

Indiana Law Review

Volume 12

1979

Number 2

Double Taxation/Fiscal Evasion and International Tax Treaties

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I. INTRODUCTION

Taxation in its original concept was free from international complications. Taxes were imposed against land, ignoring questions of sovereign disputes of ownership, and were collected by only one sovereign, against land under his rule or jurisdiction.

As the basis for taxation has changed and centered on the person rather than the land, problems of dual tax liability as well as fiscal evasion have increasingly become, inter alia, a troublesome aspect of the tax administrative process. An individual or other legal entity residing or doing business in a foreign area is subjected to possible tax liability by both the foreign state and the home country. At the same time, the state is hindered in its attempt to collect a tax if a person is able to leave the jurisdiction with all his assets while intending never to return. This Article will deal with these two problems; and, specifically, with the solutions attempted through international agreements.

Basically, the reason for turning to international agreements in extending the reach of a state's fiscal system is that, as Lord Mansfield stated: "[O]ne nation does not take notice of the revenue laws of another" (the "notice" doctrine).¹ This barrier to an alien tax authority is so well established that it is categorized as one of the fundamental rules of international law.² Its proponents have stressed the analogy to criminal law, whereby any imposition is deemed an attack on a state's sovereignty.³ It is further contended that unilateral provisions can best handle the problem of double taxation, and that allowing foreign jurisdiction in evasion cases may place the court in the embarrassing position of either applying or striking down a tax considered to be contrary to public policy.⁴ Opponents of

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¹*Planche v. Fletcher*, 99 Eng. Rep. 164, 165 (K.B. 1779).

²Leflar, *Extrastate Enforcement of Penal and Governmental Claims*, 46 HARV. L. REV. 193, 215-23 (1932).

³*Id.* at 219.

⁴*Moore v. Mitchell*, 30 F.2d 600, 604 (2d Cir. 1929) (Hand, J., concurring).

this ancient doctrine have asserted that no analogy can be made between criminal and tax law because criminal laws are punitive, whereas taxes are imposed as a social obligation.⁵ They argue that unilateral solutions to double taxation are collateral and cause as many problems as they attempt to solve.⁶ Lastly, opponents ask balancing of the stigma of striking down a foreign law against the stigma of affording delinquent taxpayers sanctuary.⁷ Regardless of the arguments, the question is whether the "notice" doctrine is merely judicial tradition without substance or a meaningful and necessary rule of international law. If it is the former, then treaty activity would seem a necessary solution.

This Article will analyze the problem in three sections: It will discuss the relevance and advisability of including both areas of tax administration, *i.e.*, double taxation and tax evasion, in the same treaty negotiations and documents, and then will examine these two areas separately, analyzing the special microcosm of considerations imposed by each.

II. ADVISABILITY OF COORDINATING DOUBLE TAXATION AND FISCAL EVASION PROPOSALS

While still in their infancy, international tax conferences created awareness of the need to consider the two basic problems of tax negotiations within the same basic framework. The best demonstration of the validity of this conclusion comes from the first attempt of the League of Nations at tax negotiations in 1920 to the resulting treaties of 1939 to 1946.⁸

A. *Work of the League of Nations and Development of the O.E.C.D.*⁹

Shortly after the International Financial Conference of 1920, a recommendation was made to the League of Nations that it consider the question of double taxation. The International Economic Conference, which had met in 1922, recommended that the League also examine the problem of fiscal evasion. This latter task, investigating the question of fiscal evasion, was entrusted to a group of high of-

⁵See Eichel, *Administrative Aspects of the Prevention and Control of International Tax Evasion*, 20 U. MIAMI L. REV. 25, 71-73 (1965).

⁶Leflar, *supra* note 2, at 221.

⁷Eichel, *supra* note 5, at 72-73.

⁸See King, *Fiscal Cooperation in Tax Treaties*, 26 TAXES 889 (1948).

⁹This discussion is based on an analysis of King, *supra* note 8, at 889; and of A. VAN DEN TEMPEL, RELIEF FROM DOUBLE TAXATION 7-24 (International Bureau of Fiscal Documentation, *Developments in Taxation Since World War I* No. 7, 1967); as well as reference to certain League of Nations and O.E.C.D. reports as cited below.

officials from the fiscal administrations of seven European countries, the Committee of Technical Experts. On the basis of resolutions submitted in 1925 to the League's Financial Committee,¹⁰ the League Committee soon submitted to the Council of the League a report containing four model bilateral conventions.¹¹ The first model convention pertained to the elimination of double income taxation, the second to the elimination of double succession duties, the third to the exchange of information, and the fourth to reciprocal assistance in the collection of taxes. By 1928, the models had been circulated to the various governments, and in October 1928, the models were discussed and revised. Pursuant to a request that a permanent committee be formed, the Council of the League named a Fiscal Committee¹² which: (1) Drafted a model convention on allocation of business profits,¹³ and (2) revised the model conventions of 1928, incorporating the 1932 draft.¹⁴

Until the formulation of these two model conventions, the vast majority of taxation treaties were deficient in most areas, and unable to be reconciled with other treaties. The promulgation of the Mexico and London models brought some semblance of uniformity to the bilateral conventions executed in the post-war period, but there still were a large number of differences in the provisions of existing treaties,¹⁵ resulting in considerable uncertainty for taxpayers doing business in foreign countries. This impediment to international com-

¹⁰*Report and Resolutions Submitted by the Technical Experts to the Financial Committee of the League of Nations*, L.N. Doc. No. F. 212, 10-30 (1925) [hereinafter cited as *L.N. 1925*].

¹¹*Report Presented to the Financial Committee of the League of Nations by the Committee of Technical Experts on Double Taxation and Tax Evasion*, L.N. Doc. No. C. 216. M. 85., 5 (1927) [hereinafter cited as *L.N. 1927*].

¹²*See Resolutions Adopted by the Council at its Fifty-Third Session*, L.N. Doc. No. C. 613. M. 190. (1928).

¹³The convention was drafted after an inquiry in many countries, the results of which were published in 1932-1933. *Taxation of Foreign and National Enterprises: 1, France, Germany, Spain, the United Kingdom, and the United States of America*, L.N. Doc. No. C. 73. M. 38. (1932); *Taxation of Foreign and National Enterprises: 2, Austria, Belgium, Czechoslovakia, Free City of Danzig, Greece, Hungary, Italy, Latvia, Luxembourg, Netherlands, Roumania, and Switzerland*, L.N. Doc. No. C. 425. M. 217. (1933); *Taxation of Foreign and National Enterprises: 3, British India, Canada, Japan, Mexico, Netherlands, Indies, Union of South Africa, States of Massachusetts, New York, and Wisconsin*, L.N. Doc. No. C. 425(a). M. 217(2). (1933), discussed in Carroll, *International Tax Law; Benefits for American Investors and Enterprises Abroad*, 2 INTL LAW. 692, 703 n.20 (1967-1968).

¹⁴The model conventions of London were published together with the models established during the war by a group of members of the League of Nations meeting in Mexico. These latter models came to be referred to as the Mexico City Convention (1943) and the London Convention (1946). Carroll, *supra* note 13, at 707.

¹⁵A. VAN DEN TEMPEL, *supra* note 9, at 13.

mercial transactions prompted the creation of the Fiscal Committee of the Organization for European Economic Cooperation (O.E.E.C.) by the O.E.E.C. Council in 1956 to study fiscal questions relating to double taxation and tax collection.¹⁶

The committee initially took as a major objective that of drafting a series of treaty articles which could be used as a model bilateral convention with the hope that the adoption of these articles by a large number of countries would eventually lead to the adoption of a single multilateral convention.¹⁷ When the Organization for Economic Co-operation and Development Fiscal Committee (O.E.C.D.) was formed with members from the O.E.E.C. countries, plus the United States and Canada,¹⁸ the Fiscal Committee continued and, in 1963, completed the report on the Draft Double Taxation Convention. This report was the culmination of the study reports issued in 1958, 1959, 1960, and 1961. It brought together in one publication the basic materials contained in these reports and the complete text of the Draft Double Taxation Convention.¹⁹ The Fiscal Committee and its successor, the Committee on Fiscal Affairs, met regularly and issued a number of other study reports relating to the problems of double taxation and tax enforcement.²⁰ More significantly, the committee has recently completed its Model Double Taxation Convention on Income and on Capital.²¹

B. Coordination of Treaty Provisions

In determining the most effective approach towards international agreements a decision must be made as to whether the collec-

¹⁶Organization for Economic Cooperation and Development Fiscal Committee, Report, *Draft Double Taxation Convention* 7 (1963) [hereinafter cited as O.E.C.D. Report]. The outstanding work carried out by the League of Nations against double taxation over a 25-year period (1921-1946) was resumed in 1956 with the creation of the Fiscal Committee of the O.E.E.C. (later O.E.C.D.). Although the League had hoped for the Fiscal Committee of the United Nations to continue its efforts on the subject, this Committee did not produce much at all in regard to the drafting of model conventions during its short existence.

¹⁷O.E.C.D. Report, *supra* note 16, at 10.

¹⁸A. VAN DEN TEMPEL, *supra* note 9, at 11.

¹⁹O.E.C.D. Report, *supra* note 16, at 41-58.

²⁰*E.g.*, COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., THE TREATMENT OF FAMILY UNITS IN O.E.C.D. MEMBER COUNTRIES UNDER TAX AND TRANSFER SYSTEMS (1977); COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., THE TAX/BENEFIT POSITION OF SELECTED INCOME GROUPS IN O.E.C.D. MEMBER COUNTRIES, 1972-1976 (1978); FISCAL COMMITTEE, O.E.C.D., FISCAL INCENTIVES FOR PRIVATE INVESTMENT IN DEVELOPING COUNTRIES (1965); COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., THE TAXATION OF COLLECTIVE INVESTMENT INSTITUTIONS (1978).

²¹COMMITTEE ON FISCAL AFFAIRS, O.E.C.D., MODEL DOUBLE TAXATION CONVENTION ON INCOME AND ON CAPITAL (rev. ed. 1977) [hereinafter cited as O.E.C.D. MODEL TREATY].

tion provisions should be made an integral part of a comprehensive treaty which contains the substantive provisions concerned with the problem of double taxation, or whether these provisions should be considered as separate and distinct treaties. The following is a list of the considerations, for the most part suggested by the League's work, necessary in deciding whether to correlate and, if so, how to correlate the problems of double taxation and collection.

