



ESSAYS IN HONOUR OF  
JOHN F. AVERY JONES

# Tax Polymath

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A LIFE IN  
INTERNATIONAL  
TAXATION

EDITED BY  
PHILIP BAKER AND CATHERINE BOBBETT

IBFD

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# Does Art. 20 of the OECD Model Convention Really Fit into Tax Treaties?

Michael Lang<sup>1</sup>

## 1. Is Art. 20 OECD Model Convention an allocation rule?

Article 20 of the OECD Model Tax Convention on Income and Capital (the Model) covers

payments which a student or business apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training, provided that such payments shall not arise from sources outside that State.

These payments shall not be taxed in the state of presence. At first sight Art. 20 of the Model seems to be one of the allocation rules of the Model: if a person receiving income is a resident of one of the two or of both contracting states so that he is covered by Art. 1 of the Model and if the relevant tax is covered by Art. 2 of the Model, one can take it for granted that one of the allocation rules of the Model will apply. As far as taxes on income are concerned, Arts. 6 to 21, with the exception of Art. 9, are referred to as allocation rules;<sup>2</sup> usually, these rules are directed at the state of source and as a result of the application of these rules the state of source may either tax certain types of income or refrain from doing so partially or totally. Where the requirements of Arts. 1 and 2 are met, one and only one of these rules is applicable. Explicit priority rules determine which allocation rule prevails in the case of an overlap. The allocation rules only determine whether and in how far the state of source may levy a tax. If under these rules the state of source is not prevented from levying taxes, double taxation may still exist. It is Art. 23 of the Model which provides relief from double taxation: the state of residence has to provide relief, either by granting a credit or exempting the income.

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2. Vogel, K., *Double Taxation Convention* (London: Kluwer Law International, 1997) Introduction MN 49.

Some authors have raised doubts as to whether Art. 20 of the Model may be categorized as a regular allocation rule.<sup>3</sup> In some respects Art. 20 is special. This paper will look at whether and in how far Art. 20 can be considered as special, compared to the “other” allocation rules, in order to find out whether Art. 20 of the Model is a true allocation rule or not.

## **2. Payments**

Some authors have pointed out that Art. 20 uses the term “payments” which differs from income used in Art. 23 of the Model. The term payment could indicate that the Model distinguishes between income, which is generated by market activity in the broadest sense, and payments which, by their nature, are not income and are therefore different.<sup>4</sup> This view seems to be supported by ECJ case law: in the *D* case the ECJ assumed that “sums such as the subsistence allowance paid to Mr Wallentin by his parents and the grant which he received from the German state did not of their nature constitute taxable income under German tax legislation” and used this argument to distinguish the *D* judgment from its *Wallentin* judgment.<sup>5</sup>

In the author’s view it is not convincing to try to determine what the nature of income is. In this respect the author wishes to remain non-committal: Kelsen already mentioned that like everything King Midas touched turned to gold, everything the legislator touches turns to law.<sup>6</sup> Under similar reasoning one may conclude that income is whatever the legislator declares to be income. In some countries grants and subsistence allowances paid to students are considered to be income, in other countries these payments are

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3. See De Broe, Luc, “Students (Art. 20 OECD Model Convention)”, in Lang, M., Pistone, Schuch and Staringer (eds), *Source versus Residence. Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* (The Netherlands: Kluwer Law International, 2008), pp. 298 and 324 et seq., Herm, Marek, “Student Article in Model Conventions and in Tax Treaties”, 32 *Intertax* 2 (2004), pp. 69 and 74; Baker, Philip, *Double Taxation Conventions*, looseleaf (London: Sweet & Maxwell, 2001), Art. 20 B1.

4. See Wassermeyer, F., in Debatin and Wassermeyer, *Doppelbesteuerung* (Munich: Beck, 1997) Art. 20 MN 15; Meurer, S., in Vogel and Lehner, *Doppelbesteuerungsabkommen*, 5th edn. (Munich: Beck, 2008) Art. 20 MN 4; Bauer, Josef, “Studenten, Gastlehrer und Gastprofessoren im DBA Recht” in Gassner, Lang, Lechner, Schuch and Staringer (eds), *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen* (Vienna: Linde, 2003), p. 231; Herm, note 3 at 79.

