British Tax Review
2013

A note on recent UK tax treaty developments (December 2011 to December 2012)[1]

Philip Baker

Subject: Tax
Keywords: Barbados; Double taxation treaties; India; Liechtenstein; Tax administration
Legislation: Barbados-United Kingdom Double Tax Treaty 2012
Liechtenstein-United Kingdom Double Tax Treaty 2012
Model Tax Convention (OECD) art.7
Protocol amending the India-United Kingdom Double Tax Treaty 2012

In the period from December 2011 to December 2012, the UK concluded two comprehensive double taxation conventions, with Barbados[2] and Liechtenstein,[3] and two protocols amending existing conventions, with India[4] and Brunei.[5] The comprehensive agreement with Barbados replaces the previous agreement of March 26, 1970; the convention with Liechtenstein is completely new, and reflects something of the new approach to Liechtenstein following the theft of bank information and the introduction of the Liechtenstein Disclosure Facility,[6] and reflecting the fact that Liechtenstein is a member of the European Economic Area.

In addition, the UK has also concluded Tax Information Exchange Agreements with Brazil and the Marshall Islands, the various agreements with Switzerland as part of the "Rubik" arrangements,[7] an agreement with the US over the implementation of the Foreign Account Tax Compliance Provisions (FATCA),[8] an exchange of letters with Switzerland on the operation of the exchange of information provision in the double taxation convention, and a Bank Levy Convention with Germany. Only the two comprehensive conventions and the amending protocols are discussed further here.

Common features in the two new conventions

The conventions with Barbados and Liechtenstein contain some common features which are different from previous UK conventions and which may perhaps reflect new directions in UK treaty practice. These common features are discussed first, then certain specific features of these two conventions are considered.

Definitions of residence

Both the new conventions contain new wording to the effect that the term "resident of a Contracting State" also includes:

(a)"a pension scheme established in that State; and

(b)an organisation that is established and is operated exclusively for religious, charitable, scientific, cultural, or educational purposes (or for more than one of those purposes) and that is a resident of that State according to its laws, notwithstanding that all or part of its income or gains may be exempt from tax under the domestic law of that State.

In both conventions a "pension scheme" is specifically defined.[9]

It may be a helpful new policy to clarify that pension schemes and charitable, etc. organisations are residents of a Contracting State for purposes of a convention, but there are a few points that are thrown up by this wording.

First, whether the inclusion is necessary at all. It has generally been accepted that the phrase "liable to tax" in Article 4(1) of both Conventions and of the OECD Model[10] includes persons such as pension schemes and charitable trusts that enjoy an exemption from tax because of the purpose they serve.[11] There is perhaps the danger that the specific inclusion of pension schemes and charitable, etc. organisations now might suggest the *a contrario* argument that they were not included in previous conventions without this specific wording. That argument should be resisted. The wording seems to have been added now only to put the matter beyond doubt and not to create a doubt over other conventions.

Secondly, Article 1 of each of the two conventions, and Article 1 of the OECD Model, provides that the convention shall apply to "persons who are residents of one or both of the Contracting States".[12] Thus it is not enough simply to state that a pension scheme or a charitable, etc. organisation is a resident, it must be a "person" as well. In the Barbados convention the definition of "person" is the standard OECD definition that includes "an individual, a company and any other body of persons" (and "company" is defined as "anybody corporate or any entity that is treated as a body corporate for tax purposes"). The definitions of "person" and "company" are ***B.T.R. 3** identical in the Liechtenstein convention except only that the term "person" includes also "dormant inheritances" (which is a rather unusual addition).

So, pension schemes and charitable, etc. organisations may be resident, but they will not come within the scope of the convention unless they are companies or bodies of persons. In the absence of an express provision, there may be an issue as to whether trustees are a body of persons (though they are now defined as such for income tax and capital gains tax purposes in the UK but possibly not in the other country). If the point is to be put beyond doubt, it would be helpful if the definition of "person" included the trustees of a trust, or, even better, also included references to pension schemes and charitable, etc. organisations.

