"Taxes Covered" – What is a "Tax" according to Article 2 of the OECD Model?

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1. ART. 2 OF THE OECD MODEL AND TREATY INTERPRETATION

The result of interpreting the provisions of a tax treaty depends largely on the view one takes. The treaties that are drafted along the lines of the OECD Model Tax Convention on Income and on Capital contain a specific interpretation clause, which is in Art. 3(2) of the OECD Model. This specific provision is not helpful, however. It is disputed whether Art. 3(2) emphasizes that a treaty should, to the greatest possible extent, be interpreted on the basis of its context or whether Art. 3(2) refers primarily to domestic law.[1] The approach taken in Art. 3(2) is very often decisive for the result of interpreting specific treaty provisions.

In the case of Art. 2 of the OECD Model, however, the situation is different. Irrespective of which position one takes regarding Art. 3(2), one cannot deny that Art. 2(3) refers to domestic law. This provision offers an illustrative list of the taxes levied in the two contracting states at the time the treaty was signed. Thus, the taxes mentioned in the list must be interpreted in light of their substantive content when the treaty was signed.

On the other hand, Arts. 2(1) and (2) of the OECD Model do not refer to domestic law at all. These provisions describe the scope of the OECD Model in a more general way and define the term "taxes on income and on capital". They have to be interpreted without reference to the domestic law of either contracting state. Since Art. 2(3) of the OECD Model refers to domestic law, Arts. 2(1) and (2) make sense only if they are seen as having an "autonomous" meaning that does not depend on the domestic law of one of the contracting states. Otherwise, there would have been no need at all for provisions such as Arts. 2(1) and (2).

2. THE TERM "TAX"

2.1. Imposition on behalf of a contracting state or its political subdivisions or local authorities

Art. 2 of the OECD Model defines the term "taxes on income and on capital", but does not define the term "tax". There are, however, some indications in both the OECD Model and the Commentary which are instrumental in determining what a tax is. Art. 2(1) makes it clear that the OECD Model applies only "to taxes ... imposed on behalf of a Contracting State or of its political subdivisions or local authorities". Such a reference to these entities was also inserted into Art. 4(1) of the OECD Model in 1995 to ensure that these entities are also entitled to treaty bene-

1. See Lang, "Die Bedeutung des originär innerstaatlichen Rechts für die Auslegung von Doppelbesteuerungsabkommen (Art. 3 Abs. 2 OECD-Musterabkommen)", in Burmester and Endres (eds.), *Außensteuerrecht, Doppelbesteuerungsabkommen und EU-Recht im Spannungsverhältnis, Liber amicorum in honour of Debatin* (1997), at 283, 296; and Loukota, H., "Vermeidung von Irrwegen bei der DBA-Auslegung", *SWI* 1998, at 559, 562 et seq.

fits.[2] The Commentary (Para. 2) on Art. 2 of the OECD Model gives some examples: "States, regions, provinces, *départements*, cantons, districts, *arrondissements*, *Kreise*, municipalities or groups of municipalities, etc." The wording of Art. 2(1) and of the Commentary seems to suggest that only "authorities" at certain *geographical* levels are covered. Thus, other legal entities, although created by law, do not fall under this provision unless they are political subdivisions of a contracting state. Not only federal taxes, however, but also provincial and local taxes levied by provinces and municipalities are covered by the OECD Model.

2.2. Manner in which the taxes are levied

Art. 2(1) of the OECD Model emphasizes that taxes are covered "irrespective of the manner in which they are levied". The Commentary (Para. 2) on Art. 2 explains that "[t]he method of levying the taxes is ... immaterial: by direct assessment or by deduction at the source, in the form of surtaxes or surcharges, or as additional taxes (*centimes additionnels*), etc.".

The use of the term "direct taxes" has been avoided. This term is considered as being "far too imprecise". This is especially true for withholding taxes, which are sometimes difficult to distinguish from indirect taxes. Under EC law[3] and also under the General Agreement on Trade in Services (GATS),[4] however, the distinction between direct and indirect taxes is relevant. Nevertheless, it has been very difficult for the European Court of Justice (ECJ) to draw the borderline.[5] Thus, the position of the Commentary can be regarded as a wise one.

2.3. Ordinary and extraordinary taxes

The OECD Model does not distinguish between ordinary and extraordinary taxes, but the Commentary (Para. 5) on Art. 2 gives some guidance:

> The Article does not mention "ordinary taxes" or "extraordinary taxes". Normally, it might be considered justifiable to include extraordinary taxes in a model convention, but experience has shown that such taxes are generally imposed in very special circumstances. In addition, it would be difficult to define them. They may be extraordinary for various reasons; their imposition, the manner in which they are levied, their rates, their objects, etc. This being so, it seems preferable not to include extraordinary taxes in the Article. But, as it is not intended to exclude extraordinary taxes from all conventions, ordinary taxes have not been mentioned either. The Contracting States are thus free to restrict the convention's field of application to ordinary taxes, to extend it to extraordinary taxes, or even to establish special provisions.