5. ECJ 5 July 2005, C-376/03, *D*, [2005] ECR I-5821, Para. 42; 1 July 2004, C-169/03, *Wallentin*, [2004] ECR I-6443.

6. See Kelsen, Hans, *Allgemeine Staatslehre* (Berlin: Springer, 1925), p. 44.

not taxed. The Model is neutral, whatever is taxed by a tax on income is covered by the Model and one of its allocation rules.

One cannot conclude anything from the fact that Art. 20 of the Model uses the term “payment” and not “income”.<sup>7</sup> The allocation rules of the Model use different terminology: Arts. 6, 10, 11, 12, 17 and 21 refer to income, Arts. 7 and 8 refer to profits, Art. 13 to gains and Arts. 15, 18 and 19 to remuneration. The fact that both Art. 21 (other income) and Art. 23 which refers to all allocation rules in order to provide relief from double taxation refer to income as well, indicates that the term “income” also covers not only income according to Arts. 6, 10, 11, 12 and 17, but also profits, gains and remuneration. Therefore, there is no reason why payments should not constitute income according to Arts. 21 and 23. Furthermore, the term “payments” is not only used in Art. 20 but in Art. 16 as well and since Art. 16 is without any doubt considered to be an allocation rule, one cannot conclude from the use of the word payment that Art. 20 is special.

### 3. Absence of an explicit priority rule

It has already been mentioned that many allocation rules contain explicit rules of priority. They determine which rule prevails over the other in case of a conflict, since the application of the allocation rules assumes that every item of income may only be covered by one allocation rule:<sup>8</sup> otherwise not every type of income would be allocated to one of the contracting states. Thus, Art. 6(4) gives priority to Art. 6 over Art. 7; Art. 7(7) makes clear that other allocation rules prevail over Art. 7; according to Art. 15(1) the Arts. 16, 18 and 19 prevail over Art. 15; Art. 17(1) gives priority to Art. 17 over Arts. 7 and 15; and Art. 18 gives priority to Art. 19(2). So it is surprising that Art. 20 is not explicitly mentioned in any other allocation rule and neither does Art. 20 refer to any other rule.

However, the absence of such priority rules alone is not a convincing argument why Art. 20 cannot be considered to be an allocation rule. There could be other explanations for this: the conditions for the application of Art. 20 may make it impossible that any of the other allocation rules is applicable.

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7. On the contrary see Wassermeyer, in Debatin and Wassermeyer, note 4 at Art. 20 MN 15; Meurer, in Vogel and Lehner, note 4 at Art. 20 MN 4; Bauer, in Gassner, Lang, Lechner, Schuch and Staringer (eds), note 3 at 231; Herm, note 3 at 79.

8. See Lang, Michael, *Introduction to the Law of Double Taxation Conventions* (Vienna: Linde, 2010), p. 68.

The 2005 Commentary takes this view:<sup>9</sup>

The Article covers only payments received for the purpose of the recipient's maintenance, education or training. It does not, therefore, apply to a payment, or any part thereof, that is remuneration for services rendered by the recipient and which is covered by Art. 15 (or by Art. 7 in the case of independent services).

However, it is hard to assume that an overlap between Arts. 15 and 20 could never occur.<sup>10</sup> Take the example of a person who lives in state A and who is employed by state B and who is obliged to spend the first year of his employment in state C to participate in an LLM programme by his employment contract and whose salary is paid for his maintenance during this period: it seems quite obvious that both Arts. 15 and 20 of the tax treaty concluded between states A and C might equally apply.<sup>11</sup>

However, the lack of an explicit priority rule does not provide evidence that no overlap could occur. Where there is no priority rule the overlap has to be solved by interpretation.<sup>12</sup> The Model provides examples for such situations: if shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other contracting states are sold and if these shares belong to movable property which is part of the business property of a permanent establishment which an enterprise of a contracting state has in the other contracting state, both Arts. 13(2) and 13(4) could be applied. There is no explicit rule that determines which of the two provisions prevails. However, that does not mean that both rules can be applied. The conflict has to be solved by interpretation. Therefore it follows that potential overlaps between Art. 20 of the Model on the one hand and Art. 15 or other rules on the other hand have to be solved by interpretation of the treaty.

