Applicability of Foreign Decisions and Interpretation of Tax Treaties in International Taxation

Dr. Justice Vineet Kothari*

* Dr. Justice Vineet Kothari, 58, is presently a Judge of Karnataka High Court, after having practiced as a Tax Lawyer in Rajasthan High Court and Supreme Court of India for about twenty years from 1984 until 2005 when he was appointed as Judge of Rajasthan High Court. He has dealt with several tax cases and decided such cases in both the High Courts. He has a Ph.D. on Tax Laws after acquiring the professional qualification of Chartered Accountants and Company Secretaries from ICAI and ICSI, India. His various articles have been published in Tax Journals regularly, and for the last five years, he has been regularly contributing papers on International Taxation on the Forum of International Association of Tax Judges (I.A.T.J.) of which he is now a nominated Director and International Fiscal Association (I.F.A.) and has been invited to contribute papers by T.P. International, London and I.B.F.D., Amsterdam. E-mail: kotharivineet@gmail.com

Abstract

This paper examines the decisions of various courts of different jurisdictions, especially the Supreme Court and the federal court, regarding the interpretation of various Double Taxation Avoidance Agreements (DTAA). Serious research and efforts have been put in to discuss such various cases with factual backgrounds giving citations of foreign decisions wherever they were applied and distinguished by the different top courts. The author concludes that for the comity of international trade and fair implementation of DTAAs so that all tax jurisdictions get their fair share of revenue generated by barrier-less trade in the world, a harmonious construction of various clauses and conditions of such taxation treaties can emerge. The author suggests that international research bodies, like OECD, IATJ, and IBFD, can be engaged into developing well researched data bank of top court decisions of all the countries so that those inputs and wisdom can be utilized by the concerned tax jurisdictions whenever the controversies with regard to the interpretation of tax treaties land on their boards, which are more often than not expected to arise. The vast developed and changing economies with digital transactions and use of technology require such harmonious patterns to develop for the good of all the economies in the world. It is expected that this paper will enlighten the readers for this purpose.

Key Words: Foreign Taxation Decisions, International Taxation, Double Taxation Avoidance Agreement (DTAA), Taxation Treaties, OECD, Enforcement of Foreign Decisions, Interpretation of Treaties, Revenue Rule, Foreign Account Tax Compliance Act (FATCA), CbC Reporting, Shell Companies, Fees for Technical Services, Royalties

Manuscript received: Feb. 21, 2017; review completed: Mar. 21, 2017; accepted: Oct. 23, 2017.

I. Introduction

When the world trade is going barrier-less and economy barriers are breaking down, except for the very recent trend of “Look Inwards” of the Trump Era and Brexit, and all countries are trying to get their fair share of the economies developed by the exploitation of the natural resources of the mother planet, the concept of international taxation to ensure such fair share of the revenue generated by such barrier-less trade becomes a very important and relevant subject. Taxation treaties or DTAAs to avoid double taxation between two or more countries are the order of the day now.

Since the size of the countries and economies in this world are different, the requirements of tax revenue are also different. Therefore, naturally, the terms and tenor of taxation treaties also differ from country to country. All countries divided along the lines of common law jurisdictions and civil law jurisdictions also provide different constitution of the judicial dispensation mechanism in the hierarchies of the courts rising up from the level of assessing officers at the bottom up to the Supreme Court of that country.

The core of this paper is to find out the rationale of applying the actual application of the foreign jurisdiction decisions while interpreting the terms and clauses of various taxation treaties, see how different tax jurisdictions and courts of the country use and apply the foreign judgments or otherwise make interpretation of tax treaties and tax cases, and understand how the foreign decisions are executed in local jurisdictions. This not only gives an insight in the local judicial dispensation and hierarchy, but also is of seminal importance for the tax professionals, courts, and business houses who have their business operations in different jurisdictions particularly, because there is now a development of digital economy where the transactions, contracts, and transfers of money are all done through e-technology. It is all in the clouds now, and therefore, different tax jurisdictions, especially some of those that deliberately develop and recognize tax havens with low or nil tax rates, have challenging task for the tax gatherers and courts to interpret such taxation treaties for the benefit of their respective jurisdictions, and at the same time, not to create an incongruous and hostile atmosphere for the other contracting states and those involved tax jurisdictions.

Organizations like Organization for Economic Co-operation and Development (OECD) undertake the task of drafting model treaties, provide guidelines and definitions of various terms used in international trade, and guide different countries to evolve a kind of harmonious and uniform taxation treaties so that a meaningful interpretation and helpful uniformity can emerge.

The Fiscal Committee of the League of Nations first prepared the model forms applicable to all countries in 1927. Later, the Fiscal Committee conducted meetings in Mexico during 1943 and in London in 1946 and proposed minor variations. The Fiscal Committee of the U.N. Social & Economic Council published the model conventions in Geneva on April 1946. Later, the Fiscal Committee of the Organization for European Economic Co-operation (OEEC) published a draft on July 6, 1963.[1]

On September 1961, the OECD was established to succeed the OEEC and the draft dated July 6, 1963, which the OEEC submitted was confirmed by the OECD. These are called the OECD Models.[2] They have further been modified in 1974 and 1977 by either the OECD or by the contracting countries in individual cases. The OECD provided its own commentaries on the technical expressions and the clauses in the model conventions.

Lord Radcliffe in *Ostime v. Australian Mutual Provident Society* described the language employed in these agreements as the "International Tax Language."[3] A complete but brief history of the tax treaties from 1870 in various countries, the League of Nations, and the U.N. is included in Dr. M.B. Rao's book on *Double Tax Treaties Between Developing and Developed Countries*.[4] Dr. Rao quotes M.B. Carrol stating, "[i]nternational tax law is 'in a state of perpetual becoming.'"[5]

In the present paper, I propose to deal with some leading judgments of Indian Supreme Court and courts of other countries on the issues of interpreting taxation principles or DTAA in order to make my efforts useful for all that are concerned with these issues, to show how the superior courts in different countries have utilized the wisdom, reasons, and interpretations given by different jurisdictions when deciding the controversies that were brought before them in different jurisdictions, and to see how different countries deal with foreign decisions in the field of taxation.

II. India

The Indian Supreme Court in *Union of India v. Azadi Bachao Andolan* (movement for saving Independence) dealt with Indo-Mauritius Double Taxation Avoidance Convention, 1983 (DTAC) where the capital gains of any resident of Mauritius arising by sale of shares of an Indian company would be

1. HALSBURYS LAWS OF ENGLAND (Lord Hailsham of Marylebone ed., 4th ed. 1992).
2. SIMON'S TAXES 351, (4.401) (3d ed. 2008).
3. Ostime v. Australian Mut. Provident Soc'y [1960] AC 459 (HL) 480 (Eng.).
4. *See* M.B. RAO, DOUBLE TAX TREATIES BETWEEN DEVELOPING AND DEVELOPED COUNTRIES (1983).
5. *Id.*

taxable only in Mauritius according to Mauritian taxation laws and would not be liable to tax in India.[6] A large number of foreign institutional investors (FII) who were residents in Mauritius invested large amounts of capital in shares of Indian companies with the expectation of making profit by sale of such shares without being subject to tax in India. This resulted in the creation of several "shell companies" incorporated in Mauritius that made Mauritius a conduit of huge funds of FIIs in India. Moreover, the sale of such shares in India, resulting in high capital gains, could not be taxed in India because of the said clause. The challenge was laid by a civil society organization, namely Azadi Bachao Andolan (Movement for Saving Independence), and while negating the said challenge, the Indian Supreme Court not only relied upon Section 90 of the Indian Income Tax Act, 1961, which provides for an over-riding effect of taxation treaties over domestic law, but also referred to several foreign decisions in order to interpret that clause. A brief discussion of that is made by the Court.

The judgment discussed the need of foreign investments in a developing country and mentioned that the treaty shopping opportunities would attract the investors to the developing countries. It also quoted several examples of European and Southeast Asian countries being tax haven to investors, Mauritius being one among those tax haven countries, and the importance of "Mauritius conduit" to India. It also pointed out the fact that the developing countries, in the interest of long-term development, tolerate the many principles in the fiscal economy.

Indian Supreme Court distinguished its own previous decisions in the case of *McDowell & Co. v. Commercial Tax Officer*[7] by relying on the following British (House of Lords) decisions. The Court quoted Lord Sumner in *IRC v. Fisher's Executors*:

> [T]he highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed terms or any omissions that he can find in his favor in taxing Acts. In so doing, he neither comes under liability nor incurs blame.[8]

This view of Lord Sumner was reiterated by Lord Tomlin in *IRC v. Duke of Westminster*.[9]

---

6. Union of India v. Azadi Bachao Andolan, (2003) 263 ITR 706 (SC).
7. McDowell & Co. v. Commercial Tax Officer, AIR 1986 SC 649.
8. IRC v. Fisher's Executor [1926] AC 395 (HL) 412 (Eng.).
9. IRC v. Duke of Westminster [1935] All ER 259 (HL) 267 (Eng.).