The position of the Commentary is not completely clear, and possibly even contradictory in itself. The Commentary leaves it to the contracting states either to "restrict the convention's field of application to ordinary taxes" or "to extend it to extraordinary taxes". The first suggestion seems to imply that extraordinary taxes are covered by a particular treaty unless the contracting states agree on an explicit exclusion; on the other hand, one could deduce from the second suggestion that, in the absence of a specific provision, extraordinary taxes do not fall under the treaty.

These confusing statements in the Commentary are due to the differing views of the members of the Fiscal Committee of the OEEC (Organization for European Economic Cooperation) at the time the provision was drafted. The decisive discussions took place on 24 January 1957.[6] The representatives of Italy, Denmark and Belgium supported the idea of excluding extraordinary taxes from the scope of the OECD Model. Their preference was to deal with these issues in separate bilateral treaties. The German delegate took the position that if it was not possible to explicitly include all extraordinary taxes within the scope of the OECD Model, they should at least not be excluded. The British delegate preferred neither to include nor to formally exclude extraordinary taxes. As a result of this discussion, the Committee decided not to mention extraordinary taxes in the OECD Model and asked a working party to explain the reason for this decision in the Commentary. Since the reason was not at all clear, the Commentary is as contradictory as the discussion among the delegates.

The history of this provision does not help to answer the question of how extraordinary taxes should be dealt with. Thus, more emphasis should be placed on the wording of Art. 2 of the OECD Model. From the wording of Art. 2, one does not get the impression that whether a tax is levied regularly or only under specific circumstances should be decisive. Therefore, there is no need to distinguish between "ordinary" and "extraordinary taxes". All types of taxes on income and on capital are covered.

2.4. Fees paid for certain benefits

In many domestic systems, the question of how to distinguish between "taxes" and "fees paid for certain benefits" is very relevant. The borderline is difficult to draw since the reason for levying taxes is to obtain funding for certain

2. See Lang, "Die Bedeutung der 1995 erfolgten Änderungen des OECD-Musterabkommens und des Kommentars des OECD-Steuerausschusses für die Doppelbesteuerungsabkommen", in Lang, Loukota and Lüthi (eds.), *Die Weiterentwicklung des OECD-Musterabkommens* (1996), at 36. See also Toifl, *Personengesellschaften im Recht der Doppelbesteuerungsabkommen* (2003), at 55 et seq.
3. From Art. 99 of the EC Treaty, it can be inferred that EC law makes such a distinction.
4. See Lang, Herdin and Hofbauer (eds.), *WTO and Direct Taxation* (2005).
5. See ECJ C-21/94, *ECR* 1995 at I-01827, where the ECJ implicitly acknowledged that, for purposes of Art. 93 of the EC Treaty, the concept of "indirect taxes" also comprises taxes that cannot be shifted to others. In another decision, the ECJ ruled in favour of the Commission and held that "the charges in question could equally be regarded as direct or as indirect taxes" (ECJ C-191/94, *ECR* 1995 at I-01859, Para. 30). The ECJ has consistently held that the concept of "tax" is to be interpreted autonomously for purposes of the Community's legal order, without regard to national definitions; see ECJ C-295/84, *ECR* 1985 at I-03759; C-200/90, *ECR* 1992 at I-02217; C-197/94 and C-252/94, *ECR* 1996 at I-00505; C-4/97, *ECR* 1998 at I-06469; C-375/98, *ECR* 2000 at I-04243; C-113/99, *ECR* 2001 at I-00471; and C-294/99, *ECR* 2001 at I-06797. See also Beiser and Pülzl, "Harmonisierung der direkten Steuern in der EU – Rechtsgrundlagen, Stand und Perspektiven", *SWI* 2004, at 596, 597 et seq. For a more detailed analysis, see Kreibohm, *Der Begriff der Steuer im Europäischen Gemeinschaftsrecht* (2004).
6. Fiscal Committee, Minutes of the 3rd Session held at the Château de la Muette, Paris, 23-25 January 1957, *FC/M (57)*, at 4 et seq.

benefits the government provides to the public, such as safety, political stability, all kinds of infrastructure, etc.[7] What exactly the notion of "public services" involves is controversial, however.[8]

The wording of the OECD working definition, according to which a "tax" is a "compulsory unrequited payment to the government",[9] indicates that a levy which is in return for a specific benefit is not a tax. Even though it is not clear whether this definition can influence the interpretation of Art. 2 of the OECD Model, in the case of social security charges it could be argued that there is a direct benefit granted in return for the payments. Regarding social security charges, the Commentary (Para. 3) on Art. 2 takes the position that: "Social security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received, shall not be regarded as 'taxes on the total amount of wages'." It is interesting that the Commentary mentions social security charges in the context of taxes on the total amount of wages. Under a literal interpretation of the Commentary, the argument could be made that social security charges can still be characterized as other types of taxes on income and on capital, not as taxes on the total amount of wages. But the reason why the Commentary mentions these charges in the context of taxes on the total amount of wages is probably that, in the same paragraph, it explains in which way these taxes are covered by the OECD Model. There is no indication that the Commentary takes the position that social security charges may still qualify as taxes on income or on capital. This is confirmed by the report of Working Party No. 30 that was prepared in 1967 to examine some issues of interpretation concerning Art. 2 of the OECD Model. On 12 June 1969, Working Party No. 30 delivered its report to the OECD Fiscal Committee:[10]

> Without going into detail it could be said that the payer of social security fees (or the person on whose account such payments are made directly or indirectly) receives specific rights against the social insurance in return for these contributions. Therefore the Working Party feels that contributions to social security funds can in principle *not* be considered to be "taxes" in the meaning of paragraphs 1 and 2.