1. *Both problems are responsive to the concerns of the taxpayers and governments involved.* — Although it might first be said that this close relationship between double taxation and fiscal evasion weighs on the side of the more comprehensive treatment, the Committee of Experts reasoned:

Taxpayers, alarmed by proposals for fiscal control do not understand why, before or during the framing of measures which may prove embarrassing to them, States do not come to some agreement in order suitably to define their respective jurisdictions as regards taxation, and to avoid taxation. On the other hand, if States, in concluding agreements to avoid double taxation, are given to make sacrifices in the matter of the yield from taxation, owing to the granting of exemption, or relief, or reduction of the rates of their taxes, etc., they may properly endeavor to find compensation for what they thus surrender in measures against tax evasion.²²

Thus, the greater the administrative reach, the more concern with double taxation by the taxpayer; the greater the relief from double taxation, the greater the desire of government to extend its administrative reach. This conflict between the two is best reconciled, it would seem, by dealing with double taxation and fiscal evasion together.

2. *Having a thorough knowledge of the other country's tax system is necessary in working with both problems.* — Opponents of these collection measures have complained that not enough is known about the foreign tax system to which one government measures part of its collection process.²³ In working out the substantive provisions on double taxation, each country must, of necessity, study in some detail the tax system of the other. Thus, collection provisions emerging from an informative exchange between the taxing authorities become less amenable to attack on the basis of a lack of knowledge of the foreign taxing system.

²²L.N. 1925, *supra* note 10, at 27.

²³See *Report to the Council on the Work of the Eighth Session of the Fiscal Committee*, L.N. Doc. No. C. 384. m. 229., 1-2 (1938).

3. *Both problems contain equitable concerns.*—The League's Committee of Technical Experts saw the connection as mainly a moral one.²⁴ The League considered the goal of both types of provisions to be the equitable distribution of tax burdens between taxpayers *and* governments. Therefore, separate treatment, allowing the possibility of a one-sided approach, would lessen the chances of achieving this goal. Stated in another way, the problem could have been viewed as achieving an equitable distribution of tax burdens and revenues. The most complete means towards equitable results calls for both the prevention of fiscal evasion *and* relief from double taxation.

4. *A causal relationship exists between the two problems.*—Notions expressed by the League as to the causal effect the two problems might have on each other support the side of the two-pronged, single-treaty approach.²⁵ There were three aspects to this causal connection. First, the decrease in double taxation caused a decrease in fiscal evasion:

Double taxation, which affects many undertakings and persons who exercise their trade or profession in several countries, or derive their income from countries other than the one in which they reside, imposes on such taxpayers burdens which, in many cases, seem truly excessive, if not intolerable. At the same time, any excessive taxation, by its very burden, brings in its train tax evasion: . . . the suppression of double taxation is therefore closely connected with the measures for the systematic prevention or checking of such evasion.²⁶

Second, assistance in matters of fiscal evasion often caused an increase in double taxation; however, this might be remedied by dealing with both problems together. In an early report, the Committee felt that a provision aimed at controlling fiscal evasion would increase "the mischievous consequences of double taxation on account of the conflict of laws in respect of domicile,"²⁷ but continued:

To this objection . . . it may be replied that the proposed resolutions (referring to its 1925 Resolutions on Double Taxation and Tax Evasion) form an indivisible whole, and that their object is to prevent both double taxation and tax eva-

²⁴See *L.N. 1925*, *supra* note 10, at 28.

²⁵*L.N. 1927*, *supra* note 11, at 8.

²⁶*Id.* at 8-9.

²⁷*L.N. 1925*, *supra* note 10, at 25.

sion. The foregoing criticism will be seen to furnish fresh proof of the close connection between the two problems.²⁸

The third aspect of this relationship arises in the context of double taxation treaties which give special benefits to the signatory states as a means of dealing with double taxation. The measures aimed at fiscal evasion in this context have quite a narrow application because their need is due solely to the double taxation provisions. The League realized this development when it concluded:

On the one hand, conventions suggested for avoiding double taxation may contain special measures against evasion, destined to prevent any abuse arising from their application; on the other hand, the exchange of information may perhaps lead to duplication in the levying (or collecting) of taxes. This is tantamount to saying that, in elaborating any practical measure for dealing with one of these problems, account must also be taken of the other.²⁹

5. *Collection provisions may reimburse a government for the loss from double taxation provisions.*—Effective measures of collection assistance are a means to reimburse countries for the loss of revenue sustained from the double taxation provisions. Provisions concerned with fiscal evasion might cushion the loss in revenue caused by double taxation provisions, and, therefore, provide an incentive for more nations to enter such agreements.³⁰

6. *Double taxation provisions may carry the collection provisions past taxpayer disapproval.*—Because governments must, in many instances, bend to the will of their taxpayers, a point of government strategy is the ability to enhance taxpayer reception of collection provisions. Taxpayers, mindful of the benefits received from double taxation provisions, would be more receptive to a comprehensive treaty with inseparable collection provisions.³¹ Coordination between the two problems may also meet the criticism that collection provisions interfere with the free flow of capital inasmuch as double taxation, which aids the flow of capital, tends to counteract any inhibiting effects that the collection provisions may have.

7. *A double taxation provision insuring equality of treatment helps meet the taxpayer's fear of abandonment to the collection pro-*

²⁸*Id.*

²⁹*Id.*

³⁰*Id.*

³¹*Conventions with South Africa, New Zealand, Norway, Ireland, Greece, & Canada on Double Taxation: Hearings Before a Subcomm. of the Comm. on Foreign Relations United States Senate, 82d Cong., 1st Sess. 66-67 (1951) [hereinafter cited as 1951 Hearings].*

visions.—Another fear on the part of taxpayers generated by these collection provisions is the State's abandonment of its citizens who are taxable in another country, leaving them entirely at the discretion of a foreign tax administration, and, moreover, putting itself under the obligation to carry out, at the request of such an administration, measures that may not be in harmony with domestic customs.³² However, such a danger is already reduced by the article of the 1946 Model Convention for the Prevention of Double Taxation of Income and Property which relates to equality of treatment.³³

8. *Separate treatment enables administrations to make better use of its few international tax specialists.*—It might be said that, since few nations have a large number of people capable of putting together sophisticated international tax agreements, treaties of the highest quality can be had only if efforts are concentrated on *either* the problem of double taxation or of tax evasion at any one time. That is, asking the sparse number of international tax people in the administrations of the various governments to work towards a comprehensive treaty may be spreading worthwhile research too thin.³⁴

9. *Separate treatment may avoid delay of the more important double taxation provisions.*—For any number of reasons, a government may be apprehensive of entering into a treaty containing collection provisions. The need for double taxation relief, however, may be of great importance to both countries. Thus, one country pressing for a collection provision may delay the needed double taxation provisions.³⁵ If it were essential that the two be treated together, this country would have to weigh the cost of any delay against the necessity of a collection provision which could not be considered in the future. But if the two might profitably be considered separately, the country desiring the collection provision need not delay.

10. *Separate treatment increases the likelihood of more countries entering into these agreements.*—The less people have to agree on, the sooner they will agree, if they are to come to any agreement at all. Therefore, if these collection provisions are at their best when as many nations at any one time as possible agree to them,³⁶ reducing the treaty to collection provisions only increases the possibility of greater acceptance. This reasoning, of course, ignores the possibility that by adding double taxation measures there

³²*London and Mexico Model Tax Conventions, Commentary and Text*, L.N. Doc. No. C. 88. M. 88., 46 (1946) [hereinafter cited as *L.N. 1946*].

³³*Id.* at 68-69.

³⁴See Eichel, *supra* note 5, at 41-42.

³⁵See *L.N. 1946*, *supra* note 32, at 46.

³⁶See *L.N. 1927*, *supra* note 11, at 4, 27.

may be increased incentive to enter into such agreements because of the possibility of increased taxpayer approval.

On balance it would seem, as the League concluded, that the weightier arguments favor a comprehensive treatment of the two problems.³⁷ Practical considerations, however, might make this double-barrelled analysis unprofitable and, thus, cause abandonment of the work on collection provisions.

Ultimately, it would seem difficult to ignore these collection provisions because they might prove to be a hindrance to relief from double taxation. This is especially so when one has conceded their importance in attempting to reach the goal of a fair and equitable distribution of tax burdens and benefits between governments and taxpayers.

III. THE PROBLEM OF DOUBLE TAXATION

Basically, double taxation treaties are designed to avoid taxation of a single event or transaction by two or more states. The basic problem of double taxation was recognized by the United States early in its history of income taxation,³⁸ when substantial relief was provided through the foreign tax credit, as well as various other measures.³⁹

Unfortunately, such unilateral solutions have several limitations. Initially, any relief granted is given by business activity, not given

³⁷*L.N. 1946, supra* note 32, at 100.

³⁸Revenue Act of 1919, §§ 222, 238(a), 40 Stat. 1073, 1080 (1919) (current version at I.R.C. § 901).