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9. See the 2005 Commentary on Art. 20, Para. 2.1. In the same way see Russo, R., "The 2005 OECD Model Convention and Commentary: An Overview", 45 *European Taxation* 12 (2005), p. 564 and Pötgens, F., "The 'Closed System' of the Provisions on Income from Employment in the OECD Model", 41 *European Taxation* 7 (2001), p. 255.

10. Concurring, see the 2005 Commentary on Art. 20, Para. 2.1; Wassermeyer, in Debatin/Wassermeyer, note 4 at Art. 20 MN 15; Bauer, in Gassner, Lang, Lechner, Schuch and Staringer (eds), note 3 at 231.

11. See Lang, M., "Möglichkeiten zur Vereinfachung der Doppelbesteuerungsabkommen", in Urnik, Fritz-Schmied and Kanduth-Kristen (eds) *Steuerwissenschaften und betriebliches Rechnungswesen* (Vienna: Linde, 2009), p. 139.

12. See Simontacchi, S., "Capital Gains (Art. 13 OECD Model Convention)", in Lang, Pistone, Schuch and Staringer (eds), *Source versus Residence. Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* (Netherlands: Kluwer Law International, 2008), pp. 135 et seq.

## 4. Interaction with Art. 1 of the OECD Model

Article 20 differs from other allocation rules in another aspect as well: it does not explicitly require that the student or business apprentice is a resident of either or both of the contracting states. According to the wording of this provision, it is possible that a student, formerly residing in state A, who decides to study in state B (where he is present and attends courses) moves his residence to state C. He could benefit from the tax treaty between A and B, although he is no longer a resident of state A and has never been a resident of state B.<sup>13</sup>

One may argue, however, that Art. 1 of the Model already requires, as a criterion for the application of the treaty, general residence in at least one of the two contracting states.<sup>14</sup> According to Art. 1 “[t]his convention shall apply to persons who are residents of one or both of the Contracting States”. Art. 20 of the Model may have to be read in connection with Art. 1. If this is the case, only students or business apprentices who are residents of one or both contracting states could be entitled to the benefits granted by Art. 20.

This view seems to be confirmed by Art. 24(6) of the Model and even more so by Arts. 26(1) and 27(1). According to Art. 24(6): “[t]he provisions of this Article shall, notwithstanding the provisions of Art. 2, apply to taxes of every kind and description”. In Arts. 26(1) and 27(1) it is explicitly stated that “[t]he exchange of information is not restricted by Arts. 1 and 2” and that “[t]his assistance is not restricted by Arts. 1 and 2”. One can draw the conclusion that it requires an explicit exception from Art. 1 for a specific tax treaty rule to be applicable to a person who is not a resident of one of the contracting states. In the absence of such an exception Art. 1 restricts the scope of the whole treaty.

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13. According to Hattingh and based on his survey on UK courts, nationals of third states (i.e. students or apprentices that moved their residence to a state other of that of presence) have more difficulties to obtain effectively the benefits derived from Art. 20 of the Model, as national (common law) courts are normally reluctant to grant benefits to non-residents – see Hattingh P.J., “Art. 1 of the OECD Model: Historical Background and the Issues Surrounding It”, *57 Bulletin for International Fiscal Documentation* 5 (2003), p. 215 at 218-219.

14. This position is taken by Hauser, Christina, “Students, Researchers and Lecturers in Trilateral Situations”, in Sutter and Zehetner (eds), *Triangular Tax Cases* (Vienna: Linde, 2004), pp. 399 and 410; Wassermeyer, in Debatin and Wassermeyer, note 4 at Art. 20 MN 7 and 39; Zehetner, Ulf, “Gastprofessoren, Gastlehrer, Studenten und Auszubildende nach dem neuen DBA Österreich-Deutschland”, in Gassner, Lang and Lechner (eds), *Das neue Doppelbesteuerungsabkommen Österreich – Deutschland* (Vienna: Linde, 1999), p. 205.

