Volume 3 – Issue 2 – June 2011

World Tax Journal

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World Tax Journal

ISSN 1878-4917 / © 2011 IBFD

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*Art. 24(5) of the OECD Model in Relation to Intra-Group Transfers of Assets and Profits and Losses**

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This article examines Art. 24(5) of the OECD Model (discrimination on the ground of foreign ownership) in so far as it affects domestic law provisions dealing with grouping of profits and losses and transfers of assets within a group. The OECD Commentary argues that it can never apply to such grouping provisions where there is non-resident ownership. The authors argue that this is too widely stated and there are good arguments why in particular it does not require the transfer of profits or assets outside the taxing jurisdiction because the ground for denying the relief is not ownership. However, there are also good arguments why it does apply to some grouping provisions, depending on their details and structure, of which there is a wide variety in the countries represented by the authors. The article concludes that the OECD Commentary needs a more sophisticated analysis of this topic.

1. Introduction and Summary of Conclusions

This article considers the effect of the non-discrimination provision based on ownership in Art. 24(5) of the OECD Model ("the ownership provision") in the light of the changes to the Commentary made by the 2008 Update to the Model. The focus is on domestic provisions relating to groups of companies, such as those relating to the intra-group transfers of assets, or profits and losses ("domestic grouping provisions").

The ownership provision reads:

> 5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not

* It is not the editorial policy of this journal to publish articles that are scheduled to appear in other reviews. However, in agreement with the editorial board of the *British Tax Review* (BTR), we have decided to make an exception for this article by a group of distinguished authors. The articles written by this group have been published by both the BTR and IBFD over many years. Because of this history and the high quality of this article, both editorial boards were of the opinion that this article deserved maximum exposure. Therefore, the same article is planned to appear in BTR 5 (2011). The article should be cited with reference to both journals.

** The authors wish to thank Stéphane Austry (France), who joined the group when the article was at a late stage, for his comments on the final drafts. David A. Ward died 13 January 2010, having made an important contribution to earlier drafts of this article. The authors can be contacted at: j.averyjones@btinternet.com (J.F. Avery Jones); pb@taxbar.com (P. Baker); PBlessing@Shearman.com (P. Blessing); luc.debroe@law.kuleuven.be (L. De Broe); mj.ellis@telfort.nl (M.J. Ellis); legallj@sullcrom.com (J.-P. Le Gall); scastro@rhtax.com (S.H. Goldberg); kinoue@JonesDay.com (K. Inoue); juergen.luedicke@de.pwc.com (J. Lüdicke); G.Maisto@maisto.it (G. Maisto); miyatake@ahmf.jp (T. Miyatake); Angelo.Nikolakakis@ca.ey.com (A. Nikolakakis); vanraad@planet.nl (K. van Raad); Henri.Torrione@unifr.ch (H. Torrione); richard.vann@sydney.edu.au (R.J. Vann); and Bertil.Wiman@jur.uu.se (B. Wiman).

> be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.[1]

Although the ownership provision is limited to the taxation of the domestic enterprise, the issue is the extent to which this includes taxation affected by its relationship with other domestic or foreign group enterprises.

It may be helpful to summarize our conclusions at the start. In any case where the ownership provision is in issue, the facts will include that the capital of a domestic enterprise (an "enterprise of a Contracting State") is "wholly or partly owned or controlled, directly or indirectly" ("owned" and related expressions for short) by a resident of the treaty partner state, which effectively means a non-resident of the state we are considering, so that for simplicity we can say that the facts must include (a) an owner of the capital of a domestic enterprise who is (b) non-resident. In addition, domestic law of the state in question will provide that on those facts a certain relief or other treatment (for example, under domestic grouping provisions) is not available which would have been available had the owner been a resident. The ownership provision requires not only that both factors (ownership and non-residence) are present, but also that the denial of the relief under the domestic grouping provision must be *by reason of* ownership by a non-resident, reflecting a *causal relationship*, just as residence in Art. 4(1) must be by reason of the listed factors. It is difficult to find a satisfactory expression for this: the OECD Commentary says that the difference in tax treatment must be *solely*[2] based on non-resident ownership, but this may preclude the ownership provision from applying where there is a combination of reasons for denying the relief;[3] we shall express it as that ownership by a non-resident must be the ground for denying the relief. If the ground for the difference in treatment is non-residence but not ownership, although ownership happens to be present (and vice versa), that is not sufficient, at least where only the application of the ownership provision is in question; and it is not enough that both non-residence and ownership are present without their combination being the cause of the difference in treatment. We consider that the OECD and certain states, who are understandably concerned about the ownership provision requiring reliefs to be given that result in the loss of taxing rights, are using unconvincing arguments to justify why it is not applicable in certain circumstances when there are good arguments based on the ground for denying the relief when profits or gains would move outside the jurisdiction – or other elements of the integrity of the tax base would be compromised.

The main difficulty we are addressing in applying the ownership provision to domestic grouping provisions is not about cases involving profits or gains moving outside the jurisdiction, but the application of grouping provisions where there is non-resident ownership and there are no profits or gains moving outside the jurisdiction. There is a wide variety of

1. The French text of Art. 24(5) of the OECD Model is: "5. Les entreprises d'un État contractant, dont le capital est en totalité ou en partie, directement ou indirectement, détenu ou contrôlé par un ou plusieurs résidents de l'autre État contractant, ne sont soumises dans le premier État à aucune imposition ou obligation y relative, qui est autre ou plus lourde que celles auxquelles sont ou pourront être assujetties les autres entreprises similaires du premier État." The wording of the English and French texts of the equivalent paragraph in the UN Model is identical.
2. OECD Commentary on Art. 24, Para. 3. Previously this was said in relation to the nationality provision only: OECD Commentary on Art. 24, Para. 8.
3. See 4.3.3. for the interaction with other non-discrimination provisions (particularly the nationality provision); 4.3.4. for the simultaneous application of the ownership provisions in two treaties; and 4.3.6. for combination of ownership and another condition.

grouping regimes in the countries represented by the authors, ranging from Australia (which effectively treats the group as a single company for all tax purposes) at one end, to Sweden and the United Kingdom (which allow the grouping of profits and losses between companies on a bilateral basis, unaffected by the taxability of other group companies) at the other. There are conceptual difficulties in applying the ownership provision in Australia in relation to subsidiaries of tax-consolidated groups, because the subsidiaries of a domestic parent are simply not subjected to taxation. There is considerably less difficulty in applying the ownership provision in relation to subsidiaries in countries such as Sweden and the United Kingdom, since the subsidiaries are subjected to individual taxation and the parent company need not be involved in the grouping. The type of grouping provision is also relevant, those dealing with transfers of assets generally being similar to the bilateral grouping of profits and losses. We conclude that it is not possible to generalize about the application of the ownership provision to domestic grouping provisions because of these wide variations. However, rather than argue, as the OECD has done, but the courts in a number of countries have not accepted, that the ownership provision does not apply to domestic grouping provisions at all, we argue that it can apply in principle but what is required is to examine carefully the features of a particular tax system in order to determine the true grounds of any differences in treatment to which an entity such as a subsidiary may be subjected. Essentially, the problem comes down to how far a state should be expected to go in accommodating non-resident ownership in relation to its grouping provisions (including by making changes) in order to respect the ownership provision. If the OECD could give guidance in this area, states would have a better idea about where they stood with respect to the operation of the ownership provision in relation to their particular grouping regime and would be able more readily to structure regimes that respect the ownership provision.

This article is intended to be a contribution to the wider debate on the non-discrimination article that the OECD is currently undertaking. Accordingly, we commence with a consideration of the history and policy of the ownership provision, which necessarily involves a broader review of the history and policy of the non-discrimination article more generally.

2. History[4]

The ownership provision was first proposed in 1957 to OEEC Working Party 4 on non-discrimination, whose members were from the Netherlands and France,[5] by the Swiss delegation to the OEEC. Such a provision had been contained in the Swiss treaty with the United Kingdom (1954) and it had been in general use by the United Kingdom from the early 1950s in its treaties with countries outside its Dominions and Colonies.[6] These UK treaties seem

4. Some of the material in this section has already been contained in an article by Avery Jones, J.F., "Understanding the OECD Model Tax Convention: The Lesson of History" (2009) 10 *Florida Tax Review* 1.
5. FC/WP4(57)2, 10 May 1957, available at <http://www.taxtreatieshistory.org>.
6. See the UK treaties with: Denmark (1950), France (1950) (one of the countries represented on Working Party (WP) 4, Norway (1951), Finland (1951), Greece (1953), Belgium (1953) (ending "... other enterprises of the first-mentioned territory similarly carried on are or may be subjected" and which stated that the provision was not to affect a specific treaty provision that profits distributed by a Belgian company to its UK 90% holding company were to be taxed at the lower rate normally applicable to undistributed profits), Switzerland (1954), Germany (1954), and Austria (1956) (also ending "... other enterprises of the first-mentioned territory similarly carried on are or may be subjected"). It was not included in the UK treaties with the United States (1946) (which contained the nationality provision only, although there was also an exemption from US tax on undistributed income under the personal holding company provisions if more than 50% of the voting power of a UK company was owned by UK residents, a provision also found in the 1942 United States–Canada treaty),

to be the source of the wording of the ownership provision.[7] The Swiss delegation's original draft of the ownership provision, which is the same as the language in the United Kingdom–Switzerland treaty (1954) with some minor drafting changes, was:

> The income, profits and capital of an enterprise of one of the States, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more persons domiciled in the other State, shall not be subjected in the first-mentioned State to any taxation which is other, higher or more burdensome than the taxation to which other similar[8] enterprises of that first-mentioned State in the like circumstances are or may be subjected in respect of the like income, profits and capital.[9]

The Swiss proposal was accepted by the Working Party on the basis that it was unlikely to apply, but that it would be important to prevent such discrimination from occurring in future. Their minutes record:

> It would appear that the discrimination arises only very rarely in the member countries of the OEEC. The working party therefore considers that the member countries will find it easy to accept the proposed provision. Nevertheless the provision will be of the fullest importance in relations with countries which see no objection to applying such discrimination. Accordingly, the Working Party considers that it should insert this provision in its draft article subject to slight modifications.[1]
>
> [1] [Footnote to the original] Indeed it is not easy to see how the Swiss delegation's proposal can have any real significance. The proposal mainly concerns companies under foreign control, as is made clear in the Delegation's commentary. However, although it is true that the company's nationality is sometimes determined by reference to the country of origin of the capital invested in it and of the individuals controlling it, the effect of the Article proposed by the Working Party is that in determining a company's nationality one must look to the law governing companies. Hence, one of two things: assuming that a company established in State A is controlled by persons domiciled in another State B, then either it will derive its status as a company from the law of the

the Netherlands (1948) (the other country represented on WP 4, although it was used in the 1951 Netherlands–Switzerland treaty, which is earlier than the 1954 United Kingdom–Switzerland treaty), or Sweden (1949) (the last two both contained nationality and permanent establishment (PE) non-discrimination provisions only). An ownership provision was introduced during negotiations in the UK treaty with France, with notes showing that this was because the original draft was not the United Kingdom's latest one (National Archives, Public Record Office (TNA) file IR40/17171), but there is no recorded discussion about it, nor is there any discussion recorded in the Public Record Office files of any of the other treaties. An earlier but more targeted provision is found in the 1948 Denmark–United States treaty: "It is agreed that section 25, paragraph 5, of the Danish law No. 391 of July 12, 1946, prescribing an addition of 50% of the capital increment tax on corporations in cases where more than 50% of the entire stock capital is owned by a single shareholder residing outside Denmark, shall not be applicable when the shareholder in question is a resident of the United States or a United States corporation or other entity." Non-discrimination articles were not included at that time in UK treaties with the Dominions or Colonies, presumably because their individuals were British subjects, whether they were citizens of the United Kingdom and Colonies or citizens of an independent dominion; Canada enacted the Canadian Citizenship Act in 1946, creating, for the first time, a true Canadian citizenship (earlier statutes of 1910, 1914 and 1921 provided only a limited definition), and Australia did not have a full concept of Australian citizenship until 1969, although the concept had developed within migration law before then, and Australian citizens ceased to be British subjects in 1984. The first non-discrimination clause concerning companies appeared in Para. 14 of the protocol to the 1936 France–Sweden tax treaty. However, it seems to be limited to situations similar to OECD Model Art. 24(3) and not OECD Model Art 24(5).

7. There were earlier treaty provisions dealing with a French provision taxing a foreign parent company having a French subsidiary, but these dealt with a different situation – the taxation of the parent company.
8. The 1954 United Kingdom–Switzerland treaty had "like" enterprises.
9. In French: "Les revenus, bénéfices et capitaux d'une entreprise de l'un des deux Etats, dont le capital est en totalité ou en partie, directement ou indirectement détenu ou contrôlé par une ou plus leurs personnes domiciliées dans l'autre Etat, ne doivent être soumis dans le premier Etat à aucune imposition autre, plus élevée ou plus lourde que celle à laquelle sont ou pourront être soumises, pour de semblables revenus, bénéfices et capitaux, d'autres entreprises analogues de ce premier Etat se trouvant dans une situation semblable."

latter State[10] and possess in consequence that latter State's nationality, in which case, it should not, by virtue of the equivalent treatment clause, be subjected to treatment different from that which will be applied to a company possessing the nationality of State A; or it will possess the nationality of State A, in which case it is inconceivable that it could be subjected to discriminatory treatment as compared with other companies of State A on the ground that it is controlled by persons domiciled in State B, when, even if it derives its status from the law of State B, it ought in virtue of the equivalent treatment clause to receive the treatment ordinarily applied in State A.

The nationality of companies was defined for the purpose of the nationality non-discrimination provision (referred to in the quotation as the "equivalent treatment clause") now in Art. 24(1) ("the nationality provision") to mean: "all legal persons, partnerships and associations deriving their status as such from the law in force in one of the Contracting Parties."[11] The argument in the footnote to the Working Party's Minutes quoted above was that for a company incorporated (established) in State A and owned by residents of State B there were two possibilities. First, if the company were governed by the law of State B on account of being controlled by residents of that state (the state of origin of the capital),[12] it will already

10. In French "... sera constituée conformément à la législation de ce dernier Etat". In "The Non-Discrimination Article in Tax Treaties" [1991] BTR 359, 421; 31 *European Taxation* (1991) 309, we argued that there was a difference in meaning between the English and French wording, but we now consider that the references to "established" and "constituée" mean the same thing – the law from which the company derives its status. Both the English (deriving its status from the law of) and the French are aimed at the governing law and it now seems to us that the French is not referring to "constituée" in distinction to governing law in a case where a company is incorporated elsewhere but recognized and governed by the law of a central administration principle state or of a state to which it is continued. It is implied that it is a matter for State A's law to determine the governing law of a company established in that state (and without renvoi if it refers status to the law of State B).
11. FC/WP4(57)3. The earlier draft by WP4 was "all legal persons, partnerships and associations deriving their status as such from the law in force in any Member country of the OEEC". The reason for referring to OEEC member countries was that the tax non-discrimination article was originally intended by the Working Party to be in a multilateral treaty – see FC/WP4(57)2 and FC/WP4(57)3. The Commentary explained: "By declaring that all legal persons, partnerships and associations deriving their status as such from the law in force in a contracting State are considered to be nationals for the purposes of paragraph 1 of the Article, the provision disposes of a difficulty which often arises in determining the nationality of companies. In defining the nationality of companies, certain States have regard less to the law which governs the company than to the origin of the capital with which the company was formed or the nationality of the individuals or legal persons controlling it. No ambiguity need be apprehended, therefore" FC (58)2 (1st Revision) Part II. Similar wording, but not including the last sentence, is still found in the OECD Commentary on Art. 3, Para. 9. Switzerland had two concerns about the drafting: first, that the objective should be a model for bilateral treaties, rather than a multilateral treaty; secondly, that the form of drafting could effectively create a most-favoured-nation obligation if inserted in a bilateral treaty in the sense that a country would have to extend to all OEEC nationals the best treatment it gave to nationals of any OEEC country. WP 4 did not initially comprehend the second concern, but the drafting was finally adjusted to deal with it – see FC/WP4(57)2 p. 9, FC/WP4(57)3 p. 14; WP 4, however, as the latter report shows, continued to prepare its drafts on the basis of a multilateral treaty. This issue was resolved in the Fiscal Committee after WP 4 had completed its work in favour of a bilateral model and the drafting was adjusted accordingly.
12. This is a corporate law principle which limits the application of foreign corporate law – or, the civilians would say, a principle to prevent a *fraude à la loi* – somewhat comparable to CFC rules for tax. They ask why legal relations between members of a company, or between them and the company, or involving third parties, should be determined by a State B court based on the corporate law of State A if the members of the company (and particularly if also the assets) are in State B. In the most fundamental sense, their premise is that incorporation is a legal fiction that provides the members with certain privileges, including in certain cases protection from liability, so they would ask why those members should be able to choose privileges under a foreign law (meaning foreign not just as one that is other than that of State B but one that has little if any connection with the members (and, possibly, the assets)) that are superior to the privileges that State B law has decided to accord. The related question is how strong the principle of "comity" is, which is what is used to justify giving effect to foreign corporate law in the first place. Examples like this understandably test the limits of "comity". Common law countries look only to the country of incorporation for the governing law, perhaps because traditionally they have not had significant minimum capital requirements and so there was no incentive to incorporate a company elsewhere to avoid such requirements. Compare also one of the Australian tests for corporate residence described in note 30.

be protected from discrimination by the nationality (i.e. governing law) non-discrimination provision, which was already in similar terms to the present Art. 24(1)[13]; or, secondly, if it were governed by the law of State A (being incorporated or having its central administration in that state), it is highly unlikely that State A would discriminate against it by treating two companies governed by its law differently on account of the residence[14] of its shareholders, particularly when, under the nationality provision, it must not treat a company governed by its law better than one governed by State B's law. In other words, it was the corollary of the nationality provision applicable in case the law of the state of establishment applied, even though discrimination was unlikely in such a case. The language and scope of the ownership provision are therefore extremely similar to those of the nationality provision, covering taxation and connected requirements that are other or more burdensome than those suffered by the object of comparison.

The nationality provision originally read:

> The nationals of a Member country of the O.E.E.C. [subsequently changed to "of one of the Contracting Parties"] shall not be subjected in the territory of any other Member country [subsequently, Contracting Party] to any taxation or any requirement connected therewith [with respect to taxes on income, on capital, on estates and inheritances and on gifts: subsequently deleted],[15] which is other, higher or more burdensome than the taxation and connected requirements to which the nationals of the latter country [subsequently, of that other Contracting Party] are or may be subjected.[16]

The Working Party's first draft of the ownership provision was:

> The income, profits and capital of an enterprise established in a Member country of the O.E.E.C., the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more persons domiciled in some other Member country, shall not be subjected in the first-mentioned country to any taxation which is other, higher or more burdensome than the taxation to which other similar enterprises in the like circumstances establishment [sic] in that first-mentioned country are or may be subjected in respect of the like income, profits and capital.[17]

13. Nationality provisions had also existed in the Mexico and London Models in these terms: "A taxpayer having his fiscal domicile in one of the contracting States shall not be subject in the other contracting State, in respect of income he derives from that State, to higher or other taxes than the taxes applicable in respect of the same income to a taxpayer having his fiscal domicile in the latter State, or having the nationality of that State." This is wider than the present Art. 24(1), comparing the treatment of a treaty partner resident (not national) to a domestic resident or national. This is extremely broad and would seem to prevent unfavourable tax treatment of non-residents compared to residents. While taxation of non-residents only on income sourced in a country compared to taxation of worldwide income of a resident would not seem to offend such a provision, the application of final flat-rate withholding taxes to non-residents compared to taxation of residents on a net basis at progressive rates without withholding would be problematic as "other" taxes and in some cases as "higher" taxes. The argument that taxation permitted elsewhere in the treaty cannot be overridden by the non-discrimination article would need to do a lot of work in the presence of such an article. The residence part only survives in relation to PEs in Art. 24(3) of the OECD Model and is expressed in a different, less onerous, form ("less favourably levied") and subject to an exception for personal allowances, etc.
14. The quotation says "domiciled" in English and "domiciliées" in French, which we take to mean residence. WP 4 on non-discrimination was working simultaneously with WP 2 (on residence); both articles were published in the OEEC First Report of 1958. In the early stages, WP 2 used fiscal domicile as the operative concept but later changed that to residence. The language of the work of various working parties was only conformed progressively over time, initially by the Fiscal Committee, as it prepared the Reports of its work for publication, and later by another Working Party charged with drafting issues. The term "residence" used here should be understood to encompass a variety of usages for the same idea found in OEEC documents.
15. See the text around note 46 for a discussion of the taxes covered by the non-discrimination article.
16. FC/WP4(57)1. This shows the original drafting for a multilateral treaty, as explained in note 11.
17. FC/WP4(57)2; this was also originally drafted for a multilateral treaty; see note 11. In French: "Les revenus, bénéfices et capitaux d'une entreprise établie dans un des Etats-membres de l'O.E.C.E., dont le capital est en totalité ou en partie, directement ou indirectement, détenu ou contrôlé par une ou plusieurs personnes domi-

Although the deletion of this provision was proposed by Italy in discussions in the Fiscal Committee,[18] the Working Party pursued its proposal and their subsequent draft was:

> An enterprise established in the territory of one of the Contracting Parties, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more persons domiciled in the territory of another Contracting Party, shall not be subjected in the territory of the first mentioned Contracting Party to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which (other)[19] similar enterprises in the like circumstances established in the territory of the first-mentioned Contracting Party are or may be subjected.[20]

The modifications were that it was no longer limited to income, profits or capital,[21] and the reference to "higher" taxation[22] was deleted.