³⁹*See* I.R.C. §§ 871, 881, 882, 901. The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), introduced various changes in regard to the foreign tax credit, including the denial of the foreign tax credit to a taxpayer cooperating with, or participating in, an international boycott based on nationality, race, or religion. Pub. L. 94-455, § 1061(a), 90 Stat. 1649 (1976) (codified at I.R.C. § 908) and Pub. L. 94-455, § 1064(a), 90 Stat. 1650 (1976) (codified at I.R.C. § 999). In addition, the amount of dividends received from corporations in less-developed countries is now increased by the amount of foreign taxes deemed paid with respect to the dividends by the recipient domestic corporation to the foreign corporation. Pub. L. 94-455, § 1033(a), 90 Stat. 1626 (1976) (codified at I.R.C. § 902). Further, the per-country foreign tax credit limitation has been repealed, requiring the use of the overall limitation to establish the amount of foreign tax paid which can be used to reduce United States taxes. This will have the effect of reducing overall income from sources outside the United States by reducing the amount of foreign taxes which can be used as a credit against United States taxes. Pub. L. 94-455, §§ 1031(a), 1032(a), 90 Stat. 1562, 1620 (1976) (codified at I.R.C. § 904). The foreign tax credit limitation was further adjusted to reflect the lower tax rate on capital gains income received by a corporation. Pub. L. 94-455, § 1034(a), 90 Stat. 1624 (1976) (codified at I.R.C. § 904(b)(2)). Further, the foreign tax credit is now allowed for foreign taxes paid by a third-tier subsidiary. Pub. L. 94-455, § 1037(a), 90 Stat. 1633 (1976) (codified at I.R.C. § 960).

by the individual country.⁴⁰ Consequently, a nation's laws are unable to deal with specific problems. Moreover, any relief granted is often at the expense of the country itself. Every time another country imposes a tax, the United States bears the burden and effectively subsidizes the foreign state.⁴¹ Beyond the benefits of these unilateral devices, the taxpayer is then burdened by a double tax. The only solution to this problem is a bilateral or multilateral agreement between individual sovereigns.⁴²

Unilateral solutions also involve another problematic area. If two countries provide separate relief from double taxation for any given transaction, an individual may escape the tax of both countries. This occurs if both countries have ceded jurisdiction to tax a specific area. This is not likely to occur if the method of relief is a tax credit, but it can easily happen if both countries grant an outright exemption for a particular type of income. Accordingly, bilateral or multilateral agreements are necessary to curb the possibility of this rather different type of tax shelter and to insure that all income is at least subject to some type of tax.

An analysis of any attempt at an international solution to these problems of double taxation encompasses three general areas—the basic scope of the treaties, the basis for allocation of the overall tax base, and, for lack of a better label, the peculiar problems involved in each type of tax base. Due to the infinite number of possible approaches to these three areas, it is necessary to choose some base, even an arbitrary one, on which to center the discussion. Thus, this analysis will center on the Draft Double Taxation Convention prepared by the Organization for Economic Co-operation and Development Fiscal Committee.⁴³

A. *Tax Treaty Scope*

All United States tax treaties are entered into by the President of the United States and subject to the consent of the United States

⁴⁰I.R.C. § 901 allows the credit for taxes of foreign countries in terms of taxes paid "to *any* foreign country or to *any* possession of the United States." (Emphasis added).

⁴¹This is so, because the tax was paid to and collected by the foreign country, and generally, the taxes paid to and collected in the United States are thereby reduced.

⁴²See Ownes, *United States Income Tax Treaties, their Role in Relieving Double Taxation*, 17 RUTGERS L. REV. 428 (1963).

⁴³The O.E.C.D. in April, 1972, published the Revised Text of Certain Articles of the 1963 Draft Double Taxation Convention on Income and on Capital. The Revised Articles and Commentaries reflect modifications of the O.E.C.D. Model Draft of 1963 which member countries have included in various bilateral treaties since publication of the 1963 Draft. Carroll, *United States Tax Treaties with the European Community Member Countries: Corporate Assets*, 44-3rd T.M. A-19 (1974).

Senate.⁴⁴ Further affirmance of the scope of these treaties is found in the Internal Revenue Code: "Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle."⁴⁵

Yet, this seeming subjugation of the Code to international treaties is not at all binding on the interpretation of provisions in a convention or treaty. The Supreme Court of the United States seems to broadly interpret provisions in treaties, while still reserving the power to limit any such provision that may cut too deeply into the intent of the Internal Revenue Code. Compare the opinion of the Court in *Hauenstein v. Lynham*:⁴⁶ "Where a treaty admits of two constructions, one restrictive as to the rights, that may be claimed under it, and the other liberal, the latter is to be preferred"⁴⁷ with its recent limitation in *Maximov v. United States*:⁴⁸ "To say that we should give a broad and efficacious scope to a treaty does not mean that we must sweep within the Convention what are legally and traditionally recognized to be domestic taxpayers not clearly within its protections"⁴⁹

Thus, the courts have a general policy of broad interpretation of treaty provisions, while also maintaining an unpredictable strain of judicial opinion subjugating international conventions to the Internal Revenue Code. In certain areas in which the Code requires strict interpretation,⁵⁰ this can lead to very discordant results. Thus, the first requirement of any tax convention is a very definite delineation of the principles of interpretation.

Clearing the hurdle problems of interpretation, the convention must set out the scope of taxes to be considered. This was discussed in Article 2 of the O.E.C.D. Convention:

1. This Convention shall apply to taxes on income and on capital imposed on behalf of each Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes

⁴⁴U.S. CONST. art. II, § 2.

⁴⁵I.R.C. § 894.

⁴⁶100 U.S. 483 (1880).

⁴⁷*Id.* at 487; *accord*, *Factor v. Laubenheimer*, 290 U.S. 276 (1933).

⁴⁸373 U.S. 49 (1963).

⁴⁹*Id.* at 56.

⁵⁰*See* *Corn Prods. Ref. Co. v. Commissioner*, 350 U.S. 46 (1955).

on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation⁵¹

What is required is a very specific enumeration of the exact taxes to be included. The Article includes taxes imposed by state and local governments and, thereby, would solve one of the more irritating aspects of the United States tax system. If a nonresident alien works in the United States for a period included within the exemption provisions of an international treaty, it is often financially embarrassing, as well as emotionally disturbing, for the individual to find himself unexpectedly subject to state or local income taxes. Although it has never been specifically determined whether a United States tax treaty is controlling over a state tax law, it appears that such an interpretation would be constitutional.⁵² The United States, however, has reserved its position on this part of the Article, probably based more on political considerations than on constitutional authority.⁵³

A further problem arises in determining the scope of taxes due to the difference in tax bases of foreign countries. Taxes covered in the conventions sometimes include, in addition to income taxes,⁵⁴ capital taxes and taxes on movable property and land.⁵⁵ Because the conventions are intended to be reciprocal, the overall foreign taxes are generally parallel in economic effect to United States income taxes subject to the Treaty.

An additional problem is determining what persons are subject to a treaty. Basically, the persons affected by the conventions are resident individuals of each contracting country as well as corporations or other entities organized under the laws of the contracting state. The term "enterprise" is also referred to with special significance in most of the conventions.⁵⁶ The recipients of benefits in the treaties are almost exclusively nonresidents of the country granting a special status. This is due to a "savings clause," which is almost always included in tax conventions. This clause provides that, to determine the taxes of its citizens, residents, or corpora-

⁵¹O.E.C.D. *Report*, *supra* note 16, at 4.

⁵²*Cf. Missouri v. Holland*, 252 U.S. 416 (1919) (treaty for protection of wild birds not a violation of state's reserved powers under tenth amendment, due to national scope of interest involved and the necessity of a treaty to protect interest).

⁵³O.E.C.D. *Report*, *supra* note 16, at 39-40.

⁵⁴*See, e.g., Convention Respecting Double Taxation*, Apr. 29, 1948, United States-Netherlands, art. I, para. (1), 62 Stat. 1757, T.I.A.S. No. 1855.

⁵⁵*See Convention for the Avoidance of Double Taxation*, Mar. 30, 1955, United States-Italy, art. I, para. (6), 7 U.S.T. 2999, T.I.A.S. No. 3679.

⁵⁶*See* discussion of the term "enterprise" in O.E.C.D. *Report*, *supra* note 16, at 65.

tions, a country may include all items in taxable income under its laws regardless of treaty provisions.⁵⁷

With the exception of the status of a citizen falling within the "savings clause" category, it is necessary to determine the residence of individuals for purposes of asserting a benefit under a tax treaty. Article 1 of the O.E.C.D. draft provides that the convention applies to residents of one of the contracting countries.⁵⁸ Article 4 defines residency with more particularity than any other United States treaty has done.⁵⁹ An adequate definition becomes more and more important with problems of multiple residences and the consequences of employing an inadequate definition. The draft sets forth various criteria for determining residence. First, the individual is treated as a resident at the location of his permanent home. In the case of multiple permanent homes, the draft chooses the home in which the taxpayer has the closest personal and economic interest ("centre of vital interests"). If there is no permanent home or if the "centre of vital interests" cannot be determined, then his habitual abode is considered his residence. Finally, in cases of multiple habitual abodes, the draft defers to the country of which the taxpayer is a national.⁶⁰ The United States bases tax liability on the basis of citizenship as well as residence.⁶¹ The term "residence" has been defined as related to, but less substantial than, the common law concept of domicile.⁶² Adoption of the draft's definition would certainly assist in bringing about uniformity, but it would allow wealthy United States citizens to establish their principal residence in low tax rate countries and obtain very substantial tax savings. Thus, the United States probably would not enter into a multilateral treaty embodying the residence concept, as demonstrated by its reservation of approval of Article 4. Possibly, however, the United States could apply Article 4 to problematic definitional questions while still retaining the "savings clause" and not derogating the right of the United States to tax its citizens.⁶³

Presently, corporations entitled to benefits under the treaties are generally corporations organized under the laws of the contract-

⁵⁷See *Crerar v. Commissioner*, 26 T.C. 702 (1956) for an explanation of the "savings clause" as well as a validation of the method.

⁵⁸O.E.C.D. *Report*, *supra* note 16, at 41.

⁵⁹*Id.* at 43.

⁶⁰*Id.*

⁶¹I.R.C. § 901; Treas. Reg. § 1.1-1(a). See also, B. BITTKER & L. EBB, UNITED STATES TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS 482 (1968).

⁶²Treas. Reg. § 1.871-2(b) (1971).

⁶³Association International de Droit Financier et Fiscal, Klimowsky, *Unilateral Measures for the Avoidance of Double Taxation*, 43 CAHIERS DE DROIT FISCAL INTERNATIONAL 12 (1961).

ing states. Thus, residence is generally based on origin, rather than principal place of business. The theoretical arguments of defining a corporation are not nearly as great as the practical necessity of obtaining some standard definition. The problem of conflicting definitions is demonstrated by a recent United States-Canadian convention.⁶⁴ A Canadian corporation under the treaty is different from the Canadian corporation under national law. The O.E.C.D. draft convention provides that, if a corporation is subject to taxation in both contracting states, and therefore a resident of both contracting states, it shall be deemed to be a resident of the contracting state in which its place of effective management is situated.⁶⁵ The implementation of this definition would free both countries to adopt broad internal definitions without fear of subjecting a corporation to double tax liability.

