Research Report

Mapping of Double Taxation Treaties (DTTs) of selected Central and Eastern European (CEE) countries with primary focus on treaties with developing countries

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Policy Research Center
Research for Policy Decisions

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Terms Used

DTA or DTT ï Double Tax Agreement or Double Tax Treaty ï refers to the international agreements on avoidance of double taxation, in the text also abreviated as tax treaty.

OECD MTC ï OECD Model Tax Convention

SPV ï Special Purpose Vehicle ï a legal entity established for a specific purpose. In the context of tax treaties the purpose is of then to gain access to the tax treaty network of a specific country ï practice also known as Treaty Shopping.

UN MTC ï United Nations Model Tax Convention

WHT ï withholding tax; this tax is collected by a way of deduction of the amount of tax from the payment made by the payer. The payer deducts the tax and remits it to the state budget.

Other:

1) **UN MTC vs. OECD MTC -** Where the report does not indicate otherwise, the references to Articles of the tax treaties (e.g. Article 6) will indicate that the same rule is present in the OECD and UN MTC. Where there is a difference, this will be indicated by specifying a specific Model Tax Convention (e.g. Article 12 UN MTC).

1. Introduction

1.1. Background to the Research Project

This research is linked with broader tax movement and public campaigning which is constantly growing especially in the EU15.

Double Taxation Treaties (DTTs) represent one of the most direct tools through which tax policies of the EU-28 could directly influence the ability of developing countries to collect taxes. Unlike in case of other key policy issues such as creation of intergovernmental tax body or EU wide public country-by-country reporting, which require coordinated actions of numerous countries, the content of DTTs is in competence of national decision-makers and government officials. This is because the content of the tax treaties can be determined by each contracting state and the provisions of the respective treaty can be tailored in favor of the developing country or in favor of developed country.

Awareness about development dimension of tax policies is quite low among decision makers and government officials in the Central and Eastern European countries (CEEs). Assumption that DTTs are beneficial to developing countries prevails in CEEs. This research will help to test how much is this assumption correct and could provide ground for calculation of direct losses of developing countries because of the DTTs.

This should help to underline the development dimension of tax policy, show that there are direct links between CEEs tax policies and developing countries and open a debate between different stakeholders (especially between government officials, political representatives, development NGOs) about how to make tax policies (concretely DTTs) more coherent with development policy goals (concretely with mobilization of domestic resources for development, capacity building for tax collection etc.). The research could be also used for communication with wider public increasing understanding about broader responsibility which CEE countries have for sustainable development (in line with global Sustainable Development Goals).

Outcomes of this research could also support debate about costs and benefits of DTTs which CEE countries have with other OECD countries and in general about their ability to defend domestic tax base in these treaties.

1.2. Research objectives

Primary objective of this report is to map impact of DTTs of selected countries form the CEE region (Czech Republic, Slovakia, Poland and Slovenia) on developing countries. The objective is to concretely identify harmful practices in the treaties that can undermine the capacity of domestic governments to effectively defend their tax base against erosion and profit shifting.

This mapping is important to engage in discussion with government officials / politicians about direct impact of CEE countries tax policy on developing countries in order to strengthen the ñpolicy coherenceò aspect of non-development policies and also to increase understanding about international and development dimension of tax. The multi-country focus enabled us to identify commonalities between the countries, which could strengthen cooperation between NGOs in the CEE region around this issue and could lead to ñregional advocacy recommendationsò towards the governments (for instance as ñVisegrad countriesò initiative).

1.3. Structure of the Report and Methodology

The approach reflected in this report, reflects the research methodology applied.

The research project consisted of comparison of the selected DTTs of respective CEE countries in respect of the developing countries covered and time-frame of their conclusion as well as geopolitical circumstances of conclusion of these tax treaties.

The analyses of the specific tax treaties was based on comparison of the selected DTTs with OECD and UN treaty model. In general, the tax treaties based on the UN treaty model tend to be more beneficial for the developing countries.

In addition, other provisions in tax treaties favourable to developing countries were addressed (such as the Technical services article ï giving taxing rights to the source country derived from South African Development Model Tax Treaty and now already incorporated into the UN Model).

The report contains an explanatory section ï **Conceptual Background**, which was prepared and based on Policy Brief: Tax Treaties ï what are the issues?[1] This section explains the key principles and issues related to the structure and operation of tax treaties.

The comparison of different approaches identified in the CEE region is addressed in the section **Comparative analyses of CEE region**. This section contains also answers to some of the questions, such as:

- What is the overall assessment of DTTs in CEE region regarding possible impacts on developing countries?
- What recommendation could be given to the region?

The report finally contains a **Country Chapter** on each country, which was subject to the analyses.

Each country chapters contains the following sub-sections, which address the following questions:

Introduction

Introduction section contains general information about the country, main features of its income tax systems and its tax treaty network.

In addition, it contains answers to the following questions:

- How many DTTs with developing countries (World Bank list) does each CEE country have (including trends ï is the number increasing / decreasing in last years)?
- What is export/import balance between selected CEE region and developing countries/region (in case of CEE countries selected for detailed research what is the trade exchange with each developing country specifically)?
- In general, how are the DTTs concluded in the country ï especially who is the leading authority (e.g. which ministry), who is involved in the process (especially regarding national parliament or any other stakeholders)?

[1] Policy Research Center, *Policy Brief: Tax Treaties ï what are the issues?*, 2017, ISBN: 978-80-87909-07-2.

Tax Treaty Network

This section contains overview of the tax treaty network of the country with the focus on timing of conclusion as well as observations of the regions covered/addressed by the tax treaty network.

Selected Tax Treaties subject to the analyses

This section explains the selection of the tax treaties for analyses and provides general details about these tax treaties.

Highlights of the key issues in Tax Treaty Network

This section contains the highlights of the analyses in form of simplified color map, which allows the reader quickly identify what elements may be in particular a matter of concern from the perspective developing country perspective.

In addition, this section addresses the following questions:

- Which model does the Country prefer in general - OECD/UN/combination?
- Taken two existing models of double taxation treaties (DTTs) ï OECD and UN ï which parts of the treaties are
    - In line with OECD model?
    - In line with UN model?
    - Going further then OECD model?
    - Going further then UN model?
- How big is the reduction of withholding tax (WHT) from interests, dividends and royalties after the DTTs was signed?

Conclusions and Recommendations

- What are the implications on tax revenue due to WHT reduction?
- What are the main elements in the DTTs
    - with negative impacts on the developing country?
    - which on contrary could be evaluated positively (e.g. anti-abuse clauses etc.)?
- What is the main learning from the country analysis (suggestion for system of ñgrading/assessmentò would be welcomed)?
- What recommendation could be given?

