DEFINITION OF TERMS AND PHRASES

Alienation of shares

Term generally used to describe the transfer of title to shares in entities whose capital is divided into shares.

Arbitration process

An Arbitration process is an extension of the mutual agreement procedure that is intended to deal with cases that cannot be solved under that procedure

Arm's length principle

According to the "arm's length principle", the determination of the price in a transaction between related or associated parties should be based on what independent unrelated parties would agree to pay in similar circumstances.

Associated enterprise

An enterprise which participates, directly or indirectly, in the management, control or capital of another enterprise (e.g. a parent company and its incorporated subsidiary). Reference is made to associated enterprises also when two enterprises have the same persons participating, directly or indirectly, in their management, control or capital (e.g. two subsidiary companies of the same parent company).

Beneficial owner

A beneficial owner is simply a person who enjoys the real benefits of ownership, even though the title to the property is in another name. In an international tax context, beneficial ownership is a term that is used in the dividend, interest and royalty Articles of double tax treaties to define entitlement to the benefit of those Articles (generally, a reduced or zero rate of withholding tax). Thus, this is a person who has the full right to use and enjoy income unconstrained by contractual or legal obligation to pass the payment received to another person (indicated by legal documents or substance from facts and circumstances).

Bilateral tax treaty

An arrangement between two jurisdictions that mitigates the problem of double taxation that can occur when tax laws consider an individual or company to be a resident of more than one jurisdiction.

Capital gains

Gains on the sales of capital assets. For instance, when a stock is sold for a profit, the portion of the proceeds over and above the purchase value (or cost basis) is known as capital gains.

Commentaries

In an international tax context, the term "Commentaries" generally refers to the Commentaries which accompany the United Nations and OECD Model Conventions. They are intended to serve as a means of illustrating or interpreting the provisions of the relevant model convention and are a widely accepted guide to the interpretation and application of the provisions of existing tax treaties. Their precise legal status is, however, a matter of considerable debate and varies from country to country.

Competent authority

"Competent authority" is a term used in tax treaties to identify the person who represents the State in the implementation of the treaty, as defined under Article 3 of it. The competent authority has certain specific functions under the treaty, including acting as a contact point for both taxpayers and the other competent authority in Mutual Agreement Procedures (MAPs). Sometimes there are different competent authorities for different functions under the treaty.

Corresponding or correlative adjustments

An adjustment to the tax liability of the associated enterprise in a second jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent.

Credit method (Foreign Tax Credit)

A foreign tax credit is a method of relieving international double taxation under which, in general terms, taxes imposed on foreign income may be credited against domestic tax on that income.

Dispute Resolution

Dispute Resolution under double tax treaties is addressed at Article 25 dealing with the Mutual Agreement Procedure (MAP) that provides for a mechanism to resolve cross-border tax disputes dealing with double taxation and double non-taxation.

Distributive rules

The term is usually used to refer to the provisions of a tax treaty which provide limitations on the taxing rights of the source or residence State (see, for example, Articles 6-21 of the United Nations and OECD Model Conventions).

Dividend

A dividend is a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. Dividends can be issued as cash payments, as shares of stock, or other property. The UN Model Convention provides that the term “dividends” as used for the purposes of the relevant Article means income from shares, “jouissance” shares or “jouissance” rights, mining shares, founders’ shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident. (see Article 10 of the UN Model Convention).

Double non-taxation

Countries have historically set-up their tax systems and the elements thereof in isolation. In a globalised world this creates opportunities for arbitrage through arrangements. These arrangements exploit differences in the tax treatment of instruments, entities and transfers between two or more countries. Typical effects are double deductions (where a deduction related to the same contractual obligation is claimed for income tax purposes in two or more different countries), deduction / no inclusion (where there is a deduction in one country but no corresponding inclusion in the taxable income in another country), and foreign tax credit generators (which generate foreign tax credits that would otherwise not be available.