In cases of individuals, permanent residence is a tangible concept. Business enterprises, however, are judged on the basis of permanent establishment.⁶⁶

B. *Permanent Establishment*

One indicator of the residence of a business enterprise is the country in which the enterprise is organized, although it may also have business operations in many other countries. The purpose of the term "permanent establishment" is to determine when the operations subject the enterprise to the taxing authority of a country.

United States treaties have universally adopted and applied the concept of "permanent establishment" as the principal limitation imposed upon the treaty parties to tax income from sources within their boundaries.⁶⁷ For example, it is generally applied to limit taxation of industrial and commercial profits, dividends, interest, and royalties. In essence, the treaty parties agree to exempt certain types of income from taxation, or at least to reduce their tax on such income, if the economic penetration into the source country by the recipient of the income does not constitute a permanent establishment.

Under the Internal Revenue Code, a foreign taxpayer will be subject to United States tax on income from United States sources

⁶⁴*Convention Respecting Double Taxation*, Mar. 4, 1942, United States-Canada, 56 Stat. 1399, T.S. No. 983, as amended, June 12, 1950, art. XII, paras. (1)-(2), 2 U.S.T. 2235, T.I.A.S. No. 2347.

⁶⁵O.E.C.D. *Report*, *supra* note 16, at 41.

⁶⁶A. VAN DEN TEMPEL, *supra* note 9, at 38.

⁶⁷*See id.*

if he engages in a trade or business within the United States.⁶⁸ This concept of "engaged in a trade or business" is carried into the conventions and coupled with the term "permanent establishment." Thus, the test under United States treaties is whether the foreign resident is engaged in a trade or business through a permanent establishment.⁶⁹ Article 5 of the O.E.C.D. draft⁷⁰ contains the definition of a permanent establishment. Specifically, the convention states:

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.
2. The term "permanent establishment" shall include especially:
 - a) a place of management;
 - b) a branch;
 - c) an office;
 - d) a factory;
 - e) a workshop;
 - f) a mine, quarry or other place of extraction of natural resources;

⁶⁸I.R.C. § 882(a) (foreign corporations subject to tax).

⁶⁹Carroll, *Evolution of U.S. Treaties to Avoid Double Taxation of Income, Part II*, 3 INT'L LAW 169 (1968-1969). See also *Johansson v. United States*, 336 F.2d 809 (5th Cir. 1964); *Samann v. Commissioner*, 313 F.2d 461 (4th Cir. 1963); *Donroy, Ltd. v. United States*, 301 F.2d 200 (9th Cir. 1962); *Commissioner v. Consolidated Premium Iron Ores, Ltd.*, 265 F.2d 320 (6th Cir. 1959); *American Trust Co. v. Smyth*, 247 F.2d 149 (9th Cir. 1957).

⁷⁰O.E.C.D. *Report, supra* note 16, at 43. United States treaty definitions of a permanent establishment since 1961 have been largely patterned after the O.E.C.D. draft prototype. Notable changes in the newer treaty definitions include allowing a foreign enterprise to engage in the five O.E.C.D. designated ancillary and preparatory activities, such as delivery and warehousing, without being designated as a permanent establishment. Williams, *Permanent Establishments in the United States*, 29 TAX LAW. 277, 303 (1976). The newer treaties based on the O.E.C.D. Draft have replaced the older treaty view of a permanent establishment, rigidly defined by a concept of fixed assets or specified agencies, with a more functional view toward economic profit and regular business activity deriving from the fixed assets or specified agencies. A fixed place of business, which is used for regular, but ancillary and preparatory activities to the realization of economic profit, such as storage, display, scientific research, and advertising will not be designated as a permanent establishment subject to taxation. The O.E.C.D.-based definitions of permissible "non-permanent establishments" permit a considerably wider scope of activities than the earlier treaties, and illustrate the O.E.C.D.'s evident intent to tax "only those agencies and assets which are continuously used for business activities having an essentially direct relation to the realization of economic profit." *Id.* at 354.

- g) a building site or construction or assembly project which exists for more than twelve months.
3. The term "permanent establishment" shall not be deemed to include:
- a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to an enterprise;
 - b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
 - c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
 - e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.
4. A person acting in a Contracting State on behalf of an enterprise of the other Contracting State—other than an agent of an independent status to whom paragraph 5 applies—shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.
5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.
6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute for either company a permanent establishment of the other.⁷¹

⁷¹*Id.* at 43.

This draft provision specifically covers some of the areas which have recently caused many problems. For example, subparagraph 3(e) specifies that the operation of a so-called "propaganda office" in one of the contracting countries shall not constitute, by itself, a permanent establishment. The propaganda office is a comparatively recent device, used particularly by large American companies, which involves establishing an office in a foreign country to handle advertising, buying, marketing or scientific research, or related activities. Usually the corporation operates its selling and manufacturing activities through a subsidiary, but the "propaganda office" is a direct arm of the parent. This draft opens the door for more extensive activities, such as the sale of research results, by using the phrase "or for similar activities which have a preparatory or auxiliary character for the enterprise."⁷² This language is also intended to exclude from the definition an office established to service a patent or "know how" agreement.⁷³ It is not, however, intended to exclude an office established principally for the sale of research results.⁷⁴

Article 5 also excludes from the area of permanent establishment an independent agent or one who does not have authority to conclude contracts in the name of the employer other than contracts for the purchase of goods. This has been the general rule under United States treaties, but it has been difficult to apply.⁷⁵ The biggest problem arises in interpreting what is "authority to conclude contracts." This can mean anything from allowing formal approval to defeat the tax jurisdiction to considering a situation of co-approval as sufficient to constitute a permanent establishment.

The open draft also adopts the principles contained in most United States treaties concerning parent and subsidiary corporations. It applies to situations in which one corporation does not directly have a permanent establishment in a country. A corporation will not be considered a permanent establishment of a company for a given country on the sole ground that the second company controls the first.⁷⁶ Whether the parent has a permanent establishment due to the subsidiary's activities must be established by the ordinary rules. Only if such a case exists is the latter taxable in the other country.⁷⁷

⁷²*Id.*

⁷³O.E.C.D. *Report, supra* note 16, at 74.

⁷⁴*Id.*

⁷⁵*See, e.g.,* Commissioner v. Consolidated Premium Iron Ores, Ltd., 265 F.2d 320, 324-26 (6th Cir. 1959).

⁷⁶A. VAN DEN TEMPEL, *supra* note 9, at 39.

⁷⁷*Id.*

C. *Classes of Income*

Tax treaties operate by either wholly or partially exempting certain classes of income from the taxing authority of one of the parties to the treaty. With minor exceptions, income subject to treaty relief can be grouped into three classes: (1) Business income, (2) investment income, and (3) earned income which derives from present or past personal services.

The concept of the permanent establishment is especially critical in properly allocating business income. Presently, if a treaty country is engaged in business in the United States through a permanent establishment, it is normally taxable as a domestic corporation on its United States income. Therefore, most treaties provide that, once an enterprise operates through a permanent establishment in the United States, all United States source income is taxable even if not attributable to the permanent establishment.⁷⁸ The O.E.C.D. draft convention, however, provides that if an enterprise conducts business through a permanent establishment, only that portion of the profits attributable to the permanent establishment may be taxed by the country in which the permanent establishment is located.⁷⁹ This revised definition has the advantage of discouraging the establishment of a separate entity to carry on the activities constituting a permanent establishment solely to enable other forms of income to enjoy the benefits of the convention.⁸⁰

The O.E.C.D. draft also presents a broad-based definition of income constituting business income: "Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."⁸¹ In effect, the definition rules provide that anything called income, which is not otherwise accounted for in the convention, shall be considered business income.

In addition, the O.E.C.D. draft includes a common provision that once an enterprise operates through a permanent establishment in the country, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise dealing at arm's length with the enterprise of which it is a part.⁸²

Finally, the O.E.C.D. treaty solves one of the most inequitable provisions of many tax treaties. By not containing any general

⁷⁸Kragen, *Double Income Taxation Treaties: The O.E.C.D. Draft*, 52 CAL. L. REV. 306, 318 (1964).

⁷⁹O.E.C.D. *Report*, *supra* note 16, at 45.

⁸⁰See generally Surrey, *The United States Tax System and International Tax Relationships*, 43 TAXES 6 (1965).

⁸¹O.E.C.D. *Report*, *supra* note 16, at 45.

⁸²See Kragen, *supra* note 78, at 319.

source of income rules, it is possible that a contracting state may attribute industrial and commercial profits from activities carried on from outside the other contracting state to the permanent establishment.⁸³ The O.E.C.D. draft provides: "[I]f the enterprise carries on business (in another Contracting State through a permanent establishment), the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."⁸⁴

One particularly difficult area of business income which is considered separately in the O.E.C.D. draft is income derived from transportation, generally from the operation of ships and aircraft. Article 8 of the draft provides for taxing profits by the country in which the "place of effective management" is located.⁸⁵ In the past, the use of such terms as "homeport," "state in which the enterprise is situated," or "state of registry" has failed to settle the matter effectively, and litigation has ensued.⁸⁶ The employment of a new term, "place of effective management," may eliminate any uncertainty or lack of precision if a clear definition crystalizes quickly. It is also possible, on the other hand, that a whole host of new problems may arise from the adoption of new terminology.⁸⁷ The treaty provisions dealing with investment income, as a general rule, alleviate double taxation. They generally provide for reciprocal exemption from or reduction of source country taxation.

Some countries tax company profits at different rates, one rate if profits are distributed and another if profits are held by the company. This has been one of the contributing factors in creating difficulties for those who seek a uniform solution in the field of tax treatment of international dividend payments.⁸⁸ Another part of the problem is that the internal laws of some countries tax dividends from resident companies at the source, while nonresidents are not taxed at all.⁸⁹ Article 10 of the O.E.C.D. draft, and now of the Model Convention too, is an attempt to recognize and meet these difficulties.

The O.E.C.D. draft substantially adopts the principle found in most United States conventions—that the payee's country of

⁸³See, e.g., *Convention for the Avoidance of Double Taxation*, Apr. 16, 1947, United States-United Kingdom, art. III, 60 Stat. 1377 (indexed at 64 Stat. B1138), T.I.A.S. No. 1546.

