from another country is exposed to such double taxation, unless one or both of the states concerned limit their fiscal claims or allow a credit against their tax on account of the foreign tax.

Under a second category come the cases of double taxation which are due to the fact that countries apply different criteria as regards the personal liability, or define differently the circumstances that give rise to such liability. Persons whose personal allegiance is divided between two or more countries or is doubtful may be subject to double taxation of this kind. The following cases may be quoted as examples: nationals of one country having their domicile or residence in another; persons having their domicile and their residence in two different countries; persons simultaneously regarded by two tax jurisdictions as domiciled or resident in their respective territories.

A third kind of international double taxation of income includes the cases where two or more countries regard a given income as taxable in their respective territories because they apply different tests of impersonal tax liability. Double taxation of this kind may occur, for instance, when the assets or activities that produce a given income are located or carried out in more than one country, or when the income is collected elsewhere than in the country where it is earned or from which it is due.

## DOUBLE TAXATION OF INCOME

The method for avoiding double taxation in the Mexico model convention consists in defining, on the one hand, the conditions under which each kind of income, as characterized by the type of property or activity from which it is derived, may be taxed in a country according to the criterion of impersonal tax liability, and in providing, on the other hand, that the taxes so paid should be deducted from, or credited against, the tax due by the taxpayer in the country where he has his residence or "fiscal domicile." This deduction is, however, limited to an amount which bears the same proportion to the tax which would have been due in the country of the taxpayer's residence or "fiscal domicile" on his entire income as the income taxable in the other country bears to that total income.

To give effect to the guiding conception that has just been outlined, Article I of the model convention defines the general object and scope of the instrument. Articles II to XII indicate the conditions under which the various kinds of income, as defined by their economic source, may be taxed in a country when the beneficiary has his residence or "fiscal domicile" in the other country. These articles generally follow the principle that income may be taxed in a country when it has its origin in that country: in other words, when it results from property or activities located in that country. This general criterion is formulated in each of the relevant articles in such a way as to facilitate its application as regards each kind of income. In certain cases derogations are provided for when reasons of administrative or business convenience or of equity appear likely to justify them in current practice. Articles XIII and XIV refer to taxation in the country of permanent residence or fiscal domicile. Article XV relates to discriminatory taxation and Articles XVI to XVIII deal with various administrative matters.

The model convention is followed by a protocol containing definitions of such phrases as "fiscal domicile," "permanent establishment," and rules of procedure on such matters as the allocation of business profits. The articles of the protocol will be dealt with, in the following commentary, in conjunction with the articles of the main convention with which they are respectively connected.

## COMMENTARY

### Article I. *Object and Scope of the Model Convention.*

According to the provisions of Article I of the model convention and Articles I and II of the protocol, the convention is to apply to all natural and juridical persons who have their "fiscal domicile" in one of the contracting states and, at the same time, derive income which is taxable in the territory of the other state.

The definition of "fiscal domicile" and certain rules as to its determination are given in Article II of the protocol, in view of the fact that national tax laws and practices differ as to the concepts of domicile and residence and as to the distinction which is to be made between them. These differences relate to the psychological and physical elements of domicile and residence and to the rules of evidence to be applied in recognizing their existence.

According to Article II of the protocol, the phrase "fiscal domicile" signifies, in the case of individuals, the place where a person has his normal residence or permanent home. In the case of partnerships, companies and other entities, it is the state under the laws of which they are constituted.

The definition of the "fiscal domicile" of individuals is the same as that used in the earlier model conventions drafted by the Fiscal Committee. It is, however, explained by a clause to the effect that "in case the taxpayer has several residences, his fiscal domicile will be his main residence" taking into account "elements such as the duration, regularity, frequency of his stays, the place where the family of the taxpayer is usually present, the proximity to the place where the party concerned carries out his occupation". Accordingly, in determining the "fiscal domicile" of an individual, reference would have to be made not only to the mere possession or availability of a dwelling but also to the family, social and economic connections binding a person to a given place.

As regards legal entities and similar associations, fiscal domicile was defined in the model conventions of 1928 and 1935, to which reference was made above,<sup>1</sup> as the place where the entity has its "real centre of management". In most cases, corporations have their "real centre of management" in the country under the laws of which they are incorporated, so that the new criteria adopted

<sup>1</sup> See page 87.



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in Mexico will usually point in the same direction as the 1928 and 1935 criteria. The proponents of the new criterion stated that it agreed better with American legal systems than the earlier one which was based on European tax practice.

According to the wording of Article I the provisions of the model convention apply to all taxpayers in the contracting states, whether nationals or foreigners, provided they have their "fiscal domicile" in one of the two contracting states. Indeed, as foreigners with their "fiscal domicile" in a country are generally subject to a personal tax liability on their income from domestic and foreign sources, it is legitimate that such foreigners should enjoy the double taxation relief provided by the convention.

Citizens of the contracting states who have their "fiscal domicile" in a third state do not come under the provisions of the model convention, since most countries do not tax their nationals having their fiscal domicile abroad except, of course, on the income they derive from their country. The status of such persons would have to be considered by tax treaty negotiators, when one or both of the states concerned bases personal liability to income tax on nationality as well as on "fiscal domicile".

It is clear from the context of the model convention that its provisions are applicable to all ordinary and special taxes on individual and corporate income, whatever may be their denomination and method of assessment. The model convention contains, however, no definition of such taxes, and Article I of the convention is drafted so as to enable tax negotiators to indicate through an enumeration the taxes to which the convention should apply. Such enumeration might include, in addition to national taxes levied by the central or federal government, taxes levied by political subdivisions and local authorities such as the states of a federation, provinces, municipalities.

Paragraph 2 of Article I of the model convention contains a provision which is intended to assure the automatic adaptation of the convention to changes in the taxes of the contracting states. It does so by providing for the extension of the provisions of the convention to taxes or increases of taxes introduced after the signature of the instrument, provided such new levies rest upon substantially the same bases as the taxes enumerated in the convention.

**Article II. *Income from Real Property.***

The model convention follows the generally accepted principle that income from real property is taxable in the country where the property is situated. In this context income from real property means the income that results directly from the ownership or possession of real property, as such income and such property are defined in the country where the latter is situated, according to Article III of the protocol. The income in question is represented by the rent received from a tenant and also the rental value of the property when it is occupied by the owner or possessor personally, provided this rental value is subject to income tax or to a substitute form of taxation under the laws of the country concerned.

It may be noted that "royalties from immovable property or in respect of the operation of a mine, a quarry or other natural resource" are mentioned separately in Article X. That article, however, follows the same principle as is contained in Article II, and recognizes that such royalties are taxable in the country where the property in respect of which they are due is situated.

Profits resulting from the sale and exchange of real property are governed by Article XII, but this article applies the same principle as in Article II and provides for the taxation of such profits in the country where the property concerned is situated.

Income derived from the exploitation of lands, buildings and sub-soil as a part of a business, including mining, forestry and agriculture, does not come within the purview of Article II, but of Article IV, concerning business income.

**Article III. *Income from Mortgages.***

The effect of Article III, paragraph 1, is to make the rule governing the income from real property apply also to taxation of income from mortgages on such property. This rule would, however, not apply to those so-called mortgage bonds which are not guaranteed by any specific real property and which are issued by credit institutions in order to finance the loans they grant on mortgages drawn up in their names. Such bonds would come rather

## DOUBLE TAXATION OF INCOME

under the provisions of Article IX, which applies to income from movable capital in general.

By analogy with the above-mentioned rule on income from mortgages on real property, the second paragraph of Article III provides a provision to the effect that income from mortgages on sea and air vessels is taxable in the country of registry, since such vessels are generally regarded as being legally situated in the country where they are registered.

### Article IV. *Income from Business.*

Article IV of the model convention, completed by the provisions of Articles IV to VIII of the protocol, deals with income from trade and business in general.

In international practice, two main questions arise in connection with such income: (a) What are the facts which may render an enterprise liable to taxation on its profits in a country other than that in which the owner has his "fiscal domicile"? and, (b) In the case of an enterprise doing business in more than one country, how should the share of profits that is taxable in each country be determined?

The rule contained in paragraphs 1 and 2 of Article IV is that an enterprise may be taxed in a country other than that of its "fiscal domicile" only if a business or activity is carried out in that country, and that profits realized through isolated or occasional transactions in a country where the enterprise does not possess a permanent establishment are not taxable in that country. The cardinal idea underlying the above-mentioned paragraphs was more categorically stated in the model convention which was prepared by the first Regional Tax Conference, Mexico, 1940, and which stated that:

"Income . . . derived from any industrial, commercial or agricultural enterprise and from any other gainful occupation carried out in a permanent establishment shall be taxable only in the state where the permanent establishment is situated. If an enterprise in one state extends its activities to the other state without possessing in that state a permanent establishment, the income derived from such activities shall be taxable only in the first state".

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The provisions of the two model conventions differ, therefore, in this respect: the 1940 model makes the existence of a "permanent establishment" an indispensable condition for an enterprise to become subject to income tax in a country other than that of its "fiscal domicile", while, according to the 1943 version of the same clause, it is sufficient, in order for income tax liability to arise elsewhere than in the country of "fiscal domicile", that the profits made by the enterprise relate to business done in the country, provided that such business is not represented by isolated or occasional transactions.