The extent of the connection between the levy and the individual benefit under a social security system is sometimes difficult to determine. Many social security systems are financed in a complex way. On the one hand, employees and employers often have to contribute; on the other hand, the funds raised from taxpayers are not in the least used to support these systems. Very often individuals who do not contribute to the fund, e.g. individuals on maternity leave or unemployed persons, are also protected. The same is true for individuals who cannot become part of the labour market, such as children. Most systems, however, have a rule that only individuals who have contributed to the social security system are entitled to specific rights under the system in return for their contributions. If the entitlement of others is simply an exception, the existence of a direct connection between the levy and the individual benefit may be assumed.

These considerations can also be helpful in distinguishing fees from taxes. In many jurisdictions, the government charges fees for the services provided by the public sector. Such fees could be paid for certain services provided to an individual or a group of individuals, such as certifying official documents or connecting houses to the public water system. Even if these fees are collected by public bodies and authorized by law, there is a direct connection between the levy and the benefit. Therefore, they do not qualify as taxes under Art. 2 of the OECD Model even if, under certain circumstances, specific individuals, such as low-income recipients, may be exempt from the fee for reasons of social policy.

2.5. Taxes must be collected in accordance with domestic law

Payments that are not mandatory do not qualify as taxes. A "donation" to the government must be treated like any other donation and is not a tax. There are situations, however, in which it is difficult to distinguish taxes from other payments – e.g. where a withholding tax is levied under domestic law and the recipient of the payment is entitled to a refund under the relevant treaty, but does not ask for a refund. This happens in practice: sometimes because the refund is so small that it is not worth initiating a refund procedure and sometimes because the statute of limitations has expired. The Federal Tax Court of Germany (*Bundesfinanzhof* or BHF) once had to decide a case where, due to the statute of limitations, the taxpayer could not ask for a refund in the source state and tried to get a credit for the whole amount of tax in Germany, his residence state,[11] although, under the treaty, the source-state withholding tax should have been reduced. The German tax authorities refused to grant the credit under the treaty. If a taxpayer fails to ask for a refund in time, the amount of tax exceeding the maximum withholding tax under the treaty cannot be considered to be levied "in accordance with the provision of this Convention", as provided in Art. 23 of the OECD Model. This decision is convincing because, otherwise, taxpayers would have the option of either asking for a refund in the source state or asking for a credit in the residence state. If, under the treaty, the tax revenues are allocated in a certain way, the residence state cannot be obliged to grant a benefit to the taxpayer which, according to the treaty, should have been granted by the source state.

7. This concept has been taken up in the relevant academic literature as a basic principle for justifying the imposition of a tax. The "benefit principle" is the idea that a tax is justified if individuals are taxed in proportion to the benefits they receive from governmentally provided services; see Homburg, *Allgemeine Steuerlehre* (2nd ed., 2000), at 8 et seq. See also ECJ C-130/93, *ECR* 1994 at I-03215, where the ECJ applied this idea to determine whether a compulsory contribution is in accordance with Arts. 9 and 12 of the EC Treaty: "... [A] charge which is imposed on goods ... may escape classification as a charge having equivalent effect as prohibited by the Treaty ... if it represents payment for a specific service actually and individually rendered to the trader of a sum in proportion to that service ...."

8. See Heij, "The Definition of Tax", 7 *Asia-Pacific Tax Bulletin* 4 (2001), at 74, 76 et seq.

9. See cs3-hq.oecd.org/scripts/stats/glossary/detail.asp?ID=2657; see also Larking, B. (ed.), *International Tax Glossary* (Amsterdam: IBFD Publications, 4th ed. 2001).

10. Working Party No. 30 of the OECD Fiscal Committee (Austria–Switzerland), received on 12 June 1969, *FC/WP 30(69)*, marginal number 27.

11. Federal Tax Court (BFH) of 21 May 1986, *BStBl* 1986 II 739.

It is interesting whether these considerations may have implications of a more general kind. May the tax authorities of the residence state reject applications for a tax credit on the grounds that the tax law of the source state was not applied correctly? If, for example, under the laws of the source state, the tax rate is 30%, but the tax authorities levy a tax of 40%, and if the tax rate in the residence state is 40% or higher (and the tax base is, for the sake of argument, determined identically in both states), the taxpayer may not be interested in lodging an appeal against the unlawful levy of the tax authorities of the source state if he or she is certain of getting a credit in the residence state for the full amount of tax. If there is a silent agreement between the taxpayer and the tax authorities of the source state, the burden of granting relief from double taxation could very easily be shifted to the residence state.

Under the credit method, the source state is always able to alter the balance between the two states if it "officially" increases its tax rates. Thus, the question of characterizing a source-state tax under the treaty with the residence state may depend on whether the tax was levied officially or unofficially. If a source-state tax is (partly) levied without a legal basis, the residence state may refuse to give credit for the 40% source-state tax only on the grounds that the difference between 30% and 40% is not a "tax" and is therefore not covered by the treaty.[12] As a consequence, this would mean that the residence state could re-examine whether the source state had applied its domestic law correctly all along and refuse to grant benefits if, in the residence state's view, this was not the case.