Originally, the only Commentary on the ownership provision was:

> Lastly, the draft Article contains a provision which so far has only rarely been adopted in existing Conventions: this concerns the taxation treatment of enterprises under the control of residents of the other Contracting state.[23]

This was expanded on in the Commentary that was developed by the Fiscal Committee, which said:

> 18. Paragraph 5 forbids a State to give different treatment to two enterprises established in its territory, the capital of one of which is wholly or partly owned or controlled, directly or indirectly,

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ciliées dans quelque autre Etat-membre de l'O.E.C.E., ne doivent être soumis dans le premier Etat à aucune imposition autre, plus élevée ou plus lourde que celle à laquelle sont ou pourront être soumises, pour des revenus, bénéfices et capitaux analogues, d'autres entreprises semblables établies dans ce premier Etat et se trouvant dans la même situation."

18. FC/M(57)2. Italy then had a tax on the capital of a company (but not an Italian partnership) which extended to foreign companies (including partnerships). It seems likely that Italy was concerned about whether the effect of the provision was to require the same treatment of foreign capital as domestic capital, and this is the reason for the Commentary quoted in the text at note 24.
19. The "other" was in handwritten brackets in the English version of the draft for reasons more clearly evident in the French version: "Une entreprise établie dans le territoire d'une des Parties Contractantes, dont le capital est en totalité ou en partie, directement ou indirectement, détenu ou contrôlé par une ou plusieurs personnes domiciliées dans le territoire d'une autre Partie Contractante, ne sera soumise dans le territoire de la première Partie Contractante à aucune imposition ou obligation y relative, qui serait autre ou plus lourde que celle à laquelle sont ou pourront être assujetties [the next word, 'd'autres', was crossed out in handwriting and changed to 'les'] entreprises semblables établies dans le territoire de la première Partie Contractante et se trouvant dans la même situation."
20. FC/WP4(57)3. This was adopted by the Fiscal Committee with minor drafting changes at FC/M(58)2: the opening words became "Enterprises established" ("Les entreprises établies"), with a consequential plural "ne seront soumises" in the French, and the reference to "other" ("les autres entreprises") was retained.
21. The coverage of taxes of the different paragraphs and the article as a whole changed as the draft evolved; see discussion below in the text around note 46.
22. In relation to the same wording in the draft of the nationality provision, the Belgian delegation proposed "more burdensome" only, and the Working Party "other" taxation only (FC/WP4(57)2 at p. 2), with the compromise being "other or more burdensome" ("plus élevée ou plus lourde", meaning higher or more burdensome, which was changed in the 1963 Model to "autre ou plus lourde" to conform to the English) in this and the nationality provision. The Swiss proposal to harmonize the PE provision with this wording was not accepted as being too wide: FC/WP4(57)2. The US Model excludes "other" taxation in both the nationality and ownership provisions. Although "higher" was contained in the original UK treaties in addition (in both the nationality and ownership provisions), it is difficult to see how higher taxation would not be more burdensome, although taxation might be more burdensome by being paid earlier without being higher. It may be that "more burdensome" was originally intended to apply only to connected requirements. The Working Party said in an interpretative note "The words '... shall not be subjected to any taxation or any requirement connected therewith which is other or more burdensome ...' mean that tax may not be in another form (no different tax, no different mode of computing the taxable amount, no different rate, etc.) and that the formalities connected with the taxation (returns, payment, prescribed times, etc.) may not be more onerous" (FC/WP4(57)3).
23. FC(58)2 (1st Revision) Part I. See note 6 for its use in practice in treaties.

> by one or more residents of the other Contracting State. This provision, and the discrimination which it puts an end to, relates to the taxation only of enterprises and not of the persons owning or controlling their capital. Its object therefore is to ensure equal treatment for taxpayers residing in the same State, and not to subject foreign capital, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital. Paragraph 5 has no connection with nationality as defined in paragraph 2 and in no way does it purport to introduce into the Article a new concept of "nationality of capital".[24]

The Commentary explained that the ownership provision had no relation to the definition of nationality and that it was not introducing a new concept of nationality of capital. The difference is semantic; if the origin of capital (or ownership) was the criterion for the application of the treaty partner state's governing law (and therefore the Model's definition of nationality), discrimination on that ground would be prevented by the nationality provision. The reason for this statement may have been to reassure Italy that its tax on the capital of a company[25] was not contrary to the ownership provision.

The Working Party gave the following example of the type of circumstance covered by the ownership provision:

> Example: State A subjects companies established in its territory to special profits tax if the majority of the shares in them are owned by persons not domiciled in it. The result is that a company established in the territory of State A, all the shares in which are owned by persons domiciled in that State, is not subject to the special tax, while another company which is also established in the territory of State A, but all the shares in which are owned by persons not domiciled in that State, has to pay the tax. The purpose of paragraph (5) is to prohibit such difference in treatment of taxpayers who are equal to one another from all points of view. As a result of paragraph (5), therefore, State A will no longer be able to subject the last-mentioned company to the special tax.[26]

The reference to enterprises *established* in a state was later changed by the Fiscal Committee to "Enterprises of a Contracting State", defined to mean one carried on by a *resident* of the contracting state concerned.[27] This was not intended to be a change of substance, because it had previously been assumed that a company established in a state was a resident of that

24. FC(58)2 (1st Revision) Part II. This wording was originally proposed by WP 4 in FC/WP4(57)3 "[t]o take account of certain observations made in the discussions on paragraph (5) in June last [which refers to FC/M(57)2, at which Italy proposed the deletion of the provision; see note 18], it is further specified that paragraph (5) and the discrimination to which it puts an end relate to the taxation only of enterprises and not of the persons owning or controlling their capital ... There is no question, therefore, of this provision ensuring the same treatment for foreign capital as for domestic capital, but rather of ensuring equal treatment for taxpayers domiciled in the same State. The provision in question has no connection with nationality and, in particular, it does not introduce a new concept of 'nationality of capital'."
25. See note 18.
26. FC/WP4(57)3. It is thought that this is a made-up example rather than one reported to the Working Party in response to the questionnaire it had sent to countries to discover the extent of existing discriminatory tax provisions. Certainly it is not mentioned among the various examples of existing tax discrimination reported by the Working Party. It does exist today in Canada, where preferential rates of income tax are imposed on part of the "active business" income of a "Canadian-controlled private corporation" and formerly China taxed only foreign-owned enterprises.
27. FC(58)2 (1st Revision) Part I. FC (58) 2 rev 1 part 1, 19 April 1958. The expression "enterprise of a Contracting State" means, according to Art. 3(1)(d), an "enterprise carried on by a resident of a Contracting State". "Enterprise" therefore in this text has more the meaning of an object (business undertaking) than of a subject (person). The "capital" is, according to the text of the provision, the capital of the "enterprise" and not of the person (entity) carrying on the enterprise. While the capital of an enterprise (business undertaking) is usually legally owned by the person carrying on that enterprise (with the exception perhaps of limited partnerships), the capital of an entity (company) is owned by another person. It cannot be said that the capital made available by an individual to his or her enterprise is owned by a person other than the individual. See the distinction made in the Commentary quoted in the text at note 24, which is still in the current Commentary between the enterprise and the owners of its capital.

state,[28] as can be seen from the Commentary's reference to ensuring "equal treatment for taxpayers residing in the same State".[29] The ownership provision thus compares two *resident* companies, whatever the governing law (nationality) of those companies – one owned by residents of the same state, and the other by residents of the other state.[30] The close link of the ownership provision, now depending on residence, to the nationality provision, depending on governing law, has continued in domestic law in Belgium and (until 2008) Germany, out of the countries represented by the authors, which regard a company as being both resident in, and governed by the law of, the country where it has its central administration.[31]

Four specific additional issues in the history bear further examination. The first concerns the comparator used in the Working Party 4 draft of the ownership provision. Of the early UK treaties, the words "in the like circumstances" are found only[32] in the United Kingdom–Switzerland treaty (1954). They were added because, during the negotiations for that treaty, Switzerland had queried whether the nationality provision required them to treat a UK national resident in the United Kingdom in the same way as a Swiss national resident in Switzerland.[33] The United Kingdom suggested the addition of "in similar circumstances"[34] in both the nationality and the ownership provisions to meet the Swiss concerns. They were originally included in the OEEC draft[35] because of its derivation from the Swiss proposal based on the United Kingdom–Switzerland treaty, but were subsequently deleted from the ownership provision but illogically not from the nationality provision, to which they had also

28. This was not the case in some common law countries at the time, including Canada, South Africa and the United Kingdom. Australia adopted an incorporation test as one of three alternative tests of residence of a company when it moved from source-only to worldwide taxation in 1930. The United States has always used the place of incorporation for residence ("domestic corporation") classification, which results in worldwide rather than source-based taxation. Some other common law countries adopted incorporation as an additional test for residence later (Canada 1965, South Africa 1962 (at the same time replacing the common law test by place of effective management), United Kingdom 1988).

29. See text at note 24. The change was probably made because WP 4 on non-discrimination was working simultaneously with WP 2 on residence and so the Working Party could make use of the work done on residence; see note 14.

30. Australia uses ownership as one of its tests of residence of companies. Australia's alternative tests for the residence of companies are incorporation in Australia (see note 28), or carrying on business in Australia plus either management and control in Australia or voting power controlled by Australian residents.

31. See *Residence of Companies under Tax Treaties and EC Law*, Maisto, G. (ed.), (Amsterdam: IBFD, 2009). As Edwards, V., *EC Company Law* (Oxford: Clarendon Press, 1999), p. 336 said, the real-seat theory "inextricably entwines a company's nationality and residence" (this was cited by Advocate-General Maduro in ECJ Case C-201/06, *Cartesio*, at [23]).

32. The United Kingdom–Belgium treaty (the draft of which was based on the United Kingdom–Switzerland treaty; see TNA (see note 6) file IR40/10707) and the United Kingdom–Austria treaty both referred to enterprises similarly carried on. In all these UK treaties (except with Belgium) the non-discrimination article applied to all taxes but the opening words effectively restricted the application of the ownership provision to taxes on income, profits and capital. The "other, higher or more burdensome" wording mirrored that in the nationality provision in those UK treaties.

33. TNA (see note 6) file IR40/11451 at p. 283J. The nationality provision was otherwise essentially the same as the current Model's. The addition of "in particular with respect to residence" made in 1992 in the nationality provision only was viewed as unnecessary but intended to explain "in the same circumstances".

34. The adopted formula of "in the like circumstances" that was actually used is better in implying sameness rather than similarity – cf. OECD Commentary on Art. 24, Para. 7 in relation to nationality discrimination that in the same circumstances "refers to taxpayers placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and fact". In French, Art. 24(1) used the expression "de même nature" in 1963, which was changed to "similaires" in 1977.

35. FC/WP4(57)4, 7 November 1957. Originally the nationality provision did not refer to the same circumstances either (FC/WP4(57)1), on the basis that it was implied, but "in the like circumstances" was added at the suggestion of the Belgian and Swiss delegates (FC/WP4(57)2).

been added in that treaty in the Working Party's final report. The following reasons were given for their deletion:

> First, they might lead to misunderstanding; secondly, they add nothing to the meaning of the provision,[36] the purpose of which is to subject enterprises situated in a given State and under foreign control to the same treatment as similar enterprises likewise established in the same State.[37]

Although the language of the nationality and ownership provisions expresses the scope of the prohibited discrimination in the same way (other or more burdensome taxation and connected requirements), they have ended up with different language for the comparator. The following addition to the Commentary made in the 2008 Update to the Model and Commentary under the new heading *General remarks* notes and discounts the difference as follows:

> 3. The various provisions of Article 24 prevent differences in tax treatment that are solely based on certain specific grounds (e.g. nationality, in the case of paragraph 1). Thus, for these paragraphs to apply, other relevant aspects must be the same. The various provisions of Article 24 use different wording to achieve that result (e.g. "in the same circumstances" in paragraphs 1 and 2; "carrying on the same activities" in paragraph 3; "similar enterprises" in paragraph 5).[38]

As discussed in the interpretation of the ownership provision below, in our view there are issues of what the comparator is and how it operates, which the OECD Commentary does not directly address and the history does not resolve.[39]

The second matter concerns the meaning of "any taxation or any requirement connected therewith". The most natural reading of these words in their context in the nationality and ownership provisions relates to taxes imposed on the person protected by the paragraph. It might, however, be possible to read the words as encompassing any requirement imposed on the person with respect to tax obligations of other persons, such as a requirement to report income or withhold taxes with respect to income payments to other persons (e.g. employment or investment income). In our view, the words should be limited to taxes imposed on the protected person, not taxes imposed on other persons but in relation to which the protected person has some tax-related obligations. The Commentary on the nationality provision refers to "when a tax is *imposed* on nationals and foreigners"[40] and the connected requirements clearly only relate to the taxation in question – "therewith".

One of the changes to the Commentary in 2008 suggests that withholding obligations with respect to income of a third person may be covered. There is a mysterious discussion of why it does not breach the ownership provision to impose withholding tax obligations on a resident company paying dividends to foreign shareholders but not for dividends paid to resident

36. The fact that the words "in the same circumstances" were deleted from the ownership provision supports the argument put forward by Kees van Raad in the authors' Non-Discrimination Article (see note 10) in the text at note 25 of that article that these words are redundant in the nationality provision.
37. FC/WP4(58)1, 19 February 1958.
38. Lord Hoffmann had made the same point in *NEC Semi-Conductors Ltd and other Test Claimants v. IRC* [2007] STC 1265 at Para. 16 before this passage was added to the Commentary: "In relation to article 24(1) of the OECD model convention, which prohibits discrimination between residents on grounds of nationality, the commentary says that the 'underlying question' is whether two residents are being treated differently 'solely by reason of having a different nationality.' It does not repeat this observation in relation to article 24(5), but the principle must be the same."
39. It should also be noted that Art. 24(1) can apply in relation to the taxation of either residents or non-residents (in that it would clearly preclude the differential taxation of two non-residents as a function of nationality, and even if they were residents of neither contracting state), whereas Art. 24(5) applies only in relation to the taxation of residents.
40. OECD Commentary on Art. 24, Para. 15.

shareholders. We do not quarrel with the result but we disagree with the implication that such withholding obligations are within the scope of the ownership provision because withholding tax is a means of collecting tax on the owner.[41] The change to the Commentary is doubly mysterious as it has always gone out of its way to point out that the ownership provision relates only to the taxation of enterprises and not to the taxation of the persons owning or controlling their capital.[42]

Thirdly, the effect of the prohibition of "other" in contrast to "more burdensome" taxation is unclear. As we have seen, the Working Party explained this to mean that there must be "no different tax, no different mode of computing the taxable amount, no different rate, etc.".[43] Without knowledge of this, the UK Privy Council applied a similar meaning in *Woodend Rubber Co. v. Comr. of Inland Revenue*:[44] "to speak in this context of 'other' taxation must ... at least include some income tax other than the income tax to which resident [in a non-discrimination provision referring to residence, rather than nationality] companies are subjected". The Ceylon (as it then was) tax in question was a branch profits tax measured by reference to (rather than on) the remittances made out of the permanent establishment (PE) state, amounting to one third of the remittances to a maximum of one third of taxable income. Resident companies, on the other hand, paid an additional tax equal to one third of the dividends paid, which they were entitled to deduct from the dividends. This was in form an additional tax on the profits of the company, rather than a withholding tax on the dividends (which would have been a tax on the shareholders). Since resident companies did not pay tax on remittances abroad, the tax was an "other" one, which was prohibited by the residence (in that treaty) non-discrimination provision, even though the charge to tax in either case was all part of income tax. The tax was actually less burdensome, since tax on the non-resident company was a maximum of one third of taxable income of the year when the remittances exceeded one third of taxable income, while the additional tax on a resident company was one third of the dividends which could relate to profits of more than one year, whatever their amount. The treaty did not, however, have effect because it had been impliedly overridden by a later major reform of taxation which had introduced this "other" tax. In enacting the reform, the legislature could not have intended to exclude non-resident companies within the treaty. Had the treaty been effective, the branch profits tax would have been held to be contrary to the non-discrimination provision, thus possibly resulting in a far less burdensome tax on non-resident companies.

The question is whether a relevant taxpayer, whether better or worse off under the "other" tax, can claim to remove the tax completely, which would have been the result in *Woodend* if

41. OECD Commentary on Art. 24, Para. 78, first two sentences, quoted at note 92. The same point was made by the UK First-tier Tribunal in *FCE Bank plc v. HMRC* [2010] SFTD 718. J.F. Avery Jones would like to state that he started to contribute to this article long before he was asked to sit on the case. An appeal is due to be heard on 6 May 2011. The US Model Income Tax Convention of 15 November 2006 Technical Explanation introduction to the non-discrimination article also seems to confuse how its ownership provision in Para. 5 operates, as it says: "This Article ensures that nationals of a Contracting State, in the case of paragraph 1, and residents of a Contracting State, in the case of paragraphs 2 through 5, will not be subject, directly or indirectly, to discriminatory taxation in the other Contracting State. Not all differences in tax treatment, either as between nationals of the two States, or between residents of the two States, are violations of the prohibition against discrimination" (emphasis added). It seems to regard the ownership provision as about the taxation of the non-resident owner, not the resident subsidiary.
42. Now in OECD Commentary on Art. 24, Para. 76.
43. See note 22.
44. [1971] AC 321, 332F.

the treaty had been effective, as opposed to being limited to claiming equal treatment, which *ex hypothesi* the domestic provisions would not have provided for and would thus have to be "rewritten".[45] The answer may depend on the way the legislation is expressed. If the legislation imposes an "other" tax on foreign-owned residents, this may be expressed as an exception to the normal tax on residents, in which case if the exception is invalid the normal rule will apply, for better or worse. This could be the case even where there are two wholly separate taxes.