During the discussions of the 1943 Regional Tax Conference, it was argued, on the one side, that if foreign enterprises were to be taxable on their profits in a country outside their "fiscal domicile" only if they had a permanent establishment in that country, certain countries would lose revenue and that certain forms of fiscal evasion might be encouraged. It was stated that some enterprises might seek to avoid taxation in a country by carrying on their business in that country without maintaining a permanent establishment therein. On the other side it was argued that such forms of tax evasion were not encouraged by the 1940 rule concerning the existence of a permanent establishment, since in virtue of Article XIII of the present model convention, the total tax liability of an enterprise is, in principle, to remain the same no matter in what proportion its income is divided between the country where it has its "fiscal domicile" and the country where it does business. It was also pointed out that the danger of taxpayers doing business in a country and concealing it from the tax authorities of that country was essentially a matter of internal tax evasion. Moreover, it was observed that past experience had shown that it was extremely difficult for the tax authorities of a country to tax foreign enterprises efficiently and equitably, when these enterprises did not possess a permanent establishment in the country.

The phrase "permanent establishment" is defined in Article V, paragraph 1, of the protocol. Two conditions are required in order for an enterprise to be considered as possessing a "permanent establishment" in a country: it must have some "fixed place" of

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business in the country, and that place of business must have a productive character, *i.e.*, contribute to business earnings.

There are establishments which fulfill only the first condition and the existence of these should therefore not give rise to income tax liability in the country where they are situated. Such are establishments which are not directly engaged in actual productive operations, but render to the concern to which they belong certain general or particular services having no definite connection with the profits currently earned by the concern. This category of establishments may include research laboratories, experimental plants, information bureaus, storehouses, purchasing offices, advertising displays, showrooms where no goods are sold. To apply income tax on an imputed profit in the case of such establishments would easily lead to arbitrary or extraterritorial taxation.

The case of purchasing offices deserves special mention. It is sometimes argued that when goods are bought in a country, the profits should be divided between the two functions of purchase and sale just as they are divided between manufacture and sale. It is added that to exempt purchasing establishments of foreign enterprises would constitute a discrimination against domestic exporters. On the other hand, it is pointed out that the act of purchasing yields in itself no profits and, unlike producing, converting, processing, manufacturing, sorting, preserving, assembling, packing and transporting, adds no value to the thing bought. Consequently, it seems that, except perhaps when income is attributed to a purchasing establishment on a commission basis, *i.e.*, as if that establishment were an independent agent working for a foreign firm, the taxation of a so-called purchasing profit by the country where the purchasing establishment is situated would give an extraterritorial scope to its income tax.

In view of the complexity of the fiscal and business interests which are involved in the taxation of purchasing establishments, the 1943 model convention does not contain any specific rule about the income tax treatment of such establishments. The model convention prepared at the 1940 Regional Conference stipulated that the "mere purchase of goods by an establishment in one country for the supply of selling or processing establishments in the other

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country" could not be regarded as a basis for income tax liability in the country where the purchase was made. It seemed to be understood that this rule applies only if the purchasing establishment which the enterprise concerned maintained in that country confined its activities to purchasing only, and rendered no other services, such as sorting, grading, or packing goods, to the enterprise to which it belonged.

The 1943 model convention has taken over from the earlier work of the Fiscal Committee the provisions which allow a distinction to be made between dealings through an autonomous agent, and dealings through a permanent establishment or branch. According to Article V, paragraph 3, of the protocol, a foreign enterprise is not, in principle, liable to income tax in a country, if its operations in that country are exclusively carried out through a broker, commission agent, or other agent of a genuinely independent status in that country. An agent, however, will not be considered as independent, according to Article V, paragraph 4, of the protocol, and the enterprise for which he acts will be liable to income tax in the country where he is established, in cases such as the following: The agent habitually acts in the name of the enterprise concerned as a duly accredited agent and enters into contracts on its behalf; the agent is a salaried employee of the enterprise and habitually transacts business on its account; the agent habitually holds, for the purpose of sale, a stock of goods that belong to the enterprise.

Article V, paragraph 5, of the protocol adds that when the office and business expenses of the agent—in particular, the rent of the premises used by him when working for the enterprise concerned—are paid by that enterprise, this fact will be regarded as evidence of a contract of employment, indicating that the enterprise possesses an establishment in the country.

According to the above-mentioned provisions, then, there seem to be consequently four distinct criteria according to which a foreign enterprise may be deemed to have an establishment in the country where it deals through an agent: (a) power of the local agent to bind the enterprise; (b) existence of a contract of employment with a local agent; (c) maintenance in the country of a stock of goods under the control of an agent for sales in that coun-

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try; (d) payment of the rent of the premises used by the agent and of his office expenses. Any of these four conditions is sufficient to render an enterprise liable to income tax in its own name in the country where an agent operates, provided that the condition which is fulfilled corresponds to a permanent state of things or an habitual practice.

On the other hand, paragraphs 6 and 7 of Article V of the protocol stipulate that foreign enterprises doing business in a country through brokers and commissioned agents of a genuinely independent status, or through commercial travelers visiting customers or suppliers in a country, should not be liable to income tax in that country.

Paragraph 8 of Article V of the protocol refers to subsidiary companies. It states that a subsidiary cannot be regarded as a permanent establishment of the parent enterprise. This provision has two main effects. In the first place, the country where the subsidiary is situated is not entitled to tax the parent company except, of course, on the dividends which the parent company may receive from its subsidiary, in accordance with the provisions of Article IX of the model convention relating to income from movable capital. Secondly, in taxing the parent company, the authorities of the country in which such company is situated may not take into account the actual profits made by the subsidiary company in the other country, but only the dividends and other income paid by the subsidiary to the parent company. These rules follow the principle that a subsidiary constitutes a distinct legal entity and should therefore be taxed separately. At the same time, Article VII of the protocol indicates the criteria according to which the correctness of the mutual relations between parent and subsidiary companies can be checked so as to avoid abuses resulting in the diversion of profits or losses from one company to the other.

While paragraphs 1 and 2 of Article IV of the model convention and the complementary provisions in Article V of the protocol, which have been considered above, define the conditions under which an enterprise may be subject to income tax in a country other than that of its "fiscal domicile", paragraphs 3 and 4 of Article IV of the model convention and Article VI of the protocol refer to the method of determining the share of its total

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profits on which an enterprise may be taxed in a country other than that of its "fiscal domicile" when it possesses an establishment in that country.

The main principle regarding allocation of profits is that the profits on which a branch or a permanent establishment of a foreign enterprise may be taxed in the country where such establishment is situated cannot exceed the earnings that are the direct result of the activities of the establishment concerned or the yield of the assets pertaining to it. Concerning the method of application of this principle, section A of paragraph 1 of Article VI of the protocol states that "there shall be attributed to each permanent establishment the net business income which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities, under the same or similar conditions". This method of determining or allocating the profits attributable to a permanent establishment is known as the method of separate accounting. Its result is that each establishment or branch is taxed as if it constituted a distinct independent enterprise and the profits of the establishment are assessed independently of the results of the business done elsewhere by the enterprise to which it belongs. This method implies as a rule that records and accounts are kept for each establishment on the same basis as in the case of an independent enterprise engaged under similar conditions in the same line of business. The purpose of these accounts is to express dealings made with other establishments of the enterprise as if those dealings were with other firms unconnected with the establishment, and were conducted in accordance with the market conditions relevant to such dealings.

The use of the method of separate accounting as the fundamental procedure for the determination of the profits attributable to each country in which an enterprise has an establishment is intended to serve four purposes. First, by treating a branch establishment not as a part of an enterprise but as a self-contained unit, and thus generally avoiding reference to results or data outside the country concerned, it gives the taxation of branch establishments a strictly territorial scope, not extending beyond the boundaries of the countries concerned. Secondly, the method helps to enforce the principle of equality of treatment of foreigners by



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placing, in principle, branches of foreign enterprises on the same footing as similar establishments of domestic enterprises as regards the computation of receipts and expenses, which, once they have been allocated or apportioned by separate accounting, are to be treated in accordance with the tax laws of the country to which they have been attributed. Thirdly, the use of separate accounting as a basis for the assessment of income tax conforms to the usual practice among concerns engaged in international business of keeping separate accounts for each of their establishments. Finally, separate accounting serves the revenue interests of the country concerned, since when it is properly applied and supervised it prevents the concealment of profits or their diversion from one country to another. In this connection, Article VI, paragraph 1, section B, of the protocol specifically foresees the possibility of a rectification by the fiscal authorities concerned of the "accounts produced, especially in order to correct errors or omissions, or to re-establish the prices or remunerations entered in the books at the value which would prevail between independent persons dealing at arm's length". A rectification made in the accounts of an establishment situated in one country should not, however, result in double taxation of the enterprise concerned. A rectification made in one country may, therefore, call for a corresponding adjustment in the accounts of the establishment in the other country with which the dealings to which the rectification referred have been effected. This matter is dealt with in the second sentence of the above-mentioned section B of paragraph 1 of Article VI of the protocol.