Finally, the term "organisation" is not one that has commonly been employed in double taxation conventions in the past. Presumably it is intended to have a wide scope to cover trusts, religious foundations, research institutes, etc. Given the requirement of Article 1 of each convention, it might have been better to use the term "a person that is established and is operated exclusively for religious, etc purposes". Again, issues may arise as to whether a charitable trust, for example, is "an organisation".

The tie-breaker for non-individuals

It might be noted that both of these two conventions contain a tie-breaker for dual residents other than individuals based upon mutual agreement by the competent authorities. In the absence of a mutual agreement, the dual resident entity is restricted to enjoying the benefit of only certain Articles of the Convention. It is possible under the alternative "effective management" form of tie-breaker for a company incorporated in the UK to be treated as non-resident for tax purposes. The use of the "mutual agreement" approach with respect to territories that are generally regarded as tax havens was probably intended to ensure that the place of effective management tie-breaker could not be used to create companies incorporated in the UK but resident in the other Contracting State for treaty and domestic law purposes.

First use of new Article 7 of the OECD Model

The new conventions with Barbados and Liechtenstein contain the first use in a UK convention of the new version of Article 7 of the OECD Model, which was adopted in 2010. This version is based on the "authorised OECD approach" to determining the profits attributable to the permanent establishment.

Inclusion in conventions with Barbados and Lichtenstein is not exactly a ringing endorsement of the new approach, and hardly deserves a fanfare. For reasons that are too complex to go into here,[13] the new approach in Article 7 is far from being without problem. It has been rejected by the UN Committee of Experts in the 2011 UN Model. The UK is a loyal member of the OECD Committee on Fiscal Affairs, but several OECD Member countries have made reservations to new Article 7 that they reserve the right to use the previous version.[14] There has been no proper debate on the move from the old form of Article 7 to the new form, and one wonders whether the limited, committee scrutiny of the conventions with Barbados and Liechtenstein will provide an adequate opportunity for this issue to be debated. There are very good reasons why the UK should think very hard before adopting the new version of Article 7 in any more significant conventions.

Other income: distributions from trusts or by personal representatives

Both of the new conventions contain a new paragraph in the "Other Income" Article as follows:

"2. Notwithstanding the provisions of paragraph 1, where an amount of income is paid to a resident of a Contracting State out of income received by trustees or personal representatives of estates in the course of administration who are residents of the other Contracting State,[15] that amount shall be treated as arising from the same sources, and in the same proportions, as the income received by the trustees or personal representatives out of which that amount is paid.

Any tax paid by the trustees or personal representatives in respect of the income paid to the beneficiary shall be treated as if it had been paid by the beneficiary." [16]

This is an interesting and innovative provision. It is generally accepted that distributions by trusts fall within the "Other Income" Article. This new provision now provides for fiscal transparency, so that the beneficiary receiving the distribution is treated as receiving the income from the same original source as the income of the trustee or the personal representative out of which the distribution is made. The beneficiary is then given credit for any tax paid by the trustees or personal representatives.

Two thoughts occur on this provision. First, it may not be all that easy in practice to identify the source from which income arose, and attribute that income to a particular distribution to a beneficiary. Secondly, does the "tax paid by the trustees or personal representatives" include tax in both the state of source of the income and the state of residence of the beneficiary (who presumably has to be a resident of one of the Contracting States to take the benefit of this provision)? What about tax that has been paid by the trustees or personal representatives in a third state? A purposive interpretation would suggest that full fiscal transparency should apply.

Elimination of double taxation: new form of UK wording

That part of the "Elimination of Double Taxation" Article which relates to the UK has developed in recent years as domestic legislation introduced a dividend exemption and subsequently an exemption for profits of permanent establishments. These two new conventions contain the most recent and most comprehensive version of this part of the Article.[17] These two conventions contain, consequently, a new provision for exemption of the profits of a permanent establishment when the conditions for exemption under UK law are met.

Provisions specific to the Barbados or Lichtenstein Convention

Aside from features which appear in both the Barbados and Liechtenstein Conventions, there are certain interesting features that appear in one only.

