

Article 22: Taxation of Capital – What It Is, How It Came About

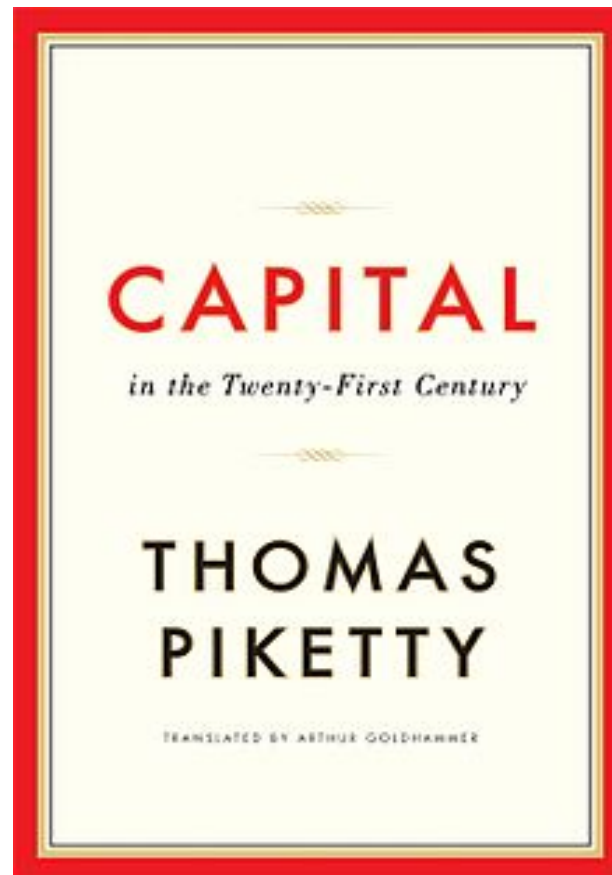
Yoshihiro Masui



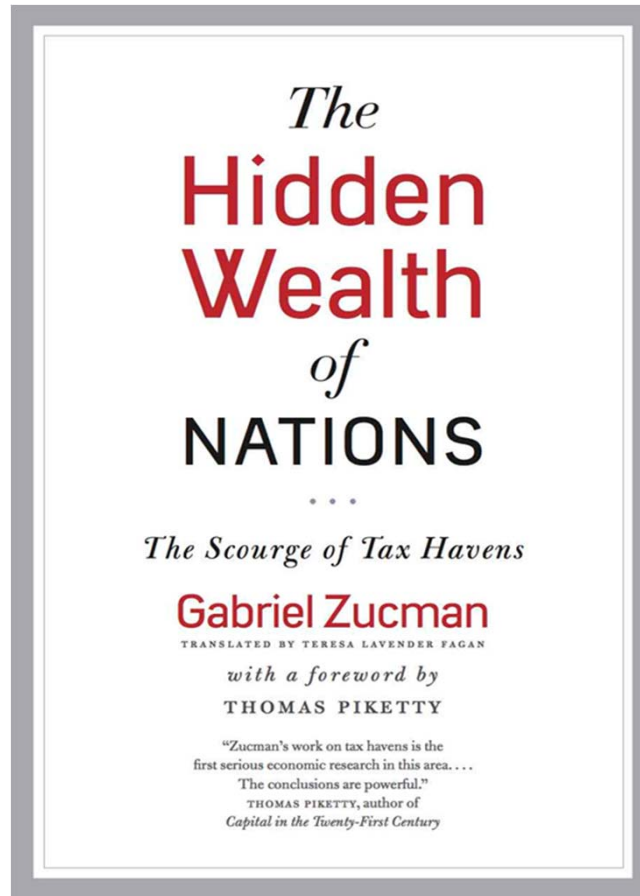


- Renewed interest in wealth taxation
- Wealth taxes in the real world
- Tax treaties
- Some history
- Treaty case law
- Estate tax treaty
- The future

Renewed interest in wealth taxation



Renewed interest in wealth taxation



Renewed interest in wealth taxation

- NYU/UCLA Tax Policy Symposium, held at NYU Law's Vanderbilt Hall on October 3, 2014.