1.4. Guide to the simplified Color Maps

Important and user friendly feature of the Country chapters is the simplified color map, which allows the reader on the first sight to identify what are the specific issues in specific treaties and to the extent there is some issue identified ï whether it is a critical matter or rather an issue requiring attention.

1.4.1. Colors used

The color maps use the following colors:

Black	The black color used indicates a critical issue, possibly caused by intentional behaviour of the developed country negotiatos. It will be an outcome of inserting an unsual and fabricated tax treaty provision.
Red	The red color used indicates a serious issue, which leads to a loss of taxing rights to the detriment of the developing country. It can be a result of the use of OECD MTC rather than UN MTC.
Yellow	The yellow color used indicates a problem area, which may be to the detriment of the developing country, but the impact may not be straight forward. The issue may need to be considered from the perspective of each specific developing country.
Dark Green	The dark green color used indicates that the provision is not perceived as problematic and that the specific provision is reasonable from the perspective of allocation of taxing rights between the developed and developing countries. Usually, where the UN MTC is used or where more suitable and favourable OECD MTC is used this color code applies.
Light Green	The light green color used indicates that the provision is even more favourable for developing country than the provisions available in the OECD or UN MTC. The example is the use of the Technical services article or taxing rights on all types of shares.

2. Conceptual Background

2.1. Tax Treaties as element of international tax framework

Double taxation agreements (DTAôs) are one of the fundamental elements of the international tax framework. The primary goal and objective of tax treaties is elimination of double taxation.

Countries around the world have been negotiating and entering into tax treaties for more than hundred years. It is interesting to note that some of the first tax treaties were concluded in the Central European region with one of the first tax treaty being the bilateral agreement between Austria-Hungary and Prussia in 1899.[2]

In general, tax treaties have historically played and should be playing a positive role in the mutual commercial and investment relations between the signatory states. That is also a reason, why countries having mutual diplomatic relations frequently also enter into tax treaties.

Conclusion of a tax treaty is often considered as an important pillar of building and advancing mutual economic, investment and trade relations.

Most often the tax treaties are being concluded by countries, which have significant levels of mutual trade and investment activities to simplify the tax compliance procedures for entrepreneurs and business[3] as well as investors[4]. The tax treaties provide for rules to facilitate elimination of double taxation and thus potential benefits to both ï legal entities, but also for physical persons ï such as employees,[5] pensioners,[6] governmental employees[7] as well as students[8].

The tax treaties are there therefore not to only facilitate the business and investment, but also to provide for simplified approaches in elimination of double taxation also to individuals, which could be otherwise burdensome and could pose an obstacle and significant burden to mutual economic as well as social relations.

2.2. Why Tax Treaties pose risk to tax revenues?

Tax Treaties help in elimination of double taxation and simplification of the tax compliance procedures through a set of elaborated rules that distribute/allocate taxing rights between the contracting states.

The allocation of taxing rights and limitation of taxing rights on the basis of DTAôs is on one side a possible solution for avoidance double taxation, yet on the other side it may also create

[2] Treaty of 21 June 1899 between Austria-Hungary and Prussia for the avoidance of double taxation which can result from the application of the tax laws in force in the Kingdoms and Lands represented in the Imperial Council and in the Kingdom of Prussia.
[3] See Articles of OECD and UN MTC ï Articles 7 and 8, 12 and also Article 14 of UN MTC.
[4] See Articles of OECD and UN MTC ï Articles 10, 11, 13.
[5] See Article 15 of OECD and UN MTC.
[6] See Article 18 of OECD and UN MTC.
[7] See Article 19 of OECD and UN MTC.
[8] See Article 20 of OECD and UN MTC.

opportunities for double non-taxation in combination with specific features of domestic law systems and tax treaties are frequently abused for the purpose of tax avoidance.[9]

From the perspective of developing countries, the tax treaties may lead to a result, where the developing country may lose the taxing rights or may be limited in exercising the taxing rights. Such restrictions of the taxing rights also lead to losses of tax revenues. One could argue that the tax treaties operate on reciprocal basis ï thus the loss of the tax revenues may be compensated with the addition tax revenue resulting from the fact that the other country is also restricted in exercising of its taxation rights. This logic may however not always be true and these losses to the tax revenues of the developing countries may not be compensated with additional revenues, where the other country would give up the taxing rights. This is because there may be limited flows of income in the reverse direction and thus the tax treaty may end up favoring only the companies and physical persons who are resident of the developed country. The outcome will be that the developed country may also tax the income of its tax residents, which they earned in the developing country, while the developing country may be prevented or limited in exercise of its taxing rights in respect of the very same income. The companies and individuals from the developed countries are more likely to derive income from their commercial activities, provision of services or investment of capital to the developing country. The end result is then that the tax revenues flow to the coffers of the developed countries on the expense of the developing countries.

2.3. Allocation of taxing rights explained

This allocation of taxing rights can be represented by 3 main possible scenarios:

- Allocation of exclusive taxing right to the country of residence
- Allocation of exclusive taxing right to the country of source
- Shared taxing right ï permitting country of source to levy tax.[10]

In the context of this report, the country of residence is considered the country, where the persons receiving the income from trade, investment or other activities are resident.[11]

In most cases from the practical perspective, the country of residence is the developed country and the income from provision of services, capital, intangible property and capital gains will flow to this developed country.

On the other hand, in the context of this report, the country of source is the country, where the income originates and in most cases it will be the developing countries, since in most cases, these countries will be the countries experiencing the outflow of the given income.

This is not to say that the situation cannot be also to the reverse, but for the purposes of this report, this source-residence perspective will be perspective taken in performing the analyses.

[9] See for instance, OECD (2015), *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241695-en

[10] This right can be however further limited by the tax treaty ï either by limitation of maximum applicable tax rate or limitation of tax base, which is subject to tax in country of source.

[11] To become tax residents, in most countries the persons should permanently live there if individuals or are established in the country as legal entities or are otherwise liable to tax on their worldwide income.

2.3.1. Allocation of exclusive taxing right to the country of residence

Allocation of exclusive taxing right to the country of residence leads to the outcome that country of source (usually the developing country) is prevented from levying tax on the given income.

In other words, the tax treaty prevents the application of the domestic law (e.g. prevents the country of source to levy withholding tax on the income or otherwise to tax it) and this country of source is not permitted to exercise its jurisdiction.

Instead, the income can be taxed exclusively in the country of recipient of the income ï country of residence (often times the developed country).