The assessment of the profits of a permanent establishment according to the method of separate accounting implies that, when required, the necessary data are made available by the enterprise concerned to the tax authorities, and that the records of the establishment conform to certain standards of completeness and accuracy. When such conditions are not fulfilled, the assessment must be made on a presumptive basis. It is to this question that Article VI, paragraph 1, section C, of the protocol refers. Here it is provided that if the establishment does not produce an accounting or the accounting produced is deficient, and the deficiencies cannot be remedied, or if the tax authorities and the taxpayer

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agree, the profits of the establishment involved may be determined by applying a certain percentage to its gross receipts. The object of the procedure remains, however, to treat the establishment of the foreign enterprise according to the same standards as a similar domestic concern engaged in the same line of business. It is, therefore, suggested that the percentage should be fixed by comparison with the conditions and the results of similar enterprises operating in the country. Moreover, it is specified that when the activities of a permanent establishment resemble those of a commission agent or broker, the income may be determined on the basis of the customary commission received for such services. It may be noted that this "commission basis" may, when appropriate, be used by establishments keeping regular accounts and entitled to be assessed according to the method of separate accounting.

Section D of paragraph 1 of Article VI of the protocol deals with the cases where neither the method of separate accounting nor the method of a percentage of gross receipts is applicable. Such a situation arises when a comparison between the nature of the activities and the conditions of operation of the establishment of the foreign enterprise cannot be made with those of full-fledged domestic enterprises. It is provided that in this case the method of fractional apportionment may be applied. Under this method, the earnings of each establishment are computed as a proportion of the entire profits of the enterprise to which the establishment belongs, on the basis of the general balance sheet and profit and loss account of the enterprise. Such fractional apportionment may be unlimited or limited. In the first case, it takes as its starting point the total income derived by the enterprise as a whole from all sources. In the second case, reference is made only to that part of the total profits of the enterprise which is derived from transactions in which the establishment whose share in the total profits is to be determined has participated. It is to this second form of fractional apportionment that recourse may be had according to the protocol. The share of the total profits from joint transactions that is attributable to the establishment concerned is to be determined by dividing these profits according to the ratio that exists between certain factors pertaining to the establishment concerned and the total of the same factors for the

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entire enterprise. Examples of the factors that may enter into the apportionment formulae are plant and equipment, circulating capital, payrolls, cost of operations, physical output, turnover. It is understood that the selection and the weighting of the different factors that it may appear appropriate to use will differ according to the type of enterprise. It is, however, provided that the formulae of apportionment should be "so selected as to ensure results approaching, as closely as possible, those which would be reflected by a separate accounting".

Though the method of fractional apportionment is mentioned by the model convention only in the third place, after the methods of separate accounting and percentage of turnover, this does not mean that the partial use of fractional apportionment is excluded when, as is generally desirable, branch establishments are taxed according to the method of separate accounting. There are indeed in most enterprises with two or more establishments, certain items of expenses that must necessarily be apportioned in order to achieve the object of separate accounting, which is to place branches of foreign enterprises on the same footing as domestic concerns. An application of this idea is found in paragraph 2 of Article VI of the protocol which provides that in the determination of the net income of a permanent establishment according to separate accounting, a share of the general expenses of the head office of the enterprise may be charged to the establishment.

The object of paragraph 3 of Article VI of the protocol is to state explicitly certain corollaries of the method of separate accounting as applied to banking and financial enterprises. Thus it says that the interest on the permanent capital allotted to a branch cannot be deducted from the income of that branch in the country where it is situated even if the capital takes the form of an advance, loan, overdraft or deposit. On the other hand, when such items do not represent the permanent capital of the establishment concerned, the corresponding interest may be deducted from the gross income of the debtor establishment and treated as a receipt of the creditor establishment.

In view of the special conditions of operation which are peculiar to insurance companies, they represent one of the forms of enterprise which call for special rules in the allocation of their profits

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between their various establishments. It has seemed desirable, therefore, to specify in Article V, paragraph 4, of the protocol that where required the taxable income of the branch of an insurance company may be determined either by the method of percentage on gross receipts or by fractional apportionment. In the first case, coefficients established by reference to corresponding national enterprises in the country concerned would be applied to the gross premiums resulting from the activity of the branch concerned. In the second case, the income of the branch in question would be determined by applying, either to the total net income of the concern as a whole, or merely to that part of the total operating and investment income of the enterprise as a whole which corresponds to the kind of activities in which the branch in question is engaged, the ratio existing between the gross premiums received by the establishment and the total gross premiums received by the enterprise in connection with the same kind of business.

#### Article V. *Income from Navigation.*

The effect of Article V of the convention is to make income from maritime and air transport taxable only in the country where the vessel concerned is registered.

This rule, which is contained in numerous tax treaties, is intended to facilitate international traffic and to avoid the difficulties of taxing the profits from international navigation in a country other than that in which the vessel is registered or that in which the owner has his "fiscal domicile".

For its part, inland water transport is not affected by Article V and remains, like rail and road transport, subject to the provisions of Article IV, which applies to business income in general. The provisions of that article remain applicable also to the income that a maritime or air transport enterprise might derive from services other than actual maritime or air transport, *e.g.*, warehousing charges, insurance commissions, travel agency fees.

#### Article VI. *Special Remuneration of Company Officers.*

In a number of countries, the taxation of the emoluments received by company directors and other officers is linked up with the taxation of dividends. It is for this reason that "directors'

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percentages, attendance fees and other special remuneration paid to directors, managers and auditors of companies" are treated in a special article, while income from personal services in general is treated in Article VII.

According to the first paragraph of Article VI emoluments paid out of company profits to directors, managers and auditors of companies are taxable in the country where the paying company has its fiscal domicile, since a company normally has its head office in that country and it is there that its dividends are taxable and that its officers usually perform their functions.

It sometimes happens, however, that certain company officers are entrusted with special duties in connection with a given establishment outside the country where the head office is situated. To cover such cases, the second paragraph of Article VI provides that when a company officer receives remuneration for services rendered in such an establishment, this remuneration is taxable in the country where the establishment is situated.

### Article VII. *Remuneration from Personal Services and Private Employment.*

Article VII is intended to cover earnings from private employment and professions. It does not apply, however, to private pensions, which are dealt with separately in Article XI, nor to other forms of earned income which are mentioned in other articles, such as Articles IV, V, VI, VIII and X.

The first paragraph of Article VII lays down the general principle that remuneration for labour and personal services, as understood in this context, is taxable only in the country where the services are rendered. According to paragraphs 2 and 3 of that Article, however, a person having his fiscal domicile in one of the contracting states will be considered as having rendered services in the other contracting state only if the period or periods during which he has stayed in the other country exceed one hundred and eighty-three days. This modification of the rule of taxing the remuneration for personal services in the country where the corresponding services are rendered is intended to facilitate the operations of enterprises engaged in international trade and the movement of workers.

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Paragraphs 4 and 5 deal specifically with independent professions and embody rules similar to those of paragraphs 2 and 3 of Article IV relating to the taxation of business income according to the criterion of the permanent establishment. According to paragraph 4, the country where the earnings from professional services are to be taxed is determined not by the actual place where the services are rendered but by the place where the taxpayer concerned has a permanent establishment in which or from which he renders his services. Paragraph 5 relates to the case of the person who has offices in both contracting states and its effect is that the taxpayer will be taxable in each state only to the extent that the income he receives results from services rendered in or from the office situated in that state.

#### Article VIII. *Public Salaries and Pensions.*

In order to conform with the rules of international courtesy and mutual respect between sovereignties, Article VIII lays down that all remuneration for present or past services rendered to the government of one of the contracting states or any of its agencies shall be taxable only in the country of the debtor state, no matter where these services are or were rendered, provided that the services relate to the normal sphere of public activities as understood in international usage. Contracting states may find it convenient to specify the officials or functions that are to be covered by this rule, which is intended to apply to all public servants who perform their duties in the other contracting state, and is not intended to restrict any tax immunity or privilege granted to diplomatic or consular agents under international usage or general treaties.

#### Article IX. *Income from Movable Capital.*

According to Article IX of the model convention, income from movable capital may be taxed in a country other than that of the "fiscal domicile" of the recipient, only when the corresponding capital is invested in that country. The phrase "income from movable capital" is defined in Article IX of the protocol. It may be construed to include the following main classes of receipts which are often treated differently in the various national tax legislations:

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- a. Interest and other earnings on debentures, bonds, certificates, notes, bills and similar documents issued by governments and other public bodies;
- b. Interest and other earnings on debentures, bonds, certificates, notes and bills, except mortgage claims to which Article III of the model applies, issued by private companies and other similar juristic persons;
- c. Interest on private loans and similar claims (other than mortgage claims to which Article III of the model convention applies);
- d. Interest on deposits and current accounts, other than earnings on deposits and current accounts pertaining to a business that are taxable as a part of the business income under the rules of Article IV of the model convention and Article VI, paragraphs 1 and 3, of the protocol;
- e. Dividends and other income from company shares and sleeping partner shares in limited liability partnerships.