Renewed interest in wealth taxation

- National Tax Association, Session 72: Taxation and Wealth (Law), November 12, 2016
- How To Tax Capital - By Mark Gergen; UC Berkeley
- Income Tax as Wealth Tax - By John Brooks; Georgetown University Law Center and David Gamage; UC Berkeley
- Taxing Wealth Seriously - By Edward McCaffery; University of Southern California

- Renewed interest in wealth taxation
- Wealth taxes in the real world
- Tax treaties
- Some history
- Treaty case law
- Estate tax treaty
- The future



Wealth taxes in the real world

- An endangered species?
- Wealth holding tax
 - Abolition in many states
 - Asset valuation notoriously difficult
 - Land taxes at sub-national government level
- Wealth transfer tax
 - Still viable in some parts of the world

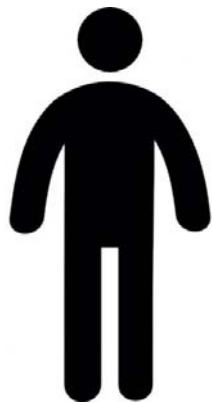
Wealth taxes in the real world

- Globalization
- Hiding assets offshore
- Enforcement issues paramount

Wealth taxes in the real world

- Allocation of taxing rights

Residence state



Situs state



- Renewed interest in wealth taxation
- Wealth taxes in the real world
- Tax treaties
- Some history
- Treaty case law
- Estate tax treaty
- The future



Tax treaties

The GTTC Project

Title: Global Tax Treaty Commentaries

Author(s): Brian Arnold, Jacques Sasseville et al.

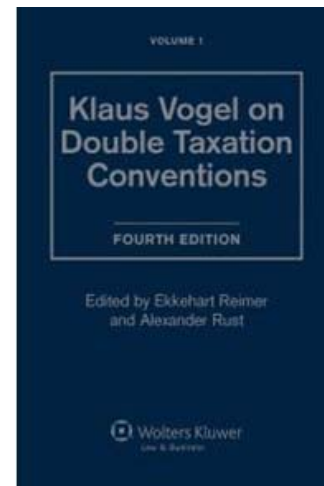
Editor(s): Richard Vann (Editor-in-Chief) et al.

Date of publication: May 2014 -

Type of publication: Online collection



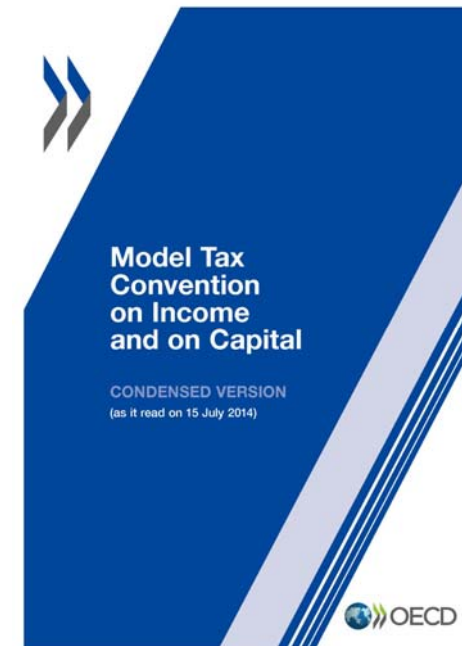
Tax Treaties



- Reimer, Klaus Vogel on DTA, Art.22 (4th edition 2015)
- Stockmann, Vogel/Lehner DBA, Art.22 (2015)

Tax treaties

- OECD MTC 2014 Article 22
- 22(1) Immovable property
- 22(2) PE
- 22(3) Ships and aircraft
- 22(4) Catch-all clause --- exclusive residence taxation



Tax treaties

OECD MTC 2014 Article 22

1. Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.
2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State may be taxed in that other State.
3. Capital represented by ships and aircraft operated in international traffic and by boats engaged in inland waterways transport, and by movable property pertaining to the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

Tax treaties


- UN MTC Article 22
- 22(4) Catch-all clause: up to bilateral negotiations between the contracting states

Tax treaties

- Many reservations on Article 22 OECD MTC.
- No capital article: Brazil, Japan, Singapore, UK, US
- Usually include capital article: Argentina, Canada, Russia
- Capital article in older treaties: France, Germany, NL, Spain, Sweden

Tax treaties

- China: 23 among 102 treaties, follows UN Model
- India: 26 among more than 90 treaties, diverges from both OECD and UN Models

- Renewed interest in wealth taxation
- Wealth taxes in the real world
- Tax treaties
- Some history 
- Treaty case law
- Estate tax treaty
- The future

Some history

- 18 May 1901, Austria and Liechtenstein, Exchange of Notes for the Avoidance of Double Taxation

"Land, buildings and the carrying on of an established business in the kingdoms and provinces represented in the Reichsrath or in the Principality of Lichtenstein shall be liable to direct taxation only in the State in which the land, buildings or business establishments are situated."

Some history - League of Nations

- League of Nations, Feb. 1925 Technical Experts Report "Double Taxation and Tax Evasion" Document F.212

"The rules adopted for the general income-tax are applicable mutatis mutandis to permanent taxes on the taxpayer's total wealth or capital and to succession duties."