> It is said that these were the sentiments of pre-Second World War expressed by British Courts and that *McDowell* took a new look at fiscal jurisprudence and that it's a radical departure, in tune with the changed thinking of such fiscal jurisprudence by the English Courts, which was evidenced in *W.T. Ramsay Ltd. v. IRC*;[10] *IRC v. Burmah Oil Company Ltd.*;[11] *Furniss v. Dawson*.[12]

The Indian Supreme Court also relied upon several decisions of the United States courts to hold that motive of tax avoidance is irrelevant in consideration of the legal efficacy of a transactional situation.

The Indian Supreme Court's judgment quoted the United States Supreme Court case of *Bas v. Comm'r*[13] and *Johansson v. Unites States*[14] that had a similar observation made in *Bas v. Comm'r* where the relevance of the motive for Johansson was questioned. It was observed in *Johansson* that status was created by petitioners with a view to reduce their taxes through qualification of the corporation under the Convention. The test, however, is not the personal purpose of a taxpayer in creating a corporation. Rather, it is whether that purpose is intended to be accomplished through a corporation carrying out substantive business functions. If the purpose of the corporation is to carry out substantive business functions, or if it in fact engages in substantive business activity, it will not be disregarded for federal tax purposes.[15]

The judgment also quoted *Barber-Greene Americas, Inc. v. Comm'r*. It was observed that a corporation would not be denied the Western Hemisphere trade corporation tax benefits merely because it was purposely created and operated in such a way as to obtain such benefits. Similarly, a corporation otherwise qualified should not be disregarded merely because it was purposely created and operated to obtain the benefits of the United States-Swiss Confederation Income Tax Convention.[16]

This rather old decision was followed again recently by the Indian Supreme Court in the historic and extensively discussed decision in the case of *Vodafone Int'l Holdings B.V. v. Union of India and Another*,[17] which prompted the Indian Parliament to undo the effect of that decision by amending the law retrospectively, which itself became a subject of great

---

10. W.T. Ramsay Ltd. v. IRC [1982] AC 300 (HL).
11. IRC v. Burmah Oil Co. [1982] STC 30 (HL).
12. Furniss v. Dawson [1984] AC 474 (HL).
13. Bas v. Comm'r, 50 T.C. 595 (1968).
14. Johansson v. United States, 336 F.2d 809 (5th Cir. 1964).
15. *Id.*
16. Barber-Green Americas, Inc. v. Comm'r, 35 T.C. 365, 383-84 (1960).
17. Vodafone Int'l Holdings B.V. v. Union of India, (2012) 6 SCC 613.

international pressure and criticism. The matter has been taken to international arbitration by Vodafone to be refunded Rs.11,000 crores, which is equivalent to 1,692 million USD.

In *Vodafone,* the Indian Supreme Court relied upon the earlier foreign decisions of *Azadi Bachao Andolan* and further extended that interpretation by developing the principle of "Look At" and not "Look Through" in the interpretation of the Indo-Mauritius Treaty by permitting the double non-taxation of capital gains by indirect transfer of shares. The Court observed that there was no transfer of capital asset in India by HTL to Vodafone, the payment for such transfer was offshore, and the parties were non-residents. The Court further commented that the extension of loan agreements by such transfer of CGP share could not be termed to be transfer of assets, rights or entitlements in India to attract the capital gains tax, or come under the purview of Section 9 of the Income tax Act.[18]

The Court further referred and relied upon the decisions in the United States and United Kingdom. The U.S. Supreme Court decision in *United States v. Bestfoods*[19] was referred in the context that the corporate veil of a parent company and of a subsidiary company under investigation can be pierced if the corporal form is misused to accomplish wrongful purposes and that mere ownership, parental control, and management of a subsidiary is not sufficient to hold a parent company liable. In *Adams v. Cape Industries Plc.*,[20] the Court of Appeal emphasized that it is appropriate to pierce the corporate veil where special circumstances exist indicating that it is mere facade concealing true facts. The court also noted that certain multinational corporations (MNCs) set up complex vertical pyramid like structures to keep the parent and operating companies separate to protect their legal liabilities.

The Supreme Court of India in this case also commented on the applicability of the "Look At" and the "Look Through" principles by stating that to ascertain the true nature and character of the transaction and by applying "Look At" principle to present case, the transaction seems to be non-taxable because it is evident that the offshore transaction was a participative investment and not a sham transaction where the transfer of share in CGP (a Cayman Island company) between HTL (a Cayman Island company) and VIH (a company incorporated in Netherlands) were completely off-shore. In addition, India tax authorities had no territorial jurisdiction to tax such transaction. The court also commented that Section 9 cannot be interpreted to include the "Look Through" principle because it only deals with the

18. *Id.*
19. United States v. Bestfoods, 524 U.S. 51 (1998).
20. Adams v. Cape Indus. Plc [1991] 1 All ER 929 (Eng.).

transaction of the assets situated in India and not off-shore and that it was purely a matter of policy. This principle had to be expressly provided for in the treaty.

The Indian Supreme Court again in a later decision in *Ishikawajima-Harima Heavy Industries Ltd. v. Director of Income Tax of Mumbai*,[21] while interpreting an Indo-Japan Double Taxation Avoidance Agreement, beautifully explained the difference between existence of "Permanent Establishment"[22] and absence of "Business Link."[23] The existence of business link was

---

21. Ishikawajima-Harima Heavy Indus. Ltd. v. Dir. of Income Tax of Mumbai, [2007] 3 SCC 481.
22. As per the OECD model, there are two types of PE contemplated. First, an establishment which is a part of the same enterprise and under common ownership and control of an office, branch, etc. This is covered by Article 5(1) to (4), which can be referred to as "Associated PE." The second type is an agent who is legally separate from the enterprise, but is nevertheless dependent on the enterprise to the point of forming a permanent establishment. This is covered by Article 5(5) and (6), which can be referred to as "Unassociated PE."
23. The term BC is discussed in Section 9(1)(i) of the ITA, which is reproduced below:
    The following incomes shall be deemed to accrue or arise in India:
    (i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or ...."
    Explanation 1—For the purposes of this clause—
    (a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;
    (b) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;
    (c) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India;
    (d) in the case of a non-resident, being—
        (1) an individual who is not a citizen of India ; or
        (2) a firm which does not have any partner who is a citizen of India or who is resident in India ; or
        (3) a company which does not have any shareholder who is a citizen of India or who is resident in India, no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India ;
    Explanation 2.—For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—
    (a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or
    (b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

necessary to attract Indian income tax. The Court held that no Indian income tax was attracted to a contract of providing overseas services in the present case. The court explained the difference between an income arising out of a "business connection" and a "permanent establishment" and opined that having a permanent establishment does not necessarily constitute sufficient business connection and that the fiscal jurisdiction of a country would not extend to taxing the entire income attributable to the permanent establishment. It was also held that business connection would be relevant for the purpose of applying Section 9 of the Income Tax Act and the concept of permanent establishment would be relevant for assessing the income of non-resident under the Double Taxation Avoidance Agreement. It relied upon the decisions in *Commissioner of Taxation v. Kirk*[24] and *Love v. Norman Wright (Builders) Ltd*.[25]

In *Commissioner of Income Tax of Bombay v. Ahmedbhai Umarbhai & Co.*,[26] this Court, having regard to the provisions contained in Section 42 of the Indian Income Tax Act, 1922, held that profits accrued to the assessment of a part of the business in an Indian State having accrued out of such business carried on in such State are exempted under the third proviso to Section 5 of the Excess Profits Tax Act. Opining that the source of income can never be the place where the income accrues or arises, Kania, CJ, stated,

> "[i]n my opinion, there is nothing to prevent income accruing or arising at the place of the source. The question of where the income

---

(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business :

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principle non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

Explanation 3.—Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

24. Comm'r v. Kirk [1900] AC 588 (PC) at 55-57 (Eng.).
25. Love v. Norman Wright (Builders) Ltd. [1944] 1 KB 484 at 50 (Eng.).
26. Comm'r of Income Tax of Bombay v. Ahmedbhai Umarbhai & Co., (1950) 1 SCR 335 (India).

> accrued has to be determined on the facts of each case. The income may accrue or arise at the place of the source or may accrue or arise elsewhere, but it does not follow that the income cannot accrue or arise at the place where the source exists. Therefore, it is necessary to ascertain whether that part of the business, which is capable of being treated as one separate unit in the Hyderabad State has given rise to the income or profit sought by the assessment to be exempted from taxation in the present case."[27]

Patanjali Sastri, J. approved the application of the principle underlying the decision in *Commissioner of Taxation v. Kirk*, namely, the principle of apportioning profits as between different processes employed in producing those profits and the different places where they were employed.[28]

> 16. Our attention was invited to a judgment of the Court of Appeal in *Love v. Norman Wright (Builders) Ltd.*.[29] In that case the respondents contracted with the Secretary of State for War to do the work and supply the material mentioned in the Schedules to the contract, including the supply of black-out curtains, curtain rails and battens and their erection at a number of police stations. It was held by the Court of Appeal that the respondents were liable to pay purchase-tax.[30]

Reliance was placed upon the observations made by Godiard, L.J.