The country of source is thus losing the possibility to generate income in form of tax revenue in respect of this income. In fact, in many cases, not only that it will not be able to exercise the taxing right in respect of the given income, but in cases, where this income is a deductible expense for the payer (such as service payments, interest payments, royalty payments, etc.), the country will experience reduction of the taxable base in respect of this other income (potential tax base erosion) and it will be able to tax less of the taxable profits of the given payer. So not only, it will not be able to tax this income originating in country of source and paid cross-border, but the deduction of this payment will prevent the country of source to tax the income from other sources ï e.g. domestic sources, because the income (tax base) from the domestic sources will be reduced by this deductible payment.

This is also a common technique of tax planning and tax avoidance ï based on tax base erosion and profit shifting.

2.3.1.1. Issues with exclusive taxing right for the country of residence

It can frequently happen with certain categories of income ï such as dividends, capital gains that these types of income will be exempt under domestic rules of the country of residence[12] and thus the income may not be taxed anywhere and double non-taxation may arise. This is also the risk identified in this report.

Furthermore, the features of special tax regimes ï such as *patent box regime*[13] or *notional interest deduction*[14] as well as *special investment funds*[15] regimes may lead to significantly low levels of taxation and thus the income having source in developing country, which the developing country may not be permitted to tax at source based on tax treaty will be taxed only by very low effective tax rates in the country of residence. Similarly, such regimes were identified in the CEE region.

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[12] This is also the case in most EU countries. See for details the Country chapters and the chapter on Comparative analysis of CEE region in this report.

[13] This is a special tax regime, which provides for low effective tax rate on income from exploitation of intangible property. Out of the countries under review in this research project, only Hungary operates such regime, leading to an effective tax rate of 5% on income generated from intangible property exploitation.

[14] This is a special measure, which permits reduction of tax base with reference to notional (hypothetical) not real interest payment. Such a measure allows low effective tax rate on interest received. This measure is proposed in the Commissionôs proposal of Common Corporate Tax Base from October 2016.

[15] Investment funds may be fully exempt from their income, or subject to a reduced tax rate. For example, the Czech Republic operates an investment fund regime that allows for a reduced tax rate of 5%.

Alternatively, the Country of Residence may be also used as an intermediary jurisdiction, permitting the income sourced in the developing countries to pass through its jurisdiction with very little effective taxation due to back to back arrangements ï where income in form of services, interest or royalties may be channeled via the SPV companies established in this country to other jurisdictions in the EU or elsewhere free of WHT, either based on tax treaties or based on absence of withholding tax in that country on certain categories of income.[16]

2.3.1.2. Provisions with exclusive taxing rights reserved for country of residence

Examples of such provisions, which provide for exclusive taxing rights in the country of residence of recipient of income, can be presented by the following:

- Article 7 ï Business profits, where in absence of a permanent establishment[17] in the country of source, this country is not permitted to levy tax on business profits of the non-resident recipient of income.[18] This means that most items of income resulting from commercial activities in the country of source will not be subject to tax in the country of source but exclusively in the country of residence;

- Article 8 ï Income from international transportation ï taxable exclusively in the country of residence (place of effective management) of recipient of income;[19]

- Article 12 (OECD MTC) ï Royalties ï Income from license fees and similar payments are taxable exclusively in the country of residence of recipient of income;[20]

- Article 13 ï Capital gains ï with the exception of sale of real estate and assets connected to permanent establishment and shares of companies that derived more than 50% value from real estate are taxed exclusively in the country of residence;

- Article 15 ï Employment Income ï taxable exclusively in the country of residence unless certain thresholds are met;[21]

- Article 18 ï Pension Income ï taxable exclusively in the country of residence;

- Article 21 (OECD MTC) ï Other Income ï taxable exclusively in the country of residence unless it is attributable to a Permanent Establishment;[22]

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[16] The Country Chapters provide overview of the WHT tax levied in each country under the review.

[17] The term ñPermanent Establishmentò is further defined in Article 5 and in simple words ï it is a threshold, which for the purpose of application of Article 7 determines whether the activities of recipient of income qualify for taxation in the country of source. The definition of the Permanent Establishment (PE) can thus further narrow or broaden the taxing rights of the country of source. The term PE It is also relevant for application of other provisions ï such as Articles 10, 11 and 12 (Dividends, Interest and Royalties), Article 13 (Capital Gains), Article 15 (Employment income), Article 21 (Other income and Article 22 (Capital).

[18] With the exception of situations, where the item of income is specifically addressed by other Article in the tax treaty ï such as Articles 10, 11 and 12 (Dividends, Interest and Royalties), Article 13 (Capital Gains), etc.

[19] It is important to note an alternative provision in the UN MTC, which provides for a limiting taxing rights in case of shipping activities ï see Article 8 UN MTC ï Alternative provision.

[20] This is where the OECD and UN MTC differ from each other. UN MTC provides for a shared taxing right with limitation on maximum tax rate ï where country of source may tax the income at source, but with maximum applicable rate of tax is set in the tax treaty.

[21] The employee exercises employment in the country of source for more than 183 days within 12-month period, the salary is paid by resident of the country of source or the salary is born by the PE in the country of source.

[22] Here is again difference between UN MTC and OECD MTC, where the UN MTC contains a special rule that the other income may be taxed in the country of source, where this income is paid from this country.

- Article 22 ï Capital ï with the exception of capital (property) represented by real estate or property connected to the permanent established, the capital (ownership of capital) is taxed exclusive in the country of residence of the owner.

2.3.2. Allocation of exclusive taxing right to the country of source

This concept is rather rare or almost absent in the traditional and most commonly used tax treaties.

Both OECD and UN MTC do contain only one instance where the income is to be taxed exclusively in the country of source and this is income from government services ï Article 19.

Based on this provision, income earned from providing services as government employee shall be taxed only in country, which pays this income with certain limitations[23].

There have been historical attempts to reverse this absence of balance of country of source and country or residence taxation and there are also model tax treaties ï such as Andean Model Tax Treaty, which reserved exclusive taxing rights for the country of source in respect of most types of income. There are several examples of tax treaties concluded based on the Andean Model Tax Treaties concluded between Latin American countries.

Furthermore, there is an example of a Multilateral tax treaty between the Caribbean countries ï CARICOM tax treaty, which is also prevailingly based on the exclusive taxing rights allocated to the country of source.[24]

This is not to say that these alternative approaches lead to problem-free environment,[25] but it presents an example that prevailingly residence based exclusive taxation approach of Model Tax Treaties does not have to be the only way of how to address solution to double taxation.

The question remains, whether the OECD and UN MTC, which are both based prevailingly on exclusive taxing rights allocation to the country or residence are the right solution for the purposes of achieving Domestic Resource Mobilization for the developing countries or other alternative approaches are to be explored in the coming future.