Barbados Convention: pension contributions

The inclusion of pension schemes within the scope of this Convention is noted above. The Pension Article also contains a provision on the taxation of pension contributions. Subject to restrictions in Article 17(4) and (5), Article 17(3) of the Barbados Convention provides as follows:

3."Contributions made by or on behalf of an individual who exercises employment or self-employment in a Contracting State ('the host state') to a pension scheme that is recognised for tax purposes in the other Contracting State ('the home state') shall, for the purposes of:

a)determining the individual's tax payable in the host state; and

b)determining the profits of his employer which may be taxed in the host state;

be treated in that State in the same way and subject to the same conditions and limitations as contributions made to a pension scheme that is recognised for tax purposes in the host state, to the extent that they are not so treated by the home state.

This would appear to be intended to cover scenarios such as the following. An individual is a resident of State A where he is a member of a pension scheme into which contributions are paid. The individual is sent to work in State B for nine months, as a consequence of which his salary for those nine months is taxable in State B, the host state. During those nine months the employer continues to make contributions to the pension scheme, and under this paragraph the contributions should be treated by the host state for tax purposes in the same way as if they had been paid to a host state pension scheme. This may mean that the contributions are deductible by the employer in computing its taxable profits in the host state (if it has a permanent establishment there, for example), and the contributions may not be included in the employee's salary computation.

So far all well and good. However, what is the meaning of the last phrase "to the extent that they are not so treated by the home state"? The individual is still a resident of State A, and the contributions to the scheme by the employer should surely continue to remain deductible (and not taxed as wages) in the home state, State A. If the last phrase of Article 17(3) means that the contributions are then not deductible in the host state, the employer will not get a deduction for the profits of the permanent establishment, and the taxpayer would then be taxed on all his salary arising from work in the host state, even though he is only taxed on part of the salary (after excluding pensions contributions) in his home state. It is rather unclear what that last phrase of Article 17(3) is intended to mean.

Liechtenstein Convention: Assistance in Collection of Taxes

The Liechtenstein Convention contains, in Article 26, a provision for "Assistance in the Collection of Taxes" which is not found in the Barbados Convention. This is modelled on Article 27 of the OECD Model, but with one rather interesting addition. Article 26(8)(e) of the Liechtenstein convention states that the Article does not impose on a Contracting State the obligation

"to provide assistance if that State considers that the taxes with respect to which assistance is requested are imposed contrary to generally accepted taxation principles".[18]

This is rather interesting. The OECD Model and Article 26(8)(b) of the Liechtenstein convention already state that there is no obligation "to carry out measures which will be contrary to public policy".[19] This raises a fascinating question of what are "generally accepted taxation principles." One can imagine some very interesting cases in the future, with expert evidence on all sides, as to what these generally accepted principles are. Presumably, retrospective tax legislation (except in those very limited circumstances where it might be legitimately warranted) would not be consistent with generally accepted taxation principles. This is a point to which the writer returns below.

The Brunei Protocol

The Protocol with Brunei[20] primarily updates the definitions of the UK and Brunei, the definitions of competent authority, and brings the exchange of information provision in line with the current version of the OECD Model and the international consensus on transparency and exchange of information.

The India Protocol

There are a number of purposes discernible behind the new Protocol with India.[21]

First, there have been real difficulties in recent years in working out the application of the existing UK-India Convention[22] to partnerships.[23] The provisions relating to partnerships in the existing Convention were clearly inadequate, and problems have been experienced particularly by partnerships involved in supplying legal services and in the shipping field. The Protocol seeks to resolve these issues by deleting the previous provisions[24] and inserting new definitions of "person" and "resident" which are intended to deal with this issue of partnerships, amongst others. New Article 4(1) of the Convention[25] introduces a "look-through" provision under which the income of a partnership, estate or trust is treated as the income of a resident of the Contracting State only to the extent that the income is subject to tax as the income of a resident, either in the hands of the partnership, estate or trust or in the hands of the partners or beneficiaries. Hopefully, this new wording should ensure that partnerships (which are treated as a taxable entity in India but are look-through in the UK) or their partners will be able to enjoy the benefits of the Convention.