Income derived by ordinary or general partners from partnerships to which they belong is not regarded, in principle, as income from movable capital but as business income subject to the provisions of Article IV of the model convention.

While the present model convention admits that income from movable capital is taxable according to the situation of the investment, the 1940 model convention<sup>1</sup> expressed a certain preference for the exclusive taxation of such income in the country of "fiscal domicile" of the beneficiary. It was, however, admitted in that text that such income remained taxable in the country from which it was derived, if, according to the legislation of that country, income from capital was either taxable by withholding at source or subject to a special tax. It was suggested in that text that the resulting double taxation could be avoided, at the option of the contracting states, by either of the two following procedures: a) deduction from the tax due to the state where the creditor had his fiscal domicile of part or the whole of the tax withheld at source or of the special tax collected in the country of the debtor; or b) refund by the state of the debtor of the tax that has been withheld at source

<sup>1</sup> See page 87 of the present document.

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upon production of proper evidence as to the identity of the creditor and the fact that he has his "fiscal domicile" in the other contracting state. In the present model convention the combined provisions of Articles IX and XII have the same effect as the method a) described above.

Article IX of the 1940 model convention contained two additional paragraphs relating to the financial investments and obligations of business enterprises. The provisions of those two paragraphs extended to the income from such assets, and the service of such liabilities, the rules laid down, in Article IV of the model convention and Article VI of the protocol, concerning the taxation of the operating profits of the establishments of business enterprises. Indeed, the effect of those paragraphs was to attribute to the state in whose territory an establishment was situated taxation rights, regarding the receipt or payment of interest and similar income, resembling those that would prevail if the establishment constituted an independent enterprise with its "fiscal domicile" in that country.

The treatment of income from movable capital is one of the most complex questions that arise in connection with the prevention of international double taxation. In this matter there is an opposition of interests between capital-exporting countries and capital-importing countries. The revenue interests of the former are best served by taxation of income from capital at the home of the creditor or beneficiary, those of the latter countries by taxation at the home of the debtor or rather, the place where the investment is used. The practical solution of the problem depends, in most cases, on the extent to which each of the contracting states is willing to limit its rights of taxation in order to facilitate international investment. In this connection, it is advisable that regard should be had not only to the incidence of a tax on the income from imported capital, and the immediate effects of such measures on public revenue, but also to the consequences, economic and fiscal, entailed by economic development, the trade and increase of income which in both countries may follow the capital movements in question.

In the light of the above-mentioned considerations, the 1943 conference attributed the right of taxing income from capital to



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the country where the investment is made, on the understanding that the capital-exporting country, which will usually be that of the "fiscal domicile" of the creditor, or beneficiary of the income, at once retains its right to tax such income and grants a deduction on account of the other country under Article XIII of the model convention.

In so far as the rule contained in Article IX of the model convention requires interpretation, it seems to mean that, in principle, income from capital should be taxed in the country where the capital is effectively used, which in turn would signify the country where the gross income from which interest and dividends are paid is produced. Taxation of the income from capital would, therefore, follow the same rule as taxation of business income. The country entitled to tax the profits of an establishment would be eventually entitled to tax also the dividends paid out from such profits. Interest on business loans, credits and advances would be taxable in the country where the establishment is situated from whose profits interest would have to be deducted, according to sound accounting standards, in order to determine the net earnings of such establishment. Interest on deposits and non-commercial accounts might be held taxable in the country where the establishment at which the deposit or account is maintained is situated. Interest on private loans not connected with business requirements would be taxable in the country of the debtor's "fiscal domicile".

### Article X. *Royalties from Real Estate, Patents and Copyrights.*

In the same way as other income from real property, which is governed by Article II of the model convention, royalties received by a person, as owner or possessor of real property, in consideration of the right to use or exploit natural deposits and resources situated on the surface or in the subsoil of his property, such as mines, quarries, wells, springs, waterfalls, are taxable in the country where the property is situated. In so far as a distinction between income governed by Article II and Article IX is required in practice, for instance, in connection with the rules of computation of taxable income or determination of the tax rate applicable, reference should be made to the provisions of Article III of the protocol, which stipulates that the real or personal nature of property

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should be determined in accordance with the laws of the state in which the property is situated.

The second paragraph of Article X refers to royalties from scientific, industrial and commercial property, such as patents, secret processes and formulae, trade-marks, trade-names. These royalties are of a complex nature, and they may be differentiated according to the conditions in which they have been acquired and the persons by whom they are enjoyed and they may appear as income from a profession, from business or from capital. The model convention, applying the principle of immediate economic origin, places them under a single rule according to which the royalties are taxable in the country where the patent or other similar right to which they correspond is exploited. As a result, the returns of patents and similar rights always remain taxable in the country where the rights are used, whether the proprietor exploits them himself through an establishment belonging to his enterprise, or whether they are exploited through a lessee. The case of the outright sale or absolute transfer of patents and similar rights is not specifically mentioned in the model convention. It is probable that, to the extent that profits on such transactions are taxable, the rules of Article IV or VII would apply in most cases.

The third paragraph of Article IX relates to royalties from copyrights on artistic and scientific works and publications. According to the model convention the incomes from such productions, wherever earned, remain exclusively taxable in the country where the owner has his "fiscal domicile" or his permanent establishment.

This rule, which has the character of an exception to the general principle followed in the convention of taxing income according to its immediate economic origin, has been laid down in order to facilitate cultural exchanges. It was asked in the course of the discussions at the Conference whether cinematographic productions should come under this special rule in view of their commercial nature and the important amounts collected as royalties in connection with such productions, and it was suggested that they should be taxable according to the rule of paragraph 2 of Article X, like royalties on patents and other industrial or commercial property.

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### Article XI. *Private Pensions and Life Annuities.*

Private pensions and life annuities are understood in their ordinary sense in Article XI of the model convention and are made taxable, according to the principle of taxation by origin, in the country where the debtor has his fiscal domicile.

Article X of the protocol contains the special provision relating to the taxation of allowances of students and apprentices from one country who are staying in the other for their studies or training. These remittances are made exempt from taxation in the country where the beneficiaries are studying.

### Article XII. *Capital Gains.*

Article XII stipulates that gains derived from the sale or exchange of real property is taxable only in the state in which the property is situated. It is clear that this article applies only when such transactions are not part of a business, in which case Article IV is applicable.

It may be of interest to recall that in the 1940 model convention, Article XII contained similar provisions as regards the sale and exchange of other capital assets. It was indeed specified that gains derived from the sale or exchange of assets other than real property, belonging to an industrial, commercial or agricultural enterprise or used in any other independent occupation, should be taxable according to the general provisions of Article IV concerning the taxation of business income. As regards gains derived from the sale or exchange of any capital assets, other than real property or business assets, the rights of taxation were reserved to the state of the "fiscal domicile" of the recipient.

### Article XIII. *Taxation Rights of the Country of "Fiscal Domicile".*

Article XIII reserves to the country where the taxpayer has his fiscal domicile, the right to tax the taxpayer's entire income even when it is taxable, in part or as a whole, in the other country. From the tax due in the country of "fiscal domicile" a deduction has to be made, however, on account of the taxes paid in the other country in accordance with the preceding articles of the model convention.

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The simplest manner of determining this deduction would be to take the actual amount of tax paid in the other country. Regard is, however, to be had not only to the interests of the taxpayer but also to those of the state in which he has his fiscal domicile. Article XIII admits, therefore, that from the tax due in the country of "fiscal domicile", the taxes due in the other country should be deducted only to the extent that they do not exceed that proportion of the tax effectively due in the country of domicile which corresponds to the proportion of the income taxable in the other country in relation to the entire income of the taxpayer.

It may be noted that the above-mentioned limit of deduction will operate in the country of "fiscal domicile" only when the tax schedule in the other country is so high that the effective percentage of tax in that country on the part of income taxable in its territory exceeds the tax percentage which in the country of "fiscal domicile" corresponds to the total income of the taxpayer.

In bilateral treaties, it may be found advantageous to combine with the clauses of Article XII provisions fixing or limiting the rate of tax applicable to the income derived from a country by a taxpayer having his "fiscal domicile" in the other country. Such fixed or ceiling tax rates might in particular be provided for in connection with income from movable capital.

A special question arises in connection with dividends paid to a person by a company in the country other than that in which he has his "fiscal domicile". Depending on the system followed by that country with respect to the taxation of corporate income, the tax borne by such dividends may take different forms, *e.g.*, the form of a tax paid by the distributing company in its own name or that of a tax on corporate earnings. Therefore, to enable the taxpayer in receipt of dividends so taxed in the country of their origin to obtain, in connection with such dividends, the deduction provided by Article XIII, it may be desirable to stipulate, in bilateral treaties, the conditions under which, and the extent to which, taxes paid by a corporation may be regarded as taxes paid by the shareholder for the purposes of the article.

Taxable years and tax collection dates differ from country to country. It is therefore desirable that regard should be had to this fact when determining, in tax treaties, the taxes which may

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be deducted or offset against one another according to Article XIII.