> The test in each case is whether the object of the party sought to be taxed is that the chattel as chattel passes to the other party and the services rendered in connection with the installation are under a separate contract or are incidental to the execution of the contract of sale.[31]

In *DIT (International Taxation) v. Morgan Stanley & Co.*,[32] Morgan Stanley and Company of United States of America (MS-USA), an investment bank engaged in the business of providing financial advisory services, corporate lending, and securities underwriting, entered into an agreement with an Indian

27. *Id.* at 479.
28. *Kirk* [1900] AC 588.
29. *Love* [1944] 1 KB 484.
30. *Ishikawajima-Harima Heavy Indus. Ltd.*, [2007] 3 SCC 481.
31. *Love* [1944] 1 KB 484, 487.
32. DIT (Int'l Taxation) v. Morgan Stanley & Co., (2007) 292 ITR 416 (SC) (India).

company, Morgan Stanley Advantages Services Private Limited (MSAS), to provide back office operations to MS-USA in equity and fixed income research, account reconciliation, and IT enabled services, such as back office operations, data processing, and support center. Interpreting the Indo-US DTAA, the Indian Supreme Court held that Advance Ruling Authority (ARA) was justified in holding that MSAS could not be said to be a "permanent establishment" of MS-USA because it had no authority to enter into or conclude a contract on behalf of MS-USA. However, to the extent of deputation of staff by the U.S. company to the Indian company to work as stewards or deputationist in the employment of the Indian company, the U.S. company would be regarded as having a permanent establishment and so long as MSAS was remunerated for its services at arm's length, no further income could be attributed in the hands of the "permanent establishment" of MS-USA. For making adjustments in income, if any, the method of Transactional Net Margin Method (TNMM) was the most appropriate method of quantifying the profits of the foreign company in the case of a service permanent establishment because under TNMM, the total operating profit arising from the transaction was apportioned on the basis of sales, costs, assets, etc.

One can conclude that India is consistently giving due importance to foreign decisions, respectfully following them to enforce foreign tax decisions and giving primary and over-riding effect to the tax treaties, which is an ideal atmosphere for international comity.

III. CHINA

A. China-U.S. Treaty

In the case decided by Beijing Secondary Court of Appeal, which was upheld by the Beijing High Court on December 26, 2002, the facts were as follows: PanAmSat International System Inc. (PanAmSat), located in Delaware, U.S., signed a contract with China Central Television (CCTV) to provide to CCTV the video distribution services that included up and the down-linking satellites, converting frequencies, beaming signals, and transmitting digital signals. This work was mostly done by PanAmSat, which operated its satellites and other accessory equipment in space. Under a Notification (Jingguoshui No. 001), the Chinese company, CCTV, withheld 7% of tax on the rent paid by CCTV to PanAmSat, which was paid by PanAmSat to the extent of $1,546,632 to the Beijing State Tax Bureau. However, the U.S. company applied for reimbursement and refund. The Chinese government withdrew the earlier Jingguoshui No. 001, and after four days, issued another Notification Jingguoshui No. 319 by imposing income tax of 7% using Article 11 of China-US Double Taxation Agreement, which provided for “May be Taxed” in the open distributive rules in the Treaty.[33]

PanAmSat challenged Jingguoshui No. 319. This was based on Article 11 of China U.S. Double Taxation Agreement, Article 19 of the Foreign Investment Enterprise and Foreign Enterprise Income Tax Law in China (Foreign Tax Law) and the Decision on the Issue of Imposing Withholding Tax on Foreign Satellite Companies issued by the State Administration of Taxation.[34] PanAmSat applied for another review. In November 2000, the review upheld the No. 319 Notification. Then, PanAmSat filed a lawsuit in Beijing’s First Court of Appeal seeking to reduce the unexpected tax burden.

PanAmSat argued that the income derived from the contract between PanAmSat and the CCTV was business income from the services it provided to the CCTV. Under the China U.S. DTA, PanAmSat had not set up its “Permanent Establishment” in China; therefore, it was not liable to the tax on business profits in China. The service provided by PanAmSat was a business activity of the provider through the satellite they owned in space. The income should not be recognized as royalties under Article 11 (3) of the DTA by classifying the payment as rent for the use of scientific equipment.

The Tax Bureau insisted that, according to Article 11 of the DTA, the income must be treated as royalties. Even though it was not CCTV itself that operated the satellite and accessory equipment, CCTV still had the right to use the scientific equipment. (Under domestic law, the income derived from the use of the scientific equipment was not defined as royalties, but rather as rent. However, under Article 28 of the Foreign Tax Law, when there is a

---

33. Avoidance of Double taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income art. 11(3), China-U.S, Apr. 30, 1984 (“The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films or tapes used for radio or television broadcasting, any patent, technical know-how, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.”).

34. Zhonghua Renmin Gongheguo Waishang Touzi Qiye Suodeshui Fa (中华人民共和国外商投资企业和外国企业所得税法) [Foreign Investment Enterprise and Foreign Enterprise Income Tax Law of the People’s Republic of China] (promulgated by Pres. Of China, Apr. 9, 1991, effective July 1, 1991), art. 19 (“Any foreign enterprise which has no organization or establishment in China but has gained dividend, interest, rental, royalty and other income from sources in China, or though it has organizations or establishments in China, the said income is not actually connected with any of its organizations or establishments, shall pay an income tax of twenty percent on such income.”).

difference between the domestic law and the DTA, the DTA provisions prevail.)

During the court hearing, CCTV was required to testify as a third party. Again, in October 2001, the decision of the Court upheld the No. 319 Notification. PanAmSat refused to accept the decision and appealed to the Beijing High Court. Finally, on December 26, 2002, the Beijing High Court overruled the appeal and upheld the decision of Beijing First Court of Appeal.

Though the China-U.S. DTA is an OECD model based tax treaty that does not consider a fee for technical services to be royalties, this causes complications with the above-mentioned approach in solving the problem. By learning from India's recent treaties, which give special treatment to fees for technical services as source country income, China's tax office may consider taxing it on a reduced gross basis with the consent of its counterpart in order not to make the taxpayer increase the price of the service to Chinese companies to offset the extra tax burden.

IV. Australia

In *Unisys Co. v. Federal Commissioner of Taxation*, the New South Wales Supreme Court of Australia dealt with a case arising under DTAA between the United States and Australia. The plaintiff, Unisys (USA), received royalty payments made by the Australian company, Unisys Licensing Partnership (ULP). Unisys, contended before the Court that it is not liable for royalty withholding tax on those receipts under the Income Tax Act, 1936.[35] ULP was bound to withhold 30% of the tax on the royalties paid to Unisys. The DTAA between Australia and the U.S., which had the force of law in Australia as per Section 6(1) of the International Tax Agreements Act 1953 under Article 12, limited the rate of withholding tax eligible in the country of source to 10%.

The Court finally held on the question of whether the business conducted by ULP was carried on at or through permanent establishment in the United States and whether the liability of withholding tax was attracted on the royalties payments received by the U.S. company under the Income Tax Assessment Act, 1936. The Court held that there was not a sufficient repetition of contractual activity to constitute the habitual exercise of a general authority to negotiate and conclude contracts, and thus, ULP could not be said to have had any permanent establishment in the United States. Therefore, the case was dismissed with cost. In doing so, the New South

35. *Unisys Co. v Fed. Comm'r* [2002] 51 ATR 386.

Wales Supreme Court relied upon the following foreign decisions and OECD models of treaties.

The judgement refers to the case, *Fothergill v. Monarch Airlines Ltd*.[36] In *Commonwealth v. Tasmania* (The Tasmanian Dam Case),[37] the court held that the Vienna Convention on the Law of Treaties would be applicable to treaties with countries that are not signatories to the convention. The judgment also mentioned Article 31 and 32 of the Convention on the interpretation of the meaning of the treaties. It mentioned that in order to interpret the DTA in international tax law, it should refer to the official commentary to the OECD models as supplementary means of interpretation.[38] It also mentioned that the courts have relied and regarded decisions of other jurisdictions on the basis of international comity in an attempt to achieve international uniformity.[39]

Several foreign judgments were referred to in this judgment in order to determine the implications of tax treaties. Relevant portions of the judgment are quoted below:

> Para 48. In *Minister of National Revenue v. Tara Exploration & Development Co.*, the Supreme Court of Canada held that a Canadian company controlled from Ireland with no permanent establishment in Canada, which bought shares in three Canadian mining companies which it sold at a substantial profit within two years, had carried out an adventure in the nature of trade which brought it within the business profits article in the DTA between Canada and Ireland.[40]
>
> 49. In *Commissioner of Taxes v. Aktiebolaget Tetra Pak*, the Rhodesian Appellate Division of the High Court held that the receipt of rent from the lease of six machines, which converted laminated paper board into containers for the packaging of milk and other liquids, constituted industrial or commercial profits and for the purpose of the DTA between the United Kingdom and Sweden which applied to the Federation of Rhodesia.[41]

---

36. Fothergill v. Monarch Airlines Ltd., [1981] 1 AC 251 (HL) 276, 282, 290 (UK).
37. *Commonwealth v Tasmania* [1983] 158 CLR 1, 222 (Austl.).
38. *Thiel v Fed. Comm'r of Taxation* [1990] ATC 4717, 4719-20, 4722-23, 4727 (Austl.); *Fed. Comm'r of Taxation v Lamesa Holdings* [1997] ATC 4752, 4758 (Austl.); Sun Life Assurance Co. of Canada v. Pearson, [1986] 59 T.C. 250, 331 (Can.); *ICR v. JFP Energy Inc.* [1990] 12 NZTC 7176 (CA) at 7179 (N.Z.).
39. *Tasmania* [1983] 158 CLR 1, at 222.
40. Minister of Nat'l Revenue v. Tara Expl. & Dev. Co. (1972), [1974] S.C.R. 1057.
41. Case T-83/91, Tetra Pak v. Comm'n, 1994 E.C.R. II-755.