⁸⁴O.E.C.D. *Report*, *supra* note 16, at 45.

⁸⁵*Id.* at 46.

⁸⁶Kragen, *supra* note 68, at 321.

⁸⁷*Id.*

⁸⁸*Id.* at 322-23.

⁸⁹See A. VAN DEN TEMPEL, *supra* note 9, at 34-37.

residence has the right to tax his dividend income received from sources in the other contracting country,⁹⁰ with the source country having a limited right to tax reserved.⁹¹ The limits are basically two-fold. Generally, the allowable tax is limited to fifteen percent of the gross amount of the dividends.⁹² A special provision is inserted, though, to benefit parent corporations receiving dividends from foreign subsidiaries. The foreign country is limited to a five percent tax on dividends paid by a subsidiary if the recipient is a company which holds at least twenty-five percent of the capital of the corporation paying dividends.⁹³

The same basic principle invoked for dividends is implemented in the tax treatment of interest income.⁹⁴ Interest income is generally taxable in the state of residence of the recipient. Debtor countries are generally reluctant to grant a complete exemption. In this regard, the O.E.C.D. draft provides for a ten percent maximum tax rate at the source country.⁹⁵ As a practical matter, the tax is borne by the borrower since lending institutions generally require that the borrower shall bear any taxes imposed by the source country with respect to interest payments.⁹⁶

⁹⁰O.E.C.D. *Report*, *supra* note 16, at 47-48. *See also*, B. BITTKER & L. EBB, *supra* note 61, at 183, 448.

⁹¹*See, e.g., Italy*, *supra* note 55, at art. VII.

⁹²O.E.C.D. *Report*, *supra* note 16, at 47-48.

⁹³*Id.* This type of provision, however, opens the door to much possible tax abuse. The O.E.C.D. draft commentary suggests that when negotiating specific conventions, states should have the opportunity to provide methods of preventing misuse of the convention to avoid taxes on dividends. *Id.* at 106.

⁹⁴*Id.* at 48. The 1972 Revised Text of Certain Articles of the Draft Double Taxation Convention contains certain modifications of the 1963 article on interest, such as recognizing the right of the state of the recipient's residence to tax, provided that the resident is the "beneficial owner" of the interest; while also permitting the State where the interest arises to levy a tax up to 10% of the interest amount. The revision provides that the reduced rate is not to be enjoyed by a resident of the State who carries on a trade or business through a permanent establishment in the taxing state. The commentary points out that since the creditor resident in the other contracting state is taxable both at the source of interest and at his residence, the double liability often hampers the movement of international investments and capital. The O.E.C.D. Committee on Fiscal Affairs concluded that interest should be taxed in the state of residence of the creditor, but left the right to impose a tax with the State of source. Carroll, *supra* note 43, at A-21. The same was confirmed in the 1977 *Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital*, art. 11.

⁹⁵O.E.C.D. *Report*, *supra* note 16, at 48.

⁹⁶A. VAN DEN TEMPEL, *supra* note 9, at 37. To lessen obstacles to international trade, the 1972 revision has suggested that parties to a treaty might wish to add a clause limiting taxation to the State of residence of a recipient where: (1) Interest is paid in relation to the sale on credit of any scientific, industrial or commercial equipment, or (2) interest is paid in relation to the sale on credit of any merchandise by one

The question involved with royalties is whether they should be treated as business income or investment income. If treated as business income, royalties would be primarily taxed at their source.⁹⁷ If treated as investment income, they would be primarily taxed in the country of residence of the recipient.⁹⁸ Thus, the definition of royalties is crucial. Many recent agreements have contained no definition of royalty, and the result has been a variation in the interpretation of the term. This has naturally led to some unhappiness among those involved, especially with today's greater use of agreements to furnish "know-how." The draft convention includes in its definition of royalty payment any "information concerning industrial, commercial or scientific experience."⁹⁹ It leaves no room for doubt that "know-how" payments are royalties and are to be treated as such.¹⁰⁰

Rentals of real property and royalties from natural resources are being exclusively treated as within the domain of the country in which the property is situated.¹⁰¹ The O.E.C.D. draft includes "immovable property" in this category, and extends the term to include livestock and farming equipment.¹⁰² The draft is very general in speaking of capital gains, basically taxing immovable property in the source state, and other property in the resident country.¹⁰³

The problem involved with the first two areas of income, namely that of distinguishing one type from the other, is not nearly as prevalent in the last area of concern—earned income. All treaties grant special exemption to foreign residents who are temporarily present in a treaty country with respect to income derived from personal services. The general rule that income from personal services is taxed at the source¹⁰⁴ remains in the O.E.C.D. draft.

The exceptions to this rule, however, are significant. Most treaties grant an exemption to a foreign resident provided he was

enterprise to another, or (3) interest is paid on a loan of any kind granted by a bank. Carroll, *supra* note 43, at A-22.

⁹⁷O.E.C.D. Report, *supra* note 16, at 49. See also *id.* at 116-21.

⁹⁸*Id.*, at 49.

⁹⁹*Id.* The O.E.C.D. Commentary of 1972 cites definition of "know-how" as "all the undivulged technical information, whether capable of being patented or not, that is necessary for the industrial reproduction of a product or process directly and under the same conditions," thus including experience and applicable to more than mere examination of the product or mere knowledge of the technique. Carroll, *supra* note 43, at A-22.

¹⁰⁰See generally Kragen, *supra* note 78, at 325.

¹⁰¹O.E.C.D. Report, *supra* note 16, at 45.

¹⁰²*Id.*

¹⁰³*Id.* at 49. See also Kragen, *supra* note 78, at 326-27, for a more comprehensive analysis. The general attitude toward capital gains is very difficult to pinpoint due to the wide variety of methods of imposing tax.

¹⁰⁴O.E.C.D. Report, *supra* note 16, at 50.

present in the country for only a limited period (usually 180 to 183 days) and that his compensation did not exceed a given amount (usually \$10,000).¹⁰⁵ Most treaties extend this exemption only if the compensation was paid by a nonresident alien or foreign corporate employer.¹⁰⁶ Several treaties additionally exempt compensation regardless of the type of employer, provided that the foreign resident spent less than ninety days in the country and earned less than \$3,000. In any case, the treaties do not employ permanent establishment as any sort of determinative in this regard.¹⁰⁷

The O.E.C.D. draft makes a distinction between independent and dependent personal services. Independent services are generally professional services such as those rendered by scientists, artists, writers, and teachers as well as those of physicians, lawyers, engineers, architects, dentists, and accountants.¹⁰⁸ Dependent services are those based on salaries, wages, and other similar compensation.¹⁰⁹ The income derived from the former is taxed in the country of residence unless the taxpayer "has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities."¹¹⁰ In such a case, the source state may tax him to the extent attributable to that base.¹¹¹ Dependent services are not taxable to the source state if: (1) The employee satisfies the 183-day rule, (2) the employer is not a resident of the source state, and (3) the salary is not paid by a permanent establishment in the source state.¹¹² Thus, the O.E.C.D. draft disregards the amount of compensation as a factor and eliminates the three-month rule. It does, however, incorporate a distinction between types of personal service income and extend the taxing authority of the source state to all employees of a permanent establishment.¹¹³

¹⁰⁵See, e.g., *Convention for Avoidance of Double Taxation and Prevention of Fiscal Evasion*, Oct. 28, 1948, United States-Belgium, art. XI, 4 U.S.T. 1647, T.I.A.S. No. 2833, as modified and supplemented Aug. 7 & Sept. 8, 9, 1957, 4 U.S.T. 1672, T.I.A.S. No. 2833, as supplemented Aug. 22, 1957, 10 U.S.T. 1358, T.I.A.S. No. 4280.

¹⁰⁶See, e.g., 4 U.S.T. at 1659.

¹⁰⁷*Id.*

¹⁰⁸O.E.C.D. *Report*, *supra* note 16, at 50-51. See also O.E.C.D. MODEL TREATY, *supra* note 21, at 34-35.

¹⁰⁹*Id.*

¹¹⁰*Id.*

¹¹¹*Id.*

¹¹²*Id.*

¹¹³See generally O.E.C.D. *Report*, *supra* note 16, at 51-52. See also O.E.C.D. MODEL TREATY, *supra* note 21, at 36-37. In addition to these provisions, most tax treaties as well as the O.E.C.D. Convention adopt special rules for directors' fees, entertainers, government employees, and students. They are disregarded here because of their limited significance to a broad analysis of the problem of double taxation.

D. Summary

The work of the O.E.C.D. has caused a great deal of change in the approach to the problem of double taxation. Although the draft was subject to many reservations, it has, for the first time, compiled the various positions of all the member countries and has developed a common ground from which to work. The effects of the draft, even disregarding the vast improvement in equitable allocation of taxing authority, can be very significant. The use of common concepts will enable taxpayers to determine their position in a broad variety of cases without having to study special provisions inherent in independently negotiated bilateral treaties. In addition, decisions in one state will, for the first time, be applicable authority to another state because of this common basis. This is not to say the draft is, or will be, a panacea. But the 1963 O.E.C.D. draft and the continuing work of the Fiscal Committee, now Committee on Fiscal Affairs, including most importantly the 1977 Model Convention, do strike an important chord in harmonizing international fiscal relationships.

IV. THE PROBLEM OF FISCAL EVASION

Unlike the problem of double taxation, the problem of international fiscal evasion has not received widespread concern or public support for the attempts at a solution. In fact, often the states involved do not wish to concern themselves with the problem. The provisions concerning fiscal evasion warranted no more than brief notice in the 1963 O.E.C.D. draft.¹¹⁴ However, the 1977 O.E.C.D. Model Convention is worded much more clearly and is more extensive on this subject so as to avoid such problems. Outside of their general support for an attempted solution of the tax evasion problem, the Internal Revenue Service and the Department of the Treasury are limited in the kind of help they can provide.¹¹⁵

Because of this general apathy, not as much work has been put forth to solve this problem of fiscal evasion as has been to solve the problem of double taxation. Thus, this portion of the Article will first discuss the original principles set forth by the League of Nations, and then analyze some of the present problems involved in reaching a solution in this significant area of taxation—international enforcement of tax claims.

A. Work of the League of Nations

In analyzing the problem, the League developed a set of broad principles as to basic problems involved with international fiscal

¹¹⁴O.E.C.D. *Report*, *supra* note 16, at 26.