Secondly, the "Dividends" Article of the existing convention is replaced by a new one reflecting, amongst other things, UK practice under which there is a 15 per cent withholding tax on income paid out of Real Estate Investment Trusts (REITs).[26]

Thirdly, a new Article 28C—Limitation of Benefits—is inserted with the following wording:

1."Benefits of this Convention shall not be available to a resident of a Contracting State, or with respect to any transaction undertaken by such a resident, if the main purpose of one of the main purposes of the creation or existence of such a resident or of the transaction undertaken by him, was to obtain benefits under this Convention.

The UK has for several years inserted a "main purpose" limitation into the key provisions of double taxation conventions, including the dividend, interest and royalty articles. It is not clear whether this new Limitation of Benefits provision was requested by the UK to achieve the same purpose throughout the UK-India Convention or was inserted at the request of India.

Finally, the Protocol inserts provisions on administrative assistance: a new Exchange of Information Article,[27] a non-standard Article on "Tax Examinations Abroad",[28] and a new Article on "Assistance in the Collection of Taxes"[29] which is again modelled on Article 27 of the OECD Model. The "Exchange of Information" Article reflects the new international policy in this area.

There are two particular comments one might make.

First, given the recent events (including the introduction of retroactive legislation in India), it might have been preferable if the "Assistance in the Collection of Taxes" provision had contained a paragraph—such as that in the UK-Liechtenstein Convention commented on above—which refers to the absence of an obligation to assist in the collection where the tax is imposed contrary to generally accepted taxation principles.

Secondly, there is a very serious issue arising from the provision relating to the entry into force of the changes effected by this Protocol. Article X(1)[30] contains a normal form of prospective provision for the entry into force of the Protocol. However, Article X(2) states that, notwithstanding this normal entry into force provision for the rest of the protocol, the provisions relating to exchange of information, tax examinations abroad, and *assistance in the collection of taxes* shall have retroactive effect, and:

"shall apply in respect of any matter referred to in these Articles even if such matters pre-date the entry into force of this Protocol or the effective date of any of its provisions."[31]

This is highly undesirable. Given issues that have arisen in recent months with respect to retrospective tax changes in India, providing retroactively for assistance in the collection of taxes can hardly be seen to be consistent with the best interests of British businesses.

There is also a specific reason why this seems undesirable here. India became a party to the Council of Europe/OECD Multilateral Convention on Mutual Administrative Assistance with effect from June 1, 2012. Article 28(6) of that Convention expressly states that, with regard to non-OECD/Council of Europe countries joining the Convention, it will only have prospective effect (unless countries bi-laterally agree expressly to the contrary). With the entry into force of the new Protocol with India, there will, therefore, be two legal regimes for administrative assistance, including assistance in the collection of taxes, between the UK and India. It seems extremely strange and somewhat undesirable that the broader, Multilateral Convention applies only prospectively, whilst an unusual exception has been made with regard to the Protocol with India that these provisions for administrative assistance operate retroactively. It is perhaps high time that the scrutiny process through Parliament gives some guidance to UK treaty negotiators as to the circumstances (hopefully rather limited) where retroactive operation of administrative provisions may be acceptable.

Philip Baker

B.T.R. 2013, 1, 1-8

1.Previous notes have discussed earlier tax treaty developments. The most recent note, covering developments from March 1, 2011 to November 1, 2011, was published in [2011] BTR 626.

2.Convention between Barbados and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, signed at Bridgetown on April 26, 2012 (UK-Barbados Convention).

3.Convention between the United Kingdom of Great Britain and Northern Ireland and the Principality of Liechtenstein for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, signed at London on June 11, 2012 (UK-Liechtenstein Convention).

4.Protocol Amending the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital (UK-India Convention), signed in London on October 30, 2012 (amending Protocol, October 2012).

5.Agreement between the Government of his Majesty the Sultan and Yang Di-Pertuan of Brunei Darussalam and the Government of the United Kingdom of Great Britain and Northern Ireland to amend the Arrangement between the Government of Brunei and his Majesty's Government for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income Made in 1950, as amended by an Arrangement in 1968 and a Supplementary Arrangement in 1973, signed in London on December 11, 2012 (UK-Brunei Agreement).