2.3.3. Shared taxing right ï permitting country of source to levy tax

Finally, we explain the preferable solution for most developing countries and that is the distribution/allocation rules, which provide for shared taxing rights. These rules permit the country of source to exercise the primary taxing right ï since as a country of source, it may also easily exercise this right by levying a withholding tax on the outbound payment or use other methods of tax collection.[26]

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[23] For details ï see Article 19 OECD MTC or UN MTC.

[24] There are 14 signatory states, which are members of Caribbean Community and Common Market, which include Barbados, Guyana, Jamaica, Trinidad and Tobago, Antigua, Belize, Dominica, Grenada, Montserrat, St. Lucia, St. Vincent and St. Kitts, Nevis and Anguilla.

[25] There have been also cases reported of abuse of such treaties, especially in cases which can also lead to double non-taxation. This happens when the country of source does not levy tax on the income based on domestic law. Due to the fact that the taxing right was allocated exclusively to the country of source and as the consequence, the country of residence is not allowed to tax, the absence of domestic tax liability in country of source leads to double non-taxation.

[26] Most developing countries, prefer levying taxation in form of withholding tax, because this provides for simplicity (no need for signing additional complex analysis ï such as transfer pricing) and also bigger tax

Subsequently, the country of residence is also permitted to levy tax on the income ï it has secondary or residual taxing right.

The resulting double taxation is in such a case eliminated by the method of credit or exemption, where the country of residence is obliged to reduce the tax due in country of residence by the tax paid in the country of source[27] or to exempt the income in the country of residence, if the income was subject to tax in the country of source.[28]

The latter can be also in some cases a cause of another situation of double non-taxation, especially in cases, where the country of source does not levy the tax at source, yet the country of residence may be obliged to grant an exemption on this untaxed income.[29]

The tax treaties may contain various variations of this shared taxing right. There can be examples of provisions, which grant the country of source unlimited taxing rights and those which provides limitations, either in form of the tax rate or in form of the tax base.

2.3.3.1. Shared taxing rights without limitations

Examples of the provisions, which provide for shared taxing rights without any limitation can be represented by:

- Article 6 - Income from immovable property may be taxed in the country of source ï no limitation is established. Similarly, income in form of Capital Gains from sale of immovable property (Article 13, paragraph 1) and taxation of ownership of immovable property (Article 22, paragraph 1) follow the same principle.
- Article 16 ï Directors fees and similar remuneration may be taxed in the country of source with no limitations established by the tax treaty.
- Article 17 ï Income of Artists and Sportsman may be taxed in the country of source and no limitations are established by the tax treaty.
- Article 21 ï Other income (Article 21 paragraph 2[30] and paragraph 3[31]) ï Other income paid from country of source may be taxed in the country of source without any limitations.

Other variation includes situations, where the country of source may tax the income at source, however limitations are established in the tax treaty. These limitations can be represented by limitation of tax rate or limitation of tax base.

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revenues, since the full amount of income is subject to tax (on gross basis), rather than being reduced by various deductible payments, which could be manipulated.

[27] This is also called Credit method, which is regulated by the Article 23 B of OECD and UN MTC.

[28] This method is called Exemption method and is reflected in Article 23 A of the OECD and UN MTC.

[29] This can be prevented by introducing ñsubject to tax clauseò in the exemption method, where the exemption will be only granted, where the income was subject to tax.

[30] This paragraph is in both the UN and OECD MTC and allows the country of source to tax income, which is connected with the permanent establishment situated therein. Where the definition of permanent establishment is narrow and it does not exist, the country of source is not allowed to levy any tax on such other income.

[31] Please note that only the UN MTC contains this 3rd paragraph, which allows for any and unrestricted taxing rights of other income in the country of source.

2.3.3.2. Shared taxing rights with limitation on the maximum tax rate

There are several provisions in the tax treaties, which provide for a shared taxing right, but with a limitation of the maximum tax rate that the country of source may levy.

As examples of such provisions, we can mention:

- Article 10 (Dividends) ï provides for a maximum withholding tax rate for dividends paid to shareholders who are:
  - Legal entities (other than partnerships), owning more the 25% of shares or voting rights are entitled for reduced tax rate of a maximum 5%.[32]
  - A maximum tax rate of 15% in other cases.[33]

- Article 11 (Interest) ï provides for a reduced tax rate of 10%.[34]

- Article 12 UN MTC (Royalties) ï while the OECD MTC provides in Article 12 for an exclusive taxing right for the country of residence, the UN MTC provides for a shared taxing right and also for an extended definition or royalty,[35] with a limited tax rate.[36]

This limitation establishes the maximum permissible tax rate, which can be levied on the income by the country of source.

2.3.3.3. Shared taxing rights with limitation on the tax base

There are several provisions in the tax treaties, which provide for a shared taxing right, but with a limitation of the tax base on which the country of source may levy tax.

As examples of such provisions, we can mention:

- Article 7 (Business profits), where the country of source may tax the business profits if the recipient carries on business through a permanent establishment. The tax base will be however limited to:
  - Business profits attributable to the permanent establishment;[37]

  - Business profits attributable to the permanent establishment, but also profits from other similar activities or sales of the same or similar goods or merchandise ï which this leads to a broader tax base (UN MTC).[38]

[32] This may look unfair, but the idea and logic is that the company being shareholder may be also subject to tax on this income and especially in cases of multiple layers of companies, the dividend may be taxed several times, before it reaches the ultimate shareholder ï a physical person.

[33] Some real life tax treaties provide for 0% tax rate in some or all cases.

[34] May be subject to negotiation and some real life tax treaties provide for 0% tax rate or exclusive taxing right in the country of residence. The interest payments have also tax base erosion effect. The 0% tax rate may be considered even more harmful than in case of dividends, because the country of source is effectively loosing taxing rights, while possibly suffering the tax base erosion due to these payments at the same time.

[35] The definition of royalty under UN MTC also provides for income from the use or the right to use of tangible property represented by commercial and scientific equipment ï thus including rental payments of tangible property. This leads to broadening of taxing rights of developing countries.

[36] The tax rate is subject to negotiation and in many tax treaties it is 10%, in some treaties may be higher than that ï 15% or 20% and in some treaties may be reduced down to 7.5% or 5%.

[37] OECD MTC provides only for this option.

[38] This provision is only provided for in the UN MTC, in the OECD MTC it is absent.