In the context of the allocation rules, however, the drafting techniques are different as almost all allocation rules contain explicit references to the residence state. According to their wording, they are only applicable if the person receiving the income is a resident of a contracting state. In this context, Art. 20 of the Model is an exception. The fact that Art. 20 differs from almost all allocation rules in not explicitly referring to the state of residence may indicate that the scope of Art. 20 is broader than the scope of the other allocation rules and is not restricted to residents of one of the two contracting states.

In this respect, however, Art. 20 is not the only exception. Art. 19(1)(a) and 19(2)(a) refer to the contracting states but only in respect of the institution paying the remuneration. These provisions do not explicitly require that the individual who renders or rendered the services to that institution be a resident of the state as well. According to prevailing opinion the absence of this requirement does not broaden the scope of this provision.<sup>15</sup> The similar drafting technique that is used in Arts. 19 and 20 weakens the argument that the scope of Art. 20 is not restricted to residents of a contracting state.

### 5. Legal consequences in the state of residence

Allocation rules are directed at the state of source. After having applied the relevant allocation rule, one knows whether and in how far the state of source maintains its taxing rights. As a rule, the state of residence does not lose any taxation rights under these provisions.<sup>16</sup> Where the applicable allocation rule leaves full or limited taxation rights with the state of source, one has to apply Art. 23 to find out whether relief from double taxation is provided by exempting the income or granting a credit. In any case, according to Art. 23, it is for the state of residence to take action.<sup>17</sup> So allocation rules and Art. 23 of the Model are usually applied by different states.

In this respect Art. 20 is different. Art. 20 is one of the few tax treaty rules which explicitly refer to sources of income: Art. 20 is only applicable

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15. See De Broe, in Lang, Pistone, Schuch and Staringer (eds), note 3 at 307 et seq.; Herm, note 3 at 80 et seq; concurring see Hauser, in Sutter and Zehetner (eds), note 14 at 410.

16. See Lang, note 8 at 67 et seq.

17. *Id.*

“provided that such payments shall not arise from sources outside that State”. “That State” is the state where the student or business apprentice is present which could either be the current state of residence or another contracting state. Therefore, Art. 20 is never directed at the state where, in the legal sense of the word, the *sources* of the payments are located.<sup>18</sup> The state from which the payments are sourced has either to be the former or the current state of residence of the student or business apprentice or a third country. Therefore the state where the taxpayer is present may coincide with the state of residence. If this is the case, the state of residence is obliged to exempt the payments. In such a situation, Art. 20 is directed at the state of residence.<sup>19</sup> In the context of the allocation rules such a legal consequence is the rare exception. Most of the allocation rules cover taxation in the “other Contracting State”.

However, Art. 20 is not the only allocation rule which prevents the state of residence from levying taxes. Art. 19(1)(a) leads to a similar result: “Salaries, wages and other similar remuneration, paid by a Contracting State ... to an individual in respect of services rendered to that State ... shall be taxable only in that State.” Similarly Art. 19(2)(a) provides: “any pensions or other similar remuneration paid by, or out of funds created by, a Contracting State ... to an individual in respect of services rendered to that State ... shall be taxable only in that State.”

The result of the application of these rules is that the state of residence, if it is the other contracting state, is prevented from levying taxes.<sup>20</sup>

Art. 19(1)(a) and 19(2)(a) differ, however, from Art. 20 insofar as the taxing right is explicitly allocated to one state, whereas according to Art. 20 one state is explicitly prevented from taxing. Therefore one may only assume that according to Art. 20 the other state is permitted to levy taxes even though the taxing right is not explicitly allocated to this state.

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18. See Vogel, note 2 at Art. 20 MN 7 et seq, Avery Jones, J. “Conflicts of Qualification: Comment on Prof. Vogel’s and Alexander Rust’s Articles”, 57 *Bulletin for International Fiscal Documentation* 5 (2003), p. 184 who states that “Art. 20 uniquely says and implies nothing about taxation in the source state”.

19. See Hauser, in Sutter and Zehetner (eds), note 15 at 399.

20. See Rust, A., “The New Approach to Qualification Conflicts has its Limits”, 57 *Bulletin for International Fiscal Documentation* 2 (2003), p. 47. In the same direction, but limiting his analysis to rules that unequivocally attribute taxing right to the source state see Vogel, K., “‘State of Residence’ may as well be ‘State of Source’ – There is no contradiction”, 59 *Bulletin for International Fiscal Documentation* 10 (2005), p. 420 at 422.