6.On which, see *HMRC, "Liechtenstein Disclosure Facility (LDF): help and advice"*, available at: http://www.hmrc.gov.uk/disclosure/liechtenstein-help.htm [Accessed January 22, 2013].

7.On which, see *HMRC, "The Swiss/UK Tax Cooperation Agreement and HM Revenue & Customs (HMRC)" (2012)*, available at: http://www.hmrc.gov.uk/taxtreaties/ukswiss.htm [Accessed January 22, 2013].

8.On which, see *"Budget 21 March 2012—Updates"*, available at: http://www.hmrc.gov.uk/budget-updates/march2012/index.htm [Accessed January 22, 2013].

9.UK-Barbados Convention, above fn.2, Art.3(1)(j) and the UK-Liechtenstein Convention, above fn.3, Art.3(1)(j). In addition, the Protocol to the Liechtenstein Convention spells out which existing types of pension schemes are included within its scope.

10.Model Tax Convention on Income and on Capital (OECD, Paris, 2010) (OECD Model).

11.And on this see the recent judgment of the First Tier Tribunal in *Weiser v Revenue and Customs Commissioners [2012] UKFTT 501 (TC)*.

12.UK-Barbados Convention, above fn.2, Art.1; the UK-Liechtenstein Convention, above fn.3, Art.1; and OECD Model, above fn.11, Art.1.

13.But see the *General Report to the International Fiscal Association, Amsterdam Congress (2006) 91b Cahiers de Droit Fiscal International, "The attribution of profits to permanent establishments" (The Netherlands: Kluwer Law International, 2006)* for some of the reasons.

14.These countries include New Zealand, Chile, Greece, Mexico and Turkey and, for a limited time, Portugal. (See the reservations to the OECD Model, above fn.11, Art.7).

15.The UK-Barbados Convention, above fn.2, has slightly different wording: "personal representatives administering the estates of deceased persons and those trustees or personal representatives are residents of the other Contracting State …"

16.UK-Barbados Convention, above fn.2, Art.20 and the UK-Liechtenstein Convention, above fn.3, Art.20.

17.The UK-Liechtenstein Convention, above fn.3, Art.22(1) and the UK-Barbados Convention, above fn.2, Art.21(2).

18.The UK-Liechtenstein Convention, above fn.3, Art.26(8)(e).

19.OECD Model, above fn.11, and the UK-Liechtenstein convention, above fn.3, Art.26(8)(b). Not worth a mention in the main text, and only in a footnote, but the new conventions have finally dropped the tendency of the OECD Model always to follow the words "public policy" by the term "*ordre public*" in French, as if only the French understood the concept of public policy and it would not be understood if left only in English.

20.UK-Brunei Agreement, above fn.5.

21.Amending Protocol, October 2012, above fn.4.

22.UK-India Convention, above fn.4.

23.See, for example, *Linklaters LLP v Income Tax Officer (2010) 13 ITLR 245 (ITAT Mumbai)*.

24.Which were found in Art.3(2) and Art.25 of the existing Convention.

25.UK-India Convention, above fn.4, Art.4(1) inserted by amending Protocol, October 2012, above fn.4, Art.III.

26.UK-India Convention, above fn.4, Art.II deleted and replaced by amending Protocol, October 2012, above fn.4, Art.IV.

27.UK-India Convention, above fn.4, Art.28 deleted and replaced by amending Protocol, October 2012, above fn.4, Art.VI.

28.UK-India Convention, above fn.4, Art.28A inserted by amending Protocol, October 2012, above fn.4, Art.VII.

29.UK-India Convention, above fn.4, Art.28B inserted by amending Protocol, October 2012, above fn.4, Art.VIII.

30.UK-India Convention, above fn.4, amended by amending Protocol, October 2012, above fn.4, Art.X(1).

31.UK-India Convention, above fn.4, amended by amending Protocol, October 2012, above fn.4, Art.X(2).