The fourth matter concerns the coverage of all taxes by the article. One of the other four working parties originally established by the OEEC and working in parallel with Working Party 4 was Working Party 3, consisting of delegates from Italy and Switzerland, dealing with taxes covered by tax treaties. It was specifically tasked to consider taxes on income and capital and taxes on estates and inheritances.[46] Working Party 4 seems to have taken its remit to consider a similar range of taxes and restricted its study accordingly. As its draft evolved, the coverage of taxes by different paragraphs of the non-discrimination article varied, but Switzerland argued that it should cover all taxes – with the exception of the ownership provision.[47] The Fiscal Committee decided that the nationality and PE provisions should apply to all taxes, but asked Working Part 4 to look further at the ownership provision, given Italy's objection to it,[48] even though the draft of Working Party 3 at this point continued to be limited to the specific taxes.[49] Working Party 4 seems to have assumed that the Fiscal Committee had decided that all paragraphs of the non-discrimination article should cover all taxes and all subsequent drafts were to that effect.[50]

What is not clearly explained is why the taxes covered by the non-discrimination article diverged from the general coverage of the evolving model treaty, due largely to the views of Switzerland. The OEEC documents give the impression that it was driven by the view that all tax discrimination is undesirable as an impediment to international trade.[51] On the other hand, UK archives suggest that the concern was that, if not so extended, countries could get around the intent of the article by subjecting the relevant taxpayer to a discriminatory tax not within the covered range, even though the tax was effectively intended to relate to one of the covered taxes (for example, a tax on turnover with the rate set in such a way that it operated much like a tax on income). The United Kingdom noted privately as follows in relation to its

45. This raises the question of what is the proper remedy in a case where discrimination is established, and whether this extends to a court-ordered "reading" of the domestic law.
46. FC/WP3(56)1.
47. The 1954 United Kingdom–Switzerland treaty and the other early UK treaties (except with Belgium and Germany) applied to all taxes but limited the ownership provision to income, profits or capital, presumably on the basis that it would not apply to other types of taxes (although there could be such taxes that were not within the treaty, such as local taxes, and the UK provision giving effect to treaties in domestic law did not include any other taxes). The Swiss proposal that the non-discrimination article should apply to all taxes was made at the same time as they proposed the ownership provision and they followed the UK practice in their suggestion limiting this provision to taxes on income, profits and capital.
48. FC/M(57)2. See note 18.
49. It produced a draft with two parallel provisions for inclusion in treaties on taxes on income and capital and separately treaties on taxes on estates and inheritances: OEEC, *The elimination of double taxation* (1958), pp. 31-32.
50. FC/WP4(57)3, p. 14.
51. FC/WP4(57)2.

negotiations leading to the 1954 treaty with Germany, which successfully resisted the coverage of all taxes by the non-discrimination article:[52]

> It is essential from the point of view of the two Exchequers to ensure that nationals and companies of one of the territories are not subjected to any discriminatory taxation in the other territory within the field of the taxes on income and profits specifically covered by the Agreement because they have undertaken to give credit for such taxes.
>
> It is also essential to ensure – and this is primarily valuable from the taxpayer's point of view – that the other country will not get round the provision by discriminating against him in other ways – e g by levying specially heavy stamp duties on his documents etc.
>
> This is valuable to both sides because it encourages the mutual flow of trade and it expresses in any case what in our view at any rate, ought to be the attitude of all reasonable governments towards foreign nationals carrying on business within their borders.
>
> For these reasons one of the things which makes an agreement a more suitable means of relieving double taxation than unilateral relief is the fact that our Agreements always contain a provision of this nature.[53]

This explanation of the coverage as mainly directed to taxes on income and capital also finds some support in the OECD Model Estate Tax Treaty (1983), which has a non-discrimination rule applying to all taxes but only the equivalent of Paras. 1 (nationality) and 2 (stateless persons) of the OECD Model on income and capital. Its Commentary says:

> It was decided not to include paragraphs 4 to 6 [now 3 to 5 after 1992 renumbering] of Article 24 of the 1977 Income Tax Model since the provisions of those paragraphs relate, more or less exclusively, to taxes on income and capital and are not appropriate in the concept of this Model.[54]

3. Policy

While the UK note is addressed to the specific issue of coverage of taxes, it provides two broader justifications for the article, as the quid pro quo for the granting of double-taxation relief and the encouragement of international commerce (although, in the case of taxes within double-taxation reliefs, the latter may just be an outcome of the former). Working Party 4 does not address the policy of the non-discrimination article as a separate question for the article overall and the comments it makes in relation to particular paragraphs are usually brief and general.

If one also considers the purpose of other parts of the non-discrimination article, nationality discrimination was included as one of the terms of reference of the OECD Fiscal Committee,

52. TNA (see note 6) file IR40/9629A, p. 110. We are grateful to the National Archives for opening this file following a Freedom of Information request by J.F. Avery Jones. Although an "all taxes" non-discrimination provision was normally used in treaties at the time, the provision giving effect to treaties in domestic law (now Taxation (International and Other Provisions) Act 2010 (TIOPA) Sec. 2(3), formerly TA 1988 Sec. 788) did not give effect to the treaty provisions relating to other taxes. The United Kingdom must have known this because the minutes of negotiations on 18 July 1952 record the UK negotiator as saying "He was not sure what would happen if legal questions on the article came before the courts." Later, the United Kingdom changed its practice to restrict the non-discrimination article to treaty taxes and entered a reservation to the Model to this effect in 1992.
53. The last paragraph is strange because unilateral relief, which had been introduced in 1950, would have applied anyway until it was provided in 2000 (now TIOPA 2010 Sec. 11, formerly TA 1988 Sec. 793A) that unilateral relief is not available if the treaty provides that relief is not available.
54. OECD Commentary on Art. 10, Para. 2 (1983 Model Double Taxation Convention on Estates and Inheritances and on Gifts). The 1966 Draft Model Double Taxation Convention on Estates and Inheritances had an identical non-discrimination article to the 1963 income tax Draft Model.

but the Working Party found few examples.[55] It simply infers support for the principle from this fact and because OEEC countries in various other treaties and in then recent tax treaties had indicated support for it.

More cases of discrimination were found by the Working Party in relation to the taxation of PEs and there is greater discussion of it.[56] Apart from invoking a number of treaties between OEEC countries including the provision, they noted the close link between the non-discrimination rule and the arm's length separate-enterprise principle for the calculation of profits of a PE. They continued that the PE provision:[57]

> ... is of great importance for the development of commercial and industrial activity across the frontiers ... the form of discrimination occurs but very rarely in the Member countries of the O.E.E.C. It feels, however, that the value of the provision, *as indeed of the Article as a whole*, is this, that the Member countries of the O.E.E.C., by their formal adherence to the principle of non-discrimination, will help to propagate this principle which is so vital for the development of international economic relations.

The difference in scope of the PE provision, compared to the nationality provision, in not extending to "other taxation" and connected requirements (by expressing the standard as "not be less favourably levied") was deliberate, in order to make it easier for states to accept.[58]

When it came to prepare its Report for publication, the Fiscal Committee picked up this theme:[59]

> 31. Although this question has no connection with problems of double taxation, nevertheless, in a number of double taxation Conventions, it is the subject of special provisions designed to prevent discriminatory treatment, in the form of other or more burdensome taxation, from being applied in one of the two States to taxpayers possessing the nationality of the other State. Similar provisions are to be found in a number of other Conventions ...
>
> 32. The Article ... contains a provision on reciprocal taxation treatment of nationals. Although tax discrimination on grounds of nationality is an exception in the Member countries of the O.E.E.C., nevertheless it is important that Member countries' adhesion to the principle of no discrimination for nationality reasons should be clearly embodied in the texts of their double taxa-

55. These related to minor differences in personal allowances that existed in France, the United Kingdom, Ireland and the Netherlands; the remittance basis in the United Kingdom and Ireland applied to non-ordinarily resident British/Irish subjects; the Netherlands did not allow foreign nationals resident there double taxation relief unless they maintain their domicile in the Netherlands for at least 3 years or unless the state whose nationality they possess extends reciprocal treatment; Ireland gave special exemptions or reliefs to companies registered, managed and controlled in Ireland (management and control being the test for residence), so far as concerns profits arising to them from certain mining business; and Sweden subjected foreign corporate bodies to a tax on capital invested in Sweden, the net wealth tax: FC/WP4(57)1 (this did not apply to foreign-owned Swedish companies). The net wealth tax has been abolished.
56. Perhaps because the Working Party was implicitly rejecting the broad League of Nations provision in relation to residence discrimination (see note 13), though there is no mention of League of Nations work in the documents produced by the Working Party, other than the unsuccessful attempt in 1929 to produce a general treaty on the treatment of foreigners (that is, a treaty extending far beyond tax); see FC/WP4(57)1, pp. 5-7. Belgium also objected to the provision and the Working Party therefore defended its inclusion at some length against the Belgian arguments – FC/WP4(57)2, pp. 5-7.
57. FC/WP4(57)2 at p. 6, emphasis added. This is the only real reference to the general policy of the article in the Working Party documents apart from general statements of being "in favour of all provisions which can eliminate discriminatory taxation to the utmost possible extent". For the ownership provision, the Working Party arguments are similar; see note 8 and text.
58. FC/WP4(57)3 at p. 12.
59. OEEC, *The elimination of double taxation* (1958), p. 21; this form of wording first appeared in the draft prepared by the Secretariat in agreement with the chairman (FC(58)2).

tion Conventions in view, particularly, of the force of example that this can have for their relations with third countries.

33. The Article also contains a provision that a permanent establishment owned by an enterprise of one of the Contracting States in the other State must not be less favourably taxed by that other State than enterprises of the latter. This provision on non-discrimination as regards permanent establishments, which is found less frequently in the existing Conventions than the provision on reciprocal taxation treatment of nationals, will give firms greater security in expanding their international business. Lastly, the Article contains a provision which so far has only rarely been adopted in existing Conventions: this concerns the taxation treatment of enterprises under the control of residents of the other Contracting State.

The OEEC, it seems, was significantly influenced by the exemplary effect that its formal commitment to non-discrimination in taxation would have for countries outside the OEEC, as it was expected that the article would have little impact on OEEC members. The explanation apparently does not reflect the view noted by the United Kingdom as to a purpose of the article being related to relief of double taxation. More recently, various scholars have returned to the purpose of the article and supported the view in the UK note[60] that the policy is, at least in the main as a practical matter, to ensure that source taxation for which relief must be given is not discriminatory. The UK note also supports the view that there is a residual policy scope along the lines described by the OEEC, in that any taxes imposed as a means of getting around a more narrowly structured discrimination prohibition would not be within the scope of the double-taxation relief obligation in any event.

On closer examination it seems likely that both approaches were influential in the drafting. The examples given of nationality discrimination found by Working Party 4 were mainly problems in the residence country of the taxpayer rather than the source country, to which the relief argument is irrelevant (although it was clear to the Working Party that the provision could also apply to discrimination in the source country). Here the argument about international trade has some relevance, though the examples given are predominantly ones concerning individual personal taxation. The PE provision fits the relief and international trade argument, as the way that the provision is worded permits the source country to tax by a different method but cannot produce more tax than would be paid by an equivalent resident enterprise, nor (under Art. 7(2)) than permitted by the arm's length separate-enterprise principle, which is the agreed standard for allocating profits internationally.

The ownership provision (and the deduction provision in Art. 24(4) introduced into the Model in 1977) deals with the taxation of resident enterprises and at first glance thus does not fit a policy about non-discriminatory source taxation. When it is recalled, however, that actual tax treaties contain provisions for relief of corporate tax at the level of shareholders who are effectively direct investors (whose investment is economically equivalent to a PE), the relief argument has some traction for these provisions,[61] especially as the Working

60. Green, "The Troubled Rule of Non-discrimination in Taxing Foreign Direct Investment", 26 *Law & Policy in International Business* 113 (1994), which is accepted and extended in Warren, "Income Tax Discrimination Against International Commerce", 54 *Tax Law Review* 131 (2001). The authors were not aware of the UK note taking the same position, as it was not in the public domain at the time.

61. European countries tend to regard the treaty as the primary relief mechanism, as indicated for the United Kingdom in the final paragraph of its note (although it is not true for the United Kingdom, as unilateral relief would have applied anyway until 2000), and tend to have a participation exemption or indirect credit in their treaties. For discussion of the view that taxation of resident subsidiaries is effectively a source tax, see Vann, "'Liable to Tax' and Company Residence under Tax Treaties", in: Maisto, G. (ed.), *Residence of Companies under Tax Treaties and EC Law* (2009), p. 197, at 199-203.

Party emphasized the separate enterprise in its discussion of the PE provision. The counter-arguments in favour of the proposition that a broader concern is in issue are that the OECD Model does not have a relief provision in the form of a participation exemption or indirect foreign tax credit for direct investment (though Working Party 4 was not aware of this outcome, as the relief article was drafted subsequently) and that neither the ownership nor the deduction provision is explicitly limited to persons who have a direct investment interest in the resident enterprise (or their associates).[62]

Apart from the limited discussion of general policy, it is clear from the OEEC documents that there was detailed consideration of the drafting of the non-discrimination article to produce provisions that were acceptable, had a relatively clear operation and generated little immediate impact on OEEC members but demonstrated a commitment to preventing tax discrimination. The main issues discussed were the detailed application of the provisions. They were not meant to generate broad and non-specific principles whose application was not generally understood. The history demonstrates that the provisions were meant to be free-standing, even if related in a policy sense to relief and facilitation of international trade. For example, it is not really possible to argue that the ownership and deduction provisions only apply when there is an obligation to give relief for double taxation. The piecemeal drafting of the OECD Model during the OEEC period, as well as the literal terms of the non-discrimination article to which considerable drafting efforts were directed, do not support such a construction.[63]

The 2008 update to the OECD Commentary on Art. 24 is intended as the first step in a two-step process and seeks to clarify interpretation of the current rules. The second step is to review the issue of non-discrimination more generally, to see whether any changes to the Model are necessary (whether in Art. 24 or elsewhere). The update confirms a number of the points derived from the history and the discussion of policy above. It now includes some general remarks by way of introduction, but there is still no general policy identified as underlying the provision. Rather, the following points are made:[64]

- The provisions are precise in operation and seek to identify specific cases where discrimination should be prevented; they thus do not lend themselves to a broad interpretation to cover cases of "indirect" discrimination (an obvious allusion to and rejection for the purposes of the OECD Model of the different position on EU non-discrimination rules in the jurisprudence of the European Court of Justice (ECJ)).
- The provisions do not embody most-favoured-nation treatment, and in particular do not permit taxpayers in one country to rely on the non-discrimination article to get more favourable treatment available under another tax treaty of the treaty partner concerned.
- The comparator claimed for proving discrimination must be in the same position and the difference in treatment must be solely because of the specific type of prohibited discrimination concerned.

62. The same is true of Art. 9 of the OECD Model, but it is generally regarded as limited to direct investment (control/influence) cases (US Model Income Tax Treaty of 15 November 2006, Technical Explanation to Art. 9). It should also be noted that the nationality discrimination article could apply to non-residents of both states.
63. Piecemeal drafting and free-standing provisions are a broader issue in actual treaties, especially where they deviate from the Model; see for example Avery Jones et al., "Whether the Definition of Dividend Limited to the Dividend Article Applies to the Double Taxation Relief Article Granting Underlying Credit", 53 *Bulletin for International Taxation* 103 (1999), [1999] BTR 163.
64. OECD Commentary on Art. 24, Paras. 1-4; Para. 3 is quoted in note 38 and text.

– The article must be read with the other articles of the Model and does not prohibit taxation expressly authorized by another provision.[65]

For the rest, the changes are mainly directed to situations where there have been arguments as to whether Art. 24 applies to prevent the operation of particular tax rules, with the conclusion in most cases that it does not. The types of argument deployed to reach these results vary and are the subject of further comment below. In some cases, the arguments adopted in 2008 for not applying the article to particular cases are different from, and displace, previous reasoning to the same end.

One clear implication of these changes (and for the most part the Commentary on the article overall) is that it is not appropriate to take an overly substance-oriented approach to characterizing tax measures, even though there are economically equivalent but structurally different ways of reaching similar ends. For example, Australia levies fringe benefits tax on employers and exempts the benefits in the hands of the employee, while most other countries tax the benefits in the hands of the employee and impose withholding tax obligations on employers; similarly in many countries there are payroll taxes related to social security, sometimes levied on the employer, sometimes levied on the employee and sometimes levied in part on both. In such cases it is only where the tax is imposed on the enterprise (the employer in the examples just given) that the ownership provision is engaged in our view.

4. Domestic Grouping Provisions

By domestic grouping provisions we intend to cover all types of provisions where group companies are involved. These include at least four varieties: group relief for losses; full consolidation (in its many varieties); rollover provisions that tie into ownership (regardless of grouping), as in intercompany liquidations, mergers, demergers and transfers among group members (including companies that thereby become group members); as well as including the disallowance or deferral of losses or certain deductions on transfers to a related party (which may or may not be a company).[66] Since the non-discrimination article in the Model extends to all taxes, there could be further situations involving other taxes, but these do not seem to be common in relation to the ownership provision.[67]

There is no evidence from the history that the effect on domestic grouping provisions was ever considered when the ownership provision was introduced; indeed most countries' grouping provisions were introduced later. Nor was the policy of the ownership provision elaborated to any degree as it was introduced, on the basis that it was unlikely to apply, although it was stated that it would be important if a state did discriminate on the basis of

65. The German *Bundesfinanzhof* refused to follow this sentence of the Commentary in its recent decision I R 6/09 of 8 September 2010 with regard to Arts. 9 and 11(4) of the 1971/1992 Germany–Switzerland treaty (which corresponds to Arts. 9 and 11(6) of the Model).
66. The US *Square D* case discussed in the text at note 77 below is an example of the last of these.
67. There are, for example, no cases where the VAT treatment of groups is contrary to the ownership provision in the countries represented by the authors. A possible exception is that, according to the Italian Ministry of Finance Rulings, two Italian subsidiaries may elect for the VAT group regime where the foreign controlling company (i) is established in another EU Member State and (ii) has a VAT number in Italy. The ownership provision might allow grouping to sister companies owned by a non EU-established company having a VAT number in Italy. The possibility of extending VAT grouping internationally has been raised in a EU Commission Green Paper on the future of VAT, COM (2010) 695. In Sweden it has been argued by Björn Westberg, *Nordisk mervärdesskatterätt*, *Juristförlaget* (1994), p. 266 that a certain VAT provision, now abolished, on Swedish intra-group transactions could possibly be subject to OECD Model Art. 24(5).

foreign ownership.[68] The only example given was that of a special profits tax on non-resident-owned companies.

Thus it is difficult to determine what approach should be taken to applying the ownership provision to domestic grouping provisions. One can see a generalized intention to prevent discrimination in relation to enterprises governed by the treaty partner state's law (the nationality provision), or owned by residents of the treaty partner (the PE and ownership provisions). On that basis, if a domestic enterprise is treated differently in relation to domestic grouping provisions because of ownership by residents of the treaty partner state, one would expect the purpose of the ownership provision to be to prevent such different treatment. The issue becomes whether non-resident ownership is the ground for the difference in treatment. Unfortunately, when the detail of domestic grouping provisions is considered, the position is more complicated, as we shall demonstrate below.

Nor is the Commentary helpful in explaining how to approach the application of domestic grouping provisions. It argues unconvincingly in a paragraph added in 2008 that they have no application:

> Since the paragraph relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital, it follows that it cannot be interpreted to extend the benefits of rules that take account of the relationship between a resident enterprise and other resident enterprises (e.g. rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership). For example, if the domestic tax law of one State allows a resident company to consolidate its income with that of a resident parent company, paragraph 5 cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company. This would require comparing the combined treatment of a resident enterprise and the non-resident that owns its capital with that of a resident enterprise of the same State and the resident that owns its capital, something that clearly goes beyond the taxation of the resident enterprise alone.[69]

We agree that the ownership provision applies to taxation of resident enterprises, but not the conclusion that is drawn from this, and we consider that the focus on grouping a resident subsidiary with a non-resident parent company is not the real issue. If the relationship of the subsidiary with other group companies (based on ultimate foreign ownership) affects the taxation of the resident subsidiary, it must be relevant to the ownership provision on its plain wording. The Commentary accepts this in relation to thin capitalization, which is an example of a situation where the relationship between the company and other companies is relevant,[70] when it tests whether the reason for the domestic law disallowance of the deduction is really foreign ownership or whether it is non-residence of the payee:

> For example, if under a State's domestic thin capitalisation rules, a resident enterprise is not allowed to deduct interest paid to a non-resident associated enterprise, that rule would not be in violation of paragraph 5 even where it would be applied to payments of interest made to a creditor that would own or control the capital of the enterprise, provided that the treatment would be the

68. See the text around note 10.
69. OECD Commentary on Art. 24, Para. 77. The Commentary makes the same point in relation to the PE non-discrimination provision in Para. 41. The different wording of that provision in stating the level of protection and the comparator (similar activities) may or may not justify a different approach on this issue; see discussion of *Saipem* below note 159.
70. Although such rules are of the opposite type, being burdensome rather than beneficial, and if such provisions are authorized by Art. 9, the ownership provision is not in point for that reason.