2.6. Taxes on income and on capital

Both taxes on income and taxes on capital are covered by Art. 2 of the OECD Model. Thus, for purposes of Art. 2, there is no need to distinguish between these types of taxes. The OECD Model, however, provides different distributive rules: taxes on income are dealt with in Arts. 6 to 21, and taxes on capital in Art. 22. Therefore, the distinction between taxes on income and taxes on capital is crucial.

Drawing the borderline between taxes on income and taxes on capital is difficult. The Dutch rules on the taxation of dividends may serve as an example.[13] Under Dutch law, income from shares is taxed even if no dividends are distributed. Dutch tax law contains a legal fiction: every corporation is deemed to distribute dividends in the amount of 4% of the value of its shares, and the deemed distribution is taxed at a rate of 25%. The economic effect is comparable to a 1% tax on the corporation's wealth at the shareholder level. Wattel and Marres correctly pointed out that this indicates that the tax should be characterized as a tax on capital and therefore the tax base should be treated under Art. 22, not Art. 10, of the OECD Model.[14] But the fact that, under Dutch law, the real distributions are also taken into account in determining the tax base[15] makes the assessment more complex.

Another example is the minimum corporate income tax levied in many countries. Corporations are subject to a type of "corporate tax" even if they do not derive any income. Sometimes this tax is determined by the value of the corporation's assets, and sometimes it is a lump-sum payment levied periodically. If the minimum corporate income tax is determined on the basis of the value of the assets, it is difficult to argue that the tax is a tax on income rather than a tax on capital. If the tax is levied as a periodic lump-sum payment, however, one might even argue that the tax is neither a tax on income nor a tax on capital. In most jurisdictions, the issue is even more complex since it is almost impossible to separate this type of tax from the regular corporate income tax. For example, very often a credit carry-forward for the minimum corporate income tax is granted which can be deducted from the regular corporate income tax levied in later years when there are profits subject to that tax.

Regarding the taxation of capital gains, it is not disputed that capital gains taxes are covered by the OECD Model, although capital gains are not considered income in all countries. Art. 13 of the OECD Model deals with capital gains and leaves no doubt that taxes levied on capital gains are covered. Further, Art. 2 of the OECD Model itself explicitly mentions "taxes on gains from the alienation of movable or immovable property".

Capital gains and capital appreciation are closely related. This is emphasized by the Commentary (Para. 9) on Art. 13:

> Where capital appreciation and revaluation of business assets are taxed, the same principle should, as a rule, apply as in the case of the alienation of such assets. It has not been found necessary to mention such cases expressly in the Article or to lay down special rules. The provisions of the Article as well as those of Articles 6, 7 and 21, seem to be sufficient. As a rule, the right to tax is conferred by the above-mentioned provisions on the State of which the alienator is a resident, except that in the cases of immovable property or of movable property forming part of the business property of a permanent establishment, the prior right to tax belongs to the State where such property is situated.

Although one might argue about whether it is convincing to deal with capital appreciation in Art. 13, since there is no "alienation",[16] it is clear from the Commentary that taxes on capital appreciation are considered to be taxes on income, not taxes on capital, and can therefore fall under one of the distributive rules applicable to income.

12. Many credit states even have specific rules explicitly denying a credit for "voluntary" taxes and therefore usually put words such "subject to the provisions of domestic law" in their version of Art. 23.

13. Wattel and Marres, "Characterization of Fictitious Income under OECD-Patterned Tax Treaties", 43 *European Taxation* 3 (2003), at 66, 67. See "'Fictitious Income' and Tax Treaties", in Hardjo and Buyne (eds.), *Liber amicorum in honour of Maarten Ellis* (2004) (forthcoming).

14. Wattel and Marres, supra note 13, at 78.

15. For more details, see the following decisions of the Netherlands Supreme Court (*Hoge Raad*): 7 January 2004, *BNB* 2004/162; 5 September 2003, *BNB* 2003/379c; 7 December 2001, *BNB* 2002/42; 3 May 2000, *BNB* 2000/328; and 29 September 1999, *BNB* 2000/16.

16. Lang, *Hybride Finanzierungen im Internationalen Steuerrecht* (1991), at 102; concurring: Schuch, *Die Zeit im Recht der Doppelbesteuerungsabkommen* (2002), at 231; contra: *Killius*, "Der anglo-amerikanische Trust und die deutschen Doppelbesteuerungsabkommen", in Conston (ed.), *Current Topics in U.S.-German Tax and Commercial Law, O. Walter Liber Amicorum* (1988), at 63.