*Article XIV. Fiscal Domicile in Two Countries.*

Article XIV relates to the case of taxpayers who, as the result of the construction given to the articles of the convention by the national tax administration or of the internal legislation of the contracting parties, might be regarded as having a "fiscal domicile" in each of the two countries concerned. It also applies to taxpayers who move from one country to another in the course of a taxable year.

In its present wording, the article implies that income tax is collected in the year following that in which the income was earned. It provides that the tax pertaining to the country of "fiscal domicile" under Article XIII shall be divided between the contracting states in proportion to the period of stay during the taxable year, or according to some other proportion to be agreed upon by the competent authorities. In connection with this article there arises the same question as was mentioned in the final paragraph of the commentary to Article XIII concerning differences in taxable years.

*Article XV. Equality of Treatment.*

The purpose of Article XV is to prevent discriminatory treatment in one country of taxpayers having their "fiscal domicile" in the other country whether they are nationals or not of that country.

*Article XVI. Taxpayers' Rights of Appeal.*

The special procedures of appeal provided for in Article XVI are intended not to replace, but to supplement the procedures of tax appeal established by the tax legislation of the contracting states. The taxpayer who, in spite of the provisions of the convention, has suffered double taxation, has the option of filing his appeal with the tax authorities of the country of which he is a national or of the country where he has his fiscal domicile, since it seems legitimate that he should be able to obtain the protection in tax matters of one or the other state according to the circum-

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stances. It should, moreover, be noted that the procedure contemplated is not a judicial procedure, but a direct consultation between the tax administrations involved.

#### Article XVII. *Relations Between Tax Administrations.*

The object of Article XVII is to entitle the tax administrations of the contracting states to correspond directly with one another and cooperate in the application of the convention, without necessarily having to resort to diplomatic channels. It also enables them to agree on administrative provisions which, while not expressly provided for in the convention, are in accordance with its spirit and may be required to give it full effect.

#### Article XVIII. *Ratification and Duration of the Convention.*

The final article of the convention contains protocolar clauses concerning the procedure of ratification and exchange of instruments of ratification. It refers also to the entry into force of the convention and to its duration. In this connection an initial period of three years is suggested, as such a period seems to be generally desirable in order to give sufficient trial to the system of preventing double taxation which is embodied in the model convention. A question which tax negotiators will have to consider in fixing the date of entry into force of the convention is that of the possible differences in fiscal years. It may also be appropriate to consider the case of tax claims that are outstanding at the time of the signature of the convention and which would not have arisen if the facts motivating such claims had taken place after the entry into force of the convention.

## II. MODEL BILATERAL CONVENTION FOR THE PREVENTION OF DOUBLE TAXATION OF SUCCESSIONS

### *General Structure of the Model Convention*

There is an analogy between the forms of double taxation that may occur through succession duties and through income taxes, respectively.

As in the case of income tax, liability to succession duties may indeed have a personal or an impersonal basis. In other words, an estate may be held liable to duty in a country on account of the nationality or domicile of the deceased and, at the same time, be taxed in another country on account of the situation of property belonging to the estate.

Double taxation of an estate may also occur because it is taxable in one country on account of the nationality of the deceased and in another country on account of his domicile. In this connection there may be, furthermore, differences as to the determination of the nationality or the domicile of the deceased.

An estate will also be exposed to double taxation when two or more countries regard a given property as subject to duty in their respective territories because they employ different criteria regarding impersonal tax liability. One country may, for instance, take into account the physical location of the property, while the other refers to the legal situs of such property, and there may be divergencies as to the determination of such situs.

Consequently, there is a noticeable parallelism between the present model convention on succession duties and the model convention which the Second Regional Tax Conference in Mexico prepared for income taxes. Moreover, the method followed in drafting the two model conventions has been the same.

Like the model convention on income taxes, the model convention on succession duties is based on the original work of the General Meeting of Government Experts on Double Taxation and Tax Evasion, Geneva, 1928, and on the treaties concluded in the 'thirties concerning the prevention of double taxation through death duties.

The task of the Conference in connection with succession duties has, however, been less laborious than in the case of income taxes.

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Indeed, while treaties on succession duties are less numerous than those on income taxes, it is possible to discern among them a still more remarkable tendency towards uniformity. Moreover, various provisions of the model convention on income tax could be applied by analogy to death duties.

The purpose of the Model Convention for the Prevention of the Double Taxation of Successions is stated in its Article I, which indicates the taxes and the estates to which it should apply.

Articles II to IV refer to the imposition of succession duties and other similar taxes on the basis of the situation of the property forming part of the estate: Article II deals especially with real property and its appurtenances, Article III with personal property pertaining to a business enterprise and Article IV with other kinds of personal property.

Article V regulates the allocation of debts between the two countries concerned in order to determine the net value of the estate taxable in each country.

Taxation in the country of domicile of the deceased is governed by Article VI which, in a manner analogous to Article XIII of the model convention on income tax, provides that the country of domicile of a deceased person, while entitled to tax the entire value of the estate involved no matter where the property is situated, should grant a deduction from its taxes on account of the taxes paid in the country where a part of the estate is taxable in accordance with any of the provisions of Articles II to IV.

Article VII refers to the continuous cooperation which should be maintained between tax administrations for the purposes of the application of the Convention, and Article VIII refers to the entry into force, duration and termination of the convention.

The convention is followed by a protocol containing rules intended to facilitate the settlement of questions arising in connection with the determination of domicile of a deceased person and the taxable situs of the various kinds of property. According to the method followed in the Commentary on the Model Convention for the Prevention of Double Taxation of Income, the provisions of the protocol to the present model convention will be dealt with in conjunction with the articles of the main convention to which they refer.



## DOUBLE TAXATION OF SUCCESSIONS

### Article I. *Object and Scope of the Model Convention.*

According to Article I, the provisions of the Model Convention for the Prevention of Double Taxation of Successions are to apply to the estates of persons domiciled at the time of their death in either one of the contracting states, whether or not they were nationals of that state or of the other state. The estate of a foreigner who at the time of his death was domiciled in a certain country is indeed generally subject in that country to the same tax liabilities as the estate of a national. It seems, therefore, appropriate that relief from international double taxation of an estate should be granted, irrespective of the nationality of the deceased, when he was domiciled at the time of his death in either one of the contracting states.

In the present model convention, "domicile" is defined somewhat differently from what it is in the Model Convention for the Prevention of Double Taxation of Income. In that text, it may be recalled, the "fiscal domicile" of the individual is "the place where the individual has his normal residence, the term 'residence' being understood to mean permanent home".<sup>1</sup> According to Article I of the protocol of the model convention on succession duties, "the domicile of a person at the time of his death is the place where he then had his permanent residence with the manifest intention of retaining it". Although the wording of this definition of "domicile" differs slightly from that of the definition given by the General Meeting of Government Experts on Double Taxation in their model bilateral convention on succession duties, their comments on the matter still apply to the new definition. They stated that:

"It is clear that the conception of domicile appropriate to a duty which is levied once and for all on the occasion of death must imply a greater degree of permanence than the conception on which an annual tax such as the income tax is based. It is unlikely that any state would claim the right to levy a death duty on the whole property of a deceased person on the ground that at the time of his death he was temporarily resident within its borders if his permanent home

<sup>1</sup> Model Bilateral Convention for the Prevention of the Double Taxation of Income. Protocol. Article II, paragraph 1, page 14 of the present document.

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and true economic allegiance lay elsewhere. But when it is sought to define the precise character and degree of permanence of the residence which should exist in order to justify a claim to tax on the ground of domicile, wide divergencies of view are found to exist in the different legal systems of the various countries of the world. In these circumstances, it has not been found possible to do more than frame a definition which seems to command the greatest common measure of agreement in the various codes of law".<sup>1</sup>

The second paragraph of Article I of the present protocol covers the case of deceased persons who at the time of their death had no domicile as defined above and were nationals of both contracting states. In such cases, it shall be presumed that the deceased "had his domicile in the country in which his family, social and economic interests were centered". Though there is no provision in the present text concerning deceased persons who had no "domicile" as defined above but were nationals of only one of the contracting states, it may be presumed that it was intended that in such cases the deceased would be considered as having his domicile in the country of which he is a national, in accordance with the rule contained in the model convention of 1928.<sup>2</sup>

The taxes to which the model convention should apply include duties based on the total value of the estate of a deceased person irrespective of the manner in which such estate is divided and distributed, among heirs or legatees, and duties assessed on the value of the share accruing to each heir or legatee and computed with reference not only to the value of that share but also to the degree of relationship between the deceased and the successor concerned.

Article I of the model convention is drawn up in such a way as to enable the negotiators using the model convention to enumerate the duties to which they desire that the convention should apply. In this connection, it would have to be determined in the case of each bilateral treaty whether it should or should not apply also to gifts *inter vivos*, as such gifts are taken into account in certain

<sup>1</sup> Report of the General Meeting of Government Experts on Double Taxation and Fiscal Evasion, Geneva, 1928. C. 562. M. 178. 1928. II, pages 28 and 24.

<sup>2</sup> *Ibid.*, p. 22.

#### DOUBLE TAXATION OF SUCCESSIONS

countries in the computation of death duties, subject to certain conditions relating to their amount and to their proximity in time to the decease of the donor. A similar question may arise with respect to the judicial and administrative fees collected in connection with the distribution of an estate.

