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OUTLINE

Non-discrimination rules (direct and indirect)

SEMINAR G | Wednesday, 25 October 2023 | 13.30 – 15.30

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I. INTRODUCTION

The non-discrimination article has already been dealt with at the 1993 (Subject 2, IFA Cahiers 78b) and the 2008 (Subject 1, IFA Cahiers 93a) IFA congresses. Since the 1963 OECD MC the non-discrimination provisions have only been changed a few times. In 1977, the deductibility non-discrimination provision of Art. 24(4) OECD MC was inserted; in 1992, the definition of "national" was moved to Art. 3(1) OECD MC and in 1996, the wording of the nationality non-discrimination provision in Art. 24(1) was clarified. The OECD Public Discussion Draft on the Application and Interpretation of Article 24 (Non-discrimination) identified several issues that require a more fundamental analysis. However, since the publication of the Discussion Draft in 2007 the OECD has never followed up on this discussion. The OECD concentrated in the past years on the fight against base erosion and profit shifting. It is time to reconsider the scope and content of the non-discrimination provisions.

II. DISPUTED ISSUES

a. Extension of treaty benefits through the non-discrimination provisions

If an enterprise of a Contracting State earns income from a third state through a permanent establishment located in the other Contracting State it is disputed whether the other Contracting State (= the PE State) is obliged to grant benefits of the tax treaty with the third state to the permanent establishment through Art. 24(3). At the level of the EU, the non-discrimination provisions require a unilateral extension of treaty benefits by the PE State.

b. Application of the non-discrimination provision to group regimes

It is disputed whether non-discrimination provisions require the extension of domestic group regimes to cross-border situations. The OECD Commentary to Art. 24(5) clearly states that the ownership non-discrimination rule does not apply to group regimes. Courts have come to different results either extending group regimes via Art. 24(5) or refusing to apply Art. 24(5) to group regimes. Avery Jones et al. showed in a detailed historical analysis that Art. 24(5) should be applied in all cases where the income of the foreign parent entity does not form part of the group consolidation regime. Refusing the consolidation of profits and losses of two domestic sister companies just because the common parent is a resident of the other Contracting State seems to be contrary to Art. 24(5) OECD MC. By contrast, there are good arguments to interpret Art. 24(5) in a way that it cannot lead to a consolidation with income of the non-resident parent company. Similar problems regarding group regimes also arise with regard to Art. 24(3) OECD MC.

c. Indirect forms of discrimination and the possibility to justify a different treatment

Currently the non-discrimination provisions only protect against distinctions on the basis of specific forbidden criteria. Article 24 does not protect against indirect forms of discrimination. Conversely, it is not possible to justify a discrimination which is based on one of the specific prohibited criteria (nationality in Art. 24(1), residence in Art. 24(3)-(5)). Constitutional Courts and the ECJ have extended the scope of non-discrimination provisions so that also indirect forms of discrimination are prohibited. At the same time Constitutional Courts and the ECJ allow a justification of different treatments. It is worth discussing whether the scope of Art. 24 should also be expanded to cover indirect forms of discrimination. A broadening of the scope would make it necessary to allow justifications as well. This development would allow more flexibility but would also lead to less predictability of the court decisions. The OECD Discussion Draft states on page 29 that these two issues require a fundamental analysis.

d. Relationship between Art. 24 and the UTPR of Pillar II

The adjustments under the UTPR depend on the specific design of the domestic tax systems. The OECD states that the implementation of the UTPR in each country should be coordinated with its tax treaty obligations. One way to implement the UTPR could consist of including an additional amount of deemed income by denying a deduction for expenses incurred in a current or prior period. Such a

denial of deductions might be contrary to Art. 24(4) or Art. 24(5).

III. RECENT CASE LAW ON ARTICLE 24

Here recent case law on issues not yet dealt with in Part II will be discussed.

IV. FUTURE MODIFICATIONS OF ARTICLE 24

a. Extension of Art. 24(3) to other types of income

Art. 24(3) only applies to business income. However, it might be worth considering whether non-resident taxpayers should be protected against discriminatory treatments whenever the non-residence state has the primary taxing right over the income. It seems legitimate to grant protection against discriminatory treatments with regard to income covered by Art. 6, Art. 14 old version, Art. 15, Art. 16 and Art. 17 as well.

b. Extension of Art. 24 to outbound situations

Art. 24 only applies to inbound situations. In EU law the scope of the non-discrimination provisions has been extended to cover outbound situations as well. For instance, EU Member States are not allowed to grant more beneficial depreciation rules in case of domestic investments compared to investments abroad. A similar concept could be introduced in Art. 24.