What proves to be more difficult is the characterization of "taxes on wages and salaries".[17] Under Art. 2 of the OECD Model, it is clear that they are covered by the OECD Model, but Art. 2 leaves it open whether they should be considered taxes on income or taxes on capital. In the case of an Austrian municipal tax that takes wages and salaries as its tax base, the Supreme Administrative Court of Austria has held that the tax should be dealt with under Arts. 6, 7 or 8 of the OECD Model.[18] Some authors have correctly pointed out, however, that it is somewhat artificial to apply these provisions since they are designed for profits.[19]

3. LIST OF TAXES IN ART. 2(3) OF THE OECD MODEL

3.1. Illustrative nature of the list of taxes in Art. 2(3)

Art. 2(3) of the OECD Model contains a provision that is to be filled in during the negotiations of a bilateral tax treaty. The treaty negotiators must mention the taxes levied in their country at the time the treaty is signed. Art. 2(3) uses the phrase "in particular" and thus makes it clear that the list is not complete. The Commentary (Para. 6) on Art. 2 adopts the view: "The list is not exhaustive. It serves to illustrate the preceding paragraphs of the Article. In principle, however, it will be a complete list of taxes imposed in each State at the time of signature and covered by the Convention." There seems to be a certain contradiction: on the one hand, the list is not complete; on the other hand, it should "in principle" be exhaustive. This raises problems of interpretation.

The non-exhaustive nature of Art. 2(3) could have relevance in treaty negotiations. Treaty negotiations frequently involve several rounds of negotiations and thus usually take considerable time. Further, once the preliminary results of the negotiations are on the table, in many countries they will have to be discussed within the government and with various interest groups, all of which is time-consuming. For the negotiators, it is difficult at a later stage to go back to issues that were already discussed and agreed to during earlier rounds of negotiations since new proposals, even if they are not of a substantive nature, might disturb the existing sensitive balance and may provoke the resumption of negotiations on these issues. Sometimes substantive domestic changes, such as the introduction of a new tax, are made before the negotiations are finalized and the treaty is signed. The phrase "in particular" ensures that the treaty also covers such a tax because Art. 2(4) of the OECD Model only applies to taxes imposed after the treaty was signed.

3.2. The limiting function of Art. 2(3)

In addition to the taxes introduced during or after the negotiations but before the treaty is signed, one might assume that the list in Art. 2(3) of the OECD Model must be read as being exhaustive. The question of which taxes will be covered by a treaty is one of the most important issues in treaty negotiations. Thus, it must be assumed that treaty negotiators are extremely careful to include all the taxes they want to be covered by the treaty. If, therefore, the treaty negotiators decide not to mention a certain tax in the list equivalent to Art. 2(3), it is a valid assumption that they want to exclude the tax from the coverage of the treaty. Even if the tax is a tax on income or a tax on capital, and thus falls under Art. 2(1) or (2) of the OECD Model, and if Arts. 2(1) and (2) remain unchanged, the fact that the tax is not mentioned in the list equivalent to Art. 2(3) indicates that the negotiators intended that the tax not fall under the treaty.[20]

The report on the interpretation issues of Art. 2 of the OECD Model delivered to the OECD Fiscal Committee by Working Party No. 30 on 12 June 1969 took a different position. The report dealt with a proposal to eliminate both Arts. 2(1) and (2) of the OECD Model and the phrase "in particular" in Art. 2(3),[21] which would have led to the result that the list in Art. 2(3) would become exhaustive. The report examined the practical consequences of such a change:[22]

> ... each Contracting Party would be obliged to scrutinize most carefully every single tax, accessory duty, charge, contribution and any other levy of any form of both Contracting States to find out whether each tax should be mentioned in the list. A wrong decision about the character of a tax or "forgetting" a surcharge would mean that those levies were not within the scope of the Convention, even if later on both Contracting Parties admitted that the tax in question should have been enumerated in the list. The Convention can only be made applicable to such tax by an appropriate amendment thereto. But making an amendment means that the Convention must run again through the machinery of parliamentary procedure ....

The members of Working Party No. 30 considered it possible that the treaty negotiators would forget to include a certain tax in the treaty. This seems plausible, however, only if it concerns a tax that raises little revenue. It is difficult to imagine that one of the major taxes would not be expressly mentioned in the treaty if the negotiators' intention was that the tax be covered.

The report of Working Party No. 30 went further:[23]

> If ... the Contracting States want to exclude in their bilateral negotiations certain taxes or charges which are or might probably be "taxes on income (capital)" within the meaning of paragraphs 1 and 2, then it is – in the opinion of the Working Party – not sufficient to exclude such taxes or charges solely from the list of taxes in paragraph 3, but it is

17. See Firlinger, "Kommunalsteuer vom sachlichen Anwendungsbereich der DBA umfasst?", *SWI* 1994, at 65; Wurz, "Kommunalsteuer und Doppelbesteuerungsabkommen", *SWI* 1998, at 231; Züger, "Kommunalsteuer, sonstige Lohnabgaben und Doppelbesteuerungsabkommen", *SWI* 2000, at 164; Sutter, "Der sachliche Anwendungsbereich des ErbSt-MA", in Aigner, D., et al. (eds.), *Erbschaftssteuern und Doppelbesteuerungsabkommen* (2002) at 41; and Burgstaller, "Kommunalsteuer und DBA", *SWI* 2004, at 17.
18. Supreme Administrative Court (VwGH) of Austria of 15 December 1999, 98/12/0021; 3 August 2000, 99/15/0265; 28 March 2001, 2000/13/0134. For details, see Züger and Burgstaller, both supra note 17.
19. Wurz, supra note 17.
20. For similar deliberations regarding the OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts, which, however, contains an *exhaustive* list of taxes, see Sutter, supra note 17, at 59.
21. See Art. 2 of the 1996 United States Model Income Tax Convention.
22. Working Party No. 30, supra note 10, marginal number 11.
23. Id., marginal number 41.