¹¹⁵See Eichel, *supra* note 5, at 25.

evasion.¹¹⁶ It was hoped that setting forth original guidelines would help the member countries implement provisions that would solve the problem. Aside from the considerations inherent in both double taxation and fiscal evasion,¹¹⁷ the League noted a number of other factors.¹¹⁸

The League initially concluded that measures for meeting the problem of fiscal evasion would provide an important link toward an international tax morality among taxpayers. The League's appeal to taxpayers declared:

[T]hese measures are in the interest of all honest taxpayers. At the present time, there is a great deal of concealment of income and there are taxable persons who pay no taxes at all. If the tax on all income could be brought into the treasuries of the various States concerned, those States would find, as compared with the present position, a very important additional yield, which might . . . enable them . . . to reduce the rates of their taxes.¹¹⁹

Thus, the League stressed an international tax morality among taxpayers which would enhance normal economic relations and at the same time reduce the burden on the honest taxpayer. Given the need and desirability of such an improved tax morality, the League was clear as to how it might be encouraged:

It is indeed the duty of revenue authorities to see that each taxpayer should pay the taxes for which he has been assessed according to the laws of the country under the jurisdiction of which he comes. Failure to collect such taxes is indeed susceptible of impairing the services which the Government should render to the public or bringing about an increase of the taxes borne by non-delinquent taxpayers.¹²⁰

A second problem caused by tax evasion was interference with the free circulation of capital. The Financial Committee, in response to the Experts 1925 Resolutions, reported to the Council of the League that any future investigation of the problems of fiscal evasion would have to consider "the disadvantage of placing any obstacles in the way of the international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction."¹²¹

¹¹⁶L.N. 1925, *supra* note 10, at 22-28.

¹¹⁷See Carroll, *supra* note 13, at 696-97.

¹¹⁸*Id.*

¹¹⁹L.N. 1925, *supra* note 10, at 28.

¹²⁰L.N. 1946, *supra* note 32, at 45-46.

¹²¹L.N. 1927, *supra* note 11, at 5.

In the process of its investigation, the League had to determine whether the model conventions should be multilateral or bilateral in form. Notwithstanding the League's previous conclusions as to the necessity of an agreement by as many nations as possible, the League was forced to use the bilateral approach. Such a course was dictated by the diversity of the fiscal systems represented. The use of a collective or multilateral approach would preclude the need for delicate negotiations between the governments due to fundamental differences in their systems. The need to consider diverse public opinions in the various countries in order to engender taxpayer confidence and support further convinced the League to follow the bilateral route.¹²²

The Committee, therefore, reasoned that it would establish standards which would both allow for the necessary bilateral negotiations and introduce a certain measure of uniformity in international fiscal law. Thus, forced to work at a higher level of abstraction than desired, the League requested the various nations to subscribe to basic standards and commit themselves to general patterns of assistance.¹²³ Unfortunately, some nations believed this was the League's sole request. But the League asked for much more, including the promulgation of regulations and more specific provisions suited to each country's peculiar tax system pursuant to any bilateral negotiations:

[I]t will be necessary to draw up regulations for the application of the Convention. In the Committee's opinion, it would be best that these rules should not be laid down in the Conventions themselves. They are of too special a nature, and, moreover, the fact that they were embodied in a convention might delay the introduction of changes which circumstances or experience had shown to be necessary. Accordingly, the Committee proposes that the highest fiscal authorities should be left free to agree upon the practical measures necessary to implement the Convention.¹²⁴

One of the more pervasive considerations with which the League chose to deal was the notion of protecting national sovereignty.¹²⁵ This idea reduced itself into three principles. The first was that tax claims from another government would not be privileged debts. The purpose was, of course, to protect the rights of both general and governmental creditors by preserving their positions against the

¹²²See *id.* at 8-9.

¹²³*Id.* at 8.

¹²⁴*Id.* at 26.

¹²⁵*L.N. 1925, supra* note 10, at 27.

taxpayer relative to the foreign tax claim. The second was that the foreign claim had to be *res judicata*. This was meant to prevent the courts of one nation from interpreting or having to interpret the tax laws of another. The third principle was that the enforcing state could neither be made to use methods other than those which it had nor be forced to use methods not provided for under the laws of the applying state. Behind this was the notion that a nation's legal processes were to be free from employment of measures based on alien concepts, and that the specific means of carrying out the intended collection assistance would have to be dictated by each nation's own internal legislation.¹²⁶

There were three basic reasons for the requirement that all claims possess the final character of *res judicata*. The first was to preserve the sovereignty of both the applying state and the state to which application was made. The second was to avoid the possibility of a nation's courts being burdened with the expensive and time consuming task of interpreting another nation's tax laws. The third was that "it would hardly be desirable to invite a foreign administration to take measures to collect a debt which was still liable to be cancelled on appeal."¹²⁷

The question of whether two tax systems of two negotiating governments were compatible was of primary importance to the League in determining the feasibility of reciprocal assistance. As a way of testing compatibility, the League used what it stated to be a "rule based to some extent on the highest common factor, [*i.e.*,] that no means of execution should be employed unless it is included in the laws of both States concerned."¹²⁸ There were two principles stated as the basis for such a rule. The first was the requirement that the methods of execution be limited to those provided by the state to which application is made. The second was the principle that the state to which application is made cannot employ any methods which might offend the system of the applying state and need not use methods not provided by the applying state.¹²⁹

One might then have asked where this rather confining test left the two negotiating governments. The only method remaining seemed to be two types of methods, one which was to be found in both systems, and one found only in the state to which application was made so long as it was not offensive to the laws of the applying state. Due to the often subtle diversities of the various tax systems,

¹²⁶*Id.* at 27, 35.

¹²⁷*L.N. 1927, supra* note 11, at 28.

¹²⁸*Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion*, L.N. Doc. No. C. 562. M. 178., 32 (1928).

¹²⁹*Id.* at 30, 32.

the question of whether a method was "offensive" could turn into a major inquiry. This inquiry could turn on an examination of the basic concepts which underlie each country's collection procedure.

There is another concept of reciprocity at which the League only hinted: namely, when one country's collection process is far less efficient than the other's, can there really be reciprocity?¹³⁰ This is reciprocity in the sense of cooperation and is perhaps most important when negotiations are between a developed and an underdeveloped country.

Finally, the League's concern for public opinion went in two directions. In one way, it was forced to deal with public sentiment vis-a-vis initial agreement to accede to such collection provisions. In the other way, the League faced the necessity of having to write into the collection provisions certain exceptions in order to provide for diverse public policies. As to the need for accommodating public sentiment towards these collection provisions, the League stated:

As regards the carrying out of the recommendations . . . for countering tax evasion, the Experts desire to emphasize the fact that it will only be possible to carry out these recommendations in any given country if, in the first place, public opinion in that country is sufficiently prepared, and secondly, if the Government of the country considers that the measures advocated are not only compatible with public opinion, but also are required for collection of its own taxes.¹³¹

The result of the League's work was the manifestation of its principles into three contexts: The basic Resolutions of 1925; the Draft Model Bilateral Conventions of 1927-1928; and the final Draft Model Bilateral Conventions of 1940, 1943, and 1946 in Mexico City and London.¹³²

The following are the basic Resolutions of 1925 in which can be found most of the League's principles and upon which all later work of the League is based:

1. Each State shall recover within its territory, in accordance with its own law, taxes due in another State, including taxes due from persons not nationals of the latter State. The State to which such an application is made may not, however, be requested to apply any method of execution not provided for under the law of the State making the application.

¹³⁰*L.N. 1925, supra* note 10, at 26.

¹³¹*Id.* at 34.

¹³²Carroll, *supra* note 13, at 701, 707.

2. Taxes to be recovered shall not, in the State to which application is made, be regarded as privileged debts.

3. Prosecutions and other measures of execution shall be carried out, without exequatur, on the production of documents proving that the liability in question is *res judicata*. If the fiscal debt may still be the subject of an appeal, conservatory measures may be taken on the production of a decision executable against the debtor.¹³³

While the latter conventions' reappraisals did not introduce any significant new thoughts, they did redefine and reinforce the old principles. There were, however, a few points which were modified or expanded. The first was the substitution of "definitely due" for "*res judicata*," which may have caused more uncertainty than usefulness. The League had previously attached certainty to the term *res judicata* by limiting it to a claim which was no longer liable to be cancelled on appeal. In the 1946 convention, the Committee's Commentary to the Conventions remarked:

According to Article XIX of the Protocol in the Mexico Draft, XVI in the London Draft, the Convention does not apply to measures of conservancy in respect to taxes that have not yet been assessed. However, as regards taxes that have been *assessed, but are not definitely due*, the tax authorities concerned may request the corresponding authorities of the other State to take such measures of conservance as are authorized by the revenue laws of the State interested.¹³⁴

Whether this meant no change from the previous requirement, "beyond all possibility of appeal," is still questionable. There may be steps between a mere assessment and a claim no longer amenable to appeal, such as when only a lower court decision is rendered. To add to the uncertainty, the convention also speaks of claims which are "finally determined" as well as those which are "definitely due."¹³⁵ However, if one assumes that the League intended to maintain the same notion that it is undesirable to allow claims that are still outstanding to be cancelled on appeal, it would be difficult to conclude that it intended to allow anything less stable for collection than a claim possessing that degree of finality which had previously been required by the term *res judicata*.

The second point was the League's response to what it considered to be a rather cool reception to the collection provisions. The League had suspected during its early work why these provi-

¹³³L.N. 1925, *supra* note 10, at 35.

¹³⁴L.N. 1946, *supra* note 32, at 53 (emphasis added).

