

University of Michigan Law School

## University of Michigan Law School Scholarship Repository

---

Reviews

Faculty Scholarship

---

2018

### Review of Double Taxation and the League of Nations

Reuven S. Avi-Yonah

*University of Michigan, aviyonah@umich.edu*

Available at: <https://repository.law.umich.edu/reviews/160>

Follow this and additional works at: <https://repository.law.umich.edu/reviews>



Part of the [International Trade Law Commons](#), and the [Tax Law Commons](#)

---

#### Recommended Citation

Avi-Yonah, Reuven S. Review of Double Taxation and the League of Nations, by Sunita Jogarajan. Gianluca Mazzoni, co-author. *Intertax* 46, no. 12 (2018): 1027-29.

This Review is brought to you for free and open access by the Faculty Scholarship at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Reviews by an authorized administrator of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

# LITERATURE REVIEW

## Sunita Jogarajan, *Double Taxation and the League of Nations*, Cambridge University Press, 2018.

Should we continue adapting the OECD Model to address tax challenges arising from digitalization of the economy or has the time come for radical reform? Sunita Jogarajan asked that question in her last study of the League of Nations' work on double taxation in the 1920s. The historical analysis provided in her book seems to suggest that the international tax regime will continue to inevitably evolve and the OECD Model can adapt. Her extensive archival research, conducted at the League of Nations Archives, the United Kingdom National Archives (London) and the Seligman Archives, Columbia University (New York), clearly demonstrates that many current issues, such as the definition of permanent establishment (PE), the treatment of agents, the apportionment of profits, as well as the problems of profit shifting and double non-taxation, had already been discussed by the League's Experts. Thus, one might conclude that, in order to reform modern-day tax treaties is better to understand the 'original intent' of the League's Models rather than undertaking unilateral actions, such as the United Kingdom (UK) Diverted Profits Tax, the Australian Multinational Anti-avoidance Law or the Indian Equalization Levy.

Let us take for a moment the case of the so-called commissionaire arrangements and similar strategies. One might think that they are a relatively new phenomenon exploited by multinationals to avoid being taxed by source countries on their active income. Wrong. The rise of e-commerce undoubtedly facilitated the avoidance of nexus rules leading to situations of double non-taxation and profit shifting, but, as Sunita Jogarajan argued, those strategies and problems were already known by the League's Experts in 1927. Evidence of this is the discussion between Damste (Director-General of Direct

Taxation, Customs and Excise, the Netherlands); Sir Percy Thompson (Deputy Chairman, Board of Inland Revenue, UK) and Borduge (Director-General of Direct Taxation, France) over the original text of Article 5 on business profits<sup>1</sup> as drafted by Dorn (Director in the Ministry of Finance, Germany) and Clavier (Director-General of Direct Taxation and Land Survey in the Ministry of Finance, Belgium). Damste (the Netherlands) asked Thompson (UK) whether section 17 of the 1925 UK Finance Act reconciled with the proposed Article 5. Thompson replied by providing three general examples: (1) a British factory selling goods directly to a German trader – no PE; (2) a British factory with an accredited representative in Germany who carried on regular business in an office; this constituted a PE; and (3) a German factory which appointed an agent who sold its goods in England for a fixed commission; England had basis to tax the German factory. Borduge (France) proposed the following footnote, 'If an undertaking has in a country an individual who brings the person supplying the goods into touch with the buyer in return for a share in the transaction, this fact shall not be held to mean that the undertaking has a stable establishment in that country.' Thompson (UK), then, provided a fourth general case: a person receiving an annual salary to work in a French office and sell goods from London. According to Borduge (France), as long as the person had the power to conclude binding contracts in the company's name, the French office would be considered a PE of the British firm. However, if the person's role was to limited to bring buyer and seller into touch in return for an ordinary commission, then the French Treasury had no basis to tax the British firm. Interestingly, according to Thompson (UK), such

### Notes

<sup>1</sup> The actual centres of management, associated companies, branches, factories, warehouses, agencies, offices, depots, places of purchase and sale and other business centres used in the exercise of their profession by the parties concerned or by their partners, holders of full powers or other permanent representatives shall be regarded as stable establishments. See also S. Jogarajan, *Double Taxation and the League of Nations*, 135 (Cambridge University Press 2018), fn. 1: 'If an undertaking has an agent in a country who acts in his own name for this undertaking in return for an ordinary commission, this fact shall not be held to mean that the undertaking in question has a stable establishment in that country.'

distinction was absent under British law, 'If, for example, he entered a London office to order champagne and the office telegraphed Rheims to determine the price, and subsequently telegraphed the order, which was accepted, then the [London] office would be considered a PE [of the French firm].'<sup>2</sup>

Applying Jogarajan's arguments, readers might thus realize that the text of Article 12 of the Multilateral Instrument (MLI) is not the result of a fundamental reform, but the continuous evolution of the OECD Model. Indeed, in our opinion, Article 12(2) of the MLI, according to which the dependent agent rule will not apply if the person acting on behalf of an enterprise of another state carries on a business as an independent agent and acts for the enterprise in the ordinary course of that business (with the exception of a person acting exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related), seems to be based on Article 5(5) of the 1993 India–UK tax treaty<sup>3</sup>; Article 5(5) of the 1994 Malta–UK<sup>4</sup>; and Article 5(6) of the 2010 France–Hong Kong tax treaty.<sup>5</sup>