Double taxation

Double taxation is traditionally divided into two kinds, juridical double taxation and economic double taxation. “Juridical double taxation” occurs where the same legal person is taxed twice on the same income or other taxable item by more than one State. A common situation is where the source State taxes a payment as it flows to a person (by dividend- or interest-withholding tax, for example, which is in effect a tax on the recipient collected by a withholding agent such as the company paying the dividend) and the residence State of the recipient also taxes that person on the same item as part of his or her worldwide income. The division of taxing rights in the United Nations and OECD Model Conventions, when combined with the effect of Article 23, is designed to prevent such juridical double taxation as far as is possible. On the other hand, “economic double taxation” occurs where two different legal persons are taxed on the same income or other taxable item by more than one State. This may occur, for example, where two States take different views of the profits made in transactions between a subsidiary resident in one of the States in its transactions with a parent company in the other State, so that at least some part of the profits on the transaction are taxed in both States. In general terms, the United Nations and OECD Model Conventions do not deal directly with economic double taxation, but Article 9 seeks to address aspects of this sort of double taxation of related entities.

Dual resident

A taxpayer that has met the criteria to be a resident for tax purposes in two countries in a single tax year under the domestic tax laws of the respective countries. This may be the result of the fact that the two countries adopt different definitions of residence under their respective tax laws.

Entry into force

The term is used to denote the moment when an international agreement, treaty or protocol acquires full legal effectiveness as a source of obligations. The fact that a treaty has entered into force does not mean that its provisions are necessarily operative, as some or all of them may be subject to a time limit or condition. Conversely, some of the treaty's provisions may become operative with retroactive effect.

Exchange of information

Exchange of information is a tool used by countries to share tax information about resident or non-resident taxpayers. This may include information relating to various categories of income, such as dividends, interest, gross proceeds, royalties, salaries, pensions, etc. Procedures for exchange of information are normally laid down in tax treaties, but also provided for under separate agreements (Tax Information Agreements – TIEAS). Information may typically be exchanged in three different ways: upon request, automatically (i.e. under a pre-agreed procedure) or spontaneously.

Exemption method

This is a method of providing relief from international double taxation under which, typically, the country of residence exempts income derived from or capital or activities situated in the other country.

Fiscal privileges

These are tax privileges, other than those provided under tax treaties, afforded to specific persons such as diplomats. Under both the UN Model and OECD Model Conventions, the tax privileges for diplomats provided under general rules of international law or under the provisions of special agreements are not affected by tax treaty provisions.

Fixed base

Fixed base is a term used in the UN Model Convention in the context of independent personal services (Article 14). This Article allows the source country to tax income from independent personal services if the taxpayer has a fixed base available to him in that country and income is attributable to that fixed base.

Force of attraction (limited)

Under the limited force of attraction principle, a state is entitled to tax profits of an enterprise which maintains a permanent establishment (PE) in that state not only if they are attributable to that PE but also to the sales of goods and merchandise in that state

similar to those sold through the PE, and to other business activities carried on in that state similar to those effected through the PE.

Immovable property

For purposes of tax treaty interpretation and application, the term ‘immovable property’ is defined by reference to the domestic law of the contracting state in which the property is situated. In general terms, the concept of “immovable property” normally includes: land, houses, buildings and property accessory to them, as well as livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to payments as consideration for the working of mineral deposits, sources and other natural resources. It is important to note that, ships, boats and aircraft are generally not regarded as “immovable property” in the context of treaties.

Intangible property

This concept describes something which has no physical substance but has a value due to the legal rights that a person or corporation has over it, including the right to transfer ownership of it to another person or corporation. It generally refers to statutory creations such as copyright, trademarks, or patents.

Interest

In the context of tax treaties, ‘interest ‘normally means: income from debt claims of every kind, in particular income from government securities and income from bonds or debentures. The definition of interest includes premiums and prizes attaching to such securities, bonds, or debentures. However, penalty charges for late payments are not regarded as “interest” for tax treaty purposes (see Article 11 of the UN Model Convention).

Memorandum of understanding (MOU)

In the context of a tax treaty, this is a document exchanged between the treaty partners that sets out the understanding of the parties regarding the treaty.

Most favoured nation

Tax treaties may contain a Most Favoured Nation (MFN) clause under which each contracting state agrees that concessions given to other treaty partners will also be applied to the other contracting state. The object of the MFN clause is twofold, to guarantee that no discriminatory treatment will be suffered by each contracting state when compared with a third country and to offer a better treatment because of a favourable change in policy.