> necessary to make express reference in the Article that those taxes and charges are excluded from the scope of the Convention.

Thus, not mentioning a tax in the list equivalent to Art. 2(3) of the OECD Model is not sufficient to exclude a tax from the coverage of the treaty if the tax falls under the general definitions in Arts. 2(1) and (2) of the OECD Model.

This has practical relevance. Treaty negotiators who intend to exclude a certain tax from the scope of a bilateral treaty often do not care enough about the general definitions in the bilateral equivalents to Arts. 2(1) and (2) of the OECD Model. They do not mention the tax on the list in Art. 2(3), but nevertheless do not alter the general definitions. In light of the above-mentioned OECD report, which is part of the "*travaux préparatoires*" of the 1977 and more recent versions of the OECD Model and which is therefore also relevant for the interpretation of treaties drafted along the lines of these versions of the OECD Model, it is not at all certain that treaty negotiators have been successful in implementing their intentions if they simply did not mention the tax. If there is no specific evidence proving that a certain tax was meant to be excluded from the scope of a bilateral treaty, the tax authorities will have a hard time arguing in court that the specific tax is not covered. The 2000 version of the Commentary therefore mentions that some countries leave out Arts. 2(1) and (2) and list exhaustively the taxes to which the treaty will apply in order to avoid covering taxes that are not on the list (see Para. 6.1 of the Commentary on Art. 2).

3.3. The "amplifying" power of Art. 2(3)

The question has been raised in the relevant academic literature whether Arts. 2(1) and (2) of the OECD Model, if included in a bilateral tax treaty, also have the power to limit the scope of the treaty.[24] This could mean that a tax expressly listed in the bilateral equivalent to Art. 2(3) of the OECD Model would still fall outside of the scope of the treaty if the tax is not covered by the general definitions in Arts. 2(1) and (2).[25]

On the other hand, it should not be assumed that a certain part of the equivalent to Art. 2(3) has no relevance at all. This, however, is exactly the result if a tax, although expressly mentioned in the list equivalent to Art. 2(3), is not covered by the treaty. Thus, if the treaty negotiators decided to include a certain tax in the list equivalent to Art. 2(3), there is good reason to assume that they were successful in achieving treaty coverage, even if they left the general definitions unchanged.

The above-mentioned report of Working Party No. 30 of the OECD Fiscal Committee supports this position:[26] "Paragraph 3 has quite obviously the power (although being principally an illustration to paragraphs 1 and 2) to amplify the scope of the Convention so that taxes and charges might be included in the Convention even if they were not considered to be 'taxes on income (capital)' within the meaning of paragraph 1 and 2."

4. "SIMILAR TAXES" ACCORDING TO ART. 2(4) OF THE OECD MODEL

4.1. The benchmark

Art. 2(4) of the OECD Model contains a clause which, under certain circumstances, guarantees that the scope of a tax treaty is automatically extended if a new tax is introduced: "The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes." Thus, treaties are applicable not only to identical taxes, but also to substantially similar taxes. This clause is designed to avoid the need to change the treaty if a new tax is introduced in one of the contracting states.

Art. 2(4) uses the phrase "identical or substantially similar taxes" and seems to refer to the list of taxes in the bilateral equivalent to Art. 2(3) of the OECD Model. The taxes levied at the time the treaty was signed serve as a benchmark.[27] Art. 2(4) neither distinguishes between the two contracting states nor requires that a newly introduced tax be identical or similar to taxes in *both* contracting states. Thus, even a tax levied only in the *other* contracting state may serve as a benchmark.[28] This is justified in light of the object and purpose of the treaty since one may assume that the similarity of a tax to a tax levied in the other contracting state would have been sufficient for the treaty negotiators to include the tax within the scope of the treaty if the tax had existed at that time.[29]

Art. 2(4) of the OECD Model seems to refer to the taxes listed in the provision equivalent to Art. 2(3) and not to include the general definition in Art. 2(2) as a benchmark.[30] This does not mean, however, that a newly introduced tax may fall under the treaty only if a similar tax was already levied at the time the bilateral treaty was signed. On the contrary, the equivalent to Arts. 2(1) and (2) applies in addition.[31] The scope of Arts. 2(1) and (2) is not limited to the taxes levied at the time of the treaty was signed. Thus, new taxes covered by the general definitions may fall within the scope of the treaty even if they are not similar to the taxes listed in the equivalent to Art. 2(3).

4.2. Modification of existing taxes

Art. 2(4) of the OECD Model covers taxes which are imposed "in addition to" or "in place of" existing taxes. From this wording, it could be inferred that this provision

24. Regarding the OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts, see Sutter, supra note 17, at 63 et seq.
25. Id. at 64 et seq.
26. Working Party No. 30, supra note 10, marginal number 40.
27. Ambiguous: id., marginal number 12.
28. Concurring: Vogel, in Vogel and Lehner (eds.) *DBA-Kommentar* (4th ed., 2003), Art. 2, marginal number 45; see also Sutter, supra note 17, at 61.
29. Working Party No. 30, supra note 10, marginal number 13 (emphatically leaving open this question).
30. Obviously taking a different view: id., marginal number 12.
31. But see Baker, *Double Taxation Conventions* (2004), marginal number 2B.04: "Of themselves, these two paragraphs are of limited practical significance, but they are relevant when determining what constitute 'identical or substantially similar' taxes under paragraph (4)."

covers only completely new taxes. If existing taxes are merely modified, one could argue that they fall within the scope of the treaty in every case. This would mean, however, that, as long as a contracting state does not change the name of a certain tax, the state could modify its tax system substantially without jeopardizing tax treaty protection.