Furthermore the tax base may be limited by reference to the separate entity approach[39], which can further reduce the tax base that the country of source may be wishing to tax, because it introduces a fiction that the business presence in the country of source is to be deemed to be a separate taxpayer and thus the allocation of profit shall be based on the transfer pricing principles, which adds to the complexities of profit determination and also often leads to limitation of tax base in the country of source.

These limitations have the objective to limit the country of source taxing rights ï to prevent excessive tax burden on the income in the source country and also to assure that country of residence may exercise its residual taxing right. In absence of such a principle, the country of source would be able to tax the whole amount of profit (e.g. 100% of the profit earned by the company, while in economic terms, the part of company in the country of residence generated 70% by the economic activities performed in that country, while the part of company located in the country of source generated only 30% of its profit through economic activities performed in that country). In absence of such a rule the country of residence may have no residual profit to tax. This may be in principle a fair notion, but in the case of developing countries, this leads to further reduction of tax base, which may be perceived as a negative feature of the rule. The negative feature may be further made worse by tax planning or avoidance practices, where the taxpayers may seek to allocate only limited profits to the permanent establishment by allocating only limited functions to be performed by the permanent establishment and thus exploiting the weakness of the existing transfer pricing concepts.

2.4. Use of Model Tax Convention is Tax Treaty Negotiation

Tax treaties are being in practice concluded on the basis of different Model Tax Conventions (MTCs). The most well known of such models include the OECD MTC and UN MTC,[40] but there are also other models such as South African Development Community Model Tax Convention[41] or Andean Model Tax Convention.[42]

In reality however, each treaty may be somewhat different and may depart from these models.

While the global tax policy organizations ï OECD and UN have offered to the world two different model tax conventions, these model tax conventions are not entirely beneficial for the interests of developing countries. The reason is that both UN and OECD MTC are based on the prevailing tendency to allocate most taxing rights to the country of residence (country

[39] Based on Article 7 paragraph 2, which establishes that the business profits shall be determined as if the PE was a separate entity dealing independently with its head office and thus the tax base should not be bigger than it would be if PE was a separate entity ï this may lead to reduction of tax base with notional payments and transactions between the PE and Head Office. This approach is partially limited in Article 7 paragraph 3 of UN MTC, which provides that no such deductions shall be granted on internal management fees, interest or royalty payments between the PE and Head Office ï this is in turn leads to a broader tax base.

[40] The UN MTC is also specifically designed for the negotiation of tax treaties between developed and developing countries, by allocating some additional taxing rights to the country of source.

[41] The SADC Model Tax Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 2013. Available at: http://www.sadc-fip.gov.na/documents/899832/1426693/SADC+MODEL+DTAA+October+2013.doc/061ed236-3978-4450-8250-555591790941

[42] Andean Community Income and Capital Tax Convention, 2004. Available at: http://internationaltaxtreaty.com/download/bolivia/dtc/Andean%20Community-DTC-May-2004.pdf

of recipient of the income). As was mentioned above, there are also marginal examples of approaches based on the exclusive allocation of taxing rights to the country of source.[43]

The UN MTC is known to take into consideration some of the interests of the developing countries, but exceptionally, it also contains several model provisions that make the developing country position weaker than the OECD MTC[44].

Furthermore, the countries often depart from the text of these MTC, especially if one of the countries insists on such departures ï either due to sound policy reasons or due to secondary objectives, which in some cases may be motivated by reserving additional taxing rights, which may create factual disproportion and unfairness in the bilateral relation.

2.5. Specifics of Tax Treaty Negotiations

The negotiation of the DTTôs is sometimes carried out under political pressure to conclude a tax treaty with a specific jurisdiction. This pressure can come from inside the country (e.g. President or Prime Minister may give a commitment to his counterpart as a part of diplomatic courtesy) or can come from outside the country (e.g. large investor will insist that the investment will be carried out only when DTT is concluded and ratified).

Furthermore, the negotiations also may be affected by the lack of balance in knowledge and capacity of negotiators. Often times, the developed country will approach the negotiation with pre-planned agenda, which is usually driven by the objective to limit the country of source taxation and to maximise the potential tax revenue for the developed country. In many cases, the developing country negotiators may not fully understand the motives and also tactics used by the negotiators from the developed country. In other cases, the tax treaty negotiators may be also ñfooledò by their more sophisticated counterparts.

[43] For example, the CARICOM tax treaty and also Andean Model Tax Convention.

[44] For example, see limitation contained in Article 13 paragraph 4, which may prevent the country of source to tax capital gains from sale of shares of real estate rich companies. For more detailed explanation and analysis of such provisions see T.Balco, *Note on selected treaty issues in relation to extractive industries*, Policy Research Center, 2015, ISBN:978-80-87909-0.

Tactics of reversing the UN Model provision with OECD Model

In year 2002, the tax treaty between Mongolia and the Netherlands was signed.[1] This treaty contained several provisions, which were not in favor of Mongolia[2] and after Mongolian officials realized the implications of this DTA, the decision was adopted to terminate[3] this treaty along with several other tax treaties.[4]

One of the tactics used by the Dutch negotiators was to reverse the UN MTC provision in Article 12 (Royalty), which on the face of the tax treaty looks like the UN MTC with a limited taxing right granted to country of source, into the OECD MTC, which allocates exclusive taxing right to country of residence and thus preventing Mongolia from levying tax at source on Royalties. This reversal took place through a protocol to the tax treaty, where the text included in the protocol restricted Mongolia in exercising its taxing rights until the time when the Netherlands will not levy withholding tax on royalties under its domestic law.[5] It is a known fact that royalty payments are payments leading to erosion of tax base and Netherlands both operates a special tax regime ï Patent box ï leading to effective tax rate of only 5% and also many times the tax advisors use the Netherlands companies as back-to-back structures, where the royalty payments flow through Netherlands to off-shore jurisdictions, which is facilitated by absence of withholding tax on royalty payments.

Unfortunately, some countries also base part of their national policy and strategic objectives on establishing special tax regimes, which may be harmful to their tax treaty partners. They may thus reserve exclusive taxing rights, while they know in advance that they will not be actually exercising these taxing rights, since they have a domestic law exemption in place of the specific income, or they have a special tax regime in place, which will lead to a low effective tax burden.

The taxing rights so agreed during the negotiation may thus lead to the loss of tax revenue of the country of source, while the country of residence does not exercise these taxing rights as a part of its domestic policy. This in turns has negative effect on Domestic Resource Mobilization, since it is further amplified by the aggressive tax planning behavior of taxpayers who exploit such special tax regimes and structure their investments through such ñfriendlyò jurisdictions.[6]

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[1] Convention between the Kingdom of the Netherlands and Mongolia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, 2002.

