Comments on CRP 11 (Capital Gains on OITs) from Committee Member, Stephanie Smith

My comment relates to page 8, proposed new paragraph 23 of the Commentary to Article 13:

> 23. One way to address such situations could be to resort to the mutual agreement procedure under the second sentence of paragraph 3 of Article 25 through discussion between the competent authorities of the States involved. For instance, in the situation described in paragraph 22 above where States C taxes company A under paragraph 6 of the treaty between States A and C while State B taxes company A under paragraph 5 of the treaty between States A and B, the competent authorities of States B and C might consult under paragraph 3 of Article 25 of the treaty between States B and C for the elimination of the resulting double taxation. Since the outcome from such consultation would not address the problem that would subsequently arise as a result of the taxation by State D of the gain realized by company B on the alienation of the shares of company D, a similar consultation might be necessary under the treaty between States C and D upon the subsequent alienation by company B of the shares of company D.

I agree that the competent authorities may consult together under Article 25(3), second sentence, for the elimination of double taxation in cases not provided for in the Convention (which would be the situation in this case). However, a number of complications exist and it is not clear that the consultation would result in relieving double taxation. In this respect, I note that paragraph 10 of the Commentary to Article 25(3) of the UN Model Tax Convention, quoting the OECD Model Tax Convention, provides the following (underlining added):

> 55. The second sentence of paragraph 3 enables the competent authorities to deal also with such cases of double taxation as do not come within the scope of the provisions of the Convention. Of special interest in this connection is the case of a resident of a third State having permanent establishments in both Contracting States. The second sentence of paragraph 3 allows the competent authorities of the Contracting States to consult with each other in order to eliminate double taxation that may occur with respect to dealings between the permanent establishments. This could for instance be the case where one or both of the Contracting States have no bilateral tax convention with the third State. Where both Contracting States have a convention with the third State, the combination of these two conventions may, however, allow the competent authorities of all three States to resolve the case by mutual agreement under paragraphs 1, 2 and 3 of Article 25 of these conventions (see paragraphs 38.2 and 38.4 above). A multilateral agreement between the competent authorities of all involved States is the best way of ensuring that any double taxation can be eliminated.
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> 55.1 There will be Contracting States whose domestic law prevents the Convention from being complemented on points which are not explicitly or at least implicitly dealt with in the Convention. In these situations the Convention could be complemented by a protocol dealing with this issue. <u>The second sentence of paragraph 3 does not, however, allow the Contracting States to eliminate double taxation where the provision of such relief would contravene their respective domestic laws or is not authorised by the provisions of other applicable tax treaties. That sentence only allows the Contracting States, in cases not provided for in the Convention, to consult each other in order to eliminate double taxation in accordance with their respective domestic laws or in accordance with a tax treaty one of the Contracting States has concluded with a third State.</u> Thus, for instance, in the case of a resident of a third State having permanent

establishments in both Contracting States, the second sentence of paragraph 3 allows the competent authorities of the Contracting States to agree on the facts and circumstances of a case in order to apply their respective domestic tax laws in a coherent manner, in particular with respect to any dealings between those permanent establishments; the Contracting States could provide relief from any double taxation of the profits of such permanent establishments, however, only to the extent allowed by their respective domestic laws or by the provisions of a tax treaty concluded between a Contracting State and that third State (i.e. applying the provisions of Article 7 and Article 23 of a tax treaty between a Contracting State and the third State). As shown by these examples, paragraph 3 therefore plays a crucial role to allow competent authority consultation to ensure that tax treaties operate in a co-ordinated and effective manner.

Not all competent authorities are willing, or able, to discuss the situation of a taxpayer that is not resident in either contracting state. In this situation, company A is resident in State A and is looking for relief under the treaty between States B and C. Both States have properly applied the relevant treaties (i.e., treaty between States A and C and treaty between States A and B) and neither is required under the treaty between States B and C to eliminate the double taxation. It is not clear on what basis either State would be willing, or able to, under its domestic law to give up its right to tax the gain (which is allowed to tax under the relevant treaty). Further, when extended to the taxation by State D, what if company B's sale of company D happens 5 years after company A's sale of company B? Would State C still be interested in consulting with State B? What if State C had already ceded its right to tax company A back when it consulted with State B as described earlier in the para?

In my view, the paragraph, as currently drafted, leaves a positive impression that the double taxation can be "addressed" or resolved by referring the case to MAP under Article 25(3). While it is theoretically possible, it will likely be challenging in practice. I propose the following modification to paragraph 23:

23. One **possible** way to address such situations could be to resort to the mutual agreement procedure under the second sentence of paragraph 3 of Article 25 through discussion between the competent authorities of the States involved. For instance, in the situation described in paragraph 22 above where State**s** C taxes company A under paragraph 6 of the treaty between States A and C while State B taxes company A under paragraph 5 of the treaty between States A and B, the competent authorities of States B and C might consult under paragraph 3 of Article 25 of the treaty between States B and C for the elimination of the resulting double taxation **of company A, resident in State A**. Since the outcome from such consultation would not address the problem that would subsequently arise as a result of the taxation by State D of the gain realized by company B on the alienation of the shares of company D, a similar consultation might be necessary under the treaty between States C and D upon the subsequent alienation by company B of the shares of company D. **As noted in paragraph 10 of the Commentary to Article 25, "the second sentence of paragraph 3 does not, however, allow the Contracting States to eliminate double taxation where the provision of such relief would contravene their respective domestic laws or is not authorised by the provisions of other applicable tax treaties."**