ec TAX REVIEW 2008-6

Editorial

Non-discrimination article in OECD Model Convention needs fundamental review

Philippe Hinnekens[1]

Non-discrimination in international tax law, with a particular focus on Article 24 of the OECD Model Convention (hereafter MC), was one of the two main topics that were discussed at the IFA Congress in Brussels in September of this year. This discussion coincided with the release of the 2008 Update to the MC, including an update of the commentary relating to Article 24. This update was preceded by a Public Discussion Draft on the application and interpretation of Article 24, which was issued in May 2007 and was prepared by Working Party nr.1 of the Committee for Fiscal Affairs (CFA) of the OECD. In this Discussion Draft WP1 analyzes some of the issues that have arisen with respect to the application of Article 24, proposes some modifications to the commentary relating to Article 24, but also recognizes that some issues require a more fundamental analysis which could lead to changes to the text of Article 24. The General Report that was prepared in view of the discussion of this topic at the IFA Congress[2] clearly supports the latter conclusion and describes the current version of Article 24 MC as 'incoherent, incomplete, uncertain, ineffective and outdated'. Or, in the words of M.C. Bennett, 'an odd collection of paragraphs which has been accumulated from different sources at different times and reveals no overarching theory'.[3]

It is not surprising that Article 24 MC is considered to be ineffective when one considers that in its main provision (Article 24 (1)) reference is made to 'nationality' as the relevant criterion to analyze whether or not there is discrimination between taxpayers in a cross border situation, whilst this notion of 'nationality' is not a relevant criterion in international tax law.[4] From the historical analysis of Article 24 MC can be derived that this was also the clear intention of the government delegates to WP4, which drafted Article 24 in 1956-1958. The delegates expressed their concern that a change of this criterion would widen the scope of application of the non-discrimination (ND) prohibition and by the same token restrict the own national tax system, policies and practice. This concern was still present when in 1992 the CFA proposed to add in the text of Article 24 (1) the wording 'in particular with respect to residence' regarding the requirement that the taxpayers to be compared must be 'in the same circumstances'.

This same conservative approach can be found in the 2007 Discussion Draft and in the changes to the OECD commentary to Article 24 in the 2008 Update. Many changes, often relating to issues that had arisen in case law in several of the OECD Member States, tend to confirm the restrictive interpretation of the scope of application of the provisions of Article 24, rather than extending this scope of application (even if, in some instances, case law was in favor of such more extensive interpretation). The following examples can illustrate this:

- no extension to 'covert' discrimination[5] (referred to as 'indirect' discrimination in Par. 1 of the Commentary);
- confirmation of exclusion of public entities and non-profit organizations from the personal scope of application of Article 24 (Par. 38 and 47 of the Commentary);
- exclusion of integrated tax mechanisms (corporate and shareholders' taxation) as well as tax consolidation and group relief mechanisms from the scope of Article 24(3) and Article 24(5) (Par. 59 and 77 of the Commentary).

This conservative approach is in sharp contrast with the development of ECJ case law relating to the application of the non-discrimination principle in the EC Treaty (which also refers to 'nationality' as the relevant criterion; see Article 12 of the EC Treaty), often linked to the exercise of one or more of the fundamental freedoms of the EC Treaty, in tax matters.[6] Therefore it is no surprise that the General Reporters sought and found inspiration in this case

[1] Tax partner with Eubelius and scientific member of the Tax Institute of the University of Louvain (KUL).

[2] Luc and Philippe Hinnekens, 'Non-discrimination at the crossroads of international taxation', *Cahiers de droit fiscal international*, 2008, Vol. 93a, 15-54.

[3] M.C. Bennett, 'Non-discrimination in International Tax Law, A Concept in Search of a Principle' in *The Tillinghast Lectures*, 1996-2005, NYU School of Law, 411.

[4] Except in certain jurisdictions as for example the US; however Art. 24 (1) US MC contains specific wording in this respect.

[5] Covert discrimination refers to a tax measure which discriminates against the protected class of taxpayers, not in explicit terms, but by its practical effect; in other words it will in practice mainly affect the protected class.

[6] See R. Lyal, 'The non-discrimination principle in EC tax law', *Cahiers de droit fiscal international,* 2008, Vol. 93a, 55-72.

law to propose a framework for a new non-discrimination Article in the MC. The choice for the ECJ case law on non-discrimination as best practice is also supported by the fact that other possible sources of inspiration (e.g. human rights and freedom treaties, WTO agreements, bilateral commercial treaties, NAFTA and MERCOSUR agreements) did not turn out to be very effective with regard to the application of the non-discrimination principle in (direct) tax matters.

The General Reporters are aware that the context and the main objective of the EC Treaty (creation of internal integrated economic market) differ from that of a bilateral tax treaty (avoidance of international double taxation) and that the presence and interpretation autonomy of a single court dealing with the actual application of the non-discrimination principle certainly has contributed to the success and uniformity of the development of this principle within the EC. Therefore they are of the opinion that the model arising from the ECJ case law cannot as such be transposed to the MC but that it should be sized down to take into account the bilateral framework and specific needs and limits of a tax treaty. Consequently the new Article 24 MC should strive to increase the level of cross border neutrality in international taxation, but not necessarily with the same intensity as the standard applied by the ECJ. OECD and the contracting states are likely to require that the new Article 24 refrains from (i) substantially altering the allocation of taxing rights in the treaty, (ii) requiring a harmonization of the tax systems of the OECD Member States, and (iii) substantially affecting their ability to exercise their taxing powers. The new framework proposed by the General Reporters provides for a more extensive, more effective and more coherent provision against direct discrimination, based on the nationality, residence or other *in personam* characteristic of the taxpayer (corresponding to current Article 24 (1) and including the current Article 24(3)), which would function as an overarching core provision, to be completed by specific provisions against indirect discrimination (current Articles 24 (4) and (5)) and specific provisions to be agreed upon by the contracting states.[7] Also the 2008 IFA Congress panel on this topic discussed the possible framework of a new Article 24 MC and assessed the choices to be made to come to a better version of this Article.

It is not clear whether there currently is sufficient 'political' support for such a major reform or whether the old conservatism is still prevailing among the government delegates. In any event the trend reflected in the 2008 Update of the commentary relating to Article 24 is not very promising. The General Report and the National Reports, as well as the panel discussion at the IFA Congress itself, have clearly demonstrated the inadequacy of the current version of the ND Article. Hopefully they will also prove to be a useful source of inspiration for a substantial modification of Article 24 in the near future.

[7] E.g. Model provision relating to tax relief for employee cross border pension contributions, included in par. 37 and 38 of the Commentary regarding Art. 18 MC; in the bilateral tax treaty between Belgium and The Netherlands a similar provision has been included in the ND Article (Art. 26 §7).