## 6. Double non-taxation as a result of the application of Art. 20 of the OECD Model

According to Art. 20 of the Model it is not necessarily the case that the taxing right is implicitly allocated to the other contracting state. There are situations in which it is extremely difficult, if not impossible, for the other contracting state to levy taxes. Let us assume that a student, who used to reside in state A, moves to state B where he starts studying and becomes a resident and receives payments from sources in state C: according to Art. 21 of the treaty between B and C, state C is prevented from levying any taxes neither may State B according to Art. 20 of the treaty between A and B. The only state which is not prevented from levying taxes is state A: the treaty between A and C is not applicable since the student is a resident of neither state. The treaty between A and B is applicable, Art. 20 of this treaty prevents only state B from taxing. State A may still levy taxes, however, the student does not have any link to this state, neither is the activity performed there nor is he a resident of this state nor does the payment arise from sources located in this state. One may even go as far as to question whether the former residence state A would have a sufficient “genuine link” according to international customary law in order to be entitled to impose taxes on the student. In any case, it is unrealistic that payments to the student would be covered under state A’s domestic tax law. Even if this were the case, it would be extremely difficult to enforce such a tax liability. So although Art. 20 does not make double non-taxation obligatory, this provision enables and encourages double non-taxation.<sup>21</sup>

It is true that the combined application of the other allocation rules and Art. 23 of the Model does not necessarily prevent double non-taxation either: taxing rights are allocated to the contracting states and the states are free to exercise (or not) the taxing rights which are allocated to them. It does by no means constitute an infringement of a tax treaty provision if a state does not levy any taxes.<sup>22</sup> If the state of residence is obliged to exempt items of income and the other contracting state, for whatever policy reason, does not impose any tax on a certain item of income, double non-taxation is, in the absence of subject-to-tax clauses, unavoidable.

However, all other allocation rules provide a realistic opportunity to the source state to exercise the taxation rights which are allocated to them.

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21. See De Broe, note 3 at 299 et seq.; Herm, note 3 at 81 et seq.

22. Lang, Michael, *Double Non Taxation*, General Report, in IFA, *Cahiers de Droit Fiscal International*, Vol. 89a (Deventer: Kluwer Law International, 2004), pp. 83 et seq.

If a permanent establishment, the residence of a person, the exercise of his employment or other activities are located in a contracting state, or if the government to which the service had been rendered is located there, the link to these states is without any doubt sufficient to impose taxes on income from these sources. A closer look at domestic systems confirms that most countries actually levy taxes whenever the income has a source in the country. Enforcement of these taxing rights is not a problem for these countries either. Therefore double non-taxation will only occur if the other contracting state deliberately refrains from imposing taxes.

So Art. 20 does not fit neatly into the system of allocation rules: its objective and purpose is different. Whereas the combined application of the other allocation rules and Art. 23 primarily aims at providing relief from double taxation with the intention of making single taxation possible, does Art. 20 go beyond these aims? The only purpose of Art. 20 is to make taxation in the state where the taxpayer is present impossible. This rule is not concerned about possible double non-taxation, which could be the effect of its application. On the contrary the application of Art. 20 makes double non-taxation possible and realistic. Ensuring single taxation is, in certain circumstances, even impossible.

## **7. Interaction with Art. 21 of the OECD Model**

If Art. 20 is different from the other or “real” allocation rules, one might consider whether payments covered by Art. 20 might be covered by Art. 21(1) as well. It is often mentioned that Art. 21 should only cover the income which is not covered by any other allocation rule. What would be the consequence if Art. 20 was not considered as an allocation rule so that Art. 21(1) was applicable in addition to Art. 20? If the state of residence differs from the state of presence, the state of residence would have the exclusive taxation right under Art. 21. Art. 20 prevents the state of presence from levying taxes and does not therefore conflict with Art. 21. In such a situation the state of residence will also be able to enforce its taxation right. Applying Art. 21 is neither problematic nor necessary. If one takes the view that Art. 21 is not applicable, the state of residence would still have the right to tax since Art. 20 does not prevent the state of residence from levying taxes.