> same if the interest had been paid to a non-resident associated enterprise that did not itself own or control any of the capital of the payer.[71]

If the treatment would not be "the same if the interest had been paid to a non-resident associated enterprise that did not itself own or control any of the capital of the payer", the Commentary would impliedly accept that the ownership provision prevented the difference in treatment.[72] It is not clear why the Commentary does not accept the argument as equally applicable to other domestic grouping provisions.

Before looking at the detail of domestic grouping provisions, we shall deal with two preliminary aspects – first, determining the ground for denying the application of the domestic grouping provision; and secondly, whether there is any significance in the expression "similar enterprises".

4.1. Determining the ground for denying the application of domestic grouping provisions

As noted above, the ownership provision requires not only that both ownership and non-residence are present, but also that the combination of the two is the reason (or ultimate cause) for the denial of the relief under the domestic grouping provision (or imposition of the requirement).[73] We can illustrate this by considering transfers of assets between subsidiaries. In the table below we assume that there is a transfer of an asset from a resident ("R") subsidiary either to a resident ("R") transferee fellow subsidiary (Case 1) or a non-resident ("NR") transferee fellow subsidiary (Case 2). The parent company of the subsidiaries is either resident (Case A) or non-resident (Case B). The transferor in all cases is an R subsidiary.

	Transferee subsidiary	Case A	Case B
		Parent company	
Case 1	R	R	NR
Case 2	NR	R	NR

In relation to reliefs for intra-group transfers of assets, the question is whether the real ground for the denial of relief is direct or indirect[74] foreign ownership. In addition to the clear case of ownership discrimination where a domestic law relief applies in A1 and A2 but in neither

71. OECD Commentary on Art. 24, Para. 79.
72. Australia's thin capitalization rules prior to 2001 required a foreign parent even though they covered payments to non-resident associates, which would on our interpretation be prevented by the ownership provision (though Australia's treaties at the time had no non-discrimination article that would produce that result). Now Australia's thin capitalization rules apply to both inbound and outbound interest payments, which would not be prevented prima facie by the ownership provision.
73. In relation to discriminatory acts by persons, as opposed to discriminatory legislation which is the issue here, grounds "can mean the motive for taking the decision or the factual criteria applied by the discriminator in reaching his decision" (*R (on the application of E) v. Governing Body of JFS* [2010] 2 WLR 153 in the UK Supreme Court per Lord Phillips at [13]), the latter meaning being the relevant one. Our meaning is closer to the latter in referring to the factual criteria (i.e. which must involve non-resident ownership) for the application or non-application of the domestic (grouping) provisions. The problem arising sometimes in relation to discriminatory acts, where one does not know whether the real ground is the one prohibited by the non-discrimination rule, as in Lord Phillips's example at [21] of the shopkeeper who refuses to serve a fat black man, and which may require a more subjective approach to determine which of those facts was the real ground of the discrimination, also arises in relation to potentially discriminatory legislation, particularly where there are multiple conditions in the domestic provisions and only some or one prohibited by treaty, as in *NEC Semi-Conductors Ltd and other Test Claimants v. IRC* [2007] STC 1265 discussed below in the text at note 83.
74. We take "indirectly" to mean that the capital is owned through a chain of other companies.

B1 nor B2, there are other possibilities. If the domestic law relief applies to the transfer in A1 but not in B1, so that the relief does not apply on a transfer between two resident subsidiaries of a non-resident parent, but it would apply if the parent were resident, the difference in treatment is prevented by the ownership provision because the only difference between the two cases is foreign ownership.[75] The same would apply if the relief applies in A2 but not in B2 (which would be unusual).[76]

The US case *Square D Co. v. Commissioner*[77] is a good example of this distinction. The issue was whether US Treasury regulations, which deferred a deduction for interest expense accrued by a US corporation to a foreign related party until the interest was paid, were in violation of the ownership paragraph of the non-discrimination article of the France–United States treaty (1967).[78] The facts involved payments by the US taxpayers to its French parent company, as well as to two French sister companies. Though a current interest deduction was denied in respect of interest accrued to the French parent company and would not have been denied had the parent company been domestic, the Tax Court and the Court of Appeals each concluded that the ownership paragraph of the non-discrimination article was not violated because the provision denied current deductibility not on the basis that a non-resident owned the shares of the US payer, but rather on the basis that a related *non-resident* entity was the payee under the debt instrument.[79] The fact that the parent company was foreign and was a payee, was not the ground for the deferral. As the Court noted:[80]

> The regulation does not impose the cash method simply because of foreign ownership, which would be prohibited, but rather for payments to a foreign related party. Even if a corporation were owned by a United States parent, it still appears all interest payments to one of these foreign related parties would lead to the use of the cash method except to the extent that the parent company was a payee (and hence was not the sole reason for the deferral).[81]

75. A clear example of this situation is the Swedish case RÅ 1987 ref. 158. Under the then applicable law, a sale of qualifying shares between two Swedish sister companies required them to have a common Swedish parent company. The Supreme Administrative Court determined that that requirement could not be applied if the parent was Dutch because of the non-discrimination article in the tax treaty between Sweden and the Netherlands.
76. For an example in Switzerland, see note 130.
77. 118 TC 299 (2002), aff'd, 438 F3d 739 (7th Cir. 2006).
78. The treaty did not contain a provision corresponding to Art. 24(4) of the OECD Model.
79. For example, in a context involving a transfer of an asset by a resident subsidiary to its non-resident parent, if non-recognition of gains is not permitted by domestic provisions but would have been permitted on satisfaction of a condition that the parent had been a resident, it is difficult to conclude that the real ground is preserving the integrity of the tax base rather than non-resident ownership if the asset remains within the taxing jurisdiction in the hands of the parent. In judging whether an asset remains within the taxing jurisdiction, there is an issue whether this should be tested by reference to domestic law which causes the taxation, or after applying a treaty. Even if treaty jurisdiction is the relevant criterion, land or PE assets would normally remain taxable in the source country. Where, as in the United Kingdom, non-residents are not taxed on gains on land in the United Kingdom, applying domestic law in circumstances in which the treaty would allow the United Kingdom to tax would mean a relief could be denied on a transfer of land to a non-resident owner – on the ground of preserving the integrity of the tax base (rather than non-resident ownership as such).
80. P.748.
81. Further US decisions on similar lines are:
    - *UnionBanCal* Corporation v. Commissioner, 113 TC 309 (1999). The taxpayer was the successor in interest to a domestic bank that had sold a loan portfolio at a loss to a related UK company. Sec. 267(f) of the Code barred the domestic bank from deducting its loss at that time as the sale was to a controlled group member within the meaning of the statute (which applied a "more than 50% by value affiliation" standard for testing group membership). When the domestic bank left the group, deduction of the loss still was not permitted under the temporary Treasury regulations in effect at that time because the related UK company still owned the loans and was in the group. Those temporary regulations provided that the domestic bank which left the group never could claim the loss, but that the UK purchasing company could increase its basis by the disallowed loss. The loss in theory could be claimed at such time as the loans were

This illustrates that, while in the case of the US subsidiary paying interest to the French parent the conditions for application of the ownership provision appeared to be present, it could be seen that they were not because the same treatment applied to interest paid to a non-resident sister subsidiary, including if the ultimate parent was not foreign. The ground was therefore the fact that the payee was non-resident and non-resident ownership was something that happened to be present. That this was so was demonstrated by considering other facts in the case where the payment was not made to the parent. The same approach can be applied using hypothetical facts which demonstrate that the ground for deferral of the relief, resulting in more burdensome taxation, is the residence of the recipient, and not ownership.[82]

Even in situations like the payment of a dividend, which must be paid to the direct owner, a similar approach can be used to determine the ground of the denial of the application of the domestic provision. This is illustrated by the UK case of *NEC Semi-Conductors*,[83] concerning a former UK rule enabling a domestic parent and subsidiary to make a joint election to the tax authority, that tax (advance corporation tax, ACT) that the subsidiary would otherwise

sold outside the group, but only by such UK company (which was not able to use the loss given its tax posture). Hence, on the facts involved, the disallowance of the loss was permanent. (The Treasury regulations were changed in a subsequent year in a way that would have permitted the selling member to claim a loss when it left the group, but the regulations were not made retroactive.) The Tax Court held that the foreign ownership non-discrimination article of the 1975 United States–United Kingdom income tax treaty was not violated because the regulations operated without regard to country of residence. Had the domestic bank's owner been a domestic corporation rather than a UK company, the result would have been the same (at least in the absence of ownership – at least 80% by vote and value – permitting and the group electing consolidated return filing, which was not referred to by the Court).

- *UnionBanCal Corporation v. Commissioner*, 305 F3d 976 (9th Cir. 2002). The Court of Appeals for the Ninth Circuit affirmed the Tax Court's decision (two judges voting to affirm, one judge dissenting on a statutory basis).
- *American Air Liquide, Inc. v. Commissioner*, 116 TC 23 (2001). The case addressed whether Art. 24(3) of the 1967 United States–France income tax treaty, which was the ownership provision in that treaty, required that royalties received by a domestic subsidiary from its French parent company be eligible for "look-through" treatment for testing whether the royalties are "general limitation" income rather than "passive" income for purposes of the applicable limitations under Sec. 904(d) of the Code. Under then applicable Treasury regulations, royalties received from any foreign corporation, other than a "controlled foreign corporation", were not eligible for look-through treatment. Because the fact of ownership by the foreign licensee in this case thus was coincidental with rather than determinative of the passive income treatment of the royalty, no violation of the ownership provision was found. (The regulations subsequently were changed to permit look-through treatment for royalties from a related company other than a controlled foreign corporation, e.g. a parent company).
- *American Air Liquide, Inc. v. Commissioner*, 45 Fed. App. 721, 2002-2 USTC par. 50,628 (9th Cir. 2002). The Court of Appeals for the Ninth Circuit affirmed the holding of the Tax Court in a memorandum decision on other grounds. Specifically, the Court declined to reach the question of whether a violation of the ownership provision had occurred, instead resting its decision on a holding that Congress had authorized (and subsequently "implicitly ratified") the Treasury regulations in question with the intention that they override any income tax treaty obligations as may have existed to the contrary.

82. The same argument was accepted by the *Commissaire du Gouvernement* to the French *Conseil d'Etat* in the SAS case (16 February 1990, RJF, 4/90, No. 393). In this case, a French subsidiary of a Swedish parent company was invoking the ownership provision to obtain the full deductibility of the interest it paid to the latter company. The French tax administration considered the interest as not fully deductible since it was paid to a foreign parent company that was not eligible for the affiliation regime (the *mère-fille* regime) and not to a French parent company eligible for the regime. As to the "similar" situation, the *Commissaire du Gouvernement* (Philippe Martin) explained that the French subsidiary could not invoke the ownership provision that is applicable to a parent company since the Swedish parent company was not in the same situation as a French parent company eligible for the affiliation regime. Indeed, this regime requires the parent company to be liable for the French corporate income tax, and that was not the case of the Swedish parent company, which did not have a PE in France.
83. See note 38.

have paid at the time of paying a dividend to the parent was postponed until the time it paid tax on its profits for the accounting period (assuming that there were taxable profits) after the end of the period; and correspondingly, assuming that the parent passed on the dividend to its shareholders in the same or a later period, the parent paid ACT at the time of paying its dividend instead of after the end of the relevant accounting period.[84] Essentially, the difference if all companies are in a tax-paying position is a cash flow one.[85] It is not clear whether this is sufficient to engage the ownership provision, on the basis that more burdensome taxation might mean the amount of tax, although it ought to be covered. Domestic law provided that the election could not be made between a domestic subsidiary and a non-resident parent company, and so it was the inability to make the election that was the alleged discriminatory provision.

The House of Lords approached the issue by asking whether the foreign ownership of the subsidiary paying the dividend was the real ground for the non-application of the relief by considering a number of examples, the results of which are summarized in the following table:[86]

Type of ownership	**Residence of recipient of dividend**	**Group income election possible**	**Whether recipient liable to pay ACT on payment of a dividend**
direct, company (the situation in the case)	US	no	no
direct, company	UK	yes	yes
indirect, non-resident company (as to the dividend between the UK sub-subsidiary and UK subsidiary)[1]	UK	yes	yes
direct, individual[2]	UK	no	no
direct, individual	US	no	no
direct, incorporated charity [not considered in the case][3]	UK	no	no

84. In summary, a company paying a dividend had to pay an amount of corporation tax (ACT) calculated by reference to the dividend (but not deducted from the dividend). So long as the company was making profits in the same year as the dividend was paid, the effect was to bring forward the time of payment of part of the corporation tax that would be paid after the end of the year on the company's profits (mainstream corporation tax). The effect in the absence of the provision with which we are concerned of a subsidiary paying a dividend to its parent was that the subsidiary paid ACT in the normal way at the time of paying a dividend to the parent, and the parent could distribute the same amount without paying any more ACT, passing on to its shareholders a tax credit equal in total to the ACT that the subsidiary had paid (this situation is applicable in domestic law to the case of a UK subsidiary with a foreign parent); alternatively, the parent could pay ACT on a dividend and surrender it to the subsidiary, which could set it against its mainstream corporation tax. The provision under discussion was that if both the parent and subsidiary are UK resident they could jointly elect that instead the subsidiary could pay the dividend without paying any ACT (thereby paying more corporation tax after the end of the accounting period), and if the parent passed on a dividend of the same amount it paid the ACT that the subsidiary would have paid. In other words, the choice for UK companies was between the normal rule of paying ACT at the time of the subsidiary's dividend; or paying no ACT at that time but paying it later when the parent passed the dividend on to its shareholders (assuming that it did so).
85. It was this factor that led the European Court of Justice in *Metallgesellschaft* (Case C-397/98) and *Hoechst* (Case C-410/98) to hold that the same statutory provision was contrary to a German parent company's freedom to establish a subsidiary in the United Kingdom: "54. Consequently, to afford resident subsidiaries of non-resident companies the possibility of making a group income election would do no more than allow them to retain the sums which would otherwise be payable by way of ACT until such time as MCT [mainstream corporation tax] falls due. They would thus enjoy the same cashflow advantage as resident subsidiaries of resident parent companies, there being no other difference – assuming equal bases of assessment – between the amounts of MCT for which the two types of subsidiary are liable in respect of the same accounting period."
86. The table is reproduced from *FCE Bank* (see note 41) at [14], [16].

1. This example was held not to be relevant in *Test Claimants in the Thin Cap Group Litigation v. HMRC* [2010] STC 301 at [360] on the basis that the interposition of an intermediate UK holding company would have made no difference to the application of domestic thin capitalization rules.
2. The treatment of an individual is not strictly relevant to a provision relating to intra-group dividends, but Lord Hoffmann presumably included it as it adds support by showing that the ground for the difference in treatment was based on liability of the recipient to ACT and was also true of non-group situations.
3. This situation is dealt with in TA 1988 Sec. 247(5). It seems from the written cases in the House of Lords that these examples were introduced in oral argument, which may account for this important example not being included.

As the table clearly shows, there is concurrence in all cases between whether the group income election is possible and whether the recipient is liable to pay ACT if it paid (or could pay) a dividend.[87] Nor was liability to pay ACT the same as whether the recipient was resident.[88] Accordingly, the ground for the difference in treatment was not ownership; it was liability of the recipient to pay ACT. An election that the parent company would take over the subsidiary's liability to pay tax when the parent could not be liable for the tax was not meaningful.[89] The House of Lords therefore concluded that:

> An election is a joint decision by two entities paying and receiving dividends that one rather than the other will be liable for ACT. This is not a concept which can meaningfully be applied when one of the entities is not liable for ACT at all.[90]
>
> …
>
> To allow an election by a group with a US-resident parent would not be to give a relief available to a group with a UK-resident parent. It would be something different in kind. It would not be an election as to who would be liable for ACT but as to whether the group should pay it at all.[91]

As with the US *Square D* case, the fact that the conditions for application of the ownership provision were present, and could not be changed by considering hypothetical facts, did not mean that non-resident ownership was the ground of the denial of the domestic provision. The reason for the denial was the fact that the recipient of the dividend did not pay tax, as is demonstrated by the fact that a dividend paid to a parent company that was a resident corporate charity would not have qualified either.

The 2008 Commentary clearly had this case in mind in a passage referring to the same domestic law provision:

> A similar example would be that of a State that levies a tax on resident companies that make distributions to their shareholders regardless of whether or not they are residents or non-residents, but which, in order to avoid a multiple application of that tax, would not apply it to distributions made to related resident companies that are themselves subject to the tax upon their own distributions. The fact that the latter exemption would not apply to distributions to non-resident companies should not be considered to violate paragraph 5. In that case, it is not because the capital

87. This not to argue that concurrence proves that one is the cause of the other. Here there is a rational connection between liability to pay ACT and the relief applying.
88. Brian Cleave in "Boake Allen Ltd and others v HMRC – group income elections and non-discrimination" [2007] BTR 604, 606, and "*Boake Allen* (or *NEC Semi-Conductors*): Non-Discrimination, Advance Corporation Tax, Tax Treaties and the Free Movement of Capital", 48 *European Taxation* (2008) 91, 95, argues that the reason why the recipient was not liable to pay ACT was because it was non-resident. This is true if one restricts the examples to companies, but the purpose of Lord Hoffmann including the example about individuals (and also our charity example) was to show that there are other cases where payment of ACT and residence are not the same.
89. The same point was in effect made by the ECJ in the *Metallgesellschaft* (see note 85) judgement at [65], that as the non-resident parent company was not liable to pay UK corporation tax there was no logic in saying that it should make an advance payment of such tax.
90. At [17].
91. At [19].

> of the resident company is owned or controlled by non-residents that it is treated differently; it is because it makes distributions to companies that, under the provisions of the treaty, cannot be subjected to the same tax when they re-distribute the dividends received from that resident company. In this example, all resident companies are treated the same way regardless of who owns or controls their capital and the different treatment is restricted to cases where distributions are made in circumstances where the distribution tax could be avoided.[92]

This clearly makes the distinction between ownership and taxability and demonstrates that ownership may be present but is not the ground for the denial of the relief, which is the fact that the recipient of the dividend is not taxable.

By contrast, a recent decision of the German *Bundesfinanzhof*[93] (BFH) shows a different approach in relation to the former German thin capitalization provision. This provision did not apply if the recipient of the interest was entitled to the former imputation tax credit (in 1999/2000) or was taxable on such interest by way of assessment (in 2001). It thus was argued (on a basis similar to that in *NEC*) that, as the provision applied to interest paid to some domestic tax-exempt entities, it did not contravene the ownership provision, as its application related to whether the recipient was taxable on the interest or not and not on whether the recipient was a non-resident. However, the BFH explicitly referred to the similar reasoning of the ECJ in *Lankhorst-Hohorst*,[94] in which a German company with a foreign shareholder being a corporation had to be compared with a company having a domestic shareholder who is also a corporation (rather than a tax-exempt entity). In *Lankhorst-Hohorst* the Advocate-General described tax-exempt entities as "intrinsically different from those which, like the plaintiff's parent company, are involved in commercial activities and operate with a view to a profit".[95] The court therefore adopted the usual non-discrimination approach of comparing two identical situations except for the residence of the recipient of the interest.

It is doubtful whether the residence of the owner was really decisive for the German rule to apply. Whereas most commentators in German tax literature affirmed this with regard to the rule in force until 2000, the law effective from 1 January 2001 cannot be construed as to necessarily imply a foreign owner.[96] It merely required a foreign payee. For the years 1999 and 2000 at least, the court consistently followed the majority commentator opinion and held that the German thin cap rules violated Art. 24(3) of the Germany–Switzerland treaty (which corresponds to Art. 24(5) of the Model), because in these years a foreign owner always had to be present to trigger the thin cap rule even if interest payments were made to another affiliated foreign company.[97] We shall develop the issues raised by these cases in the following sections.