Article VIII of the protocol contains a clause which in varying forms is found in a number of conventions concerning death duties. It safeguards the tax immunities that are granted or may be granted to diplomats and similar public officials, and protects the right of the country of which the above-mentioned officials are nationals to tax upon their decease the property which they leave in the other contracting state, subject to the general rules of international law and of internal law of the two countries concerned.

#### Article II. *Real Property.*

Article II of the model convention merely conforms to the rule contained in all national legislation and bilateral agreements according to which real property, personal property accessory thereto, and rights relating to, or secured by, real property are subject to the succession duties and similar taxes in the country where the property is situated, irrespective of the domicile or nationality of the deceased.

Article II of the protocol, which states that it is the law of the state in which the property is situated that should determine whether it is real or personal, also follows a generally accepted practice.

#### Article III. *Business Establishments.*

The provisions of Article III, which were not contained in the model convention on death duties prepared in 1928 by the General Meeting of Government Experts, have been drawn up in the light of the bilateral conventions on succession duties concluded during the inter-war period. Most, if not all of these conventions stipulate that commercial, mining and agricultural establishments are subject to succession duties in the country where they are situated. This rule applies not only to the tangible property which materially represents the business establishment but also to

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all assets which pertain to the business carried on in such establishment, since such business property constitutes an accounting unit which should be taxed as a whole.

In conformity with these principles, Article III contains two rules which relate respectively to the case where an enterprise which is part of a taxable estate has a permanent establishment in one country only and the case where it has one (or more) establishments in each of the contracting states. In the first case, the entire property pertaining to the permanent establishment is taxable in the country where the establishment is situated. In the second case, each country is entitled to tax the property of the enterprise to the extent to which such property belongs or relates to the establishment or establishments situated in that country. The problem of allocation, which this procedure entails, is to be solved, according to Article IV of the protocol, by means of the criteria and accounting rules contained in Articles IV, V and VI of the protocol of the Model Convention for the Prevention of Double Taxation of Income which define, among other things, the phrase "permanent establishment", and indicate the accounting rules to be followed in the allocation of the assets and liabilities of such establishments.

#### Article IV. *Personal Property.*

Property not governed by Articles II and III falls under Article IV. This article therefore applies mainly to tangible and intangible personal property that is not accessory to, or secured by, real property nor pertains to a business enterprise. The property referred to may, it seems, be divided into the following main groups:

- (a) Tangible personal property, *i.e.*, personal effects, furniture, cash and currency notes, the situs of which is clearly the place of its actual physical situation;
- (b) Ordinary intangible personal property such as personal claims including non-commercial current accounts, notes, securities and equities which are not normally transferable or which may be transferred by notification to the debtor or by endorsement: according to the various national jurisprudences, the situs of such claims and rights

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is sometimes considered to be the place where they are to be enforced, sometimes the place of domicile or residence of the debtor;

- (c) Claims, rights, notes, securities and equities to the bearer as well as any other right transferable by mere delivery of the documentary title: according to the various national jurisprudences, the situs of such property is considered sometimes to be the place of physical situation of the title, sometimes the place where they are to be enforced, sometimes the place of domicile or residence of the debtor;
- (d) Claims and rights the existence of, and the title to, which is legally established by record in registers maintained by public authorities or private corporations, such as registered debentures, bonds, shares and patents, copyrights, etc., which are generally considered as situated in the country where the relevant registers are kept.

In the course of the discussions of the Conference, it was suggested that the article covering these kinds of property should be worded as follows:

“All other property to which Articles II and III do not apply shall be exclusively taxed in the country of the fiscal domicile of the deceased”.

It was argued in support of this suggestion that it was by no means generally admitted in private international law that, for purposes of succession, the law of situation of the property should apply in so far as personal property is concerned; in this respect, many jurisdictions refer to the law of domicile. It was observed that none of the bilateral conventions that had been concluded for the prevention of double taxation through death duties provided for the taxation of property other than real estate and business enterprises and their appurtenances in the country of situation. Attention was also drawn to the fact that exclusive taxation of property other than that covered by Articles II and III in the country of domicile of the deceased was more convenient both for the heirs and for the tax administrations concerned.

Nevertheless, in view of the fact that the model convention on income taxes recognized the principle of taxation of income by

the country of origin of the income, the view prevailed at the Conference that in so far as death duties were concerned, the country of situation of personal property, whether tangible or intangible, should be entitled to impose its succession duties on such property. The Conference did not, however, attempt to give a definition of the tax situs of the various kinds of property. This matter was left to the negotiators of bilateral treaties and Article V of the protocol provides a framework where the clauses eventually required in this respect may be inserted.

The final clause of Article IV of the model convention concerning the rate of duty applicable in the country where the property is situated is based on the assumption that the tax is progressive. It has appeared desirable to state that this rate should be determined without taking into account the property situated in the territory of the other state, in order that the duty collected by the state where the property is situated should have a purely territorial scope.

#### Article V. *Deduction of Debts.*

Death duties being generally assessed on the net value of the taxable estate, the Conference found it necessary to provide a rule indicating in what manner and proportion debts should be deducted from the property taxable in each of the contracting states. Such is the purpose of Article V of the model convention.

Two main kinds of debt may be distinguished for this purpose: (a) special debts which are secured by or relate to specific property, such as debts guaranteed by a mortgage or a lien; (b) general debts which are not especially guaranteed by, and are not otherwise manifestly connected with, any particular asset of the deceased.

As regards the first kind of debt, the conventions concluded during the twenties and thirties have stipulated that they were deductible from the real estate or the industrial and commercial establishments to which they were related. The fairness of such provisions is obvious. Section A of Article V is therefore worded to that effect.

It may happen that such special debts exceed the value of the

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property from which they should be primarily deducted. Section B of Article V prescribes that the amount of such excess should be deducted from the value of the other property which the deceased may have held in the same country at the time of his death. In the normal course of events it may, indeed, be presumed that the debt has a greater degree of connection with the property situated in the same country as the original guarantee than with property situated elsewhere.

It is only when the amount of the special debt involved exceeds the value of all the property left by the deceased in the country where the original guarantee is situated that the debt may be deducted from property situated in the other country (Section C).

As regards general debts, it seems logical, as suggested in Section D of Article V, that they should be deducted proportionately to the value—net or gross according to the terms of the agreement which would have to be reached in that connection—of the property left by the deceased in each country, in view of the present wording of Articles II, III and IV.

If Article IV had been drafted in such a way as to give to the state of domicile the exclusive right of taxing property not covered by Articles II and III, then the rule as regards the deduction of general debts should have been the following:

“A general debt without specific guarantee shall be deducted from the property taxable in the country of domicile of the deceased in accordance with Article IV. If such a debt exceeds the value of the property taxable in the country of the domicile of the deceased, the excess shall be deducted from the value of the property in the other country”.

Article V of the model convention is completed by Articles VI and VII of the protocol. The effect of the first of these provisions is that, once the debts of a succession have been allocated between the two contracting states according to the provisions of Article V of the convention, the question of whether a debt so allocated is to be deducted from the property in the country concerned will depend on the general provisions which the legislation of that country contains as to the conditions under which a debt may be deducted from the value of an estate for tax purposes.

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Article VII of the protocol modifies the rules of Article V of the model convention by stipulating that debts may not in principle be deducted from inalienable property. At the same time, it prevents individuals from changing the operation of the rules of Article V concerning allocation of debts, as it provides that when property has been made inalienable by the deceased himself, debts will remain deductible from such property.

#### Article VI. *Domicile Taxation.*

It may be recalled that, according to Article IV, the country where property is situated is entitled to apply to the net value of such property the rate of duty which under its own legislation corresponds to that amount, as if the deceased had left no property in the other state. These provisions are completed by Article VI which stipulates that, while the country of domicile is entitled to impose its duties on the entire estate of the deceased, it should deduct from the tax so assessed the amount of tax due in the other country, under Articles II, III and IV, provided that the amount of this tax does not exceed a certain proportion of its own tax. This proportion is determined by computing the ratio which the tax of the country of domicile that corresponds to the property taxable in the country of situation according to Articles II to IV bears to the total tax which would have been due if the entire estate had been taxable in the country of domicile of the deceased.

It may be noted that the system of preventing double taxation through death duties, which is embodied in this article, corresponds to that provided in Article XIII of the Model Convention for the Prevention of Double Taxation of Income.

#### Article VII. *Inter-Administrative Cooperation.*

As in the matter of income taxes, the prevention of double taxation through death duties cannot be merely assured through provisions which each administration would apply separately and interpret independently. Article VII of the present model convention reproduces, therefore, the provisions of Article XVII of the model convention on income taxes which relate to inter-administrative consultation and cooperation.



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**Article VIII. *Ratification and Duration of the Convention.***

The wording of Article VIII of the model convention on succession duties is the same as that of Article XVIII of the model convention on income taxes and the same considerations apply in both cases.