> 50. In *Secretary for Inland Revenue v. Downing*, the Appellate Division of the Supreme Court of South Africa held that a domiciliary of South Africa, who went to live permanently in Switzerland and left a large portfolio of shares to be managed by a stockbroker, conducted a business through the broker for the purpose of the business profits article in the DTA between the Republic of South Africa and the Swiss Confederation.[42]

Based on the facts of the case, the judge held the view that "[t]here was not a sufficient repetition of contractual activity to constitute the habitual exercise of a general authority to negotiate and conclude contracts and ULP is thrown back on establishing that it had a place at or through which it carried on business in the US."[43] Therefore, the judge rejected that ULP's business activities were carried out "through" the entity and ordered the plaintiffs to pay the defendants the cost of the proceedings.[44]

V. Canada

A ten judges' bench of the Canada Supreme Court in the case of *United States v. Harden*[45] dealt with an appeal from the Court of Appeal for British Columbia, which held in the year 1963 that in no circumstances will the courts directly or indirectly enforce the revenue laws of another country, which is one of public policy. The claim by the United States of America as the plaintiff before the Supreme Court of Canada against the respondent, Harden, was of tax dues against him as per the judgment of District Court of United States for the Southern District of California, Central Division. The plaintiff sought recovery from the respondent who, at the relevant point of time moved to Canada and resided in the provinces of British Columbia in Canada. An action was commenced against the respondent alleging that he was indebted for taxes. The Canadian Supreme Court held that such liability could not be enforced against the respondent in Canada because the claim by the United States of America remains a claim for taxes and it is not merged in that judgment by a Canadian Court and enforcement of United States of America District Court decree against the respondent would be an enforcement of the tax claim by the United States of America against the respondent.

42. Sec'y for Inland Revenue v. Downing, 1975 (4) SA 518.
43. *Id.*
44. *Id.*
45. United States v. Harden, [1963] S.C.R. 366.

Relying upon its previous four judges' decision in the case of *Peter Buchanan Ld. & Macharg v. McVey*,[46] the Canadian Supreme Court held the rule that the courts of this country will not entertain a suit by a foreign State to recover tax, which has been restated recently by the House of Lords in *Government of India v. Taylor*.[47] Viscount Simonds adopted the following passage from the judgment of Rowlatt J. in *King of the Hellenes v. Brostron*:

> [i]t is perfectly elementary that a foreign government cannot come here—nor will the courts of other countries allow our Government to go there—and sue a person found in that jurisdiction for taxes levied and which he is declared to be liable to in the country to which he belongs.[48]

Viscount Simonds also adopted the following from the judgment of Tomlin J. in *In re Visser v. Drukker*.[50]

> My own opinion is that there is a well-recognized rule, which has been enforced for at least 200 years, or thereabouts, under which these courts will not collect the taxes of foreign States for the benefit of the sovereigns of those foreign States; and this is one of those actions, which these courts will not entertain.[51]

Various reasons have been suggested for this ancient rule. In his speech in *Government of India, v. Taylor,* Lord Keith of Avonholm having approved of the judgment of Kingsmill Moore J. in the High Court of Eire in *Peter Buchanan Ld. & Macharg v. McVey,* reported as a note in [1955] A.C. 516, and particularly, the proposition "[t]hat in no circumstances will the courts directly or indirectly enforce the revenue laws of another country…."[52]

. . . .

> [T]he argument that the claim asserted is simply for the performance of an agreement, made for good consideration, to pay a stated sum of money must also fail. We are concerned not with form but with substance, and if it can properly be said that the respondent made an

46. Peter Buchanan Ld. & Macharg v. McVey [1955] AC 516 (Eng.).
47. Gov't of India v. Taylor [1955] AC 491 (HL) 503.
48. King of the Hellenes v. Brostron [1923] 16 LI. L. Rep. 190 (KB) 193 (Eng.).
50. In re Visser v. Drukker [1928] 44 TLR 692 (Eng.).
51. *Taylor* [1955] AC 491(HL) 504.
52. *Harden*, [1963] S.C.R. 366.

agreement it was simply an agreement to pay taxes which by the laws of the foreign State she was obligated to pay.

Neither the foreign judgment nor the agreement does more than make certain the fact and the amount of the respondent's liability to the appellant. The nature of the liability is not altered. It is a liability to pay income tax.

The views,

(i) That the application of the rule that foreign States cannot directly or indirectly enforce their tax claims in our courts is not affected by the taking of a judgment in the foreign State, and
(ii) That the liability to pay tax does not become converted into a contractual obligation, both appear to me to be supported by the following passage in the speech of Lord Somervell of Harrow in *Government of India, v. Taylor*.[53]

A. MIL (Investments) Company of Canada

The Federal Court of Appeal in Canada took a liberal view in a more recent decision in the case *MIL (Investments), S.A. v. The Queen*,[54] which was decided on June 13, 2007. In 1993, MIL Investments, a Cayman Islands company, acquired a minority stake in Diamond Field Resources Limited (DFR) incorporated in Canada and traded on the Toronto Stock Exchange from its sole shareholder, Mr. Boulle. In June 1995, DFR sold a minority stake in the property to Inco Limited (Inco) and MIL Investments exchanged some of its DFR shares for common shares in Inco Limited. In August 1995, the MIL (Investments) disposed of its shares in Inco, and in September 1995, MIL (Investments) sold some of its DFR shares. MIL (Investments) claimed exemption from Canadian tax on the resulting capital gains on the sale of shares under Article 13 of the Tax Treaty of 1990 between Canada and Luxembourg. MIL (Investments) was not assessed in Canada in respect to these capital gains nor did it pay any tax on the said capital gains in Luxembourg. In 1996, Inco Limited acquired the shares of DFR, and thus, MIL (Investments) realized capital gains of $425.8 million CAD and again claimed exemption from Canadian tax under Article 13 of the Treaty. However, the Canadian tax authorities denied the exemption on the ground of

53. *Id*.
54. MIL Investments S.C.A. v. The Queen, [2006] D.T.C. 3307.

Domestic General Anti-Avoidance Rule (GAAR). The tax court, however, ultimately set aside this levy of tax saying that the sale of shares was not an avoidance transaction and it was not necessary to analyze whether the sale was abusive under GAAR. The court said that there is nothing inherently proper or improper with selecting one foreign regime over another. Respondent's counsel was correct in arguing that the selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the use of the selected treaty that must be examined.[55]

VI. Switzerland

The Swiss Federal Court took a different view in contrast with the aforesaid Canadian Federal Court in the *MIL (Investments)* case. In this case, A Holding (ApS), a company resident in Denmark, purchased all shares in F AG, a company resident in Switzerland, on December 1999.[56] ApS was a letterbox company. On November 30, 2000, F AG distributed dividends in the amount of CHfr.5.5 million and F AG paid 35% of this amount as withholding tax to the Swiss tax authorities and the rest was paid to ApS. ApS further distributed the fund received to its shareholder, C. Limited, a company domiciled in Guernsey. C. Limited was held by D. Limited, which was domiciled in Bermuda. Under Article 10 of the Tax Treaty between Switzerland and Denmark, dividends paid by a resident of Switzerland to a person residing in Denmark are taxable only in Denmark, and on this basis, ApS, Denmark Company, applied for a refund and reimbursement of 35% of the withholding tax. The Swiss tax authorities, however, rejected the claim on the ground that ApS was only incorporated for the purpose of benefiting from the advantages of the treaty in question. The tax treaty, however, did not contain any anti-abuse provision.