4.2. Whether there is any significance in "similar enterprises"

The reason for the use of the expression "similar enterprises" may be that what is to be compared is: (a) enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, and (b) other similar enterprises of the first-mentioned State. Since "of a Contracting State"

92. OECD Commentary on Art. 24, Para. 78.
93. 8 September 2010, I R 6/09.
94. Case C-324/00.
95. At [33].
96. See Rust in Vogel and Lehner (eds.), DBA (5th German ed.), Art. 24, m.n. 165a; the former German thin capitalization rules differed from the *Organschaft* rules in this respect, since the latter clearly attach to domestic/foreign ownership (see note 131).
97. For the combination of foreign ownership and another requirement, see 4.3.6.

equates to "of the first-mentioned State", the relevant portion of (b) is "other similar enterprises". This reflects a common drafting pattern – set up a case (a), which describes certain conditions, and then define the case (b) with the word "other", often as part of the longer phrase "in any other case" (i.e., in the most basic, binary logic: "(a)" and "not (a)"). Here, case (a) is an enterprise "the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State" – such that case (b) is any "other" (similar) case – meaning an enterprise "the capital of which is [*not*] wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State". The addition of "similar"[98] would clarify what is inherent in the concept of discrimination – treating similar cases differently, but is understandable here as an effort to clarify that differences resulting from different regimes for different industries or activities, or even legal forms of entity, are permitted.[99]

The OECD Discussion Draft of 3 May 2007, in a passage that is not repeated in the 2008 Update, argued that the reference to "similar enterprises" is the reason why the ownership provision has no relevance to domestic grouping provisions. The argument was that "similar enterprises" referred to the company concerned as a separate enterprise only, so that transactions with other members of the group should be ignored since in respect of such transactions similarity could not be achieved between subsidiaries with domestic parent companies and those with non-resident parent companies:

> 11. These questions [relating to groups of companies] are linked to the meaning of the term "similar enterprises" in paragraph 5. Contrary to paragraph 1, paragraph 5 does not explicitly require that the enterprises must be in the same circumstances. However, the term "similar enterprises" might imply that they should be comparable and that this is not always the case. The term "similar enterprises" might suggest that paragraph 5 is dealing with companies as separate entities only and that as far as transactions between the subsidiary and the parent are concerned, the subsidiary of a domestic parent might not be a similar enterprise. Also, the question has been

98. Other references in the article to the comparator are all to the same, rather than "similar": "same circumstances" in the current Art. 24(1) (but see note 34 for the Commentary's interpretation of "the same circumstances" to mean "substantially similar circumstances") and (2), "same activities" in Art. 24(3), and "same conditions" in Art. 24(4). "Similar" may be used in the ownership provision because it might be said that a foreign-owned enterprise is not the same as a domestically owned one, but it is similar if carrying on the same activities and whatever else is required, cf. Art. 7(2) – "same or similar activities under the same or similar circumstances ...". If we exclude for the moment the effect of domestic grouping provisions, it is clear that the ownership provision compares the actual treaty partner-owned subsidiary with a (similar) hypothetical (normally) domestically owned subsidiary. One can argue that there is no similarity of the subsidiaries only if similarity is impossible. An example of this can arise with the nationality provision, which by a clarifying addition made in 1992 states that the national of the treaty partner state and the hypothetical national of the state in question should in particular have the same residence (if residence is relevant to the particular tax issue: see OECD Commentary on Art. 24, Para. 18 and Example 4 in Para. 23). If a national company is automatically resident, then subject to an exception noted below, one cannot have a hypothetical non-resident national company with which to compare an actual national and resident of the treaty partner state (although there is no difficulty in comparing two residents of a state, one of whom is a national of the other state whose residence is determined by a management test). The effect of the dual-residence tiebreaker can complicate both cases if one of the companies is a dual resident, but since the company is a dual resident under domestic law, which may affect its domestic law treatment, this may itself be a non-similar circumstance. The effect of a tiebreaker on the nationality provision is now dealt with in the OECD Commentary on Art. 24, Paras. 17-25, making it clear that residence is determined for the purposes of Art. 24(1) after application of the tiebreaker (compare Art. 1, which must be before the tiebreaker). This may mean that even in the case of a country with incorporation as its only domestic test of residence, it is possible to have a non-resident national after application of the tiebreaker (or after application of domestic law if, like Canada and the United Kingdom, domestic law residence is denied if the tiebreaker would otherwise assign the company to the other treaty partner).
99. One would thus not normally compare an enterprise owned by an individual with one owned by a company, particularly when considering domestic grouping provisions.

raised whether or not an enterprise is "similar" if the foreign parent company is not necessarily subject to national taxes on a worldwide basis.[100]

The Commentary, as amended in 2008, now makes the point that the ownership provision has no relevance to domestic grouping provisions because it is limited to the taxation of the enterprise and not the owner of the capital, without reference to "similar enterprises".[101] The history gives no support for the argument in the quoted passage up to the final sentence. The original UK treaties, other than the treaty with Switzerland, just said "other enterprises"; "similar" was added in the Swiss proposal to the OEEC Working Party[102] in place of "like" in the 1954 United Kingdom–Switzerland treaty at the same time as the addition of "in the like circumstances".[103] The Fiscal Committee's minutes stated: "It was agreed that the expression 'other similar enterprises established in the territory of that first-mentioned Contracting Party' referred to enterprises not under foreign control."[104] This was implicit in the Working Party's original proposal but unfortunately this statement was never included in the Commentary (nor was the provision redrafted to say this). If it had been, it would have avoided the disagreements that have subsequently developed about the meaning of this phrase. For example, the UK Revenue's long-standing interpretation[105] and their original argument in *NEC Semi-Conductors Ltd and other Test Claimants v. IRC*[106] was that the comparison should be with an enterprise owned by third-state residents. It was, however, accepted by all the UK courts[107] that the comparison is with domestic-owned enterprises. The OECD Discussion Draft considered that this interpretation was clear and that there was no need to change the Commentary.[108] The history shows that the Discussion Draft was correct on this point.

With regard to the OECD's argument quoted above, while it is true that the ownership provision was intended to deal with companies as separate entities only, this does not depend on the meaning of "similar enterprises" or the absence of "in the same circumstances",[109] but arises because the ownership provision is expressly limited to taxation of the subsidiary.[110] Whether or not the term "similar" is employed, the object of comparison is normally a domestically owned enterprise, which in the nature of discrimination should be an identical

100. We return to this topic later in connection with whether the ground for discrimination is solely that of residence in cases where the same applies to domestic tax-exempt entities.
101. OECD Commentary on Art. 24, Para. 77, quoted in the text at note 69. This deals with a different point: whether there should be grouping between a domestic subsidiary and its non-resident parent company, which we agree is not required, though not because the ownership provision is restricted to the taxation of the subsidiary.
102. See text at note 8.
103. See text at note 33.
104. FC/M(58)2. This must mean enterprises under domestic control only, i.e. not including items (1) and (2) in note 107.
105. See [1978] BTR 198. Although in a memorandum to the Select Committee on Statutory Instruments (25 October 1994, HC 20-xi) the Revenue gave an example where the comparison was with a company owned by residents of the same state.
106. See note 38. The case is also known as *Boake Allen v. IRC*.
107. Park J in the High Court lists four possible interpretations: UK subsidiaries of (1) other parent companies in the treaty partner state (which he described as the most correct grammatical reading but obviously not intended); (2) third-state parent companies (which was the Revenue's contention; the amendment that Canada makes in its treaties is to this effect, see text at note 113); (3) UK parent companies (which he accepted as being the correct interpretation); (4) that there are no similar enterprises: [2004] STC 489 at [27]. We make the point below (text around note 99) that the correct comparators may be all of (1) to (3).
108. OECD Discussion Draft, Para. 88.
109. For the reason for its deletion, see text at note 37.
110. Example 5 in the OECD Commentary on Art. 24, Para. 24, is an example of a grouping provision in relation to the nationality provision which, while not using the expression "similar enterprises", also deals with the company as a separate entity.

enterprise (or at least substantially similar) but for its domestic, rather than treaty partner, ownership.[111] It is still possible to argue "that as far as transactions between the subsidiary and the parent are concerned, the subsidiary of a domestic parent *might* not be a similar enterprise"[112] and to ask "whether or not an enterprise is 'similar' if the foreign parent company is not necessarily subject to national taxes on a worldwide basis". Support for this interpretation is obtained by comparing the wording of Canadian treaties, which make the comparison with "other similar enterprises that are residents of the first-mentioned State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of a third state ...".[113] Clearly in that context "similar enterprises" cannot include the residence of the owner per se[114] but must at most refer to the *nature* of the owner, such as ownership by individuals, or public versus private ownership, or the interface of the owner with some significant aspect of the tax regime. A difficult aspect arises when the parent company is not directly involved, or involved only to a limited extent, in the grouping process, which we consider below. We do not think that any help can be obtained by considering the meaning of "similar enterprises" in the abstract.

4.3. The application of the ownership provision to domestic grouping provisions

We consider that it is impossible to generalize about the effect of the ownership provision on domestic grouping provisions, because of the numerous different factors that can be relevant. We shall adopt the approach of looking at some of them, as follows:

- the categorization of domestic grouping provisions relevant to the application of the ownership provision;

111. Normally after the application of the tiebreaker, but this could cause it to be not similar; see note 98.
112. The UK Revenue had used this argument unsuccessfully in the High Court in *NEC*: "However, so the argument ran, if the hypothetical United Kingdom resident parent would receive (so far as dividends are concerned) the normal tax treatment applicable to United Kingdom resident companies, its United Kingdom subsidiary, though an enterprise of the United Kingdom, would not be an enterprise 'similar' to the actual enterprise under consideration. For example it would not be an enterprise 'similar' to NEC Semi-Conductors Ltd. Why not? Mr Glick's [counsel for the Revenue] answer is: because of the United Kingdom tax treatment of dividends received and paid, not by the 'enterprises' themselves (NEC Semi-Conductors Ltd and another hypothetical United Kingdom subsidiary), but by their parent companies (the Japanese parent company of NEC Semi-Conductors Ltd and the hypothetical United Kingdom resident parent company of the hypothetical United Kingdom subsidiary). The Japanese parent company of NEC Semi-Conductors Ltd was not liable to pay United Kingdom ACT if it paid dividends itself; the hypothetical United Kingdom parent company of a comparator United Kingdom subsidiary would have been liable to pay ACT if it paid dividends itself. The Japanese parent company of NEC Semi-Conductors Ltd was not entitled to a United Kingdom tax credit if it received dividends from United Kingdom sources; the hypothetical United Kingdom parent company would have been so entitled. Therefore, so the argument concluded, because the tax treatments of the parent companies would have been different, the two subsidiaries would not themselves have been 'similar enterprises'" [2004] STC 489 at [27]. This is another way of saying that foreign ownership is not the ground for the difference in treatment, which we consider below. The non-similarity argument could arguably lead to the absurd result that would permit legislation preventing a domestic parent and subsidiary from grouping if there was non-resident ownership of the parent, on the ground that the parent and subsidiary were not similar enterprises because the subsidiary was domestically owned and the parent foreign-owned.
113. Canada generally grants non-discrimination protection to foreign nationals (along the lines of Art. 24(1)), and to non-residents in respect of their Canadian PEs (along the lines of Art. 24(3)), but (contrary to Art. 24(5) of the OECD Model) reserves the right to discriminate against Canadian companies and partnerships that have foreign ownership or control by making the comparison with third-country controlled companies (i.e. a most-favoured-nation treatment) in the ownership provision. This reserves the right, consistently with Canadian tax policy, to discriminate against foreigners indirectly (where they have a Canadian subsidiary), but not directly (where they have a Canadian PE).
114. See also the example given by WP 4; see text at note 26.

- the effect of different types of grouping provisions on the ownership provision, such as grouping profits and losses (which in many countries necessarily involves the parent company) and transfers of assets (which are bilateral);
- the interaction with other non-discrimination provisions, particularly the nationality provision and the PE provision;
- the simultaneous application of the ownership provisions of two treaties;
- grouping between a domestic parent company and its domestic sub-subsidiary where there is an intermediate non-resident subsidiary; and
- combination of ownership and another condition.

4.3.1. The categorization of domestic grouping provisions relevant to the application of the ownership provision

4.3.1.1. Grouping of profits and losses

We are not concerned with much of the detail of the many different types of domestic grouping provisions,[115] except so far as they relate to whether it is possible to compare a domestic subsidiary of a domestic holding company with a domestic subsidiary of a non-resident holding company.[116] Domestic grouping provisions relating to the grouping of profits and losses form a spectrum, at one end of which is Australia – where the group is for all tax purposes treated as one company, with the subsidiaries' assets being treated as owned by the parent and having a new base value at the start of consolidation[117] – and at the other end of which are Sweden and the United Kingdom – in which the grouping between companies can be carried out on a bilateral basis by the transfer of profits (Sweden) or the surrender of losses (the United Kingdom) between two subsidiaries without involving the parent in the process (even though domestic law in both countries before 2000 required a domestic parent); and with many different types of consolidation regimes falling in between these extremes. Belgium, Canada[118] and Switzerland have no provisions for grouping profits and losses.

We consider that the relevant difference between these regimes is the degree to which the grouping necessarily affects the taxation of the parent company, and integrates the taxation of the subsidiaries and the parent company to a fundamental degree.[119] Where a domestic parent

115. For example, the definition of the size of holding necessary for grouping is not relevant, since the ownership provision applies where the capital is wholly or partly owned or controlled, directly or indirectly, regardless of the size of holding; or whether grouping is voluntary or compulsory and how long it must last.
116. We are very grateful to Antony Ting, a doctoral student at the University of Sydney, for showing us extracts from his thesis from which we have adopted a number of points in making the comparisons in this section. Other sources of information about the treatment of groups are the IFA *Cahiers de droit fiscal international* (2004) Vol. 89b, and Maisto, G. (ed.), *International and EC Tax Aspects of Groups of Companies* (Amsterdam: IBFD, 2008). The Canadian consultation paper (note 118) also has some international comparisons.
117. The subsidiaries are taken "to be parts of the head company of the group, rather than separate entities ..." (ITAA 1997 Sec. 701-1).
118. The Canadian Department of Finance issued a consultation paper on the Taxation of Corporate Groups on 23 November 2010. Currently, informal methods of grouping are possible, which allow grouping of two Canadian subsidiaries of a non-resident parent company, such as financing arrangements under which money is borrowed by one member of a corporate group to invest in preferred shares of another member (with the interest deduction reducing income in the first corporation's hands, and generating additional interest or other income in the second), and the dividends on the preferred shares, which reverse the cash flows, being neither deductible to the payer nor taxable to the recipient.
119. One question here is whether gaining and having the status of not being subjected to taxation individually is a treatment that is envisioned by the ownership provision. If so, then the ownership provision may be engaged where such treatment is conditional on being wholly owned by a resident. However, it may also be argued that the ownership provision is applicable and precludes discrimination only in relation to more specific treat-

is necessarily involved in the grouping with its domestic subsidiaries, it can be argued that the relevant company for the operation of the ownership provision is the parent company only (because only the parent is effectively subjected to taxation), with the result that only the ownership of the parent should be considered. Under such circumstances, so long as the domestic parent can consolidate its domestic subsidiaries without regard to the residence of the owner of the parent, it is not relevant that direct subsidiaries of its non-resident ultimate parent cannot consolidate their profits and losses, which would be the effect of applying the ownership provision to the subsidiaries. Perhaps another way of putting it is that in such circumstances a subsidiary with a foreign parent (because it cannot deliver the quid pro quo of the involvement of its parent) is not comparable (i.e. not a "similar enterprise") to one with a domestic parent (because the latter can deliver the quid pro quo), but even if the two subsidiaries are "similar" we consider that the ground for the denial of the treatment in question is the inability to deliver the quid pro quo and not, as such, non-resident ownership.[120]

This approach would suggest the ownership provision is most clearly satisfied by a regime such as that in Australia. Australia has managed to have an additional regime which allows consolidation of subsidiaries with a foreign parent in some, but not all, cases, only at the cost of considerable complexity and a large amount of additional legislation.[121] At the other

ments affecting domestic companies that are subjected to taxation in the first place, on the basis that those that are simply not subjected to taxation are not "similar enterprises". Thus, the proper comparison would be as between two domestic companies that are both subjected to taxation – and the question would be whether the nature and extent of the taxation to which one is subjected are other or more burdensome than those to which the other is subjected on the ground of non-resident ownership. One problem with the argument that gaining and having the status of not being subjected to taxation individually is a treatment that renders the subsidiary of a domestic parent dissimilar to a subsidiary of a foreign parent, is that it is circular to some extent in that the tested treatment – that is, that of gaining and having the status of not being subjected to taxation individually – is being posited as the basis for the dissimilarity, thereby providing its own justification. We consider that tax treatment can in certain cases be a relevant consideration in the similarity determination, but not with reference to the tested treatment. Thus, where the tested treatment is gaining and having the status of not being subjected to taxation individually, it must be justified on independent grounds. We consider that it can be justified where it is available only to subsidiaries that have their entire tax position thereby transferred to their parent companies. In such a context, we consider that the universe of eligible parent companies can reasonably be restricted to resident parent companies, in that Art. 24(5) cannot require a contracting state to permit a transfer of the tax position of its subsidiary to a non-resident parent company because Arts. 7 and 21 would not permit that contracting state to tax such income where it is not income attributable to a PE of the parent company – in brief, the treaty cannot require under Art. 24(5) what it does not permit under Arts 7 and 21, and it cannot be read to require a contracting state to permit the benefit of a particular tax treatment (i.e. gaining and having the status of not being subjected to taxation individually) to be enjoyed where it cannot apply the corresponding treatment (i.e. substitute or transferred taxation of the parent company) that is the quid pro quo for the first treatment. In such a case, we consider that the real ground for the denial of same treatment to subsidiaries of non-resident parents is not non-resident ownership but rather absence of the possibility of quid pro quo. It is this quid pro quo that we refer to herein at times as the substantive involvement of the parent.

120. Here, it is not the presence of domestic ownership as such that renders the second subsidiary dissimilar (as the OECD suggests), but the inability to deliver the quid pro quo. In contrast, domestic ownership never relieves UK (and certain other) subsidiaries from subjection to taxation, such that residence of ownership does not directly or indirectly affect the similarity of enterprises even on a view of similarity that distinguishes subsidiaries as a function of being or not effectively subjected to taxation – that is, even on a somewhat circular view of similarity. In any event, though, for UK (and certain other) subsidiaries, there is no question as to similarity except on the OECD's view – which we consider completely circular in that it posits that non-resident ownership as such can be a distinguishing factor under a rule testing for non-resident ownership discrimination. We consider that such subsidiaries are similar to those of a non-resident parent because the parent is not necessarily involved in their grouping arrangements such that they are not in a position of inability to deliver the quid pro quo.

121. These are called multiple-entry consolidated groups and have special and different rules from normal consolidation for losses and calculating the cost of shares in the first onshore company (which is relevant if they are land-rich, which is not uncommon because of the importance of mining in Australia). Australia previously had

extreme, if the parent is not involved in the grouping of its subsidiaries (or is only involved as a matter of computation and making returns), and the subsidiaries remain effectively subjected to taxation in the same manner as the subsidiaries of a domestic parent, it cannot be said that it is only the parent's right to consolidate that is relevant to the operation of the ownership provision, and so the relevant companies for the operation of the ownership provision must include the subsidiaries, in which case the residence of the owner of the subsidiaries (the parent) has to be considered. Under this heading we describe the different types of grouping in the countries represented by the authors; we shall consider how the ownership provision relates to them under the following heading.

Germany attributes profits and losses of a subsidiary in an *Organschaft* to the parent. The parent and each subsidiary must enter into a grouping agreement (*Ergebnisabführungsvertrag*), which will also provide for payment for the transfer of profits from the subsidiary to the parent and for the assumption of the subsidiary's losses by the parent. As a consequence of such *Organschaft*, any positive or negative income of the subsidiary is attributed to the parent. The system does not allow a direct transfer of taxable income between the subsidiaries. Interestingly, a PE of a non-resident company can be a "parent company"[122] for this purpose.