¹³⁵*Id.* at 52.

sions met with such distrust.¹³⁶ In essence, the various governments were fearful of placing their tax facilities at the disposal of foreign authorities and, thereby, being required "to introduce new tax practices in order to suit the requirements of foreign governments."¹³⁷ Also of concern to the governments was the possibility of prejudicially affecting the free circulation of capital. Of concern to taxpayers was the possibility of these provisions granting a foreign taxing authority greater or additional powers not allowed by its domestic legislation. To meet this lack of confidence in the provisions, the new Model Conventions contained several articles which stressed the reciprocal aspects and provided certain safeguards. Reciprocity was provided in the sense of compatibility as well as in the sense of cooperation. The League provided a rather bland test to discover whether reciprocal cooperation existed: "[R]eciprocity shall be deemed to exist when the request is accompanied by a declaration by the competent authorities who make the application, officially confirming that any similar request would be complied with in accordance with the laws of the applicant state."¹³⁸

Safeguards were directly provided for in the Article allowing certain excuses from compliance, such as when the request relates to a taxpayer who is a national of the state applied to or when compliance with the request compromises its security or sovereign rights.¹³⁹

The third distinguishing factor of the Mexico and London Conventions was the limiting provisions. The new collection provisions were limited to those items of income dealt with in the Conventions on double taxation. This made the collection provisions complementary to the double taxation provisions, thereby carrying even further their prior considerations of the correlation between the two. Further limitations were set out in the accompanying Protocol, which provided for a monetary limit below which no assistance would be given, and for a required statement by the interested state that the amount due was not recoverable in the applying state.¹⁴⁰

B. Present Problems of Tax Evasion Treaties

This discussion begins with the most telling, if not fundamental complaint: namely, the problem of having to connect two systems which do not share a common background. Most arguments against

¹³⁶See *id.* at 44-48.

¹³⁷*Id.* at 46.

¹³⁸*Id.* at 47.

¹³⁹*Id.* at 48.

¹⁴⁰*Id.* at 52.

collection provisions, if not initially founded on it, always seem to fall back on this incompatibility. Since this problem emerges in diverse contexts throughout the rest of this section, only a few of its more obvious aspects, stated in extremely general terms, are herein mentioned. Such provisions, say the critics, would "force upon the courts of the United States the duty of interpreting foreign tax statutes and will require a scrutiny of the relations between the foreign state and its citizens and force the courts to pass on questions of local policy."¹⁴¹ And what has turned out to be the most critical aspect of all is the risk that taxpayers might be unjustly prejudiced in the enforcement of such assistance provisions without adequate judicial safeguards.

It is next suggested that the United States treaty provisions dealing with collection assistance are not self-executing and, therefore, are in need of *enabling* legislation.¹⁴² Aside from the weight which might be given to the question of whether any revenue measures can be self-executing due to the restrictive language of article I, section 7 of the Constitution, the critics have concluded that the gap resulting from the language of the Internal Revenue Code has to be filled by Congress.¹⁴³ With the possible exception of the wording of the Internal Revenue Code, one might counter these contentions by stating that what in fact has caused all this uncertainty was not the lack of supposedly needed legislation, but rather silence on the part of the Treasury.

The opponents of collection provisions, in addition, have expressed doubts as to the constitutionality of what they deem to be needed implanting legislation.¹⁴⁴ Their reasoning is as follows: Article 1, section 8 of the Constitution provides that the Congress shall have the power "to levy and collect taxes, duties, imposts, and excises to pay the debts and provide for the common defense and general welfare of the United States." Therefore, "this authorization does not envisage the collection of taxes for a foreign government."¹⁴⁵ Furthermore, they reason: "It is equally clear that the purpose behind this Constitutional grant of authority has not been extended by the enactment of the Sixteenth Amendment so as to include the right to collect foreign taxes or otherwise enforce the revenue statutes of a foreign government."¹⁴⁶ However one feels about this argument, the

¹⁴¹1951 *Hearings*, *supra* note 31, at 23 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁴²*Id.* at 27-28.

¹⁴³*Id.* at 29.

¹⁴⁴*Id.* at 37-38, 73.

¹⁴⁵*Id.* at 36.

¹⁴⁶*Id.* at 30.

fact is that many extremely important questions remain unanswered.

The use of the terms "finally determined" and "definitely due" in reference to claims eligible for enforcement have raised many interpretative difficulties.¹⁴⁷ A threshold distinction must be made as to whether such claims are in the nature of a judgment or something less, such as an administrative assessment. As noted before,¹⁴⁸ the League of Nations was quite clear that the claim must be beyond *all* avenues of appeal and, therefore, a final judgment was required. However, this intent was later blurred by its abandonment of "res judicata" in favor of "finally determined" and "definitely due."¹⁴⁹ In the Swedish Treaty of 1939, the accompanying Protocol states that "finally determined" is to mean "claims which are no longer appealable, or which have been determined by decisions of a competent tribunal, which decision has become final."¹⁵⁰ The problem with this definition is whether "or" applies to "claims" or to "appealable." If it applies to the former, it implies that an administrative assessment is valid; if to the latter, it merely requires that all judicial and administrative remedies have been invoked and decided.

One commentator has concluded that the United States, having in mind the term "res judicata" to mean beyond all possibility of appeal, chose to use "finally determined" in order "to represent a difference not only in phraseology but also in substantive effect," intending this term to mean "only that it must be based upon an assessment by an administrative body."¹⁵¹ In light of the use of "finally determined" by the League of Nations and the reason suggested for such a change, this above conclusion is of doubtful validity.

No matter whether one chooses to take the administrative assessment route or the judgment route, there are further questions that must be answered. Within the realm of allowing an administrative assessment to form the basis of a claim for collection assistance, the most often heard complaint is that of allowing the case to be heard on the merits in a foreign court. It seems to always be assumed that a claim based on an administrative assessment can be tested on the merits, thus causing a foreign court to interpret complicated tax laws.¹⁵² It has been suggested that not allowing the taxpayer to contest the claim on the merits in a foreign court would

¹⁴⁷See Note, *International Enforcement of Tax Claims*, 50 COLUM. L. REV. 490, 496-98 (1950).

¹⁴⁸See text accompanying note 125 *supra*.

¹⁴⁹See text accompanying note 133 *supra*.

¹⁵⁰*Convention with Sweden on Double Taxation*, Mar. 23, 1939, United States-Sweden, art. XXII, para. 12, 54 Stat. 1759, T.S. No. 958.

¹⁵¹Note, *supra* note 147, at 498.

¹⁵²See Leflar, *supra* note 2, at 218.

violate the due process clause of the Constitution, and thereby relegate the claim to an administrative assessment, placing the claim in a better position than a judgment which must at a minimum comply with notions of competency, jurisdiction, and notice.¹⁵³

Furthermore, the question is raised as to whether one in a state which applies the Act of State Doctrine will be in a position to question the tax on the merits. However, there is considerable doubt as to whether this doctrine, limited in any event to a very few countries, will protect the revenue laws of a foreign state. As one source has stated:

In the language of the Sabbatino decision, it involves the "validity of the public acts a recognized foreign sovereign power commit(s) within its own territory." "Act of State" refers to "public acts" which have been completely "executed" within the foreign territory, as distinct from executory court judgments or penal or revenue laws whose enforcement is sought abroad.¹⁵⁴

In support of the validity of administrative assessments is quite simply the fact that they are easier to get than judgments. This is so because the United States tax jurisdiction reaches further than its adjudicatory jurisdiction. But countering this perhaps more desirable interpretation is the notion that the requirement of a judgment with its more limited reach has a constraining effect on a country's tax laws by saying the country can have all the country can get but the country can get only what its courts can reach. Therefore, those taxpayers who feel that the reach of the United States taxing jurisdiction is justified will be more susceptible to arguments in favor of the validity of administrative assessments; those opposed to the extent of the United States tax reach will tend to favor the more limiting requirements of a judgment.

If one concludes that judgment is to be the intended requirement, there exists a further range of possible interpretations. One possible approach would accord the foreign tax judgment the same status as that of a state or federal tax judgment. Although the foreign tax judgment could not be challenged on the merits, it would still be subject to a variety of defenses; *i.e.*, lack of jurisdiction, lack of notice, or lack of competence.¹⁵⁵ But, inasmuch as assistance is often needed to reach those who are neither citizens nor domiciliaries of the applying state, the defense of lack of *in personam*

¹⁵³1951 *Hearings*, *supra* note 31, at 20-21 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁵⁴H. STEINER & D. VAGHTS, *TRANSNATIONAL LEGAL PROBLEMS* 588 (1968).

¹⁵⁵Note, *supra* note 147, at 497.

jurisdiction would work to greatly inhibit the use of these collection provisions. Again, one may not view this as being an overly burdensome limitation if he feels that a taxpayer who is neither domiciled in nor a citizen of the taxing state should not have been subject to its taxes in the first place. An alternative to the above interpretation would be to regard the judgment as one to be enforced on the basis of comity.¹⁵⁶

At the other end of the spectrum of possible interpretations from administrative assessment is the construction which gives the judgment extraordinary treatment by barring *all* defenses to the claim. Such a position, it is claimed, would be the only way to make the collection provisions "fully effective."¹⁵⁷ However, this interpretation is subject to doubt, for such a status has been challenged as "legally untenable, inasmuch as it might result in a violation of the due process clause of the Constitution,"¹⁵⁸ as well as being an impractical solution by according a foreign tax judgment a more favorable treatment than a state or federal tax judgment.

If and when the United States is asked to enforce a foreign tax claim, the question will arise as to whether it will look to the substance behind the claim or merely test it along the lines of procedural due process.¹⁵⁹

¹⁵⁶See Eichel, *supra* note 5, at 67.

¹⁵⁷1951 Hearings, *supra* note 31, at 21 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁵⁸*Id.*

¹⁵⁹The following examples show areas where the United States might want to test a foreign claim on its merits.

The first claim to consider is that based on a discriminatory tax. There might be two answers to this. The first is the public policy exception found in all existing American general collection assistance agreements. The second answer is not to enter into such assistance agreements with a state having a "discriminatory" tax system. If one were to examine the legislative history of tax conventions, one would readily see that a thorough scrutiny is made of the other country's tax system before an agreement is signed. See, e.g., JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS (1962). If, at some later date, a country were to engage in discriminatory practices, the United States could, if it chose to do so, resort to the "public policy" exception and refuse to grant enforcement to the tax claim. See Note, *supra* note 147, at 499. This defense of a discriminatory tax system is of course more potent when made by a United States citizen faced with a tax bill owed to another country but is enforced by the United States.