Some history - League of Nations

- Looks at the 1922 treaty between Italy and Czechoslovakia
- Articles 1-5: *impôt réel*
- Articles 6-7: personal taxes (general income-tax and taxes on capital)
- Classification and assignment according to origin

Some history - Interwar period

- 23 May 1922 Treaty between Germany and Austria
- 1(2)(b) Taxes on capital must be levied in the State of which the taxpayer is a national.
- 2(1) Landed estates and buildings and income derived therefrom shall only be subject to direct taxation in the State in which they are situated.
- 3(1) Industrial undertakings and the income or profits derived therefrom shall only be...

Some history - Interwar period

- 24 Dec 1936 France-Sweden Income and Capital Tax Treaty Article 12 [Capital]
- 12(1) Immovable Property
- 12(2) Shares in a land-rich company
- 12(3) Furniture
- 12(4) PE
- 12(5) Substantial participation in the capital of a company
- 12(6) Ships and aircraft
- 12(7) All other elements of capital

Some history - Interwar period

- 23 Mar 1939 Sweden- United States Income and Capital Tax Treaty Article XIII
- (1) (a) immovable Property and (b) commercial and industrial enterprises - follows the distributive rules in the income tax Articles.
- (3) all other forms of property - residence only
- The same applies to the U.S. capital stock tax with respect to corporations of Sweden.

Some history - OEEC/OECD


- Pijl (2013) on the history of capital gains article
- 1958 August 28: WP13 report (Switzerland)
- 1959 January 10: WP 13 second report --- immovable property and PE following income tax, catch-all clause for other capital
- 1959 June 9-12: approved at the 13th session
- 1963 OECD MTC Article 22

Some history - OECD

- 1977 OECD MTC Article 22 --- 22(1) "owned by a resident of a CS and situated in the other CS"
- 2000 OECD MTC Article 22 --- 22(2) deletion of "fixed base" following the deletion of Article 14

Some history - OECD

- Symmetry between 22(capital) and 13(capital gains)
- 22(1) Immovable Property - 13(1)
- 22(2) PE - 13(2)
- 22(3) Ships and aircraft - 13(3)
- 22(4) Catch-all clause - 13(5)
- Missing - 13(4) shares in land-rich companies

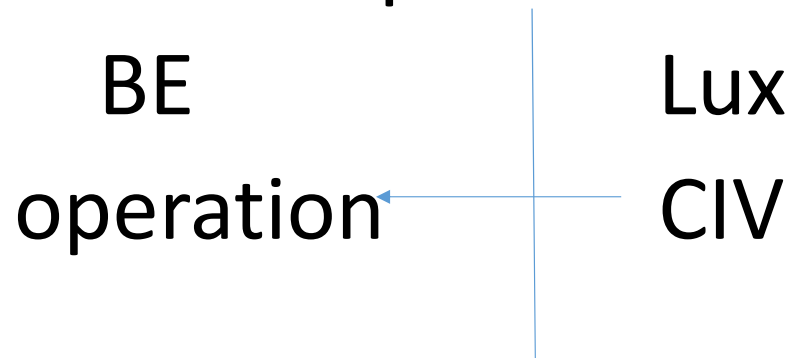
- Renewed interest in wealth taxation
- Wealth taxes in the real world
- Tax treaties
- Some history
- Treaty case law 
- Estate tax treaty
- The future

Treaty case law - data set

- IBFD Tax Treaty Case Law data set
- 47 cases dealing with Article 22
- Half of them: no detailed case summary
- A few of them: not discussing capital article
- 19 cases selected

Treaty case law - how it works

- How does Article 22 work?
- BE: Tribunal de Première Instance Bruxelles, 23 Nov. 2011 - Belgian NAT (net asset tax) levy on Lux CIV not permitted by 22(4)



Treaty case law - deduction of debt

- Deduction of debt
- Article 22 Commentary Para. 7 -- No treaty rules!
"The Article does not provide any rule about the deductions of debts. The laws of OECD member countries are too different to allow a common solution for such a deduction."
- Nondiscrimination clause in Art 24(4)

Treaty case law - deduction of debt

- NL: Hoge Raad 20 Apr. 1983 --- three cases on the same day (NL/DE treaty BNB 1983/203, NL/US treaty BNB 1983/204, and NL/CH treaty BNB 1983/205)
- Issue: gross value or net value of the real property for the purpose of double taxation relief?

Treaty case law - deduction of debt

- Hoge Raad: gross value should be used, i.e., no allocation of mortgage deductions to DE.