Same can be said for BEPS action 6 on the prevention of treaty abuse through inclusion of a *principal purposes* test. Such general anti-abuse rule based on the principal purposes of transactions or arrangements does not result from a radical reform, but apparently was modelled after similar provisions ('the main purpose' standard) found in treaties of other countries, such as many of the modern treaties of the UK. From a search run into the IBFD database, it results that UK had included such standard in almost thirty of its tax treaties entered into force between 1 January 1930

and 31 December 1999. The predecessor of the main purpose standard firstly appeared in Article 12(5) of the tax treaty between Ireland and the UK (1976),<sup>6</sup> followed by the tax treaty between Guyana and the UK (1992).<sup>7</sup>

In addition, one of the recent proposals that advocates the overthrow of the arm's length standard and favours the method of fractional apportionment for allocating business income, at least in the absence of true comparables, seems to be based on Article 3(4) of the 1933 Draft Convention Adopted for the Allocation of Business Income between States for the Purposes of Taxation, according to which, '... If the methods of determination described in the preceding paragraphs are found to be inapplicable, the net business income of the permanent establishment may be determined by a computation based on the total income derived by the enterprise from the activities in which such establishment has participated. This determination is made by applying to the total income *coefficients based on a comparison of gross receipts, assets, number of hours worked or other appropriate factors*, provided such factors be so selected as to ensure results approaching as closely as possible to those which would be reflected by a separate accounting.'<sup>8</sup> Among the rules suggested for the allocation and apportionment of business income between States, Mitchell B. Carroll in his 1934 Columbia Law Review article commenting the Draft Convention made reference to the productive factors used in the allocation formulas of two US States, Wisconsin<sup>9</sup> and Massachusetts.<sup>10</sup> Again, nothing new on the horizon.

## Notes

<sup>2</sup> S. Jogarajan, *Double Taxation and the League of Nations*, 141 (Cambridge University Press 2018).

<sup>3</sup> India–UK tax treaty (1993), Art. 5(5): '... An enterprise of a Contracting State shall not be deemed to have a PE 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. However, if the activities of such an agent are carried out *wholly or almost wholly* for the enterprise (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to the same common control) he shall not be considered to be an agent of an independent status for the purposes of this paragraph.'

<sup>4</sup> Malta–UK tax treaty (1994), Art. 5(5): '... An enterprise of a Contracting State shall not be deemed to have a PE 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. However, if the activities of such an agent are carried out *wholly or almost wholly* for the enterprise (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to the same common control) and the conditions made or imposed between them in their commercial or financial relations differ from those which would have been made or imposed if this had not been the case, that agent shall not be considered to be an agent of an independent status for the purposes of this paragraph.'

<sup>5</sup> Hong Kong–France tax treaty (2010), Art. 5(6): '... An enterprise shall not be deemed to have a permanent establishment in a Contracting Party merely because it carries on business in that Party through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted *wholly or almost wholly* on behalf of that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.'

<sup>6</sup> Ireland–UK tax treaty (1976), Art. 12(5): 'The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned *mainly for the purpose* of taking advantage of this Article and not for bona fide commercial reasons.'

<sup>7</sup> Guyana–UK tax treaty (1992), Art. 12(9): 'The provisions of this Article shall not apply if it was *the main purpose or one of the main purposes* of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.'

<sup>8</sup> This means that fractional apportionment should be used in international cases only as a last resort. See M. B. Carroll, *Allocation of Business Income: The Draft Convention of the League of Nations*, 34(3) Columbia Law Rev. 494 (Mar. 1934).

<sup>9</sup> The factors in the Wisconsin fraction are: (1) Tangible property, real, personal and mixed, but exclusive of cash on hand or in bank, shares of stock, notes, bonds, accounts receivable, or other evidence of indebtedness, special privileges, franchises, goodwill or property, the income of which is not taxable or is separately allocated. (2) Cost of manufacturing, collection, assembling or processing, which generally includes: (a) cost of goods, materials and supplies used; (b) wages and salaries; (c) overhead or manufacturing burden. (3) Sales. See M. B. Carroll, *supra* n. 8, at 492.

<sup>10</sup> The factors used in computing the 'allocating percentage' for the Massachusetts excise tax are: (1) Average value of tangible property (not including intangible property such as stocks, bonds, notes, bills receivable and goodwill). (2) Wages and salaries. (3) Sales, which heading includes compensation for personal services, rentals and royalties. See M. B. Carroll, *supra* n. 8, at 492.

In conclusion, the lesson that policymakers can draw from reading Sunita Jogarajan's outstanding new book is that sometimes, rather than pushing for radical reforms of the status quo, it is better to look back at the 'original intent' of the legislative material. Sunita Jogarajan showed how tax treaty history might be very helpful for international tax scholars, practitioners and administrators in

interpreting tax treaty provisions in such a way to avoid profit shifting and double non-taxation.

*Reuven Avi-Yonah*

*Irwin I. Cohn Professor of Law, Director, International Tax  
LLM Program, University of Michigan Law School*

*Gianluca Mazzoni*

*SJD Candidate, University of Michigan Law School*