Next in order are the United States and Japan,[123] in which the common parent must be an eligible company and the inclusion of all eligible companies in the group is required so that the parent is necessarily included and the results of all eligible companies are consolidated for purposes of determining the group tax liability. The system does not allow grouping between subsidiaries without including the parent. Assets, liabilities and various tax attributes of the various subsidiaries (e.g. intercompany items of gain or loss and the stock basis of group subsidiaries) are separately determined and become relevant if a company leaves the group or the group ceases to exist. During the consolidation, one cannot consider the relationship between two group subsidiaries in isolation from the parent, because the tax attributes of all three are consolidated in determining the group liability and the parent's earnings and profits account and so are treated in this respect as in effect a single enterprise – such that the subsidiaries are not effectively subjected to taxation in a manner that is similar to a subsidiary of a foreign parent. At least in the United States, a hypothetical different regime that would accommodate a foreign parent (i.e. horizontal consolidation of brother/sister companies) would not meet certain basic tenets of US corporate tax law, such as (i) the determination of the second-level tax on earnings of the entire group and (ii) the US taxability of dispositions of parts of a US group.[124]

The Netherlands deems the transactions and assets and liabilities of the subsidiaries to be those of the parent, while preserving the subsidiaries as theoretical taxpayers. The current

regimes for transfer of losses and assets among members of wholly owned groups, but it did not matter if the ultimate parent was domestic or foreign under such regimes. While consolidation has replaced these regimes generally, they remain in place in some limited cases. The loss transfer has been fundamentally changed, however, as it is now limited to PEs of foreign banks and 100% onshore subsidiaries; in no other case before or after consolidation has loss transfer involving local PEs been permitted.

122. The quotation marks are intended to indicate that we are not spelling out in full that the question is whether the non-resident company can be the parent (or similarly, a member) of the group to the extent of the PE.
123. We refer to this as the "consolidated tax return" system, in contrast to the group taxation system, described in note 129.
124. Attempts to adjust for these (e.g. in the case of (1) having the taxation of one subsidiary's distributions affected by distributions by the other, and conditioning liquidating tax treatment of one subsidiary on liquidation of the other, and in the case of (2), requiring the foreign parent company to elect to be taxed on gain from a disposition of the subsidiaries), would be theoretically and administratively awkward to say the least.

regime allows grouping of domestic subsidiaries attributed to a PE in the Netherlands of many types of foreign parent companies,[125] as it allows a PE in the Netherlands to be a "member" of the group. Intra-group transfers of assets are possible and the participation exemption will apply to such transfers of shares in the subsidiaries.

France[126] and Italy retain the separate tax status of the subsidiaries, but merely allow the parent to merge their results. As in the Netherlands, in France and Italy a PE may be a "member" of the group (but only in Italy as the "parent" of the group). France allows intra-group transfers and exempts the transfers of subsidiaries.[127]

Finally, at the other end of the spectrum, Sweden and the United Kingdom allow the transfer of profits and surrender of losses, respectively,[128] between group companies (or PEs in the country concerned) on a bilateral basis, decided from time to time without involving the parent unless it is a party to such transfer. The same applies in Sweden and the United Kingdom to the transfer of assets without realizing a profit on the transfer, and also in other countries in cases not covered by grouping of profits and losses. Where the parent is not involved in the transfer, the subsidiaries (or PEs in the country concerned) can be considered entirely separately from the parent. The process and effect are the same as between the subsidiaries, whether the parent is domestic or foreign.

4.3.1.2. Transfers of assets within a group without realizing a profit and other reliefs

Apart from cases where the effect of grouping of profits and losses automatically includes the transfer of assets between group members, the transfer of assets within a group is necessarily also carried out on a bilateral basis, except that in Australia such transfers are automatically treated as being within the parent company, although bilateral rules also exist for tax-free asset transfers for cases involving non-residents in 100% groups. Such provisions exist in all countries represented

125. Applying to parent companies effectively managed in the Netherlands Antilles, Aruba, an EU Member State, and a state with which the Netherlands has a tax treaty containing a nationality non-discrimination provision (presumably because the domestic law lists the applicable Dutch incorporated companies to which the foreign company must be similar).
126. The "tax integration regime" (Secs. 223 A to 223 Q of the French General Tax Code) enables a French parent company (or the French PE of a foreign parent company) to become the only entity liable for corporate income tax, assessed on profits and losses generated by itself and its French subsidiaries. All the members of a tax-integrated group have to be liable for the French corporate income tax. Tax adjustments will be carried out at the level of the tax group so as to mitigate the profits or losses realized by the subsidiaries and to neutralize sales of assets between group companies, intra-group subsidies or intra-group distributions. Tax group companies have to compute their taxable profits as if they were taxed on a stand-alone basis. In addition, the parent company has also to file a global tax return integrating the whole group's tax profits or losses.
127. We shall not deal here with the French worldwide "tax consolidation regime" (Sec. 209 quinquies and Secs. 113 to 134 Appendix II of the French General Tax Code), as our primary interest is grouping of domestic companies. This regime enables French companies to assess their taxable income by taking into account profits and losses generated worldwide directly or indirectly through their PEs and subsidiaries. The French entity will have to report the consolidated profit of the whole group and to make adjustments for intra-group transactions and distributions that would otherwise entail double taxation. Foreign taxes levied on the profits of foreign branches and subsidiaries, as well as withholding taxes on dividend distributions by the foreign subsidiaries, are creditable against French tax assessed on the consolidated profits. This regime is available only to a few French companies, since it is subject to obtaining a specific tax ruling. There is also a "worldwide profit regime" (Sec. 209 quinquies and Sec. 134 A Appendix II of the French General Tax Code), which enables French companies to assess their taxable income taking into account profits realized worldwide directly or indirectly through their PEs. The difference from the tax consolidation regime is that subsidiaries are excluded.
128. Another difference is that in Sweden full payment (but see note 178) must be made for the transfer of the profit, while in the United Kingdom payment for the surrender of losses is voluntary and, if made, has no tax effect.

by the authors, except Belgium, Germany and Italy. Entirely different legislative rules exist for the treatment of profits and losses, for example in Japan[129] and Switzerland,[130] enabling tax to be deferred on transfers of assets between two domestic companies owned by a foreign parent. Grouping may also have other effects, such as in France, Germany,[131]

129. The Japanese group taxation system is compulsorily applicable to the transactions of certain specified assets, including (1) fixed assets, (2) land, (3) securities (other than those held for trading purposes), (4) monetary claims, and (5) deferred assets, but excluding inventory assets, of the value of JPY 10 million or more between all Japanese corporations under direct or indirect common complete control by either a Japanese or foreign corporation. Under the group taxation system, capital gains or losses arising from the first transfer of such specified assets between Japanese corporations within the same group (100% directly or indirectly controlled) will be deferred for tax purposes.
130. The relief for the transfer of business assets within a group to a Swiss resident transferee is available both when the Swiss resident transferor is held by a resident and when it is held by a non-resident group company, and the relief is also available to a Swiss PE of a non-resident company (transfer of business assets to such a PE, or transfer of such a PE) (Art. 63, Para. 3 LIFD and Circular 5 on restructuring, Sec. 4.5.2.3). The relief for the transfer of a participation within a group is available not only when the transferee is a Swiss resident company or a Swiss PE of a non-resident company, but also when it is a non-resident company, but the relief is available for such an intra-group transfer only if the non-resident company is held directly or indirectly by a Swiss resident company and only if this Swiss resident company accepts to take over from the transferor the potential tax liability for the unrealized gain connected with the transfer of the participation (Circular 5 on restructuring, Sec. 4.5.2.6). According to the Circular, this is assimilated to a transfer to a Swiss resident transferee, with a subsequent push-down of the participation to a non-Swiss resident subsidiary of the transferee (Tax-free transfer according to Sec. 4.4.2.2.5).
131. In Germany interest payments between members of an *Organschaft* are disregarded for the purposes of the interest capping rule (*Zinsschranke*) and are therefore deductible even if the payor does not meet the requirements of this rule. Interest, as well as royalties and leasing fees, paid between domestic PEs of members of an *Organschaft* is fully deductible for trade tax purposes, whereas the deductibility would be restricted if the payor was taxed on a stand-alone basis. The denial of these other advantages of an *Organschaft* for such payments between domestic subsidiaries of a non-resident parent is apt to contravene the ownership provision; however, one may debate whether the domestic group companies need to have concluded grouping agreements (*Ergebnisabführungsverträge*, EAVs) with the foreign parent in order to be "similar enterprises". The benefit of full deduction of the interest or other payments is unrelated to the concept of income attribution to the parent of the *Organschaft* and may therefore contravene the ownership provision. With regard to the deductibility for trade tax purposes of interest payments made by a German company (claimant) to its German parent company, the Hessian Tax Court decided differently under Art. XX (4) of the 1964 Germany–United Kingdom treaty (Hessian Tax Court of 18 May 2010, cases 8 K 3137/06 and 8 K 1160/10). The parent was a merely passive intermediate holding company owned by an active UK plc. According to former trade tax law *Organschaft* was only available with an active parent (for trade tax *Organschaft*, the existence of an EAV was not required at that time); had, however, the UK plc been a domestic corporation, the claimant and its immediate parent would have been members of an *Organschaft*, which would have existed between the claimant and the top company on the one hand and between the intermediate holding company and the top company on the other hand. The Court held that the ownership provision was not violated; according to the Court, it was required to compare the facts of the case with a hypothetical situation in which the owners of the plc – and not the plc itself – were residents of Germany (see 8 K 1160/10, m.n. 36 and the critical note by Mössner, 19 *Internationales Steuerrecht* [2010], p. 778). However, the Tax Court's judgements were reversed by the *Bundesfinanzhof* on 9 February 2011 (case I R 54,55/10). The *Bundesfinanzhof* found a violation of Art. XX(4) of the Germany–United Kingdom tax treaty to be present. It held that Germany was required not only to remove the disadvantageous effect of restricting the full deductibility of interest payments made by the claimant to its German parent company, but to accept all effects of an *Organschaft* between the claimant and the UK plc. The *Bundesfinanzhof* expressly acknowledges that this may lead to under-taxation under certain circumstances if the effort to enforce taxes against the non-resident parent of the *Organschaft* fails; this is merely regarded as a consequence of Arts. 7(1) and 5(7) OECD Model. The authors tend to disagree with the *Bundesfinanzhof*'s conclusion that Art. XX(4) of the Germany–United Kingdom tax treaty (Art. 24(5) OECD Model) requires – in the absence of a reservation similar to Protocol No. 21 of the 2006 Germany–United States tax treaty – a cross-border consolidation of income; rather, the application of the ownership provision should be restricted to effects within the taxing jurisdiction (see also note 136).

the Netherlands,[132] Italy[133] and Sweden,[134] with respect to the deductibility of interest paid between members of the group.

Other differences in the way in which countries structure their domestic grouping provisions may also be relevant to the application of the ownership provision: for example, that the types

132. Under Art. 10a(1)(c) CITA, restrictions apply to the deductibility of interest (along with currency losses and other costs) incurred with respect to equity-financed loans obtained by an – often newly created – Dutch (intermediate) company from a related party (for example, its parent company) to finance the acquisition of a Dutch (operating) subsidiary that is to enter into a fiscal unity with the acquiring Dutch company.
133. The law provides some limitations to the deductibility of interest expense incurred by Italian resident companies and by Italian PEs of foreign companies (Art. 96 of Presidential Decree dated 22 December 1986, No. 917 ("Italian Income Tax Code", IITC), as amended by the Law of 24 December 2007, No. 244 (Finance Law for 2008)). In short, based on such limitations, interest expense is entirely deductible from the taxable income only to the extent of interest proceeds realized in each fiscal year. The amount of interest expense exceeding interest income (if any) is deductible to the extent of 30% of the company's EBITDA realized in the same and subsequent fiscal years. The amount of net interest expense exceeding 30% of the company's EBITDA may be deducted against (30% of) the EBITDA exceeding the amount of net interest expense of (1) Italian resident subsidiaries included in the domestic tax group and (2) non-Italian resident subsidiaries fulfilling certain requirements which could be included in domestic tax consolidation if they were Italian resident. The possibility to use the excess of (30% of) the EBITDA of foreign resident subsidiaries is granted only to Italian companies and to Italian PEs of foreign companies that are actually part of a domestic tax group (according to the interpretation of Art. 96(8) IITC by the tax authorities, which is not conclusive since there are arguments also for the opposite conclusion). Thus, an Italian resident company owned by a non-Italian resident company or two Italian sister companies owned by the same foreign parent cannot use for the deduction the excess of (30% of) the EBITDA of their non-Italian resident subsidiaries (provided that they do not own Italian subsidiaries and enter into a domestic tax group together with them) and this circumstance may contravene the ownership provision. The limitations to the deductibility of interest expense above described are applicable to companies which do not qualify as financial entities for regulatory purposes. By contrast, financial entities may deduct 96% of their interest expense gross of interest proceeds irrespective of the amount of the EBITDA they have realized (Art. 96(5-bis) IITC). However, interest expense incurred by Italian companies qualifying as financial entities against other Italian financial companies included in a domestic tax group is entirely deductible to the extent of the amount of interest expense incurred vis-à-vis companies that are not part of the tax group (for instance: A and B are both financial entities part of the same tax group and B pays 100 of interest to A; if A and/or B pay interest to companies outside the tax group for an amount of 100 (or more), interest expense incurred by B with A is entirely deductible and not subject to the 96% limitation). Again, the possibility to entirely deduct intra-group interest expense is granted only to Italian companies and PEs of foreign companies that are part of a domestic tax group. Thus, an Italian resident financial company owned by a non-Italian resident company or two Italian sister financial companies owned by the same foreign parent can deduct 96% of the interest expense incurred with each other (provided that they do not own Italian subsidiaries and enter into a domestic tax group together with them) and this circumstance may contravene the ownership provision. Art. 115 IITC provides Italian resident companies with the possibility to opt for a transparency regime (so-called consortium relief) where shareholders are companies that own a shareholding with a percentage of voting rights and rights to participate to company's profits from 10% to 50%. Such an option may be elected also if shareholders are non-Italian resident, provided that dividends distributed to them would not be subject to Italian withholding tax (Art. 115(2) IITC). The fact that the Italian resident company may opt for the transparency regime only where dividends distributable to non-resident shareholders would not be subject to withholding tax implies that the possibility to opt for the regime depends on the status of the foreign shareholder; this may contravene the ownership provision. The previous Italian thin capitalization rules (Art. 98 IITC, repealed by Finance Law for 2008) (1) were initially structured to limit only the deductibility of interest paid by Italian resident companies to non-resident qualified shareholders and their related parties and (2) were subsequently amended to cover also interest paid to resident shareholders and to their resident related parties. Indeed, in such a case, the ownership provision could not be considered as applicable given that the same regime applies notwithstanding the residence status of the shareholder. As for the application of thin capitalization rules, this conclusion was supported by some Italian literature.
134. Responding to increased tax planning through a so-called debt push-down, Sweden introduced prohibition of deductions on interest payments between related companies effective 1 January 2009 (Chap. 24, Secs. 10 a-e Income Tax Act). Only interest on loans granted as part of an intra-group sale of shares is subject to the statute. If the recipient pays at least 10% tax on the received interest, the restriction does not apply, nor if the taxpayer can show valid commercial reasons for the arrangement.

of companies that qualify as members of a group are those governed by domestic law and fully taxable. We consider this in 4.3.2.

4.3.2. The effect of different types of grouping provisions on the application of the ownership provision

We have argued that whether the ground for the different treatment is truly non-resident ownership, and alternatively whether a subsidiary of a domestic or a foreign parent company is similar, depend on the extent to which the taxation of the parent company is necessarily affected by the substance of the grouping process, and not merely in relation to the computation and making returns of the combined profits and losses. This is most clearly the case in Australia, where the only company subjected to taxation is the parent company (and where the ownership of the parent is irrelevant), and where this is the quid pro quo for the treatment of the subsidiaries, and so it cannot be said that either the subsidiaries or a direct foreign parent are deprived of any rights.[135] Since Germany allows grouping only vertically by treating the subsidiary as an organ of the parent, the parent is a necessary party to the grouping agreement (*Ergebnisabführungsvertrag*) and necessarily resident (or a German PE), and so the two subsidiaries cannot be considered separately from the parent. Finally, since foreign ownership is permitted (in that a PE of a foreign parent can be the German "parent"), this regime permits what appears to us to be more than would be required under the ownership provision and thus does not give rise to a violation.[136]

135. The non-discrimination articles of recent Australian treaties (e.g. the 2007 Australia–Finland treaty) deal with the application of the ownership provision explicitly: "5. This Article shall not apply to any provision of the laws of a Contracting State which:
   a) ...;
   b) does not permit the deferral of tax arising on the transfer of an asset where the subsequent transfer of the asset by the transferee would be beyond the taxing jurisdiction of the Contracting State under its laws;
   c) provides for consolidation of group entities for treatment as a single entity for tax purposes provided that a company, being a resident of that State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, may access such consolidation treatment on the same terms and conditions as other companies that are residents of the first-mentioned State; ..."

136. For countries such as Germany, which permit a domestic PE of a non-resident parent to be the "parent" under a multiple-year vertical grouping regime that includes a domestic subsidiary, we note the interesting question of whether it would be open to the parent to take the position that the subsidiary's country of residence could not impose taxes on the parent in respect of the income of the subsidiary that is attributed to the parent under the grouping regime even if not factually attributable to the PE on the basis that this would be incompatible with Arts. 7 and 21, particularly where the income arises in a third state. While this position may be sound in an involuntary context – for example, where, quite apart from any more generally applicable grouping regime, the domestic rules simply provide that a non-resident parent that has a PE in that state will be taxable on all the income of all its subsidiaries that are resident in that state – it seems difficult to accept that the parent could be permitted to absorb the losses of a domestic subsidiary in one particular year and then decline liability for tax on the income of the subsidiary in another year, even if the subsidiary would lose its ability to shed its liability in that year – or, even more difficult to accept, that the subsidiary could be permitted to rely on the domestic rules to shed its liability in a particular year and the parent to rely on Arts. 7 and 21 to decline that liability in the same year. Thus, while we consider that Arts. 7 and 21 would generally preclude a country from forcing a non-resident to be taxed in respect of the income of a domestic subsidiary, we also consider that this should not be the case where the non-resident has accepted and may have benefited from the status of being the "parent" under a vertical grouping regime. Thus, while we consider that Art. 24(5) cannot be read to require a state to permit a domestic PE of a non-resident parent to be the "parent" under a vertical grouping regime, on the basis that Arts. 7 and 21 would generally preclude a country from forcing a non-resident to be taxed in respect of the income of a domestic subsidiary and thus create an interpretive context for Art. 24(5), we would not consider it to be a violation of Arts. 7 and 21 that a state would permit such a treatment on an elective basis. For other tax benefits, apart from the grouping of profits and losses, see the text around note 131.

The analysis is less clear for the United States[137] and Japan (for the consolidated tax return)[138] because they adopt a mixture of the single-company approach and a separate-entity approach. But because the taxation of the parent company is necessarily affected, the issue is whether there is sufficient of a single-company approach to make the result the same as for Australia. Although the subsidiaries still have identity for tax purposes to which the ownership provision could be applied and have certain separate or potentially allocable tax attributes, these attributes are principally relevant to non-member shareholders, and to the subsidiary if and when its membership in the group terminates. Thus, it can be argued that the single-company aspect is dominant for purposes of the ownership provision. It is also relevant that a PE in the United States or Japan (for the consolidated tax return),[139] respectively, cannot be included in a grouping either as a member or as the "parent", because its tax regime is different than that of a domestic company.