The Federal Court of Switzerland held that both Switzerland and Denmark are member States of the OECD and were in principle obliged to take into account the OECD model and the commentary. But since 2003, the OECD model was a later commentary and under this provision, treaty benefits are disallowed to a company that is not owned, directly or indirectly, by the residents of the State of which the company is a resident. Had the Treaty contained a "Look Through" provision, it would have applied to ApS since

55. *Id.*
56. A Holding APS v. Fed. Tax Admin., (2005) 8 ITLR 536.

the company was indirectly controlled by a resident of Bermuda. However, because the treaty did not contain this provision, an abuse could only be assumed if ApS did not carry out a real economic activity or an active business activity. According to the Federal Court, since ApS did not fulfill these conditions, the Federal Court confirmed that the tax authorities lawfully denied the refund and reimbursement of withholding tax.

It is notable that the Canadian and Swiss courts reached opposite conclusions on the issue of whether there is a general anti-abuse rule inherent within tax treaties. Clearly the facts of the cases differed where A Holding that was in interposed between Switzerland and Bermuda received a dividend, but in MIL (Investments), a Cayman Island company, that migrated to Luxembourg realized a capital gain. However, that cannot explain the opposite outcomes of the decisions. In both cases, the relevant tax treaty was concluded long before the revision of the commentary of the model treaty in 2003 (the Swiss–Danish tax treaty was concluded in 1973 and the Canadian–Luxembourg tax treaty concluded in 1990). Yet, the Swiss court decided that the 2003 commentary on Article 1 can be considered a supplementary means of interpretation as it is an intended amendment of already existing rules, whereas the Canadian court ruled that one can only consult the commentary in existence at the time the treaty was negotiated without reference to subsequent revisions. This implies that the courts have different views on the topic of whether the 2003 revision of the commentary on Article 1 can be seen as a clarification of already existing rules. In this respect, the Canadian court relied on the expert presented by the tax authorities who confirmed that there was no inherent anti-avoidance rule under the 1977 model treaty. In the Swiss case, conversely, the commentary prevailing at the time the treaty was concluded was not the 1977 but the 1963 version, which was silent on the issue of abuse of tax treaties. Moreover, the historical background against which the treaty was concluded, particularly the Swiss 1962 anti-abuse resolution, and the fact that Denmark had not made a reservation against the application of this resolution, played an important role in the decision of the Swiss court.

VII. United States of America

The "Revenue Rule" discussed above and adopted by the Canada Supreme Court is applied and invoked even now in the U.S., contrary to the spirit of international comity and desirability to enforce foreign judgments in the realm of international taxation aside from conflicting provisions in their domestic law.

Not content by merely passively permitting the revenue rule to continue, in several instances, the government has expressly acted to perpetuate it. The 2006 Model Income Tax Convention, for example, does not include any provisions permitting the enforcement of tax judgments.[57] Likewise, of the United States' sixty-eight income tax treaties currently in force,[58] only five include provisions permitting the enforcement of foreign tax judgments.[59] Moreover, the U.S. originally ratified treaties with four of the five countries in the 1930s and 1940s.[60] By the 1950s, the Senate had become disillusioned with the collection provisions and declined to ratify new treaties with collection provisions.

Also, the government's perpetuation of the revenue rule does not limit itself to passively perpetuating a model treaty that does not include a collection provision. In 1989, the U.S. signed the OECD Convention on Mutual Administrative Assistance in Tax Matters, the first multilateral tax treaty of its kind.[61] The Convention includes provisions requiring signatories to assist in the collection of taxes on behalf of other signatory countries.[62] The United States, however, adopted a reservation to the reciprocal collection provisions.[63] By adopting this reservation, the United States surrendered its ability to require other parties to the treaty to provide assistance in collecting U.S. taxes.[64] The United States apparently decided, however, that the value of the revenue rule outweighed the value of any revenue other countries could help it recover.

---

57. Lee A. Sheppard, *Will U.S. Hypocrisy on Information Sharing Continue?*, 138 TAX NOTES 253, 254 (2013).
58. Allison Christians, *How Nations Share*, 87 IND. L .J. 1407 (2012).
59. Attorney Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103, 115 (2d Cir. 2001).
60. Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century*, 16 DUKE J.COM. & INT'L L. 79, 94 (2006).
61. Marian Nash Leich, *U.S. Practice*, 84 AM. J. INT'L L. 237, 245 (1990).
62. Convention on Mutual Administrative Assistance in Tax Matters art. 11, June 28, 1989, 27 I.L.M. 1160.
63. *See* 136 CONG. REC. S13,295 (daily ed. Sept. 18, 1990) (ratifying convention except "[t]hat the United States will not provide assistance in the recovery of any tax claim, or in the recovery of an administrative fine, for any tax"); *see also* COUNCIL OF EUROPE TREATY OFFICE, http://conventions.coe.int/Treaty/Commun/ListeDeclarations.asp?NT=127&CV=1&NA=&PO=999&CN=999&VL=1&CM=9&CL=ENG (list of declarations made with respect to treaty No. 127 (2014)).
64. *See Explanation of Proposed Convention on Mutual Administrative Assistance Matters*: *Hearing Before the Comm. on Foreign Relations*, 101st Cong. 22 (1990) ("A party that has made a reservation is not permitted to require another party to observe that reserved provision of the convention.").

As recently as 2005, the Supreme Court confirmed the continuing viability of the revenue rule. In its decision in *Pasquantino v. United States*,[65] the Supreme Court had to determine whether a scheme to defraud the Canadian Government of tax revenue violated the federal wire fraud statute.

U.S. courts, where appropriate, do refuse to enforce foreign judgments even where such refusal challenges a foreign country's sovereignty. In *Bank Melli Iran v. Pahlavi*,[66] for example, Pahlavi, the sister of the former Shah of Iran, had signed a number of promissory notes held by two Iranian banks. As a result of the Iranian revolution, the Shah and his family fled Iran, and the banks brought collection actions against Pahlavi in Iranian courts. The banks obtained default judgments of $32 million against her and sought to enforce those judgments under the California Uniform Foreign Money-Judgments Recognition Act. Pahlavi filed a motion to dismiss, claiming the courts had not provided for due process of law. The Court of Appeals found the Iranian courts' judgments deficient: "Pahlavi could not expect fair treatment from the courts of Iran, could not personally appear before those courts, could not obtain proper legal representation in Iran, and could not even obtain local witnesses on her behalf."[67] Because the Iranian justice system lacked even the most rudimentary due process, U.S. courts would not enforce the judgment.

A. Revoking Revenue Rule Through Treaties

1. Foreign Account Tax Compliance Act (FATCA)

If the U.S. decided to revoke the revenue rule through treaties rather than through a change in domestic law, reciprocity would assume a central role in the revocation. The terms of bilateral income tax treaties are reciprocal, at least formally.[68] If the U.S. agreed to enforce a treaty partner's tax judgments, that treaty partner would simultaneously agree to enforce U.S. tax judgments. The multilateral treaty context illustrates even more strongly the centrality of reciprocity. The OECD Convention on Mutual Administrative Assistance in Tax Matters expressly allows for signatories to take a reservation to the mutual provisions.[69] If a country makes such a reservation, however, it cannot

65. Pasquantino v. United States, 544 U.S. 349 (2005).
66. Bank Melli Iran v. Pahlavi, 58 F.3d 1406 (9th Cir. 1995).
67. *Id.*
68. Diane Ring, *Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation*, 9 FLA. TAX REV. 555, 584 (2009). The formal reciprocity may not always translate into reciprocal treatment, though, if one of the countries is a net capital exporter, while the other is a net capital importer.
69. Convention on Mutual Administrative Assistance in Tax Matters, *supra* note 62, art. 30(1)(b).

require other signatories to enforce its tax judgments, even if they took no such reservation.[70]

Moreover, recent history indicates that even a unilateral decision by the United States to enforce foreign tax judgments could affect significant worldwide change. In 2010, in the wake of the UBS tax-evasion scandal, Congress passed the Foreign Account Tax Compliance Act (FATCA).[71] FATCA requires foreign financial institutions to report information about accounts held by U.S. persons and about foreign entities with significant U.S. ownership. The reportable information includes, among other things, identifying information about the owner of the account and the balance of the account. Foreign financial institutions that failed to make the disclosures required under FATCA would face a 30% withholding on certain payments from withholding agents. The United States indicated that it could, by virtue of the coercive value of FATCA's withholding provisions, use FATCA to obtain information about hidden foreign accounts unilaterally.[72]

B. Using Treaties to Revoke the Revenue Rule

Treaties represent a natural starting point for revoking the revenue rule. The United States is a signatory of the OECD Convention on Mutual Administrative Assistance in Tax Matters,[73] which provides for mutual assistance in collecting taxes.[74] More than sixty countries, including a number of developing economies in Latin America and Africa, have either signed the convention or stated their intention to sign the convention. If the United States eliminated its reservation, it would, through a single action, eliminate the revenue rule with respect to all of the countries that had signed the OECD Convention. As an additional benefit, the United States would enjoy a network of countries willing to enforce its tax judgments.

Alternatively, the United States could revoke the revenue rule on an individualized basis through bilateral tax treaties. Models exist for how to

---

70. *Id.* art. 30(5) ("A Party which has made a reservation in respect of a provision of this Convention may not require the application of that provision by any other Party....").