### III. MODEL BILATERAL CONVENTION FOR THE ESTABLISHMENT OF RECIPROCAL ADMINIS- TRATIVE ASSISTANCE FOR THE ASSES- MENT AND COLLECTION OF DIRECT TAXES

#### *Introduction.*

Following the procedure of the General Meeting of Government Experts on Double Taxation and Fiscal Evasion of 1928, it appeared desirable to the Second Regional Tax Conference in Mexico to complement its model conventions on the prevention of double taxation with a model convention on reciprocal administrative assistance in tax matters.

Nevertheless, while the Government Experts drafted two separate model conventions dealing respectively with assessment of taxes and with collection of taxes, the 1943 Mexico Conference covered both subjects in a single instrument. Indeed, the kind of cooperation which is required for reciprocal assistance between administrations for the assessment and for the collection of taxes is substantially the same in both fields. Consequently, many formal provisions are valid in both cases. At the same time, if tax negotiators desire to restrict administrative cooperation to matters of assessment, as is not infrequently done in bilateral agreements, it is simple to eliminate from the model convention the provisions which find an application only as regards the collection of taxes.

The object of the model convention is indicated in its Article I, which provides that cooperation between tax administrations for the assessment and collection of taxes should be limited to taxes in connection with which double taxation has been or is being avoided and this article makes the provisions of the convention subject to reciprocity.

Article II lays down the bases upon which tax administrations would be entitled to correspond in connection with exchange of information.

Article III relates to certain kinds of easily available data for which the procedure of exchange of information is simplified. It may be noted that, under certain existing agreements, the infor-

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mation listed in this article is automatically exchanged at the end of each year without special request.

Administrative assistance as regards collection is dealt with in Article IV.

Article V indicates certain cases where a request for information or for assistance in tax collection may be rejected at the discretion of the authorities receiving the request.

The rules as to the secrecy to be guarded by the officials of one administration in connection with information received from the administration of the other country are contained in Article VI.

Article VII deals with the measures which the tax administrations of the contracting states may take in consultation to carry out and interpret the convention, and Article VIII refers to the entry into force, duration and termination of the agreement.

A detailed protocol contains provisions concerning the following matters: designation of the authorities entitled to correspond with one another for the application of the convention; manner in which the existence of reciprocity will be ascertained in the case of the various types of requests; form in which requests may be made and the documents that should accompany them; action to be taken by an administration receiving a request for assistance; form which should govern legal and judicial acts performed in compliance with the convention; rules applying to collection, handling, transfer of funds, and settlement of accounts between the two administrations.

#### Article I. *Object and Scope of the Model Convention.*

According to the initial clauses of Article I, the object of the Model Convention on Reciprocal Administrative Assistance is that "of assuring, in the interests of governments and taxpayers, an effective and fair application of the taxes to which apply the Conventions for the Prevention of Double Taxation of Income and Successions". It is indeed the duty of revenue authorities to see that each taxpayer should pay the taxes for which he has been assessed according to the laws of the country under the jurisdiction of which he comes. Failure to collect such taxes is indeed susceptible of impairing the services which the government should

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render to the public or bringing about an increase of the taxes borne by non-delinquent taxpayers.

Bilateral arrangements between tax administrations for the prevention of fiscal evasion have, on various occasions, met with suspicion. Various reasons may explain this distrust. There may have been a certain background of opposition to direct taxation, or at least to certain of its forms, and to an increase of the investigating powers of revenue authorities. Another factor was an unwillingness to place the facilities of the national tax administration at the disposal of foreign authorities and still more to introduce new tax practices in order to suit the requirements of foreign governments. In certain instances, there was a fear that the existence of too close a system of tax supervision and control would induce capital to prefer countries where its tax treatment was less strict or less burdensome. Moreover, the feeling was sometimes manifested that the proposals which ostensibly related to the prevention of fiscal evasion constituted in reality an attempt to interfere with the freedom of capital movements.

These objections have not, however, prevented some thirty-odd bilateral conventions from being concluded by some fifteen countries, mostly European, during the inter-war period, and it is clear that, in so far as they exist, the dangers mentioned above may be avoided through appropriate provisions.

The Conference was of the opinion that reciprocal assistance between tax administrations should exist only as regards taxes concerning which double taxation is avoided, or at least mitigated, between the two countries. This is clearly stipulated in Article I, which makes the convention on reciprocal administrative assistance a complement to the conventions on the prevention of double taxation through income taxes and death duties.

It is also stipulated in Article I that assistance must be reciprocal. To exist, such reciprocity requires that the tax legislation and organization of each of the contracting states is such that the powers of the respective national administrations to obtain information and to enforce revenue claims are substantially the same, except for mere formal differences in procedure. Article II of the protocol indicates the manner in which the existence of reciprocity should be ascertained in each case.

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Reciprocity means also that the state that receives a request for assistance from the other state should in principle exert the same diligence in carrying out such request as if it were acting on its own behalf. The provisions of Article I of the model convention are completed in this respect by those of Article VII of the protocol concerning the duties of the tax authorities of a country with regard to requests for assistance from the corresponding authorities of the other country.

The fact that there is an arrangement for tax assistance with another country should not give to any national tax administration greater powers of investigation and tax enforcement against its own taxpayers than those which are conferred upon it by its own domestic legislation. Such extension might, indeed, indirectly violate the guarantees granted to the taxpayers by that legislation. At the same time, an agreement for reciprocal tax assistance should not imply for any administration the obligation to take any measure that is repugnant to its national legislation or its established practices. It is therefore stipulated in Article I, in addition to the general requirement of reciprocity, that the information that may be furnished under the convention will be "such information in matters of taxation as the competent authorities of each state have at their disposal or are in a position to obtain under their own laws. . . ."

Mention may also be made, in this connection, of Article V of the model convention which stipulates, among other things, that requests for information may be denied if they involve the obligation to obtain or supply information which is not procurable under the legislation of the state applied to or under that of the applying state, or if they imply administrative or judicial action incompatible with the legislation and practices of either contracting state.

Reference should also be made, however, to Article X of the protocol which admits as an exception to or modification of the principles which have just been outlined that "any special forms of assistance not being incompatible with the laws of the state applied to may be adopted at the request of the applying state".

In order to complete the enumeration of the general conditions under which reciprocal assistance may be granted in tax matters,

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it may be well to mention at this juncture certain other provisions contained in Article V of the convention which is in effect a complement of Article I.

In addition to the requirements which Article I imposes, as mentioned above, regarding reciprocity and compatibility of the requests for assistance, and the action taken thereon, with the legislation and practice of both contracting states, in Article V it is provided that administrative assistance should never entail for either administration the necessity of taking measures that might imply the violation of a professional, industrial or trade secret. This matter of administrative secrecy is also dealt with in Article VI of the model convention.

It may not be thought desirable that an agreement for reciprocal administrative tax assistance should result in a state abandoning its citizens who are taxable in another country entirely to the discretion of a foreign tax administration, and, moreover, putting itself under the obligation to carry out at the request of such an administration measures that may not be in harmony with domestic customs. Such a danger is already reduced by Article XV of the Model Convention for the Prevention of Double Taxation of Income, which relates to equality of treatment. Moreover, Article V gives the authorities of the state applied to the right in various cases to refuse at their discretion to give effect to a request for tax assistance when it relates to one of its nationals.

The safeguarding of the rights of domestic creditors in the state which receives a request for assistance as regards collection of taxes may also have to be taken into account. It is for this reason that Article XI of the protocol provides that "revenue claims for collection shall not receive preference over either public or private claims in the state applied to" whatever may be the priority given to such revenue claims in the country by which the request for assistance in collection is made.

### *Article II. Information to be Supplied on Request.*

The object of Article II is to enable the competent authorities of the contracting states to correspond directly as regards the information they may need from one another in connection with

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the taxes to which the convention applies, as such taxes are defined in Article I of the present model convention and by the initial articles of the model conventions on the prevention of double taxation through income taxes and death duties.

The compliance with such requests is of course subject to the general conditions which have been reviewed above in the comment on Article I.

As to the rules that apply specifically to the subject matter of Article II, it may be noted that according to Article I of the protocol, the competent authorities that are entitled to correspond in this connection are "the highest tax authorities of each of the contracting states or the duly authorized representatives of such authorities".

Such requests should be formulated in the official language of the applicant state and accompanied by a translation in the official language of the state applied to, according to Article V of the protocol. They should specify the authority making the request, the name and address and nationality of the person to whom the request relates, the taxation in respect of which it is imposed, according to paragraph 1 of Article IV of the protocol. And they should be accompanied by a declaration by the competent authorities who make the application, officially confirming that any similar request would be complied with in accordance with the laws of the applicant state, according to Article II of the protocol, unless the information falls within the scope of Article III of the convention, in which case reciprocity will be presumed to exist without any specific declaration to that effect.

The information that may be applied for under this article may be in the hands of the administration to which the request is directed or it may have to be secured from an outside source. This source may be the party concerned himself or persons who, as a result of their relations with the taxpayer, can give information about his affairs, or resort may have to be made to experts or witnesses. In all such cases the authorities receiving a request, provided that the request is allowable under Articles I and V of the model convention, must exert diligence in complying with the request (Article XII of the protocol), must advise the applicant authority as to the action taken on the request (Article XIII of

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the protocol) and, if the request cannot be complied with, must state the reasons why, transmitting all the relevant information that is in their possession and that they may communicate (Article XIV of the protocol).