[2] Other key issues included provisions related to taxation of dividends ï 0%, capital gains ï exclusive taxing right to country of residence, where Netherlands applies special exemption leading to double-non-taxation of both types of income.

[3] Termination effective from 1 January 2014. Decision of Mongolian parliament issued on 2 November 2012.

[4] The other tax treaties terminated by Mongolia included: tax treaty with Luxembourg and the UAE.

[5] See article XIII in the Protocol of tax treaty between Mongolia and the Netherlands: ***ñ**With reference to paragraph 2 of Article 12 it is understood that, as long as the Netherlands does not, according to its internal law, levy a tax at source on royalties paid to non-residents, the provision of paragraph 2 of Article 12 shall not apply and royalties shall be taxable only in the Contracting State of which the beneficial owner of the royalties is a resident**ò**.*

[6] *They will do so by establishing SPV in such country **ï** separate legal entity, which becomes a person entitled for the tax treaty benefits **ï** also known as Treaty Shopping.*

3. Comparative analysis of selected CEE countries

This chapter contains comparative overview of findings.

3.1. General observations

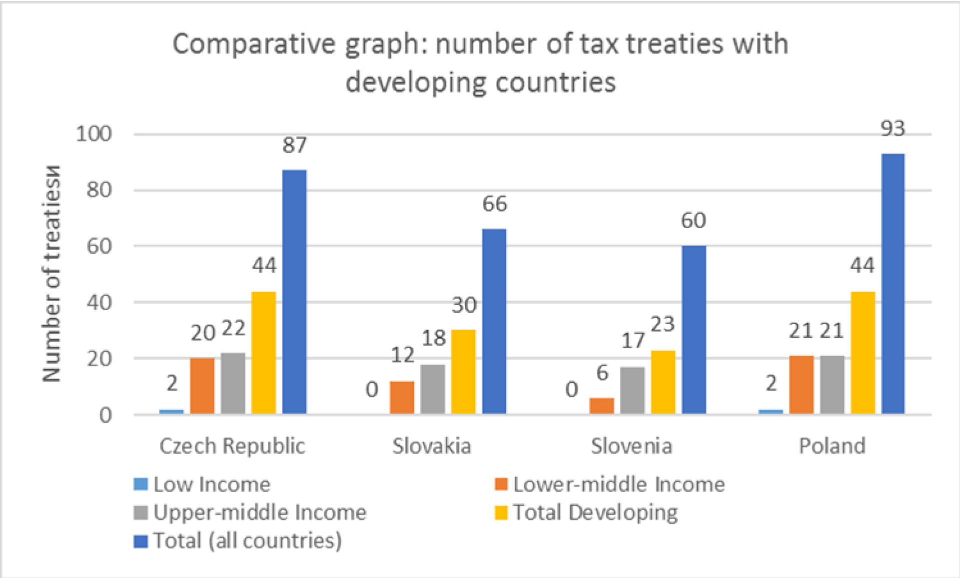
Based on the comparison of the issues arising from the four CEE countries, the following high level observations can be made and given in respect of the tax treaties concluded between the CEE countries and developing countries.

3.1.1. Limited tax treaties with developing countries

There are currently only limited tax treaties concluded by CEE countries with the developing countries. This seems especially the case in respect of the less developed countries (low income countries as classified by the World Bank). This may be the result of the fact that there may be limited diplomatic and economic relations with these countries. The absence of such treaties indicates a rather reasonable tendency ï that the tax treaties are not negotiated for the sake of negotiation, but rather that the tax treaties concluded usually reflect the actual economic relations and thus also needs to eliminate double taxation.

The graph below illustrates and compares the number of tax treaties concluded by CEE with the developing countries. From the graph, it may be observed that all countries tend to have the same tendency with respect to the relative number of tax treaties concluded with the developing world. Thus, as was mentioned above there are very few treaties concluded with the low income countries. Significantly more treaties were concluded with the lower and upper middle income countries.

Graph 3.1. Comparative graph: number of tax treaties concluded by CEE countries with the developing countries



Source: prepared by authors

In terms of comparison, then Czech Republic and Poland have very similar picture in terms of tax treaties. Both countries have about 90 tax treaties, where 44 in each case are concluded with the developing countries (almost 50%). Additionally, both countries stand quite closely also with respect to the remaining numbers ï about 20-22 treaties with lower and upper middle income countries, and 2 tax treaties with low income economies.

Similarly, Slovakia and Slovenia have more in common in their situations, but they have concluded significantly less tax treaties with developing countries ï only approximately 1/3 of total tax treaties of these two countries have been concluded with the developing countries.

3.1.2. Lack of obvious and intentionally harmful practices

None of the 4 countries in the review seems to indicate intentionally harmful practices in the tax treaty negotiation practice. There seems to be a lot of inconsistencies of approaches the CEE countries adopted in negotiating the different tax treaties, but there does not appear an obvious or harmful trend, which could be however found in respect in some other countries around the world, which intentionally facilitate treaty shopping practices.

The exception could be identified in the case of the Czech Republic, which tends to negotiate 0% tax rate on interest and also has comparatively lower tax rates on dividends in the tax treaties concluded by the developing countries. The combination of existence of exemption of dividends as well as capital gains and existence of special tax regimes for investment funds ï there could be a risk of double non-taxation and base erosion of profit shifting as a result of the combination of low tax rates, absence of UN MTC provisions in Article 13 (capital gains) and existing special regimes.

Likewise, Slovak Republic has exemption on dividends, however none of the tax treaties reduces the tax rate on dividends down to zero.

3.1.3. Inconsistency in tax treaty negotiation practice

The research indicates that in respect of four analysed CEE countries, there are inconsistencies between the different tax treaties concluded with developing countries. Only some of the tax treaties ï usually with Vietnam and India (or other countries, usually from the South-Asian region) indicate provisions beneficial for the developing countries, which was perhaps the result achieved due to the tax treaty policies of these developing countries rather than approaches taken by the CEE countries.

Among the other tendencies observed, the tax treaties of Nigeria: seem to be based on the OECD MTC. Only in some instances there are visible some efforts visible by the Nigerian government to include at least in some instances the UN MTC based provisions.[45] Many other tax treaties may contain provisions significantly restricting the developing countries, but in most cases such provisions are not worse than those inspired by the OECD Model.

3.1.4. Shift towards the OECD MTC

There is a trend, which seems to be in place and that is the fact the more recently negotiated treaties by CEE countries with the developing countries tend to follow the OECD MTC rather than the UN MTC. This may be influenced by the fact that all the CEE countries are also OECD member countries and as such they are committed to use the OECD MTC with some modifications expressed by these countries in the OECD MTC as their national reservations. The other reason may be also the fact that the developing countries may not be always properly advised and they may believe that the OECD MTC is the suitable approach that they

[45] The reviewed tax treaties of Nigeria with the Czech Republic, Slovakia and Poland.

should follow. Such lack of awareness and understanding indicates low level of capacities in respect of the specific needs that the developing countries have.