71. Itai Grinberg, *The Battle Over Taxing Offshore Accounts*, 60 UCLA L. REV. 304, 334 (2012) ("In 2010, following the UBS scandal and President Obama's campaign commitment to crack down on offshore tax evasion, the U.S. Congress enacted sections 1471 to 1474 (generally known as FATCA) of the Internal Revenue Code.").

72. Lee A. Sheppard, *Getting Serious About Offshore Evasion?*, 125 TAX NOTES 493, 493 (2009) ("[FATCA] continues the unilateral approach to address tax evasion by U.S. residents.").

73. *See* OECD, STATUS OF THE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS AND AMENDING PROTOCOL—29 JUNE 2017, http://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf (listing signatories to the Convention).

74. Convention on Mutual Administrative Assistance in Tax Matters, *supra* note 62, art.11.

draft such a provision. The OECD model tax treaty includes a provision requiring mutual assistance in enforcing revenue claims. Moreover, even without the OECD model, the United States already has five tax treaties with France, Denmark, Sweden, the Netherlands, and Canada that provide for assistance in collecting taxes.[75] These five treaties use similar language; that language could serve as a model for further revoking the revenue rule on a country-by-country basis. [76] The U.S. Government also may be more comfortable addressing the revenue rule on a country-by-country basis. A protocol to the U.S.-Canada tax treaty providing for the mutual enforcement of tax judgments entered into effect in 1995, shortly after the U.S.'s 1991 ratification of the OECD Convention.[77] In contrast to its reservation in the Convention, the U.S.-Canada tax treaty provided for mutual enforcement of tax judgments.

Thus, one can conclude that the Revenue Rule deserves to be relaxed and it serves no legitimate purpose. US and other developed countries should enforce foreign tax judgments.

---

75. *R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d at 116. The United States signed treaties with the first four of these countries in the 1930s and 1940s; by the end of the 1940s, the Senate "sought to limit the extent to which United States courts and agencies would be obligated to render foreign tax collection assistance."
76. Income Tax Treaty art. 28, Fr.-U.S., Aug. 31, 1994 ("The Contracting States undertake to lend assistance and support to each other in the collection of the taxes to which this Convention applies . . . in cases where the taxes are definitively due according to the laws of the State making the application."); Income Tax Treaty art. 27, U.S.-Den., Aug. 19, 1999 ("The Contracting States undertake to lend assistance to each other in the collection of taxes referred to in Article 2 (Taxes Covered), together with interest, costs, additions to such taxes, and civil penalties, referred to in this Article as a 'revenue claim.'"); Income Tax Treaty art. 31, U.S.-Neth., Dec. 18, 1992 ("The States undertake to lend assistance and support to each other in the collection of the taxes which are the subject of the present Convention, together with interest, costs, and additions to the taxes and fines not being of a penal character."); Income Tax Treaty art. 27, U.S.-Swed., Sept. 1, 1994 ("The Contracting States undertake to lend assistance and support to each other in the collection of the taxes to which this Convention applies, together with interest, costs, and additions to such taxes."); Income Tax Treaty art. XXVIA(1), U.S.-Can., Sept. 26, 1980 ("The Contracting States undertake to lend assistance to each other in the collection of taxes referred to in paragraph 9, together with interest, costs, additions to such taxes and civil penalties, referred to in this Article as a 'revenue claim.'").
77. Benjamin Berk & David L. Raish, *United States Activities of Foreigners And Tax Treaties*, *in* THE TAX LAWYER 1391, 1393 (1992).

VIII. Netherlands

In *BNB 2007/36c*, a resident of the Netherlands who was the sole shareholder of a company resident in the Netherlands migrated to Belgium on October 15, 1996. On October 24, 1996, the decision was taken to liquidate the company. A few weeks later, the seat of the Dutch company was moved to Belgium. Shortly thereafter, the company made liquidation payments to its shareholder. The tax authorities argued that the transfer of seat of the Dutch company to Belgium should be ignored on the basis of *fraus conventionis* and tax the liquidation payments as if they were made by a company resident in the Netherlands to a resident of Belgium. The taxpayer, however, claimed that the liquidation payments were made to him by a company resident in Belgium, and that as a result, the 1970 tax treaty between the Netherlands and Belgium prevented the Netherlands from levying tax. The Court of Appeal agreed with the tax authorities and ruled that it followed from a reasonable application of the treaty that the transfer of the seat of the company to Belgium could not alter the tax consequences of the liquidation payments.

The Supreme Court, conversely, considered as follows:

> To the extent that the Court of Appeal's judgment expresses the view that in case the current liquidation payment would not be taxed in the Netherlands, the object and purpose of the tax treaty would be denied, it is incorrect. As the treaty accords consequences to the place of effective management of the company, the treaty cannot be interpreted in such a manner that the intent of the migration still plays a role in respect to the consequences.[78]

Thus, the liquidation payment could not be taxed.

In *BNB 2007/42*, the Dutch Supreme Court considered the treatment of a capital gain realized shortly after the emigration of Dutch B.V. and its sole shareholder from the Netherlands to Belgium. Pursuant to the 1970 tax treaty between the Netherlands and Belgium, the taxation over capital gains was allocated to Belgium. One of the issues at stake was the question on whether a "reasonable application" of the tax treaty should lead to the outcome that the Netherlands should nevertheless be regarded as competent to tax the capital gain. The Supreme Court held that this was not the case:

78. 12 mei 2006, BNB 2007/36c (Neth.).

> As B BV does for purpose of the tax treaty not constitute a resident of the Netherlands, the Netherlands is not permitted to levy income taxation on the litigant. As the treaty connects consequences to the place of effective management of the company whose shares are being alienated, the treaty cannot be interpreted in such a manner that the intent of the migration nevertheless plays a role in respect to those consequences.[79]

The Supreme Court's decisions seem to suggest that *fraus conventionis* can never be applied. Under *fraus conventionis*, the facts that avoid taxation are substituted by facts that will lead to taxation. The Supreme Court's reasoning, however, appears to imply that once the facts are determined, they cannot be substituted by other facts. Notwithstanding the above, Van Weeghel has argued that the decisions should not be read as a dismissal of *fraus conventionis*. He suggested that the wording of the judgment might have been caused by the way in which the parties organized their defense. In older decisions, the Supreme Court used other language. For example, in *BNB 1994/294*, the Supreme Court held that capital gains, which had been re-qualified as dividend for purpose of Dutch national law under the *fraus legis* doctrine, could not be regarded as dividend in the sense of the tax treaty. Crucially, the Supreme Court held that neither from the text of the treaty nor from the explanations by the treaty partners it appears that they had the common intention to include, for the application of said article, under dividends income that is treated as dividend with the application of the doctrine of *fraus legis* under the national law of the State in which (the distributing company) has its residence. The position advocated by the Under Minister of Finance before the Supreme Court that in case of non-taxability of the income in the Netherlands where the object and purpose of the treaty would be ignored is not supported by the text of the treaty or by the explanations of the Contracting States.[80]

So far the Dutch Supreme Court has not allowed the application of *fraus legis* in treaty situations nor has an appeal to *fraus conventionis* been successful. Based on its previous judgments, it follows that, in cases like *A Holding*, the Dutch Supreme Court will probably not apply the doctrine of abuse of law unless there is a clear indication that the common intention of the treaty partners was otherwise.[81]

---

79. 14 juli 2006, BNB 2007/42 (Neth.).
80. 29 juni 1994, BNB 1994/294 (Neth.).
81. J. Vleggeert, *Abuse of Tax Treaties: A Discussion of Recent Court Cases in Various Countries with Opposite Outcomes*, https://openaccess.leidenuniv.nl/bitstream/handle/1887/37150/Vleggeert%20-%20Abuse%20of%20Tax%20Treaties%20-

IX. Germany

In the vast majority of cases, Germany has concluded with other countries that, among other matters, double taxation treaties determine the primary right of taxation of income derived from employment. In cross-border scenarios where Germany is to be regarded as the country of residence for double taxation treaty purposes, potential double taxation is often prevented by the tax exemption method applied should the other Contracting State have – as the state of source – the primary right of taxation.

However, this approach might lead to a scenario where income from employment remains inadvertently exempt from taxation when taxpayers simply do not comply with foreign tax legislation. For that reason, the German legislature introduced a statutory law that came into effect on January 1, 2004.[82]

The German Constitutional Court in its latest decision of December 15, 2015 in *2 BVL 1/12* considered whether Article 50d (8), first sentence, of the Income Tax Act 2002, as amended by the Tax Amendment Act 2003, infringes Article 2 (1) in conjunction with Article 20 (3) and Article 25 and Article 3 (1) of the Grundgesetz (Hereinafter referred to as the first sentence of Article 23 (1) (a) of the first sentence of Article 15 (1) of the DBA-Turkey, 1985, in conjunction with the Act of Approval of 27 November 1989 on the subject). The taxpayer needs to prove that the State, which is entitled to the right of taxation under the Convention, has waived this right of taxation or that the taxes imposed on that income in that State have been paid.