The Netherlands deems the transactions and assets and liabilities of the subsidiaries to be those of the parent and so in principle the parent is necessarily involved, thus suggesting at first sight that it is only the parent's right to consolidate its subsidiaries that is relevant to the operation of the ownership provision. However, the legislation provides that for treaty purposes the profits of the subsidiary are still considered to be its profits (as the profits of a resident of the subsidiary's residence country) and not of the parent (as a resident of the parent's residence country), so that the treaties of the subsidiary's residence state apply and the treaties of the parent's residence state do not. This suggests that, when applying the ownership provision, it may not be the case that the only relevant company is the parent.[140] Suppose

137. The underlying concept of the US grouping regime is a consolidation of separate entity results into overall net results of a single taxpayer, with each subsidiary being a subunit of the whole, included on a single tax return, with the parent company (as direct or indirect owner of all other group members) obligated to file the return, pay the tax, and represent the group in all matters before the Internal Revenue Service. The parent company must be a group member, and (like every other group member) subject to the same tax regime, for these purposes and generally to aggregate the results of the other group members with its own, including for testing whether a distribution from the group is a dividend from a tiered-up "earnings and profits" account. Moreover, because viewed as a single taxpayer, gain and (subject to certain limitations) loss of the subsidiary's shares or assets must be subject to US corporate-level tax on a sale in order to confirm with general US corporate tax law principles. Further, for the same reason that domestic subsidiaries of a foreign company may not be grouped with each other, such companies may not be grouped if owned by certain domestic non-member persons, confirming that the distinction is not motivated by the residence of the owner. Similarly, although a US branch of a foreign corporation cannot be included in a consolidated return, that is not solely because of the residence of the owner but because, as in the case of certain domestic excluded entities, the branch and transactions with the branch (which is subject to US net income tax only on attributable business income and only allowed deductions connected therewith and is subject to an entirely different secondary tax regime) cannot replicate the single-taxpayer model that underlies the US grouping regime. Further, domestic branches of domestic entities that may not be included in a consolidated filing also may not be grouped.
138. See note 123. One aspect of the Japanese group taxation system should be mentioned, as it allows the transfer of profits (but not losses) between Japanese corporations which is non-deductible for the transferor and non-taxable for the transferee. The law allows such transfers between two Japanese corporations owned by a foreign parent company and so the application of the ownership provision does not arise, and we shall not include this provision in the discussion as it does not have any tax effect.
139. See note 123.
140. Certain countries obviously see the potential effects of their grouping regimes on the treaty residence of their subsidiaries. The Netherlands has tried to finesse this issue as described above. Australia has taken a different route, generally departing from the OECD Model's "liable to tax" formulation in favour of a formulation that is perhaps easier to meet with reference to grouped subsidiaries – being along the lines of "a person is a resident of a Contracting State if that person is a resident of that State for the purposes of its tax" (from the treaty with Canada), though the position may be changing. While the matter is uncertain, it is our view that an important distinction must be drawn in this context between being effectively subjected to taxation and being "liable to tax", such that the absence of the latter does not necessarily follow from the absence of the former. A good example is an entity that is not effectively subjected to taxation because it is exempted because of its charitable

the parent were a foreign company with a PE in the Netherlands, holding only the shares in the subsidiaries, without incurring any profit or loss. Domestic law allows grouping of the PE and the subsidiaries. Thus, as in Germany, since the regime permits what at most would be required under the ownership provision, we consider that it does not give rise to a violation.

France and Italy involve the parent company only in the computation of the group profit and paying the tax; in all other respects the results of the subsidiaries are separate. There is nothing to prevent this computation and payment (with the subsidiaries being jointly and severally liable for payment) from being performed by a foreign parent company, providing that it has a PE subject to French corporate tax in the case of France, and so any discrimination must be viewed at the level of the subsidiaries.

Sweden[141] and the United Kingdom[142] are even more obviously cases where discrimination must be viewed only at the level of the subsidiaries since, unless the parent company is actually involved in the transfer of profit or loss, the parent company performs no function.

The above differences are found in provisions grouping profits and losses. In countries where assets can be transferred between members of a group at their base value, these are necessarily bilateral transactions, more comparable to the grouping of profits in Sweden and the United Kingdom. In such cases it is much easier to argue that the ownership provision can be applied where there is a foreign parent. Indeed, in Japan (since 2010) and Switzerland the legislation allows the transfer of assets between subsidiaries of a foreign parent company.

The applicability of the ownership provision therefore depends on differences between different countries' regimes. The answer is affected by fine distinctions of domestic law about which one cannot make any general statements, and differing views may exist about the outcome within a particular state. Our tentative conclusion in relation to grouping profits and losses of domestic subsidiaries of a non-resident parent company is that in Australia, assuming that the legislative provisions allowing it did not exist, Germany,[143] the United States and Japan domestic grouping provisions that do not allow grouping of the subsidiaries' profits and losses are not prevented by the ownership provision, on the basis that the parent's involvement in the process is necessary – in that the parent's tax position is necessarily affected. Indeed, only the parent company remains effectively subjected to taxation and this is the quid pro quo and true ground or cause of the treatment of the subsidiaries and of the dissimilarity of the subsidiaries of a domestic parent to those of a non-resident parent. Thus, the

or similar purposes. It is our view that a grouped subsidiary that is not itself subjected to tax because its results are taxed to its parent company can be yet another such example.

141. From 2000, foreign companies resident in the EEA area qualify as companies under the group contribution rules. This means, inter alia, that such a foreign company qualifies as a parent company to two Swedish companies engaged in a group contribution arrangement.

142. From 2000 relief for the transfer of assets within a group and group relief for losses are both available where the UK resident company is held by a non-resident group company, and the reliefs are also available to a UK PE of a non-resident company so that the ownership provision is not contravened (amendments made by FA 2000, Schedules 27 and 29; see now CTA 2010 Sec. 152).

143. For other tax benefits, apart from the grouping of profits and losses, see the text at note 131. Until 2001 German profit and loss grouping (*Organschaft*) required the parent company to have both its statutory seat and its place of management in Germany. In a very special case concerning a Delaware corporation with dual residence in the United States and Germany and its effective place of management in Germany, the Federal Fiscal Court held that the requirement was contrary to Art. 24(4) of the 1989 United States–Germany tax treaty, which equals Art. 24(5) of the Model (judgement of 29 January 2003, I R 6/99). With effect from 25 December 2001, the *Organschaft* rules were amended in order to allow profit and loss grouping with a foreign parent as long as the parent has its place of management in Germany.

only relevant company for the operation of the ownership provision is the parent company in respect of its right to consolidate its subsidiaries (for which it is ownership of the parent that is relevant). However, we consider that in France, Italy, Sweden and the United Kingdom the relevant companies are the subsidiaries and it is their ownership that is relevant, with the result that the ownership provision applies to require grouping between two resident subsidiaries of a non-resident parent, which the courts have accepted in Sweden and the United Kingdom. The Netherlands is close to the borderline, having attributes of both extremes, although the separate-entity aspect seems to predominate by virtue of what could be viewed as a deliberate statutory displacement of the notion that the subsidiaries cease to be effectively subjected to taxation. Only for those countries where a comparator exists is it necessary to go on to consider whether the ground for denying the relief is non-resident ownership. But, as noted above, since the regime permits what at most would be required under the ownership provision, we consider that it does not give rise to a violation.

In relation to provisions dealing with the transfer of assets within a group, our conclusion is that the ownership provision is in principle applicable to transfers between domestic subsidiaries of a non-resident parent company in all countries where this is permitted within a wholly domestic group,[144] except in relation to the Australian consolidation regime, where all transactions are treated as being within the parent company (although domestic law does permit this in most cases where there is non-resident ownership).[145] In the United States, transfers of assets for cash or other non-equity consideration that do not qualify under the tax-free transfer rules are taxable, even if within a wholly domestic group, unless that group files a consolidated income tax return. Domestic legislation enables intra-group transfers to be made between domestic subsidiaries of a non-resident parent in Japan, Sweden,[146] Switzerland and (since 2000) the United Kingdom.

4.3.3. The interaction with other non-discrimination provisions, particularly the nationality provision

In almost all countries represented by the authors, the types of company eligible to be members of a group for the application of domestic grouping provisions are defined by reference to companies that are nationals within the nationality provision (all of which are resident), sometimes restricting grouping to particular types of national company,[147] although in several

144. Not Belgium and Germany. In Canada, non-recognition of gains to the transferor is not automatic and requires shares of the transferee to be received by the transferor, regardless of their pre-transfer relationship or the degree of relation resulting from the issued shares.
145. Australia still has tax-free transfer rules outside consolidation, e.g. between a single Australian subsidiary and its 100% foreign parent, even though consolidation is not available in such a case as there is only one group company resident in Australia and consolidation needs more than one company.
146. The issue arises only on the sale of assets at below market value between sister companies; if the transfer is at market value it will be taxed whether or not the parent is resident in Sweden. If the transfer is of a whole business, it is sufficient that the parent is resident in a treaty country. If the transfer only concerns individual assets, i.e. not a whole business, in order to qualify the two subsidiaries must be able to qualify under the group contribution provisions, which they will not if the parent is not an EEA company.
147. For example, in Italy, the only companies to qualify as controlled companies are the S.p.A., S.a.p.a. and S.r.l. (i.e. national corporations), while more entities may qualify as controlling companies, namely the S.p.A., S.a.p.a., S.r.l., *societas europaea*, *societas cooperativa europaea*, national mutual companies (*società cooperative*, *società di mutua assicurazione*) and other commercial entities mentioned in Art. 73, Para. 1, lit. b), of the Income Tax Code; in the Netherlands, the only companies to qualify are an NV, BV, cooperative and a mutual insurance company; in Sweden a limited liability company and a cooperative society and (except as a parent company) some other associations subject to tax on business income.

countries a PE of a non-national company also qualifies.[148] The purpose of such a provision may be to ensure that eligible companies are fully taxable,[149] but its effect may be discriminatory in relation to a fully taxable resident non-national. However, in Italy,[150] the Netherlands[151] and Sweden[152] the legislation (or the tax department's published understanding of it) specifically allows non-national companies to be members of the group,[153] and Australia and the United Kingdom define group companies in a way that means that nationality is irrelevant.

This raises a number of issues. One is the issue of how the nationality and ownership provisions are to be applied to a company (be it a subsidiary or a parent) that is a resident of the state with the grouping provisions in question but a national of the treaty partner state. Another is how the nationality and ownership provisions are to be applied to a company that is both a national and a resident of the treaty partner state.

Assume that we are considering whether the ownership provision applies to group the profits and losses of two state A subsidiaries of a state B holding company when they could be grouped if the holding company were a state A national and resident company, and that the state B company is similar in type to one of the listed types of state A company. Assume also that the ownership provision can potentially be applied to allow the grouping in spite of the non-residence of the holding company. There is then the further problem that the law also requires a state A national holding company. If the nationality provision is separately applied after[154] the ownership provision, grouping will still not be permitted if state A does not allow the possibility of a non-state A company to be resident, because the only resident companies are state A companies (i.e. where there is no distinction between residence and nationality).[155] Here a comparator for the application of the nationality provision cannot exist. In other cases where a state B national company can be a resident of state A, both the nationality and ownership provisions can potentially be applied separately.

On the other hand, it can be argued that both nationality and residence are the grounds for the difference in treatment, which raises the questions whether both can be applied simultaneously, and how exactly they might be applied. The history gives no support for combining non-discrimination provisions of the same treaty since they were developed independently

148. France, Germany, Italy, the Netherlands, Sweden and the United Kingdom. A PE also qualifies for the regime relating to assets and losses in Australia.
149. It is clear that this is the purpose of the Dutch provision, since it is not sufficient that the listed type of company be incorporated in the Netherlands, the European Union, the Netherlands Antilles, Aruba, or a state with which the Netherlands has a tax treaty containing a nationality non-discrimination provision (see note 125); it must also have its place of effective management in the Netherlands. The distinction is made in order to prevent a dual-residence provision from giving the company a treaty residence outside the Netherlands.
150. In Italy, the types of company eligible to be members of a tax group are, in principle, defined by reference to companies that are nationals within the nationality provision, but the Italian tax authorities have explicitly affirmed (*risoluzione* 123/E of 12 August 2005) that non-national companies may also be included, to the extent their juridical nature is analogous to that of Italian companies qualifying to be members of a tax group (analogy was supported, in that case, by making reference to companies listed in the EU tax directives); note that the Italian tax authorities have not mentioned Art. 24(1) to support their interpretation.
151. See note 125.
152. See note 141.
153. On 30 September 2010 the European Commission sent Germany a formal request to change the rule that a company incorporated outside Germany but resident in Germany did not qualify to be included in an *Organschaft* as being discriminatory under EU law.
154. The problem does not arise if the nationality provision is applied first.
155. As in Japan and the United States (although this issue may not arise because we have argued that the relevant company for the operation of the ownership provision is the parent company only; see 4.3.2.).

and contain different standards, such as that the PE provision does not apply to "other" taxation or to connected requirements. Some provisions seem to be impossible to combine – for example the PE and the deduction provisions, since the latter contains an exception for Art. 9(1) which cannot apply to a PE.[156] The Commentary's wording that the discrimination must be *solely* because of the prohibited grounds[157] might be an indication against combining different provisions, but the expression is not directed to this issue but rather to whether a particular provision is applicable, as in the *NEC* case where the prohibited grounds were present but were not the cause of the discrimination. The Commentary also deals with the interaction of the non-discrimination provision with the rest of the treaty, saying that something authorized by another treaty provision does not violate the non-discrimination article, and that something that does not violate the non-discrimination article might still violate other articles.[158] This does not deal with the interaction of different non-discrimination provisions, but the approach of considering the non-discrimination article in the context of the rest of the treaty might suggest that if a state has made a commitment against two different types of discrimination, they should be capable of being combined at least so long as it is possible to do so. This issue is pending in Canada in relation to the combination of the nationality and PE provisions.[159]

If the issue is whether the subsidiaries can participate in bilateral grouping, then it seems inappropriate to apply the ownership provision at the level of the parent. It would seem more appropriate to apply it at the level of the subsidiaries. In that context, if it is possible for a parent to be resident in but not a national of that state, and its grouping provisions require both, it becomes very difficult for the subsidiaries to claim that their inability to group bilaterally is caused by non-resident ownership, since they would not be entitled to that treatment if the parent had been a resident because it would not be a national. Moreover, it seems difficult for the subsidiaries to invoke the benefit of the nationality provision in that context, because they are not being affected by their own non-nationality. In contrast, if the facts are that the parent is a non-resident but is a national, then it seems to us that the subsidiaries could claim that their inability to group bilaterally is caused by non-resident ownership, since they would be entitled to that treatment if the parent had been a resident because it would be a national. However, in that case only the ownership provision is at play.

156. One could argue that if the exception is inapplicable the provision should apply, but the existence of the exception suggests that it might be relevant and so the rule should not apply.
157. OECD Commentary on Art. 24, Para. 3.
158. OECD Commentary on Art. 24, Para. 4.
159. In the current *Saipem* non-discrimination litigation in Canada (recently decided by the Tax Court of Canada [2011] TCC 25), there were two UK companies with Canadian PEs. One became the subsidiary of the other, and was then wound up. The subsidiary had Canadian losses, and the parent sought to use those losses in relation to the taxation of its Canadian PE profits. If they had been "Canadian corporations", the losses of the subsidiary could have been used by the parent. To be "Canadian corporations", they must meet two conditions – namely, being resident in Canada, and being incorporated in Canada, unless they were resident in Canada throughout the period that began on 18 June 1971, in which case only continued residence is necessary. These companies are neither resident nor incorporated in Canada, so they fail both tests. The taxpayer therefore needed to apply both the nationality and the PE provisions of the Canada–United Kingdom treaty to succeed. The Tax Court held against the taxpayer, though the judge felt some sympathy for its position. The judgement considers the ownership and nationality provisions separately and concluded that neither applied. There was an argument for combination of them (see Para. [25] of the judgement in the last paragraph of the quotation from the taxpayer's counsel's argument), but it does not seem to be dealt with in the judgement. The point we are making does not seem to have been put to the court. The case is currently on appeal.

It is interesting that the non-nationality of the parent, which is an argument against the ownership provision applying, has not been considered by the courts in the countries where the ownership provision has been considered. The approach of the courts in Sweden and Finland has been restricted to considering whether the non-resident parent company is of the same type as one of the listed types, because references to a company in legislation in those countries includes foreign entities similar to domestic ones. The Swedish[160] and Finnish[161] cases, which concerned group contributions that are payments within a group that are deductible for the payer and taxable on the recipient, compared the type of non-resident parent company to the listed type of domestic company. On finding that these were similar, the court found that the domestic grouping provision contravened the ownership provision. Thus the court considered whether the circumstances of the non-resident parent were similar to a domestic one.

The Dutch courts have not addressed whether the type of company is similar, perhaps because of the requirement that the treaty contains a nationality provision, but have concentrated on whether the ground for the difference in treatment was residence. The *Hoge Raad*[162] case relates to the same case that was referred to the ECJ as *Halliburton*.[163] The situation was that tax-free transfers could be made between Dutch NVs and BVs in a group where the parent was a BV or an NV (or certain other fully taxable entities) under rules separate from the Dutch fiscal unity regime. The parent was a US company and the *Hoge Raad* decided that the ownership provision applied to allow the relief between two Dutch companies in principle where the parent was a US resident. The effect of the ECJ decision was that the transfer by a German subsidiary of its Dutch branch to a Dutch subsidiary was entitled to the same relief

160. Swedish Supreme Administrative Court, RÅ 1996 ref. 69 and 1998 ref. 49. In both cases the issue concerned group contributions between Swedish sister companies having a foreign common parent, and the issue was whether the foreign parent could be considered similar to one of the listed types of Swedish company, all of which were fully taxable, to which the relief applied. In the 1996 case, a German KGaA (at that time) was considered similar to a Swedish company, and in the 1998 case a Cypriot offshore company also qualified under the treaty. Since only fully taxable Swedish parent companies would qualify as a member of the group (no doubt on the basis that the parent company might be a party to the group contribution), it could have been argued (but it was not) that the difference in treatment of the foreign parent companies was not on the ground of foreign ownership but because they were not taxable. As stated in note 141, from 2000, foreign companies resident within the EEA qualify in the same way as Swedish companies for the purpose of the domestic grouping provisions. Thus, the rules are directly applicable when the parent company is an EEA resident. With respect to non-EEA parent companies, the ownership provision is still relevant.
161. The first two Finnish decisions mentioned below were cited in *FCE Bank* (see note 41), and we are most grateful to Prof. Marjaana Helminen for reviewing the references and adding the further Finnish material here and under 4.3.5. and 4.3.4. In the first, Finnish Supreme Administrative Court, Decision KHO 10.05.2000/864 against the refusal of an advance ruling, A Oy (a Finnish company) intended to demerge and form the new companies A Oy and B Oy. In the demerger the Danish company C A/S would become the parent company of each of the two new companies. The court held that group contributions between A Oy and B Oy would be permitted by the equivalent of the ownership provision in the Nordic treaty. The second case, KHO 2003/2773, concerned a Swedish AB with a PE in Finland and a Finnish Oy. The companies had a common parent company in the Netherlands. A tax-deductible group contribution was allowed between the PE situated in Finland and the Finnish company. The third case, KHO 2004/1525, concerned two Finnish Oys, which were owned via several companies in treaty states and in non-treaty states (Bermuda) by a US Inc. The two Finnish sister companies were allowed to make tax-deductible group contributions to each other because they had the common parent company in a tax treaty state (the United States), even though companies in other treaty states and a company in a non-treaty state were interposed. The non-discrimination article of the treaty between Finland and the United States was considered to require allowing the tax-deductible group contribution. (See further under 4.3.4. and 4.3.5.)
162. Dutch Supreme Court, 23 December 1992, BNB 1993/71c.
163. Case 1/93.

as if the transferor had been a Dutch company. The Advocate-General (of the Dutch Supreme Court) said (in translation):

> 5.2.3. According to the clarification given for section V of the ground for cassation the requirement that the top company of the group is founded in accordance with Dutch law results in a heavier burden of tax for a Dutch company of which the shareholder is an American company than would be the case for a Dutch company of which the shareholder is another Dutch company.
>
> 5.2.4. If the German GmbH must be placed on the same footing as a Dutch NV or BV pursuant to the EEC Treaty, the non-application of the exemption of art 15, first paragraph, letter h, WBR [the Dutch Legal Transactions Tax Act] must rest exclusively upon the fact that the parent company is an American Inc. The affected party is consequently subject to a tax that would not be levied if the parent company was a Dutch NV or BV, which is what art. XXV, fourth paragraph, of the USA Treaty prohibits.[164]
>
> 5.2.5. For the sake of completeness I observe further that art. XXV, fourth paragraph, USA Treaty according to the literal text is not applicable to the affected party, given that its shares are held by a Dutch intermediate holding company. I assume, however, that a reasonable interpretation of art. XXV, fourth paragraph, entails that the intermediate holding company be disregarded.[165]

Thus, in Para. 5.2.4. the Advocate-General looked for the exclusive ground for the difference in treatment and found that this was the US residence of the holding company. The Supreme Court agreed with the Advocate-General without, as is its normal practice, giving any further reasons.