If compliance with a request requires a formal procedure such as legal service of documents, the provisions of Article IV, paragraph 2, of the protocol apply. Accordingly, the authority making a request has to indicate "the address of the recipient and the nature and purpose of the document for service". The form of service is itself governed by Articles VI and VII of the protocol, which provide that the authorities receiving a request for the service of a document "may limit their action in connection with the service of the document to merely handing it to the recipient, if the latter is willing to receive it" and that, "if the competent authorities of the applicant state so desire, the document may be served in the form prescribed in similar cases by the internal law of the state applied to". It may also be noted that Article X of the protocol stipulates that "assistance procedure shall be in the form for which the laws of the state applied to provide. . . . Any special forms of assistance not being incompatible with the laws of the state applied to may be adopted at the request of the applying state".

As regards the expenses which may be involved by requests for assistance, reference should be made to Article XVIII of the protocol, which provides that in principle, assistance is to be gratuitous, except with regard "to emoluments paid to witnesses, experts, agents of execution and to legal and judicial fees incurred in connection with the service of a document or the enforcement of a revenue claim. The revenue authorities shall notify one another as required of the probable amount of such costs, fees or charges".

#### Article III. *Exchange of Readily Available Information.*

A number of existing agreements on reciprocal tax assistance provide for the automatic exchange at the end of each year of certain kinds of information on such matters as interest and dividend and other income payments, individual bank balances, inventories of estates, which tax administrations frequently compile



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through vouchers, or tabulate in the ordinary course of their activities.

In a draft which was submitted to the Conference, Article III of the model convention was intended to provide for such automatic exchange of information with respect to the four classes of data enumerated in that article. In that connection, it may be appropriate to quote the text of the draft, which read as follows:

“In accordance with Article I, the competent authorities of each contracting state shall transmit in the ordinary course as soon as possible after the expiration of each calendar (or fiscal) year to the competent authorities of the other state:

“(a) the name and address of all individuals, partnerships, corporations, or other entities having an address in the territory of the other state and deriving from sources within the territory of the former state rents, dividends, interests, royalties, income from trusts, wages, salaries, pensions, annuities or other fixed or determined periodical income, and indicate the amount of such receipts in the case of each addressee;

“(b) an extract of all inventories received by the competent authorities in the case of property passing on the decease of persons who had an address in the territory of the other state or the nationality of that state;

“(c) any particulars which the competent authorities may obtain from banks, insurance companies, or other financial institutions concerning assets and claims belonging to persons having an address in the territory of the other state;

“(d) any particulars which the competent authorities may obtain from inventories in the case of property passing on death, concerning debts contracted to or property passing to persons having an address in the territory of the other state”.

It appeared, however, to various members of the Conference that such a system of automatic exchange of information could work satisfactorily only in the case of countries having a very well-established tax system and administration. It was, therefore, deemed desirable not to include such automatic exchange of information in the model convention, in order not to make it appear

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as an obligatory element in any system of reciprocal tax assistance, nor as a standard basis of negotiations.

Nevertheless, there remains a distinction between the information generally included under Article II and the four kinds of data specifically mentioned in Article III. Indeed, a request for information under Article II may be rejected by the administration receiving such a request on any of the grounds mentioned in Article V. On the other hand, these limitations do not apply to the information specifically mentioned in Article III, since the reservations and safeguards contained in Article V do not seem to be called for in the case of such information. Moreover, reciprocity is presumed to exist as regards information covered by Article III, without any special declaration to that effect in the case of each individual request.

#### Article IV. *Assistance in Tax Collection.*

The main rules governing the assistance which the tax administration of one state may render to that of the other state as regards tax collection are contained in Article IV. The provisions of this article are of course subject to the reciprocity requirements of Article I of the convention and Article II of the protocol and to the general safeguards of Article V (in particular, Sections B and D) of the model convention.

Assistance as regards collection may, in principle, be asked only as regards revenue claims which are definitely due, though paragraph 4 of Article IV contemplates the possibility of measures of conservancy in connection with revenue claims not definitely due.

Under the general rule requests for collection assistance "shall be accompanied by such documents as are required by the laws of the applying state to establish that the taxes are definitely due" (paragraph 3 of Article IV of the model convention) and that requirement will be satisfied "by a copy or official extract of the final decision or order by the competent authorities concerning the revenue claim in question and by a statement from the competent authorities to the effect that the revenue claim is final" (Article VIII of the protocol). The claims for which collection assistance may be requested include in addition to the principal of

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the tax, the "interest, costs, additions to taxes, and fines not being of a penal character, according to the laws of the state applied to" (Article IV of the convention, paragraph 1). Nevertheless, requests for assistance should only be made when the amount involved justifies such procedure and when the state concerned cannot collect it by its own means (Article IX of the protocol).

The provisions mentioned in the last two paragraphs of the comment to Article II, as regards the form of service of documents, rules of procedure (including forms of representation) and the refund of expenses, apply when requests for collection assistance involve legal action or judicial proceedings. In such cases, however, requests for the service of documents should indicate, in addition to the information required for collection purposes: "amount of principal due and interest due and the date from which such interest begins to run; in the case of fiscal penalties, the nature and amount of such penalties; and any other information of a nature to facilitate or accelerate collection" (Article IV of the protocol, paragraph 3).

To safeguard the interests of domestic creditors in the state applied to, Article XI of the protocol provides that "revenue claims for collection shall not receive preference over either public or private claims in the state applied to".

According to Article XVI of the protocol, "collection shall always take place in the currency of the state applied to". To that effect, the amount for collection will be converted by the authorities of the state applied to into their own currency at the last exchange rate quoted on the appropriate market. Article XV of the protocol provides that "the state applied to shall be responsible to the applying state for the sums collected on the latter's behalf . . ." and Article XVII of the protocol stipulates that the amount so collected shall be paid over to the account of the central bank of the applying state with the central bank of the state applied to after deduction of the costs that may be due as indicated in the last paragraph of the comment to Article II.

According to Article XIX of the protocol, the convention does not apply to measures of conservancy in respect to taxes that have not yet been assessed. However, as regards taxes that have been assessed, but are not definitely due, the tax authorities con-

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cerned may request the corresponding authorities of the other state "to take such measures of conservancy as are authorized by the revenue laws of the state interested", subject, of course, to the general requirements of reciprocity contained in Article I of the convention, Articles II and XII (last sentence) of the protocol, and the safeguards contained in Article V of the convention.

#### Article V. *General Safeguards.*

Reference has been made in connection with all the preceding articles of the model convention to Article V, since its clauses are key provisions which delimit the practical scope of the system of reciprocal administrative assistance contemplated in the model convention. According to this article, any request for information or for assistance with regard to collection is allowable only if it entails action that is compatible with the legislation of both contracting states. It safeguards also professional, industrial and trade secrecy, and it gives the authorities receiving a request for information or for assistance the right to decline to comply with such a request when it relates to a taxpayer who is one of their nationals or when compliance may endanger the security or sovereign rights of the state applied to. It should, however, be noted that the reservations of Article V do not apply to the information mentioned under Article III of the convention as in ordinary practice such information is readily available and does not involve probing into the intimate affairs of a person or into governmental secrets.

#### Article VI. *Safeguards of Administrative Secrecy.*

Reciprocal assistance between tax administrations is possible only if each administration is assured that the other administration will treat with proper confidence the information which may have to be communicated to it in the course of their cooperation. At the same time, the respect of such secrecy by the officials of a country is a matter of national jurisdiction. It is therefore provided in Article VI that information communicated under the provisions of the convention shall be kept secret by the authorities receiving it "in the same way and to the same extent as is done in the state that supplies it". Sanctions for the violation of such

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secretary by an official of the state that has received information, shall, however, be governed by the administrative and penal laws of that state.

### Article VII. *Application of the Convention.*

The object of Article VII of the present model convention is similar to that of Article XVII of the model convention on income tax and Article VII of the model convention on succession duties. It is intended to furnish the basis for continuous cooperation between the tax authorities concerned as regards the interpretation and application of the convention and the adoption of special measures in order to enforce the convention, or to complete it with respect to doubtful cases or matters not expressly provided for. It may be of interest to note that the second sentence of this article enables the contracting states, when signing a convention for reciprocal administrative assistance in tax matters to agree formally only on the essential provisions of the agreement and to dispense as they see fit with the detailed provisions contained in the protocol and those of the model convention which appear secondary or superfluous in view of the kind of relations that are likely to develop between the tax authorities in the contracting states. Indeed, the second sentence of that article stipulates that "with respect to the provisions of this convention relating to exchange of information, service of documents and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and reply, conversion of currency, disposition of amounts collected, minimum amounts subject to collection and related matters".

### Article VIII. *Ratification and Duration of the Convention.*

The provisions of Article VIII of the present model convention are identical with those of the final articles of the model conventions on double taxation through income taxes and death duties. It is, of course, clear that the entry into force and duration of the convention on reciprocal assistance between tax administrations should coincide with that of the convention or conventions for the prevention of double taxation in respect of the taxes to which the convention on administrative assistance applies.

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