Mutual Agreement procedure (MAP)

This procedure is a means by which competent authorities consult to resolve disputes regarding the application of tax treaties. It is described and authorized by Article 25 of the United Nations and OECD Model Conventions and can be used to eliminate double taxation that could arise from a transfer pricing adjustment; it can also be relevant for other aspects of a tax treaty's operation.

Non-discrimination

This is a concept in tax treaties which prohibits the tax discrimination in certain precise circumstances of citizens, nationals or residents of one country. In general terms, they cannot be subjected to taxation which is different from or more burdensome than the taxation to which citizens, nationals or residents of the other country are subjected under the same circumstances.

Observations on the OECD Commentaries

Observations on the Commentaries by OECD Member countries are included in the OECD Commentaries where the Member country concerned is unable to agree with the interpretation given in the Commentaries on specific articles.

Permanent establishment

The term “permanent establishment” is generally used to refer to a non-resident’s business presence in a particular country that is of a sufficient level to justify that country’s taxation of the attributable profits. The term is most commonly used in tax treaties but may also be found in some countries’ domestic tax laws. When used in the context of tax treaties, a permanent establishment is generally constituted by a fixed place of business in the source country through which the business of an enterprise is wholly or partly carried on, but may also be constituted in certain circumstances by virtue of the activities carried on in the source country by a dependent agent, sometimes referred to as an “agency permanent establishment”. Certain activities of a relatively insignificant level (generally referred to as “preparatory or auxiliary activities”) are usually excluded from permanent establishment status in treaties as are the activities of an independent agent acting in the ordinary course of its business.

Primary adjustments

An adjustment that a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction.

Protocol

A protocol is a signed document containing the points on which agreement has been reached by the negotiating parties preliminary to a final treaty. It is also an agreement reached by the parties to a tax treaty and signed and ratified by them, in addition to an

existing tax treaty. The protocol may be signed simultaneously with the tax treaty or later, and it clarifies, implements or modifies treaty provisions.

Ratification

Ratification is the formal legislative consent or acceptance required by the constitution or domestic laws of a country before a treaty to which it is a party can come into effect.

Reservations on the OECD Model Convention

The OECD Commentaries may include reservations entered by Member countries on specific aspects of the articles of the Model Convention, which indicate the position taken by that country on the article.

Residence State

The residence State is the country where a person is resident under the treaty at the relevant time. In international tax law, generally this is a basis for taxation of the global income of the resident, unless the territoriality principle applies (that is to say, the principle of levying tax only within the territorial jurisdiction of a sovereign country, with the consequence that both residents and non-residents of it are only taxed on the income from sources situated therein, while residents are not normally taxed on any foreign-source income).

Royalties

In the context of tax treaties, royalties normally mean payments of any kind received as a consideration for the use of, or the right to use: any copyright of literary, artistic or scientific work including cinematographic films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience (see Article 12 of the UN Model Convention).

Soft law

Refers to rules that are neither strictly binding in nature nor completely lacking legal significance. In the context of international law, soft law refers to guidelines, policy declarations or codes of conduct which set standards of conduct. However, they are not directly enforceable. Thus, soft law is most commonly defined to include hortatory, rather. than legally binding, obligations.

Source State

The source State is where, for the purposes of a treaty, a taxable amount is regarded as arising or deriving from. As rules in domestic law about where an amount arises differ (for instance, some might look to where the profits that become a dividend are made as the source of a dividend, whereas others may look to the State from which the dividend

is paid), the United Nations and OECD Model Conventions often provide implied or specific rules in this respect. Source States may, under general international tax law, tax income sourced in that State. The residence State may then provide an exemption or a credit for tax paid in the source State. A tax treaty often limits or prevents source State taxation, and generally provides that the residence State must give a credit or exemption for tax paid in the source State.