If the state of residence coincides with the state of presence, the situation is more complex: Arts. 20 and 21(1) seem to contradict each other. Art. 20 prevents the state of presence from levying taxes whereas Art. 21(1) allocates the taxation right exclusively to the state of residence. Which rule

prevails? If, however, one takes a closer look at these rules, it becomes clear that these rules do not contradict each other because Art. 21(1) does not oblige the state of residence to impose taxes on the payments, it only entitles the state of residence to levy taxes. If this state refrains from exercising this right under Art. 20, this is not necessarily a contradiction. Furthermore, Art. 20 covers only students and business apprentices and only on specific conditions. Therefore it would be obvious that Art. 20 prevails where one sees a contradiction. Having taken these deliberations into account, the question whether Art. 21 is in principle also applicable on payments which are covered by Art. 20 becomes irrelevant: Art. 20 would in any case prevail if the state of residence is also the state of presence. This result does not differ from the situation where Art. 21(1) does not cover Art. 20 income at all.

Although the question is not relevant in practice, it might still be interesting to examine whether Arts. 20 and 21(1) of the Model can overlap. Art. 20 immediately precedes Art. 21(1) of the Model, which is the catch-all clause of the tax treaty: “[i]tems of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State”. Art. 20 may be considered as covering “items of income of a resident of a Contracting State ... not dealt with in the foregoing Articles of this Convention”. In my view it is difficult to argue that payments covered by Art. 20 can be considered as income which is “not dealt with in the foregoing Articles”, since Art. 20 is one of the foregoing Articles.

However, one might take into account that not all foregoing Articles are allocation rules. It is widely accepted that Art. 9 cannot be considered as an allocation rule.<sup>23</sup> This rule only puts limits on domestic tax rules which are adjusting relations between associated enterprises. Therefore one might take the view that Art. 20 is comparable to Art. 9, as it is not an allocation rule either. If the application of Art. 9 does not exclude the application of Art. 21(1), one is tempted to conclude that the application of Art. 20 does not exclude the application of Art. 21(1) either and that Arts. 20 and 21(1) might both be applied.<sup>24</sup>

Nevertheless, according to the wording of Art. 21(1) it is only relevant whether the income is “not dealt with in the foregoing Articles”. Art. 9 is a specific rule for business profits. Whenever Art. 9 is applicable, Arts. 7

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23. Vogel, note 2 at Art. 9 MN 10 et seq.

24. See Lang, Michael, in Umik, Fritz-Schmied and Kanduth-Kristen (eds), note 11 at 139.

or 8 are therefore applicable as well. Consequently income dealt with in Art. 9 is already excluded from the application of Art. 21(1) because it is dealt with in Arts. 7 or 8 anyway. For that reason the existence of Art. 9 is, seen from the perspective of Art. 21(1), not crucial. Income dealt with in Art. 9 is not covered under Art. 21(1). This is, however, different in the case of Art. 20. Payments which fall under Art. 20, maybe with a small exception in respect of Art. 15, are not covered by any other rule. The fact that this income is dealt with in Art. 20 is crucial for the application of Art. 21(1): income dealt with in Art. 20, seen from the perspective of Art. 21(1), is “dealt with in the foregoing Articles” and therefore not covered by Art. 21(1).

## 8. Conclusions

It has been demonstrated that Art. 20 has some peculiarities when compared with the other allocation rules of the tax treaties. Art. 20 does not completely fit into the system of application rules. Its objective and purpose according to which double non-taxation is not only accepted but even encouraged, distinguishes this rule from other rules. There are good reasons why Art. 20 does not qualify as an allocation rule. The rule exempts certain payments to students and business apprentices in the state of their presence without enabling the other contracting state to exercise its taxation right. Policywise it is not at all objectionable to subsidize students and business apprentices. However, it is questionable whether tax treaties are the right instrument for such measures. Policy decisions which are implemented in a treaty through international public law are more difficult to change. Furthermore, the effect of integrating such a subsidy into a tax treaty could also mean that it may be more difficult for its content to be tested in the ECJ. It is not at all convincing that such rules should not be challenged in the same way by EU law as is the case with other exemptions.