NL



DE



Treaty case law - deduction of debt

- DE: BFH 9 Aug 2006, IIR59/05 - loan excludable from PE assets
- DE: BFH 20 Mar 2002, IIR84/99 - direct method
- CH: Verwaltungsgericht Graubünden 13 Jan 1999, V6 - no deduction of debt
- DE: BFH 29 Jul 1992, AZ. IIR39/89 - PE asset valuation
- AT: Verwaltungsgerichtshof 14 Mar 1990, 86/13/0179 - Debt deduction allowed

Treaty case law - PE

- Cases on 22(2) foreshadow AOA discussions
- DE: BFH 25 Jun 1986, IIR213/83 - computation of PE equity capital
- DE: BFH 21 Jan 1972, IIR57/71 - recognition of PE-Head Office debt

Treaty case law - immovable property

- 22(1) Immovable property
- NL: Rechtbank Zutphen 12 Aug 2009, 08/1347-
NL levy of municipal tax on immovable property
allowed under NL/CH treaty.
- DE: BFH 15 Dec 1993, IIR66/89 - "ground-rent
accounts (Erbbauszinsforderungen)" are not
"immovable property" for DE/IT treaty purposes.

Treaty case law - immovable property

- AT: Verwaltungsgerichtshof, 27 Jun 1991, 90/13/0156 - claims, legal tender, credits and shares of co-operative unions were not accessories to farming and forestry property, and therefore not accessories to immovable property under AT/DE treaty.

Treaty case law - ships and aircraft

- 22(3) ships and aircraft
- no cases
- "race to the bottom" story?

Treaty case law - catch-all clause

- 22(4) catch-all clause
- DE: FG Nordrhein-Westfalen (Düsseldorf) 4 Nov 1988, K493/82 - no affiliation privilege for DE/NL treaty
- DE: BFH 29 Oct 1986 IIR226/82 - shares in Italian SpA held to be business property of a partnership, DE/IT treaty does not prevent them from being taxed in DE

Treaty case law

- Not really an active area overall
- Treatment of debt a significant issue
- PE capital cases foreshadow AOA
- No cases on shares in land-rich companies
- Data set limited - need to dig further

- Renewed interest in wealth taxation
- Wealth taxes in the real world
- Tax treaties
- Some history
- Treaty case law
- Estate tax treaty
- The future



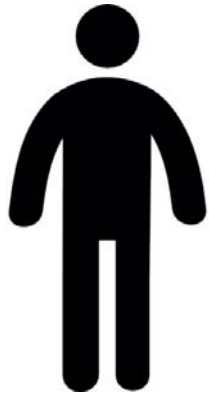
Estate Tax Treaty

- Wealth Holding Tax vs. Wealth Transfer Tax
- 1966 OECD Draft Estate and Inheritance Tax Model Convention
- 1982 OECD Estate, Inheritance and Gift Tax Model Convention

Estate Tax Treaty

- Three nexus points:

Deceased



Situs



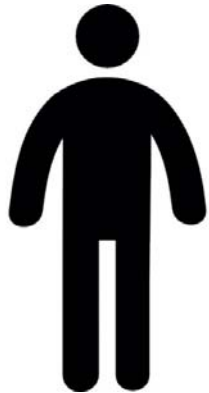
Successor



Estate Tax Treaty

- Looks at the residence of the deceased rather than the successor

Deceased



Situs



Successor



Estate Tax Treaty


- Defines the fiscal domicile of the person whose estate is liable to comprehensive taxation (Art.4)
- Avoids double taxation arising from concurrent worldwide taxation

Estate Tax Treaty

- Distributive rules between the situs state and the residence state
- Article 5: Immovable property
- Article 6: PE
- Article 7: Other property
- Article 8: Deduction of debts

Estate Tax Treaty

- Parallel to capital article in the income tax treaty
- Major differences
 - Three nexus points rather than two
 - Article on deduction of debts
 - No special rules for ships and aircraft

- Renewed interest in wealth taxation
 - Wealth taxes in the real world
 - Tax treaties
 - Some history
 - Treaty case law
 - Estate tax treat
 - The future
- 

The future

- Do we continue to need a treaty article on capital?
- Depends on the use of wealth holding taxes in many countries.
- In the case of their revival, DTA provisions with effective EOI likely to be necessary
- But...

The future

- In an age when people speak of a transition to rent tax from CIT covering normal return to capital, are taxes on the stock of capital viable?
- Intangibles and financial assets - increasing stock of wealth - all dealt with in the catch-all clause (OECD MTC) or up to bilateral negotiations (UN MTC)
- Debt deduction - "negative" financial assets highly mobile within a MNE

The future



masui@j.u-tokyo.ac.jp