In the main proceedings, the applicants, jointly assessed husbands, objected to the income tax assessment for the year 2004 in which the husband, partly in Germany and partly in Turkey, obtained income from non-self-employment. The applicants claimed that the income generated in Turkey should be tax-exempt in accordance with the provisions of the Turkish Data Protection Act. However, since they have not shown that the Turkish income tax had been taxed there or that Turkey had waived taxation, the Finanzamt treated the entire gross wage as taxable not in accordance with § 50d Para. 8 sentence 1 EStG. The appeal to the Finanzgericht remained unsuccessful.

The Court held that the decision of the majority of the Senate gives preference to the principle of democracy under the principle of the rule of law in accordance with the principle of international law. As a result, the later legislature is free to deviate deliberately from the provisions of a treaty under

---

%20a%20Discussion%20of%20Recent%20Court%20Cases%20in%20Various%20Countries%20with%20Opposite%20Outcomes.pdf?sequence=1.

82. OECD Model Tax Convention, art 15.

international law, irrespective of the related international law. There is no need for special requirements or justification. On the other hand, the approach presented here calls for the dissolution of the tension between the rule of law and the principle of democracy in a manner that leaves both principles as broad a function as possible.[83]

Criteria to be taken into account in the weighing-up of accounts are, in particular, the following: the regulatory objective pursued by the later law and its importance for the common good; the effects on the legal position of the individuals benefiting under international law; the possibility of recourse to reasonable means of international law accordance with international law for the termination of international ties, such as the issuing of an interpretative statement; the denunciation or modification of the treaty; the legal consequences of a breach of international law.

If the weight of the criteria for a one-sided departure from the specifically international treaty in question does not weigh the weight of the points of view that conflict with the overlapping of the Convention, the rule of law in the light of international law must take precedence over the principle of democracy. Such a balancing must be made in each individual case in order to bring an appropriate balance between the rule of law and the principle of democracy.

The effects on the legal position of the persons benefiting under international law may be very different depending on the specific circumstances. It should be borne in mind, however, that the exemption method agreed upon in the DBA-Turkey in 1985 on the basis of virtual double taxation is primarily in the interest of the two Contracting States that are not to depend on the regulatory situation and tax practices of the other country or its knowledge.[84]

On the other hand, it is not the intention of the Contracting States to grant taxpayers affected by the exemption a legal position, which would enable them not to pay taxes in either State, even if the international agreement could have such an effect. Thus, the taxpayer's financial advantage associated with a "no-time taxation" of the taxpayer's income in the other Contracting State is more likely to be a favorable legal reflex, which is not significant in balancing.

According to the DBA-Turkey in 1985, the funds available to international law were available to resolve the contract. Pursuant to the first sentence of Article 30 (2) of the Turkish Data Protection Act (DTA), 1985, each Contracting State may, from January 1 of the third year following the year of ratification of the Agreement, terminate the Agreement during the first six

83. BVerfG, 2 BVL 1/12, Dec. 15, 2015, http://www.bverfg.de/e/ls20151215_2bvl000112.html.
84. BFH Jan. 10, 2012, IR 66/09, http://juris.bundesfinanzhof.de/cgi-bin/rechtsprechung/document.py?Gericht=bfh&Art=en&Datum=Aktuell&nr=31898&pos=16&anz=64.

months of a calendar year. There is therefore a right of termination after the expiration of approximately three years after the entry into force of the contract, which must be exercised in the first six months of the year in which notice is given. There are no special grounds for dismissal. In 1985, the Federal Republic of Germany would have been able to terminate the DBA-Turkey in 2003, when the Tax Change Act was discussed, or in the first half-year of 2004, and negotiate a new, improved agreement. As the referring court points out, the fact that the agreement has been terminated by the German authorities on July 27, 2009 with effect from December 31, 2010 is shown by the fact that this route was basically viable. The newly negotiated double taxation agreement of September 19, 2011, which replaces the DBA-Turkey in 1985 with effect from January 1, 2011, still provides for the exemption method (see Article 22 (2) (a)) 22 (2) (e), a so-called swap or relapse clause enabling the Federal Republic of Germany to change from the exemption to the incentive method. The purpose of this clause is that there is no German tax treaty if income is not taxed in either Contracting State.[85] In addition, as already mentioned, a clause on the applicability of national abuse rules has been expressly agreed in the protocol to the DBA-Turkey 2011.

The Court, thus, held that "[t]he German Constitutional Court announced its decision that the so-called 'treaty override' by national statutory law is permissible under the German Constitution."[86]

The underlying decision solely affects the German treatment of income from employment in double taxation treaty scenarios. The German government is allowed to impose German income tax on individuals who do not provide evidence of actual taxation abroad ("proof of foreign taxation"), although this approach might violate double taxation treaty rulings.

X. South Korea

In the context of this paper, a recent ruling and matter of contention in the case of *LSF-KEB Holdings S.C.A. v. Republic of Korea*[87] is considered.

Lone Star Fund (LSF), through its Belgium subsidiary KC Holdings S.A., purchased 51% shares of Korean Exchange Bank (KEB) during financial crisis in Korea in 2003 to bail it out.

85. Avoidance of Double Taxation and of Tax Evasion with Respect to Taxes on Income, Ger.-Turk, Sept. 19, 2011.
86. BVerfG, 2 BVL 1/12.
87. LSF-KEB Holdings S.C.A. v. Republic of Kor., ICSID Case No. ARB/12/37.

The LSF got 20% management control premium, and later on, it acquired affiliated company of KEB, known as Korean Exchange Bank Credit Service (KEBCS) once the share value of KEB started rising. In 2007, to reap the benefits of increasing share prices, LSF sought to sell its share holdings in KEB to the private parties like HSBC. However, the KEB financial regulators refused to approve the transfer and the allegations of manipulation in the share prices of KEBCS were leveled against LSF and colluding Korean authorities, where a pending investigation in criminal trials against them arose between 2005 to 2011.

Finally, under the court's directions, LSF sold its shares of KEB to Hana Financial Group in the year 2012 and its interest in a skyscraper known as Star Tower in Seoul in 2004.

The Korean tax authorities imposed a capital gain tax on both the sale of Star Tower and the sale of share-holdings in KEB.

LSF contended that it was not liable to pay Korean tax because under the Bilateral Investment Treaty (BIT), it was free to sell its share-holdings, and as per Article 6 of Belgium-Korean Tax Treaty (BTT), such capital gains could only be taxed in Belgium, and not in Korea.

The Korean Tax Authorities contended that the Belgium company was only a shell company to evade Korean tax, and therefore, LSF was liable to pay taxes under Korean law.

The High Court of Korea's holding that LSF was guilty of stock manipulation, violating the Korean-Belgium Tax Treaty, was upheld by the Supreme Court of Korea.

On the issue of capital gains tax imposed on LSF on the sale of share-holdings of KEB, the matter is now pending before the International Arbitration Tribunal ((ICSID), The Hague, Vide ICSID Case No.ARB/12/37), which was instituted in 2012 to decide whether LSF should be held liable to pay capital gains tax to Korean tax authorities on the profits of such sale of shares of KEB when the Korean regulatory authorities allegedly failed to approve the sale of shareholdings by the Lone Star for a long period.

The case of *Vodafone* decided by the Indian Supreme Court in 2012, which held that the capital gains tax cannot be imposed by the Indian tax authorities on the sale of shares of a Cayman Island company, off-shore in Mauritius, is a pointer in the case. The Indian Supreme Court did not allow treaty override to the tax authorities or the domestic tax legislation over the DTAA. The usual conflict between the DTAA or BTT and BIT and the domestic tax provisions deserves to be resolved dispassionately and treaty overrides should not be allowed to safeguard merely the revenue stakes of the Contracting State. The approach of the Korean Tax Authorities in the present case, on the one hand, denying the approval of shares of KEB to Lone Star, and on the other hand, imposing tax on the sale of Star Building as well as sale of shares of KEB, deserves to be resolved in favor of Lone Star.

A. RODAMCO Case

The Korean Supreme Court in the case akin to the case involved in U.S. Supreme Court's decision in *Gregory v. Helvering*[88] applied the business purpose doctrine to uphold the Korean tax assessment against RODAMCO, which acquired a building in Seoul, Korea, not directly through its Korean holding company, but by setting up its two Dutch subsidiary companies that both acquired 50% of Chilbong shares of that Korean holding company to avoid acquisition tax. Applying the principle of substance over form or piercing the corporate veil, the Korean Supreme Court held that the acquisition of shares made by two Dutch subsidiaries was for their parent company, RODAMCO. The Korean Supreme Court held that substance over form principle does not lose its full force, even in applying the provisions of tax treaties.

The Korean tax system has also enacted Law for Coordination of International Tax Affairs (LCITA), which made substance over form principle applicable to cross-border transactions. This enactment is similar to the provisions of Framework Act on National Taxes (FANT) and Inheritance Tax and Gift Tax (IGTA), which is intended to act as the General Anti-Avoidance Rule (GAAR).