Tax avoidance

For tax purposes, avoidance is a term used to describe taxpayer behaviour aimed at reducing tax liability that falls short of tax evasion. While the expression may be used to refer to "acceptable" forms of behaviour, such as tax planning, it is more often used in a pejorative sense to refer to something considered "unacceptable", or "illegitimate" (but not in general "illegal"). In other words, tax avoidance is often within the letter of the law but against the spirit of the law. It generally contains elements of artificiality, for instance as to the legal form adopted, and may often be considered to be contrary to the spirit of the law. However, its scope may vary from country to country, depending on attitudes of government, courts and public opinion. Some jurisdictions appear not to recognize the concept on the grounds either that the behaviour is legitimate or, if illegitimate, that it constitutes evasion. Examples of tax avoidance include locating assets in offshore jurisdictions, conversion of income to non- or lower-taxed gains, spreading of income to other taxpayers with a lower marginal tax rate and lease and lease-back arrangements to take advantage of early input tax deduction. Various treaty provisions, for example Limitation of Benefits (LOB) clauses, deal with tax avoidance situations.

Tax evasion

Tax evasion, in contrast to tax avoidance, may be characterized as intentional illegal behaviour, or as behaviour involving a direct violation of tax law, in order to escape payment of tax. Tax evasion is generally accompanied by penalties that may be, but are not always, criminal in nature. Deliberate underreporting of taxable income would generally be considered an example of tax evasion.

Tax sparing credit

A tax sparing credit is generally understood to refer to a tax credit granted typically under tax treaties by residence countries for source-country tax notionally borne on certain kinds of income (in general, dividends, interest, or royalties), that is to say, in excess of actual tax borne. The credit is typically limited to the maximum source-country tax permitted under the treaty. A distinction may be made between tax sparing, where the notional foreign tax represents tax foregone by the source country under special measures (typically to encourage foreign investment) – sometimes referred to as pioneer relief, and matching credits where the notional tax is not necessarily linked to the level of source-country tax or any reduction thereof. Matching credits may also be found in unilateral double taxation relief rules as well as in treaties (in the latter case, the rate of credit is not necessarily limited to the maximum source-country rate). Both kinds of credit, in effect,

operate as a kind of partial (or full) exemption. Tax sparing relief is designed to respect the source country’s taxing right and prevent the incentive effect of the measure in question being negated by residence taxation of the same income. The effectiveness of tax sparing credits for the purpose of giving economic assistance to developing countries, however, is currently a matter of considerable debate.

Tie-breaker rules

These rules, which are provided under Article 4 (2) and (3) of the United Nations and OECD Model Conventions, seek to determine a single residence for tax treaty purposes, in those cases where a person is a resident for domestic law purposes under the domestic tax laws of both treaty States. That can most obviously happen when the two States apply different tests for residency. The tie-breaker rules do not themselves affect the situation at the domestic tax law level generally, although domestic laws sometimes expressly provide that certain tax benefits are not available to a domestic law resident who is regarded as a resident solely of the treaty partner State under the relevant treaty's tie-breaker rules.

Transfer pricing

Transfer pricing is the area of tax law and economics that is concerned with ensuring that prices charged between associated enterprises for the transfer of goods, services and intangible property accord with the arm’s length principle.

Treaty override

Treaty override has been described in a tax context in terms of the enactment of legislation that is intended to nullify unilaterally the application of international treaty obligations. In a less technical sense, the term is sometimes used to refer to a number of other situations, including legislation that reverses a judicial decision that conflicts with the legislature’s interpretation of the treaty, a change in the definition of a term used under domestic law as a result of which the meaning of a treaty term (generally the same term) also changes through operation of the treaty provisions for interpreting undefined terms, and a change in domestic legislation that unintentionally conflicts with a treaty provision. The expression “treaty override” may be compared with the expression “material breach” used in the Vienna Convention on the Law of Treaties, the two not necessarily being identical. The expression should be distinguished from the issue whether derogation by way of changes in a country’s domestic law from an international treaty obligation is permitted under that country’s constitutional law.

Withholding tax

A withholding tax is one that is imposed at source, whereby a third party, the paying agent (such as a bank paying interest or a company distributing dividends to shareholders), must withhold an amount from the payment and remit it to the local tax authorities. It is a common way of ensuring that tax is collected from benefits accruing to overseas

taxpayers who are beyond a State's immediate legal jurisdiction. A withholding tax will be "final" if there is no later adjustment as part of assessment. Otherwise, it is regarded as "provisional", and depending on the taxpayer's final tax liability there may be a refund or (more rarely) a requirement for further payment by the taxpayer.