If this assumption is correct, each contracting state could interfere with the scope of a bilateral treaty by mere unilateral measures. If a contracting state wanted a newly introduced tax to fall under the treaty, all it would have to do is give the tax a name that was already in use for a certain tax at the time the treaty was signed, even if, in substance, the two taxes are not similar at all. To avoid this result, it makes sense to look, not at the name of a tax, but at its substance and to compare the different types of tax liabilities contained in the two taxes.

The minimum corporate income tax can serve as an example to explain the practical relevance of these considerations.[32] If such a tax is introduced after the bilateral treaty was signed and if the tax is structured in such a way that it is questionable whether the tax can be characterized as a tax on income or on capital under Arts. 2(1) and (2) of the OECD Model, the mere integration of the tax into the existing corporate income tax (which is expressly listed by name in the equivalent to Art. 2(3) of the OECD Model) does not guarantee that the minimum corporate income tax will fall under the treaty. This would depend on whether the tax liability, which is formally part of the corporate income tax, qualifies as a tax on income or on capital under the equivalent to Arts. 2(1) and (2) or whether the tax liability is similar or comparable to the corporate income tax or another tax listed in the equivalent to Art. 2(3) of the OECD Model.

4.3. Interfering with the balance of a treaty

According to the considerations just presented, contracting states have only a limited power to decide unilaterally whether a newly introduced tax falls under the treaty. The contracting states could, however, interfere in the balance of a bilateral tax treaty by other means. For example, assume that, at the time the treaty was concluded, both contracting states levied a net worth tax and, some years later, one state abolished its net worth tax. The other contracting state still levies a net worth tax, but does not see why it should fall under the tax treaty since there is no longer any possibility of double taxation. On the contrary, the application of the treaty may even lead to double non-taxation.

In such a case, the contracting state must accept these results as long as the treaty is applicable. Each contracting state is free to abolish taxes even if they are covered by the treaty. The treaty in no way obliges the contracting states to continue levying a tax mentioned in the treaty. If the contacting state that still levies a net worth tax wants to exclude the tax from the scope of the treaty, it must ask the other contracting state to negotiate[33] or, if the other state is not willing to negotiate, it must terminate the treaty.[34]

5. TAXES ON INCOME AND CAPITAL VERSUS TAXES ON ESTATES, INHERITANCES AND GIFTS

5.1. Scope of estate, inheritance and gift tax treaties

The OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts (OECD Model on Estate Taxes, etc.) dates back to 1966 and was revised in 1982. Its structure is similar to that of the OECD Model Tax Convention on Income and on Capital. There is also a provision on the scope of the Convention: Art. 2(1) of the OECD Model on Estate Taxes, etc., has the following wording: “This Convention shall apply to taxes on estates and inheritances and on gifts imposed on behalf of a Contracting State or its political subdivisions or local authorities, irrespective of the manner in which they are levied.” Art. 2(2) of the OECD Model on Estate Taxes, etc., adds:

> There shall be regarded as taxes on estates and inheritances taxes imposed by reason of death in the form of taxes on the corpus of the estate, of taxes on inheritances, of transfer duties, or of taxes on donationes mortis causa. There shall be regarded as taxes on gifts taxes imposed on transfers inter vivos only because such transfers are made for no, or less than full, consideration.

Like Art. 2(3) of the OECD Model Tax Convention on Income and on Capital, Art. 2(3) of the OECD Model on Estate Taxes, etc., also contains a provision that lists the taxes which are imposed at the time the treaty was signed. Further, Art. 2(4) of the OECD Model on Estate Taxes, etc., has its equivalent in Art. 2(4) of the OECD Model Tax Convention on Income and on Capital.

5.2. How to draw the borderline

At first glance, there appears to be no overlap in the scope of the two OECD Models. The borderline seems easy to draw: individual and corporate income taxes usually cover what can be generated in the market, while estate, inheritance and gift taxes cover transfers of money or property without consideration. What inheritance and gift taxes and capital taxes have in common is that they apply to property. While capital taxes are usually levied on a regular basis, inheritance and gift taxes are levied only when a specific transfer takes place.