3.2. Specific observations

3.2.1. Business Profits taxation

The analysis of CEE treaty network with developing countries has indicated that in the majority of cases is used the OECD MTC with respect to determination of profits attributable to PE. Thus, in particular, very rarely one can see the limited force of attraction inspired by the UN Model (article 7 paragraph 1).[46] Similarly, very few tax treaties limit the deductibility of intercompany charges between the PE and its head office, as inspired by Article 7 paragraph 3 of the UN Model.[47] Last, almost no treaty provides for allocation of profits to the PE in case of sole purchasing function performed by the permanent establishment as inspired by the UN model.[48] So, with respect to the most critical aspects of article 7, CEE countries manage to incorporate the provisions inspired by the OECD Model.

3.2.2. Permanent Establishment issues

With respect to the definition of PE, the analysis shows a mixed tendency of using both models in the real treaties, but still slightly higher influence by OECD Model may be noticed.

Construction Activities PE

Time-period thresholds

Thus, with respect to the construction PE and threshold period countries often use the 6 months-period based on the UN Model.[49] On some occasions even shorter period of 3 months can be found, although in the same tax treaty the OECD based provisions are also present.[50]

Supervisory activities

What concerns the inclusion of provisions on supervisory activities in connection to the constructions works, then in this respect the countriesô practices are quite diverse: where, for instance, the Czech Republic includes this provision in all of the reviewed treaties, then Slovakia and Slovenia include the same rule in only 3 out of 5 treaties, while Poland has it included in 5 of the 8 reviewed tax treaties.

Services PE

Further on, the general service PE provision is absent in many of the reviewed treaties, with exception of the Czech Republic (present in 7 out of 8 treaties), which indicates that CEE countries mainly use the OECD Model also in the negotiations of tax treaties with developing countries, and sporadic appearance of the service PE provision in some of the treaties is more

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[46] Among the 8 treaties considered per each CEE country, the limited force of attraction is contained in 2 tax treaties of Czech Republic, 3 tax treaties of Slovakia, in none of the Slovenian treaties and only in three of the Poland treaties.

[47] Among the 8 treaties reviewed per each CEE country, the limit in respect of deductibility of intercompany charges is included only in 2 of the Czech treaties, 3 of the Slovak treaties, none of the Slovenian treaties and 2 of the Polish treaties.

[48] The OECD based provision is used in 7 out of 8 Czech treaties, 7 tax treaties of Slovakia, all 8 treaties of Slovenia and 7 out of 8 tax treaties of Poland.

[49] This is for instance an often case in the treaties of Czech Republic, Poland and Slovakia.

[50] For instance, in the Slovak and Czech treaties with Nigeria, there are examples of having 3-month period for construction activities and absence of service PE provision.

likely to be the initiative of the developing countries, such as Vietnam, which treaties are significantly stronger than treaties of many other developing countries.

Other

Lastly, in terms of paragraphs 4, 5 and 6 of article 5 (auxiliary activities, agency PE and insurance PE in the UN MTC respectively), the inclusion of UN based provision in some of the treaties is more accidental rather than the frequent in the reviewed treaties. Thus, in the majority of cases one can notice the OECD Model provisions, which exceptions of the treaties with technically more advanced developing countries in terms of treaty negotiations such as Vietnam and India, as was indicated earlier, which in many aspects strongly follow the UN provisions.

3.2.3. Taxation of income from provision of services and Technical Service Fees

Technical Services Fees

The article on taxation of fees from the provision of technical services is very rare in the tax treaties concluded by CEE countries and if they are included, it is a clear tendency that this happen consistently not by CEE countries, but by their specific counterparts ï such as India, and sometimes also African countries, which in later case could have been inspired by the SADC Model.[51]

Independent Personal Services

With respect to Independent Personal Services, the majority of the reviewed treaties do contain article 14 as is currently provided only by the UN Model, but it was also included into the OECD Model until this provision was eliminated from the OECD Model in 2000. This is an interesting tendency, which could be partially caused by the fact that some of the tax treaties were concluded prior to the 2000 change of OECD Model. Alternatively, it can be that some of the national tax treaty models of the CEE countries still incorporate the old provision from the OECD MTC.

3.2.4. Taxation of international transport

With respect to taxation of profits from international transportation, Czech and Slovak treaties use the OECD Model, where only in one of the treaties (in both cases in the treaties with Nigeria) the specific article on taxation of international transport is absent, which by default makes the profits from international transport be subject to general rule provided in article 7. This actually makes these tax treaties more in favor of Nigeria, which could in theory tax the international transportation companies carried out through a fixed place of business in Nigeria. The practical implication is however very limited, because to our knowledge there is no regular international transportation between Nigeria and these two countries. The Slovenian treaties also follow the OECD MTC, and have only one treaty with Thailand, which contains the UN based rule. In the Polish treaties, the UN model is used more often (in the treaties with Bangladesh, Nigeria and Sri Lanka), which may be also explained by the fact that Poland has an access to the open waters and in this respect may recognise the benefits of the UN model also for itself. Alternatively, this could be also insistence of the developing countries to use the UN MTC provisions.

In general, in addition to the OECD MTC basic provisions for taxation of income from international transportation, authors also observed that some treaties include other types of income to be covered by the same article and principle therein. In particular, under some

[51] The SADC Model Tax Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 2013.

treaties, also the income from rent or leasing of international transport or containers is covered under article 8.[52] This further limits the taxing rights of country of source, which could tax such income as income in form of royalty, if the UN MTC version of definition of royalty is used. In addition some treaties also cover interest payment related to funding the purchase of vehicles used in international transport (ships and aircrafts), which also limits the country of source in its taxing right, because it could otherwise tax such income at source as income in form of Interest (Article 11).[53]

3.2.5. Taxation of dividends

With respect to dividends taxation, there are no obvious harmful tendencies in the CEE treaties with the selected developing countries. All of the reviewed treaties include the shared taxing rights for dividends and the common rate of withholding tax is about 10% and above, and only occasionally goes down to 5%, which is also acceptable for intercompany dividends in case of qualified shareholding. However, it was noticed by the authors that in the number of tax treaties is provided only one rate of withholding tax - e.g. 5% or 10%, which does not distinguish between the major and portfolio investors and does not require any conditions to be met, except for the fact that the recipient shall be the beneficial owner of an income, which in theory means that all the dividends flow may be subject to the reduced rate of withholding tax.[54] Such tax treaty may be potentially used for tax treaty shopping for investments in other EU or non-EU states and as was noted by the authors in some of the country chapters may not be even in line even with the OECD MTC, which as a result of the BEPS Project recommends to apply the reduced rate of withholding tax only in case of qualified shareholding, where in addition to the number of shares owned will be also considered the duration of ownership.[55]