The UK provision in issue in the *FCE Bank* case[166] was similar to that in the Swedish and Finnish cases, except that a loss made by a resident company could be surrendered to another resident group company having a profit so long as all members of the group were UK resident (the residence requirement for the holding company was removed in 2000, but the case concerned earlier years). However, the eligible type of company was defined in terms of a body corporate, so that there was no requirement for the non-resident company to be similar to a UK company so long as it was a body corporate, and no requirement for it to be incorporated in the United Kingdom so long as it was resident. Nationality discrimination did not therefore arise. The case dealt with the surrender of a loss by one resident subsidiary to another where both were owned by a US holding company. It found that there were no examples corresponding to the ones given by Lord Hoffmann in *NEC* and summarized in the table above,[167] with the result that the only reason for the denial of group relief was the ownership of the two subsidiaries by the US holding company. The decision cited the Dutch, Finnish and Swedish cases and relied on the reasoning in the Dutch case.

One last example bears examination. Assume that bilateral grouping is permitted under domestic law between subsidiaries of a common parent only if the parent is resident in that state and the subsidiaries are resident in and nationals of that state. The situation of two resident non-national subsidiaries of a non-resident parent may give rise to simultaneous

164. The treaty wording was "4. A corporation of one of the Contracting States, the capital of which is wholly or partly owned by one or more citizens or corporations of the other Contracting State, shall not be subjected in the former Contracting State to more burdensome taxes than is a corporation of the former Contracting State, the capital of which is wholly owned by one or more citizens or corporations of that former Contracting State."
165. BNB 1993, Vol. 1, p. 572. This point seems to be covered by the fact that the ownership provision deals with discrimination on the ground of indirect ownership or control.
166. See note 41.
167. See note 86.

application of the ownership provision and the nationality provision. The argument would be, in relation to the application of the ownership provision, that resident ownership could not be required of them, as that would violate the ownership provision, and that their foreign nationality could not be held against them either. In other words, the argument could be that their foreign nationality could not be held against them because that would violate the nationality provision, and thus that in applying the ownership provision one must posit either that they should be treated as nationals or that this condition should be ignored, such that the only reason left causing their inability to group is the non-residence of the parent, which in turn violates the ownership provision. The counter-argument would be that even if they were treated as nationals, they would not qualify, because of non-resident ownership, such that the situation does not violate the nationality provision (i.e. the reason – for the purposes of the nationality provision – is non-resident ownership, not their foreign nationality), and that the ownership provision is also not violated because even if the parent were a resident they would not qualify because of their foreign nationality.[168]

4.3.4. The simultaneous application of the ownership provisions in two treaties

A related issue is whether two different treaties can be applied simultaneously or successively. In a decision of the Swedish Supreme Administrative Court,[169] the parent company was German, having a Swiss and a German subsidiary, and each of them had a Swedish subsidiary. A transfer between the two Swedish sub-subsidiaries would qualify for the relief for group contributions if all the companies in the upwards and downwards chain between the two Swedish sub-subsidiaries had been Swedish. Is it possible to apply first the ownership provision of the Germany–Sweden treaty, so that the Swedish sub-subsidiaries should not be subjected to more burdensome taxation than if their (indirect) parent, and the direct parent of one of them, had been Swedish, and secondly, the ownership provision of the Switzerland–Sweden treaty, so that they should not be subjected to more burdensome taxation than if the (direct) parent of one of them had been Swedish? The court declined to apply two treaties on the basis that each treaty was intended to be applied only between the states who are parties to it. On the other hand, the Finnish Supreme Administrative Court has applied two treaties successively.[170] The case concerned a Swedish AB with a PE in Finland and a Finnish Oy. The companies had a common parent company in the Netherlands. A tax-deductible group contribution was allowed between the PE situated in Finland and the Finnish company. The

168. See also the discussion below under 4.3.6.
169. RÅ 1993 ref. 91 (II). In this case the question was whether the two Swedish subsidiaries could give each other group contributions (i.e. tax-deductible transfer of profits). For the statutory provisions to apply to group contributions between two subsidiaries that are not directly owned by a common parent, one would have to test whether a contribution is allowed in each step of the chain of ownership. The test was whether one Swedish subsidiary could give a group contribution to its Swiss parent and then from the Swiss parent to the German subsidiary and further down to the other Swedish subsidiary. If all companies involved were Swedish, this would have been possible. Both the tax treaty between Sweden and Germany and the tax treaty between Sweden and Switzerland contain a non-discrimination provision equivalent to Art. 24(5) of the 1992 Model. However, in order to apply the provision on successive group contributions one would have to involve companies resident both in Germany and in Switzerland. It was thought that a group contribution would require that the non-discrimination clauses in both treaties were simultaneously applied. The Board of Advance Rulings stated that there is no room for such an interpretation as the provisions in each tax treaty are intended to be applied only between the contracting states and not in relation to a state that is not a party to the treaty. The Board here referred to the 1977 OECD Commentary on Art. 24, Paras. 54 and 55. On appeal, the Supreme Administrative Court concurred in the conclusions of the Board. Therefore, a deduction for a group contribution was not permitted in this case.
170. Case KHO 2003/2773.

court simultaneously applied the Nordic treaty, the Finland–Netherlands treaty and the freedom-of-establishment article of the EC Treaty.[171] The court merely said that the Nordic treaty and the EC Treaty require the Swedish company with the PE to qualify as a party of the contribution and that the Dutch treaty and the EC Treaty require allowing the contribution despite the fact that the common parent was not Finnish but Dutch, without discussing the issue in more detail. The court therefore applied the PE provision in the Nordic treaty to treat the PE in Finland of a Swedish company in the same way as a Finnish company, and the ownership provision of the Finland–Netherlands treaty to treat the Dutch parent company as a Finnish company. Presumably the court would have come to the same conclusion even if the EC Treaty had not been applicable.

The point about the application of the ownership provision of two treaties is arguable either way, as the conflicting decisions demonstrate. If a state has agreed with state A that enterprises with indirect ownership by a state A resident are not to be subject to more burdensome taxation, and with state B that enterprises with direct ownership by a state B resident are not to be subject to more burdensome taxation, the fact that the ownership provision deals with both direct and indirect ownership envisages that two different treaties might need to be involved at the same time.[172] On the other hand, the Commentary states that the non-discrimination articles of two treaties cannot be combined to create a most-favoured-nation result, because each is a separate bargain based on the economic relationship between the particular states.[173]

4.3.5. *Grouping between a domestic parent company and its domestic sub-subsidiary where there is an intermediate non-resident subsidiary*

This situation raises slightly different issues from grouping two domestic subsidiaries of a foreign parent, because here the parent is domestic. Even where the taxation of the parent is necessarily affected by the grouping, it may be possible to have grouping by excluding the intermediate foreign company. While this may not be possible in Australia, it might in theory be possible in Japan (for the consolidated tax return).[174] In the United States the tiering-up of earnings and profits would be interrupted and a sale of the sub-subsidiary would be taxable under a different regime (CFC rules), but it would seem easier to adapt the regime to accommodate these issues than with a foreign parent. Grouping in these circumstances is permitted by legislation in France (for an intermediate company resident in the EU or EEA area or a PE in such countries of a foreign company), Germany, Italy, Japan (for the group taxation system), Sweden (for an intermediate company resident in the EEA area)[175] and the United

171. See text at note 162 for another example of the combination of a tax treaty and the EC treaty applying.
172. The Commentary requires two treaties to be applied successively in relation to the residence article. If a taxpayer is a resident of states A and B, and B is the loser under the dual-residence provision of the A–B treaty, the Commentary says that in applying the B–C treaty the taxpayer is not a resident of state B because, having applied the A–B treaty, it is liable to tax only on sources within state B and accordingly not a treaty resident of state B under Art. 4(1) (OECD Commentary on Art. 4, Para.8.2, second sentence). Whether this is correct is arguable and this is not necessarily a good analogy. The OECD Report "the Application of the OECD Model Tax Convention to Partnerships" (1999) argues that different provisions in different treaties can be applied to different taxpayers in respect of the same income. However, the application of the ownership provision in two treaties goes further than this.
173. OECD Commentary on Art. 24, Para. 2.
174. See note 123.
175. See note 141.

Kingdom.[176] This question has not been decided in the Netherlands. A further consideration is that if the effect of grouping is that profits are moving upwards, application of the ownership provision would prevent the sub-subsidiary from charging the subsidiary with the withholding tax that would have applied if the profit had been distributed as a dividend. This may mean that the situation is not comparable to one where the intermediate company is resident.

In the situation we are considering and assuming that the parent company is not the only company to which the ownership provision is being applied,[177] the only company apparently relevant to the ownership provision is the sub-subsidiary which has foreign ownership. We have to consider the effect of the sub-subsidiary being either the profit or the loss company.

Suppose the transferor company has a profit of 100, on which tax of 30 would be payable, and under the Swedish group contribution system it pays 100[178] to the transferee company, which has a loss of 100. If the group contribution applies so that the payment is deductible in the hands of the transferor and taxable in the hands of the transferee, neither company pays any tax and the transferee's assets are 100 greater. If group contribution does not apply on account of the foreign intermediate company and the effect is that the same payment is neither deductible nor taxable, the transferor has a profit of 100, pays tax of 30, but has assets of 100 less; and the transferee has a loss of 100, pays no tax, and has assets of 100 more.[179] Comparing the two, the transferor suffers more burdensome taxation if grouping does not apply, and the transferee has no loss if grouping applies and a loss of 100 if it does not, so that it is likely to pay more tax in the following year if grouping applies – with the result that its taxation is not more burdensome if grouping does not apply. If one is permitted to take into account the assets of each company on the basis that the transfer of assets is necessary to the tax result, the transferor has 100 less, and the transferee 100 more, assets in all cases, and in addition the transferor has to pay tax of 30 if grouping does not apply. Accordingly, if the sub-subsidiary is the profit company the ownership provision applies, but if it is the loss company it might not because its taxation is not more burdensome than if grouping does not apply.

176. This was the situation in the ECJ in *Papillon*, Case C-418/07, and in the UK First-Tier Tribunal decision in *Philips Electronics UK Limited v. HMRC* [2009] UKFTT 226(TC) in relation to group (consortium) relief, which may be the reason why the ownership provision was not in issue (a reference to the ECJ has been made by the Upper Tribunal but the law has since been changed to allow it, but with additional conditions inserted that require the link between the surrendering company and the claimant company to be traced only though companies resident in the United Kingdom or the EEA)). General French Tax Code provisions regarding the tax integration regime have been modified, following the ECJ decision in *Papillon*. Now a French company liable for the French corporate income tax, where at least 95% of its share capital and its voting rights is held by a French parent company (liable for the French corporate income tax) through an EU or EEA resident company or a PE in such countries of a foreign company can become a member of a tax-integrated group. As a consequence, integration of profits and losses between a resident parent company and a sub-subsidiary where there is an intermediate EU or EEA resident subsidiary is allowed under French tax law. German law allows consolidation of profits and losses (*Organschaft*) between two German companies where there is an intermediate non-resident company. Italian law also allows tax consolidation between two Italian resident companies where there is an intermediate non-resident company, and this was acknowledged by the Italian tax authorities in *circolare* 53/E of 20 December 2004, Sec. 3.10.

177. See 4.3.1.1. for a discussion of this point.

178. There are cases where the transferee repays the value of the contribution less the tax value of it. I.e. the transferee receives a group contribution of 100, is taxed on it, and uses it against its losses. Assuming a 30% tax rate, it then sends back 70 without claiming a deduction. The Supreme Administrative Court has accepted this: RÅ 2001 ref. 79. The net result is that only the tax value of the loss is absorbed by the payer. Accordingly, we can change all references to 100 in the example to 30, but the result is still the same.

179. We have not dealt with any tax effects that may arise in the foreign intermediary. Depending on direction of the group contribution, it may be characterized as a dividend distribution or a contribution to capital.

This point arose in a case in the Swedish Supreme Administrative Court,[180] in which a US company was inserted between the Swedish parent and its Swedish subsidiary. The question was whether the Swedish parent company could give a group contribution to the Swedish subsidiary. In order for a group contribution to be possible from the parent to the second-tier subsidiary, the conditions for a group contribution must be met in all steps of the chain,[181] which was not met when a US company was inserted in between. Although no discrimination was directed towards the Swedish parent company, as the denied group contribution did not have anything to do with how the parent company was owned, it was noted that the situation of the Swedish subsidiary also had to be taken into account. That company did not have the same opportunity to be included in a group taxation regime because of the US intermediary, as it would have if the intermediary had been Swedish. The court focused on the wording that an "other" connected requirement may constitute discrimination. It noted that what is now Para. 76 of the Commentary did not give explicit guidance. The court noted, however, that support for equal treatment as a norm could be found in what is now Para. 15 of the Commentary to the nationality provision. Equal treatment could in this context have no other meaning than that the group contribution for both receiving and contributing company shall be allowed. The ownership provision[182] was applied. We are sympathetic to the court's decision to look at both the transferor and transferee companies together in view of the difficulty in applying the ownership provision to the transferee company, even if this is difficult to reconcile with the wording, given the reference to "other" taxation, which arguably must include something which is not "more burdensome" taxation if it is not redundant in that context.

Two cases in the Finnish Supreme Administrative Court concern the opposite situation, that the transferor was the sub-subsidiary and the court by a majority found that the prohibition on group contributions was contrary to the ownership provision.[183] The minority made the point that the ultimate parent company was Finnish, that no Finnish taxes were levied on the intermediate Swedish companies, and that Swedish tax was not in issue, none of which is a convincing argument. A later Finnish Supreme Administrative Court case permitted a group contribution between two Finnish companies with a US holding company where there were intermediate companies in other treaty countries and in one case a non-treaty country, on the basis that the treaty with the US required Finland to allow the group contribution between the Finnish subsidiaries, and it did not matter that the intermediary companies are not Finnish nor US companies and may be from treaty states or from non-treaty states.[184] The non-resident ownership caused by the US parent did not cause the barrier to the application of the group contributions rules, which would have been blocked even if the US parent had been a Finnish resident. It is difficult to understand how the Finnish companies were subjected to

180. RÅ 1993 ref. 91 (I). The same outcome was reached in RÅ 1993 not. 677. This case concerned the Swedish income tax treaty with the Netherlands (1992) and the issue that reached the Supreme Administrative Court was the same as in RÅ 1993 ref. 91 (I), namely whether an intermediary Dutch company would prevent a group contribution from the Swedish parent to its Swedish second-tier subsidiaries.
181. Chap. 35, Sec. 6 Income Tax Act.
182. In Art. 10, third paragraph of the treaty between the United States and Sweden on estates, inheritance and gifts, which applied to all taxes.
183. Finnish Supreme Administrative Court, Decisions KHO 1992-B-509 and KHO 1992-B-510.
184. Case KHO 2004/1525 concerned two Finnish Oys, which were owned via several companies in treaty states and in non-treaty states (Bermuda) by a US Inc. The two Finnish sister companies were allowed to make tax-deductible group contributions to each other because they had the common parent company in a tax treaty state (the United States), even though non-treaty state companies were interposed. The non-discrimination article of the treaty between Finland and the United States was considered to require allowing the tax-deductible group contribution. The court did not consider the issue of simultaneous application of treaties (see 4.3.4.).

other or more burdensome taxation by reason of such non-resident ownership. If there was a burden because of non-resident ownership, it was because of the ownership below the top Finnish company and above the sub-subsidiary Finnish company. Thus, it would seem to us that if there is to be treaty relief it would have to be at that level – that the sub-subsidiary would have to be able to point to a treaty obligation owing to a direct or indirect owner in that part of the chain. Otherwise, the US treaty's ownership provision would seem to be getting beyond protecting Finnish companies from discrimination by reason of US ownership. It would be having the effect of requiring treatment equivalent to Finnish ownership at all levels of the chain if there simply happens to be any US ownership at any level of the chain, which seems to us to be a stretch.

4.3.6. Combination of ownership and another condition

Domestic law may impose both an ownership condition (which, as we have seen, is a dual condition of ownership by a non-resident) and another condition for the denial of a relief. We said in our introduction that "If the ground for the difference in treatment is non-residence but not ownership, and ownership happens to be present (and vice versa), that is not sufficient; it is not enough that both non-residence and ownership are present without their combination being the cause of the difference in treatment." We now extend that analysis to include the other condition.

By way of example, suppose a thin capitalization rule provides that an interest deduction is denied if (a) a payment be made to a non-resident recipient and (b) that the payer be owned or controlled at least in part by a non-resident that (i) is, or (ii) is related to, the non-resident recipient. Effectively, there are three conditions: (a) that a payment be made to a non-resident recipient, (b) that the payer be owned or controlled at least in part by a non-resident, and (c) that the non-resident owner (i) is, or (ii) is related to, the non-resident recipient.[185] Since the deductibility is a question of the tax treatment of the payer, it is the ownership of the payer that is the issue for the application of the ownership provision. Here, there are two further requirements: one depending on the residence of the recipient, and the other depending on the identity or ownership of the recipient.

We have argued above that non-resident ownership is not the ground for the denial of a relief if the relief would not have applied to a transfer to a non-resident who was not the owner. The difference here is that the thin capitalization rule requires both a payer with a non-resident owner and a non-resident recipient that is or is related to the owner. There is no possible hypothetical alternative under which the non-resident owner of the payer is not present, and non-resident is not equivalent to non-taxable. The non-resident ownership is more than something that happens to be present and so must be the ground for the disallowance, even though other conditions were necessary in addition, and so it may be prevented by the ownership provision.

185. The thin capitalization rule described is similar to Sec. 8a of the German Corporate Income Tax Act which was in force from 1994 until 2000. Most commentators in German tax literature assumed that this law involved the triple requirement (see the text around note 96). It was therefore correctly held to infringe Art. 24(5) by the *Bundesfinanzhof* in its decision of 8 September 2010 (I R 6/09).

5. Conclusion

We have stated our conclusion at the beginning of this article and we shall not repeat it. We consider that a better case can be made for grouping provisions generally not being in conflict with the ownership provision than the Commentary[186] does in arguing that "Since the paragraph relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital, it cannot be interpreted to extend the benefits of domestic rules that take account of the relationship between a resident enterprise and other resident enterprises"[187] or by relying on arguments based on the meaning of "similar enterprises" that test that similarity based on the residence of the owner rather than on the treatment of the subsidiary and its ability to deliver the quid pro quo that is the substantive involvement of a parent company. These are too widely stated and many court decisions on the ownership provision have clearly proceeded on a different path.

The real issue is whether non-resident ownership is the ground for denying a relief, and it makes little sense to us to approach this exercise from the perspective that non-resident ownership alone renders the subsidiary dissimilar. We consider that a more sophisticated analysis is appropriate, and that there can be cases in which a subsidiary with domestic ownership is similar to a subsidiary with foreign ownership even in relation to grouping provisions, such that the ownership provision can be applicable in such cases, depending on the details of the structure of the particular regime. Even if there is general agreement on the results in specific examples – and we are in general agreement with the OECD's results on the ownership provision – the reasoning is very important when applied to other examples not included in the Commentary. This is necessary because of the wide variation in the systems used by different countries and within a country the type of grouping provision concerned.

In our view the OECD still has work to do in explaining its conclusions and in doing so consistently and precisely. The work on developing and refining the Commentary on the existing non-discrimination article should continue in parallel, as the OECD moves into the second stage of its work and looks at the terms of the Model in the non-discrimination area more generally.

186. And even more so in respect of the arguments in the Discussion Draft that were not included in the Commentary; see 4.2.
187. See text at note 69. Even in countries such as Sweden, where the courts have previously applied the ownership provision to grouping, there is a danger that at least the Swedish Tax Agency will be influenced by the new Commentary saying the opposite. Although it goes beyond the purview of this article, we see difficulties for the Supreme Administrative Court not to apply the ownership provision if the same type of facts as in the cases we have analysed in this article would come before the court again.