A second consideration is whether, while enforcing a judgment or assessment against a citizen of a third state, the United States will look behind the judgment or assessment to see if the tax treatment applied to him is the same as that applied to American citizens. That is to say, if France were to discriminate against Englishmen, would the United States still enforce a claim against the Englishman for France? Fortunately, a provision similar to that in the Swedish Treaty will remedy such a situation. *United States Treaties and Other International Agreements*, Mar. 23, 1939, 15

There are several problems in attempting to discern an intended method of collection because of the uncertainty generated by the wording of these collection provisions. Additional problems concern the possible unavailability of the Internal Revenue Code provisions and the inability—or unwillingness—of the United States revenue authorities to say exactly what procedures they intend to follow. The problem here is not concerned with the methods to be used in the other country, which is extremely uncertain in itself, but rather what methods the United States must use. The methods to be used will be determined only if the nature of the claim transmitted can be adequately defined. The range of possible definitions can run from looking upon these claims as strictly American,¹⁶⁰ to invoking what the League of Nations suggested, or to using methods common to *both* systems.¹⁶¹ The task of determining how these claims were intended to be viewed is certainly a hopeless one for the variations among the treaties point in all directions.

The limitation along lines of nationality, which prevented the operation of collection provisions against citizens, corporations, or other entities of the state to which application was made, was in response to a series of objections directed toward the unrestricted application of these collection provisions. The most fundamental objection indicated the reluctance on the part of Americans to subject themselves to taxation abroad if they felt the United States was bound to place a lien or distraint on their property at the request of a foreign government asserting the claim.¹⁶² Another closely related objection concerned the possibility of an American operating abroad being subject to the added risk of levies which he justifiably felt were arbitrary or were inconsistent with the principles of American law. The result was that the United States, committed to collection assistance, would be in the embarrassing position of having to render help against its own citizen on what might be a completely unjustified claim.¹⁶³ A further objection stated that the relationship between citizens and the federal government did not contemplate the federal government using citizens' contributions to enforce foreign tax claims against them. Such an objection was certainly reminiscent of a problem the League of Nations had experienced

U.S.T. 1824, T.I.A.S. No. 5656, *modified and supplemented* Oct. 22, 1963. However, this limitation stops far short of the scope within which the negotiators have expressed they would like to work.

¹⁶⁰*See*, 1951 *Hearings*, *supra* note 31, at 17 (statement of Mitchell B. Carroll, National Foreign Trade Council).

¹⁶¹*L.N. 1925*, *supra* note 10, at 34-35.

¹⁶²1951 *Hearings*, *supra* note 31, at 16-17.

¹⁶³*Id.*

concerning the possible distrust that might infect a domestic system if part of the internal machinery had to respond to foreign claims against its own citizens.¹⁶⁴ Therefore, operation of these provisions by the United States against its own citizens would put Americans operating abroad at a disadvantage, inasmuch as it would remove the limited liability protection against tax claims enjoyed by most aliens.¹⁶⁵

Many questions of the interpretation and allocation of tax burdens placed on American business abroad had been negotiated for years with competent tax authorities of the foreign country without any assistance from Washington. Thus, the added leverage given a foreign tax administration by these collection provisions was met with understandable concern by taxpayers. Because of this added leverage, it was also assumed, due to the growing influx of American business abroad, that these provisions were of greater interest to foreign governments than to the United States, and that Americans should therefore not be willing to so readily accede to such provisions.

An interesting objection stated that the American policy of political sanctuary, long afforded aliens, should be extended to their property as well, for without such an extension, the United States might find itself in the position of allowing political asylum to an alien while simultaneously attacking his property on behalf of the country from which safety was sought.¹⁶⁶ The objection goes further to include the possibility that collection provisions might prevent a taxpayer from placing property in the United States for safekeeping, looking toward the day he might have to seek refuge from adverse political developments at home.

A broader concern, perhaps including much of the above, is possible interference with the free flow of capital caused by collection provisions. Contrary to the broad purpose of tax treaties to eliminate trade barriers, these collection provisions could cause unnatural shifts in capital as well as delay the more important promulgation of substantive provisions on double taxation.¹⁶⁷

Finally, the most pervasive of all taxpayer concerns is the possibility of having to defend against a United States tax claim being executed by a foreign procedure which does not meet the American concept of due process. As this notion has permeated so much of the discussion of other problem areas, it is noted here only to emphasize the fear generated by taxpayer uncertainty when

¹⁶⁴*L.N. 1925, supra note 10, at 26.*

¹⁶⁵*1951 Hearings, supra note 31, at 41.*

¹⁶⁶*Id. at 39-40.*

¹⁶⁷*L.N. 1946, supra note 32, at 46.*

these agreements are entered into with countries whose notions of notice, jurisdiction, and competence differ from the American notions. Much of this fear has often been encouraged by the possibility of a taxpayer having to face an overzealous tax collection machine which operates outside of the foreign country's judicial process. It has been sought to counter these doubts by again indicating the need for a certain latitude of discretion to rest in those who would administer these provisions. But assurances by the authorities that requests for assistance will only be made in rare cases and with due consideration for maintaining the taxpayers rights have failed to allay these apprehensions.¹⁶⁸

C. *The 1977 Model Convention*

The purpose of the 1977 Model Convention is not to question the principles and general structure of the 1963 Draft Convention,¹⁶⁹ but rather to scrutinize all the questions of a legal, theoretical, or practical nature which have arisen in the intervening years.¹⁷⁰ In drafting the 1977 Model Convention, it has been possible in several instances to broaden or alter the texts of certain articles.¹⁷¹ Consequently, this work has produced a much clearer and more specific text and official commentary.

Nevertheless, the O.E.C.D. Committee on Fiscal Affairs considers that, in regard to its work in the 1977 Model Convention, the most important results are those reflected in the Commentaries on the Articles.¹⁷² These commentaries have definitely, in every way, clarified many of the issues or doubtful points created by the 1963 draft.

Briefly stated, the following are some of the most noteworthy improvements brought about in the 1977 Model Convention. Article

¹⁶⁸See *1951 Hearings*, *supra* note 31, at 58-61. The 1972 O.E.C.D. revision, under the Commentary of Article 25, provided for a mutual agreement procedure, whereby a United States corporation may apply to a competent Treasury Department authority to appeal a mere risk of incorrect taxation, but not in accordance with the convention of a particular country. In the procedure, states can authorize competent authorities to settle questions of double taxation who can call on the O.E.C.D. Fiscal Commission for guidelines. Carroll, *supra* note 43, at A-22-23.

¹⁶⁹See O.E.C.D. MODEL TREATY, *supra* note 21.

¹⁷⁰*Id.*

¹⁷¹See, *i.e.*, art. 5 (Permanent Establishment), paras. 3 & 4; art. 9 (Associated Enterprises), para. 2; art. 17 (Artists and Athletes), para. 2; art. 19 (Government Service); art. 21 (Other Income), para. 2; art. 24 (Non-Discrimination), para. 5; art. 25 (Mutual Agreement Procedure), paras. 1 & 2.

¹⁷²*Id.*, *see, i.e.*, the commentaries on arts. 5 (Permanent Establishment), 10 (Dividends), 19 (Government Service), 24 (Non-Discrimination), 25 (Mutual Agreement Procedure), 26 (Exchange of Information).

7, paragraph 1 aims at the establishment of a fair tax regulatory system for the revenue obtained through a permanent establishment. Article 7, paragraph 1, parallels Article 9 on associated enterprises and employs the well known "arm's length clause." Under such a clause, only profits attributable to the permanent establishment can be taxed by the country or countries where that establishment is located. Article 9 (Associated Enterprises), 11 (Interests) and 12 (Royalties) seek to avoid excessive tax payments and make it possible for the parties to readjust the target base to which the taxes are applied. Article 9 also touches upon the adjustment of taxes by the other contracting state and makes a modest attempt to avoid excessive double-taxation by recommending a readjustment in both directions.¹⁷³

Turning from the subject of tax avoidance, Article 26 (Exchange of Information) deals with tax evasion. Although the 1963 Draft Convention contained an abbreviated form of Article 26, the 1977 Model has expanded quite significantly upon the material, introducing, *inter alia*, the new concepts of *automatic* and *spontaneous* exchange of information.¹⁷⁴

V. CONCLUSION

Although most recent tax treaties include clauses aimed at avoiding cases of economic double taxation, specifically those which follow the Model Treaty, problems involved in establishing a framework for agreement and dependability are a very complex task. Beyond even the traditional problem of general apathy on the part of the governments and taxpayers, there are still serious difficulties in reaching a common ground of agreement. In the past, efforts at a model convention have either put forth such a strict model that no one could agree to any substantial provisions while attempting to implement the model, or have adopted the overly broad principles established by the League which, while being accurate in what they portray, do not establish any tangible tools with which two countries can negotiate.

Now that we have a more sophisticated and precise model convention which, rather than laying down a strict path to follow, sets out some methods of approach to the problem, the O.E.C.D. and other international organizations ought to continue their efforts to

¹⁷³Van Hoorn, *Problems, Possibilities, and Limitations with Respect to Measures against International Tax Avoidance and Evasion*, 8 GA. J. INT'L & COMP. L. at 768 (1978).

¹⁷⁴O.E.C.D. MODEL TREATY, *supra* note 21, at Commentary, art. 26, No. 9 (b) & (c), 186.

create more definite methods of implementation.¹⁷⁵ These methods will not necessarily result in a multilateral harmonization of international tax enforcement procedures, but they will at least enable countries to reach some workable agreement. Judging from the past dirth of agreement in this area, such a result would be a significant step forward.

¹⁷⁵Among other activities in this respect, the United Nations Group of Experts on Tax Treaties between Developed and Developing Countries (U.N. Group of Experts) has held seven meetings between 1968 and 1977. To date, seven reports have been published by the United Nations under the title, *Tax Treaties Between Developed and Developing Countries*. Each report is divided into two parts, one being a summary of the proceedings, the other including a suggestion and consideration prepared by the Secretary General on behalf of the Expert Group. The reports bear, respectively, the following document numbers: U.N. Doc. E/4614-ST/EC/110 (1969); U.N. Doc. E/4936-ST/EAC/137 (1970); U.N. Doc. ST/EAC/166 (1972); U.N. Doc. ST/ECA/188 (1973); U.N. Doc. ST/ECA/18 (1975); U.N. Doc. ST/ESA/42 (1976); U.N. Doc. ST/ESA/78 (1978).