A closer look into the issue reveals that overlaps may occur. The principles mentioned above describe only the general concepts of these taxes. In practice, these principles are not fully implemented. An Austrian tax provision serves as an example.[35] Under Austrian law, private foundations (*Privatstiftungen*), which are often set up in

32. For other examples, see Lang, “Der sachliche Anwendungsbereich der Doppelbesteuerungsabkommen auf dem Gebiet der Steuern vom Einkommen und vom Vermögen”, in Jirousek and Lang (eds.), *Praxis des Internationalen Steuerrechts, Liber amicorum in honour of Helmut Loukota* (2005) (forthcoming).
33. See Runge, “Entwicklungstendenzen zum DBA Österreich–Deutschland”, *SWI* 1997, at 191, 195.
34. For more details, see Lang, supra note 32.
35. For more details, see id.

the interest of a certain family, are legal entities that do not have any owners or shareholders, but have beneficiaries instead. The management board of a private foundation may decide to make transfers to one or all of the beneficiaries. If there were no special rules, these transfers would be characterized as donations and would be subject to gift taxation. There is, however, an explicit exemption under the gift tax law for such donations and, instead of a gift tax liability, these donations constitute, under another special provision, income of the beneficiaries and are therefore taxed under the income tax law.

Private foundations have existed since 1993. At that time, the Inheritance and Gift Tax Act was amended to exempt such donations, which otherwise would have been subject to the inheritance and gift tax. The Individual Income Tax Act was also amended to include a special income tax liability in respect of donations to beneficiaries since these donations would otherwise not have been taxed under that Act. Although these donations are taxed under the Individual Income Tax Act, it is not at all clear that the income and capital tax treaties are applicable. The fact that the tax is levied under the banner of an individual income tax is not per se sufficient. One could question whether the income tax liability in respect of these donations is identical or at least similar to the tax liability under the other taxes listed in the bilateral equivalents to Art. 2(3) of the OECD Model Tax Convention on Income and Capital.

If an income and capital tax treaty was signed in 1993 or in subsequent years, it may be assumed that the income tax liability in respect of donations is covered since the Austrian individual income tax listed in the equivalents to Art. 2(3) of the OECD Model Tax Convention on Income and on Capital at that time contained that type of tax liability. On the other hand, as regards inheritance and gift tax treaties, at least those signed before 1993, one could assume that donations from private foundations to beneficiaries are covered. Even under the more recently signed treaties, one may assume that such donations qualify for treaty protection since the only reason why the donations do not trigger the inheritance and gift tax is their explicit exemption.[36] Under the general rules of the inheritance and gift tax, however, a levy would be imposed. Thus, one could conclude that the provisions of the Individual Income Tax Act creating tax liability in respect of these donations are similar, if not identical, to parts of the inheritance and gift tax and that the donations are thus covered by the inheritance and gift tax treaties. This example shows that there are situations in which it is not at all easy to determine whether a certain tax liability is covered by income and capital tax treaties or by inheritance and gift tax treaties.

5.3. Is there a need to draw a borderline?

In light of the above example, one could ask if it is necessary to draw a borderline and decide whether the income and capital tax treaties or the inheritance and gift tax treaties are applicable. In the context of income and capital tax treaties, taxpayers are accustomed to applying more than one treaty at the same time. Since treaties reduce tax liabilities, it is possible to apply two treaties at the same time. They do not have contradictory aims.

Objections can, however, be raised to this line of reasoning. Many countries have concluded numerous income and capital tax treaties, but the situation is different for inheritance and gift tax treaties. Most countries have concluded only a few of these treaties, if any. This must be respected as a policy decision; thus, it must also be respected that a lack of inheritance and gift tax treaties cannot be "corrected" by extending the scope of income and capital tax treaties. Even if the income and capital tax treaties are also applied in borderline cases, it will still be necessary to conclude inheritance and gift tax treaties to guarantee the avoidance of double taxation in this field.

Looking at the possible consequences of applying both an income and capital tax treaty and an inheritance and gift tax treaty at the same time shows that this possibility would cause practical problems. Again, the case of donations made by an Austrian private foundation to a beneficiary resident in the other contracting state illustrates the problem.[37] Under the OECD Model Tax Convention on Income and on Capital, these donations fall under Art. 21, according to which the residence state has the exclusive taxing rights. Thus, Austria as the source state may not levy tax. Under the OECD Model on Estate Taxes, etc., however, Art. 7 applies. The residence state of the private foundation that makes donations to the beneficiaries has the exclusive taxing rights. The residence state of the beneficiaries may not levy tax. Thus, applying both OECD Models results in double non-taxation. Double non-taxation may be perfectly in line with the object and purpose of tax treaties when one contracting state does not have taxing rights and the other contracting state does not exercise its taxing rights for domestic reasons.[38] Nevertheless, it must be stressed that, in this case, double non-taxation occurs due to the application of both OECD Models at the same time. It is difficult to argue that this result is in line with the object and purpose of a tax treaty. Thus, there seems to be a need to draw a borderline between the scope of income and capital tax treaties and the scope of inheritance and gift tax treaties.[39]

6. CONCLUSION

This article contains more questions than answers. It is surprising that so far relatively little research has been done on Art. 2 of the OECD Model Tax Convention on Income and on Capital. Although Art. 2 contains a crucial requirement for the application of tax treaties, not many scholars have made it their focus. Art. 2 deserves more attention!

36. For an in-depth discussion, see Sutter, supra note 17, at 66.
37. For more details, see Lang, supra note 32.
38. For supporting arguments, see Lang, General Report on Subject I: Double non-taxation, in *Cahiers de droit fiscal international*, Vol. 89a (2004) at 21, 29 et seq. (58th Congress of the International Fiscal Association, Vienna, 2004).
39. See the considerations in Sutter, supra note 17, at 54.