XI. Conclusion

From the above, it appears that there are diverging and conflicts in opinions of different jurisdictions with regard to the interpretation of tax treaties and while some countries have made use of cases decided under foreign jurisdictions to strengthen their views, others who have refused to follow them and have interpreted the taxation treaties to suit the interests of their own countries. This obviously is not good for international comity, uniformity, and harmonious interpretation of taxation treaties in international trade and economies. Therefore, the author is of the opinion that some international body, like OECD. that provide treaty models and OECD., IAJT, and IBFD., should undertake constant research work and prepare a data bank of decisions of various jurisdictions, at least of their top court regarding the interpretation

88. Gregory v. Helvering, 203 U.S. 465 (1935).

of taxation treaties, so that such decisions can be made readily available to the courts of other countries where such research materials are required. Furthermore, it can at least allow for uniformity or harmonious construction to develop in the world for the greater benefit of all the countries and different tax jurisdictions concerned.

For example, BEPS Project of OECD or UNIDROIT principles for Commercial Contracts that are developed by intergovernmental Organization introduce harmonization of private international law. The term UNIDROIT is an acronym for a French term “Institut International Pour L’Unification de Droit Prive,” roughly translated in English to be “International Institute for the Unification of Private Law,” to which 68 countries are now evolving common principles for interpretation of international taxation treaties from such data bank of judgments from top courts of different jurisdictions, which is certainly a desirable objective for which endeavor should be made at the international level.

Bibliography

12 mei 2006, BNB 2007/36c (Neth.).

14 juli 2006, BNB 2007/42 (Neth.).

29 juni 1994, BNB 1994/294 (Neth.).

136 CONG. REC. S13,295 (daily ed. Sept. 18, 1990).

A Holding APS v. Fed. Tax Admin., (2005) 8 ITLR 536.

Adams v. Cape Indus. Plc [1991] 1 All ER 929 (Eng.).

Allison Christians, *How Nations Share*, 87 IND. L .J. 1407 (2012).

Attorney Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103 (2d Cir. 2001).

Avoidance of Double Taxation and of Tax Evasion with Respect to Taxes on Income, Ger.-Turk, Sept. 19, 2011.

Avoidance of Double taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income art. 11(3), China-U.S, Apr. 30, 1984.

Bank Melli Iran v. Pahlavi, 58 F.3d 1406 (9th Cir. 1995).

Barber-Green Americas, Inc. v. Comm'r, 35 T.C. 365 (1960).

Bas v. Comm'r, 50 T.C. 595 (1968).

Benjamin Berk & David L. Raish, *United States Activities of Foreigners And Tax Treaties*, *in* THE TAX LAWYER 1391 (1992).

BFH Jan. 10, 2012, IR 66/09, http://juris.bundesfinanzhof.de/cgi-bin/rechtsprechung/document.py?Gericht=bfh&Art=en&Datum=Aktuell&nr=31898&pos=16&anz=64.

Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century*, 16 DUKE J.COM. & INT'L L. 79 (2006).

BVerfG, 2 BVL 1/12, Dec. 15, 2015, http://www.bverfg.de/e/ls20151215_2bvl000112.html.

Case T-83/91, Tetra Pak v. Comm'n, 1994 E.C.R. II-755.

Commonwealth v Tasmania [1983] 158 CLR 1 (Austl.).

Comm'r v. Kirk [1900] AC 588 (PC) (Eng.).

Comm'r of Income Tax of Bombay v. Ahmedbhai Umarbhai & Co., (1950) 1 SCR 335 (India).

Convention on Mutual Administrative Assistance in Tax Matters art. 11, June 28, 1989, 27 I.L.M. 1160.

COUNCIL OF EUROPE TREATY OFFICE, http://conventions.coe.int/Treaty/Commun/ListeDeclarations.asp?NT=127&CV=1&NA=&PO=999&CN=999&VL=1&CM=9&CL=ENG.

Diane Ring, *Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation*, 9 FLA. TAX REV. 555 (2009).

DIT (Int'l Taxation) v. Morgan Stanley & Co., (2007) 292 ITR 416 (SC) (India).

Explanation of Proposed Convention on Mutual Administrative Assistance Matters: *Hearing Before the Comm. on Foreign Relations*, 101st Cong. 22 (1990).

Fed. Comm'r of Taxation v Lamesa Holdings [1997] ATC 4752 (Austl.).

Fothergill v. Monarch Airlines Ltd., [1981] 1 AC 251 (HL) 276 (UK).

Furniss v. Dawson [1984] AC 474 (HL).

Gov't of India v. Taylor [1955] AC 491 (HL) 503.

Gregory v. Helvering, 203 U.S. 465 (1935).

HALSBURYS LAWS OF ENGLAND (Lord Hailsham of Marylebone ed., 4th ed. 1992).

ICR v. JFP Energy Inc. [1990] 12 NZTC 7176 (CA) at 7179 (N.Z.).

Income Tax Treaty art. XXVIA(1), U.S.-Can., Sept. 26, 1980.

Income Tax Treaty art. 27, U.S.-Den., Aug. 19, 1999.

Income Tax Treaty art. 27, U.S.-Swed., Sept. 1, 1994.

Income Tax Treaty art. 28, U.S.-Fr., Aug. 31, 1994.

Income Tax Treaty art. 31, U.S.-Neth., Dec. 18, 1992.

In re Visser v. Drukker [1928] 44 TLR 692 (Eng.).

IRC v. Burmah Oil Co. [1982] STC 30 (HL).

IRC v. Duke of Westminster [1935] All ER 259 (HL) 267 (Eng.).

IRC v. Fisher's Executor [1926] AC 395 (HL) 412 (Eng.).

Ishikawajima-Harima Heavy Indus. Ltd. v. Dir. of Income Tax of Mumbai, [2007] 3 SCC 481.

Itai Grinberg, *The Battle Over Taxing Offshore Accounts*, 60 UCLA L. REV. 304 (2012).

J. Vleggeert, *Abuse of Tax Treaties: A Discussion of Recent Court Cases in V arious Countries with Opposite Outcomes*, https://openaccess.leidenuniv.nl/bitstream/handle/1887/37150/Vleggeert%20-%20Abuse%20of%20Tax%20Treaties%20-%20a%20Discussion%20of%20Recent%20Court%20Cases%20in%20Various%20Countries%20with%20Opposite%20Outcomes.pdf?sequence=1.

Johansson v. United States, 336 F.2d 809 (5th Cir. 1964).

King of the Hellenes v. Brostron [1923] 16 LI. L. Rep. 190 (KB) 193 (Eng.).

Lee A. Sheppard, *Getting Serious About Offshore Evasion?*, 125 TAX NOTES 493 (2009).

Lee A. Sheppard, *Will U.S. Hypocrisy on Information Sharing Continue?*, 138 Tax Notes 253 (2013).
Love v. Norman Wright (Builders) Ltd. [1944] 1 KB 484 (Eng.).
LSF-KEB Holdings S.C.A. v. Republic of Kor., ICSID Case No. ARB/12/37.
Marian Nash Leich, *U.S. Practice*, 84 Am. J. Int'l L. 237 (1990).
M.B. Rao, Double Tax Treaties Between Developing and Developed Countries (1983).
McDowell & Co. v. Commercial Tax Officer, AIR 1986 SC 649.
MIL Investments S.C.A. v. The Queen, [2006] D.T.C. 3307.
Minister of Nat'l Revenue v. Tara Expl. & Dev. Co. (1972), [1974] S.C.R. 1057.
OECD Model Tax Convention, art 15.
OECD, Status of the Convention on Mutual Administrative Assistance in Tax Matters and Amending Protocol—29 June 2017.
Ostime v. Australian Mut. Provident Soc'y [1960] AC 459 (HL) 480 (Eng.).
Pasquantino v. United States, 544 U.S. 349 (2005).
Peter Buchanan Ld. & Macharg v. McVey [1955] AC 516 (Eng.).
Sec'y for Inland Revenue v. Downing, 1975 (4) SA 518.
Simon's Taxes 351, (4.401) (3d ed. 2008).
Sun Life Assurance Co. of Canada v. Pearson, [1986] 59 T.C. 250 (Can.)
Thiel v Fed. Comm'r of Taxation [1990] ATC 4717 (Austl.).
Union of India v. Azadi Bachao Andolan, (2003) 263 ITR 706 (SC).
Unisys Co. v Fed. Comm'r [2002] 51 ATR 386.
United States v. Bestfoods, 524 U.S. 51 (1998).
United States v. Harden, [1963] S.C.R. 366.
Vodafone Int'l Holdings B.V. v. Union of India, (2012) 6 SCC 613.
W.T. Ramsay Ltd. v. IRC [1982] AC 300 (HL).
Zhonghua Renmin Gongheguo Waishang Touzi Qiye Suodeshui Fa (中华人民共和国外商投资企业和外国企业所得税法) [Foreign Investment Enterprise and Foreign Enterprise Income Tax Law of the People's Republic of China] (promulgated by Pres. Of China, Apr. 9, 1991, effective July 1, 1991), art. 19.