3.2.6. Taxation of Interest

With respect to interest taxation, the situation is not so good as with the dividends. First of all, there are treaties which allocate exclusive taxing rights for interest taxation exclusively to the residence states.[56] Secondly, the recommended 10% withholding tax rate is often reduced to a lower rate, including the exemption, which in view of the authors could be harmful. This is for instance the case, where the treaty grants exemptions from withholding taxation in the case the loan, which was merely secured or approved by the government of the Contracting State or agencies established to support import and export. It can be relatively easy and affordable to obtain such guarantees and the consequence is that the country of source is giving up the taxing rights. On the other hand, it can be less harmful, if the interest payment takes place between the states or authorised banks or special state organizations established with the special purpose restricted to the state functions.

3.2.7. Taxation of Royalties

With respect to royalties, no tendencies for harmful provisions were observed by the authors. All of the reviewed treaties include the shared taxing rights and in general tend to use the UN

[52] This is the case in 2 out of 8 reviewed Czech treaties, one treaty of Poland, 3 tax treaties of Slovakia and one tax treaty of Slovenia.
[53] See for instance tax treaties between India and Slovenia, India and Slovakia.
[54] This is the case of 5 of the reviewed tax treaties of the Czech Republic, 3 treaties of Poland, 2 treaties of Slovakia and 1 tax treaty of Slovenia.
[55] See the OECD recommendations as part of final report on Action 6 Prevent and limit abuse of tax treaties.
[56] See the Tax Treaty between the Czech Republic and Bosnia and Herzegovina, the tax treaty between Slovakia and the South Africa.

definition of royalties.[57] However, there are few treaties, which reduce the withholding tax rate down to 0% in case of certain types of royalties. This is for instance, the treaty between the Czech Republic and Bosnia and Herzegovina, which imposes general 10% tax rate on royalties, except the case when the royalties are paid in consideration of any copyright of literary, artistic or scientific work except of computer software and including cinematograph films, and films or tapes for television or radio broadcasting. In a similar manner the tax treaty of Slovakia with Sri Lanka grants exclusive taxing right to the country of residence in case of payment of royalties as consideration for the use of, or for the right to use, any copyright or cinematograph films.

3.2.8. Taxation of Capital Gains

Article on taxation of capital gains was specifically analysed from the perspective to understand whether it allows for source taxation of gains derived from the sale of shares in the company, where the value of the shares is derived from immovable property. The research has identified that in many treaties, where this specific provision is present ï it is usually based on the OECD Model, which is the rare case when it is better for the developing country to have the OECD Model provision in place rather than UN. However, the research also indicates that in many treaties this provision is absent in general, which automatically allocates the exclusive taxing right with respect to the same to the country of residence of the shareholder.[58] This combined with the special exemption of capital gains, which is in place in Czech Republic (participation exemption) creates double non-taxation. In contrast, very rarely was observed that the specific provision for taxing all the capital gains from sale shares inspired by the UN MTC was used.[59]

3.2.9. Taxation of Directorôs fees

With respect to the taxation of directorsô fees, in the majority of treaties the OECD Model was used. Very occasionally may be also found the UN Model, but again, perhaps brought into the convention with the initiative of the developing state.[60]

3.2.10. Other Income

With respect to other income, the tendency between CEE countries is different. Where the Czech Republic, Slovakia and Slovenia tend to use both models but with the prevailing number of provisions based on the OECD MTC, then Poland, at least based on the tendency in the selected treaties, systematically uses to the UN Model in this respect. This practice of Poland grants more taxing rights to source/developing countries.

3.3. Conclusions

Based on the undertaken study, the authors did not observe the intentional harmful effect of the CEE countriesô treaties on the economies of developing countries.

While it is understood that, the CEE countries as OECD member countries use the OECD MTC as the base for negotiation of tax treaties with the developing countries, the actual

[57] Exception are the tax treaties of Slovenia, where in half of the treaties is used the OECD based provision for definition of royalties.

[58] In case of Czech Republic these are 5 tax treaties, in case of Slovakia these are 5 tax treaties, in case of Slovenia these are 3 tax treaties and in case of Poland this is 1 tax treaty.

[59] In case of Czech Republic this is the case in 1 tax treaty, in case of Slovakia ï 1 tax treaty, in case of Slovenia ï 1 tax treaty, in case of Poland ï 1 tax treaty.

[60] See the tax treaties of Slovakia with India and Indonesia.

treaties are not worse than provisions inspired by the OECD MTC itself. In many cases, the provisions of UN MTC are used. This is especially the case with the treaties concluded by CEE Countries and the countries such as India and Vietnam. Some of these treaties go even beyond the benefits provided by the UN MTC.

There is however no consistency in how the four CEE countries approach the developing countries. It is clear that the more beneficial treaties for developing countries are mainly a result of negotiation skills of some of the developing countries as well as their persistency.

In addition to specific country recommendations provided in each chapter, the authors would generally recommend the CEE countries to take into account the particular needs and interest of the developing countries when negotiating the tax treaties with them and where appropriate use the UN MTC.

It may be considered, whether the CEE countries could formally commit to use of the UN MTC, when concluding tax treaties with developing countries, which are not members of OECD. This could be in line with the policies to assist the developing countries to mobilise their domestic resources.

The UN MTC is not harmful to the policies of CEE countries. While the UN MTC may give some more taxing rights to the developing countries, this is unlikely to undermine the public budgets of the CEE countries, while it can make significant difference in the tax revenues of the source countries.

This is especially the case, where the CEE countries under domestic law exempt certain types of income and insistence on provisions, which take away taxing rights from developing countries may also lead to double non-taxation.

The provisions of most of the reviewed tax treaties are not explicitly harmful for developing countries, but they may be considered as potentially harmful from the perspective that there may be unbalanced flow of income between CEE and developing countries. The allocation of taxing rights may thus favor countries which may be receiving return on investments as well as income from provision of services.

The authors also perceive there are benefits arising from the BEPS recommendations ï specifically Action 6 and 7, which can strengthen both the existing treaties, which could be amended by accession to the Multilateral Instrument (MLI) and accepting the options provided by the MLI also in respect of developing countries.

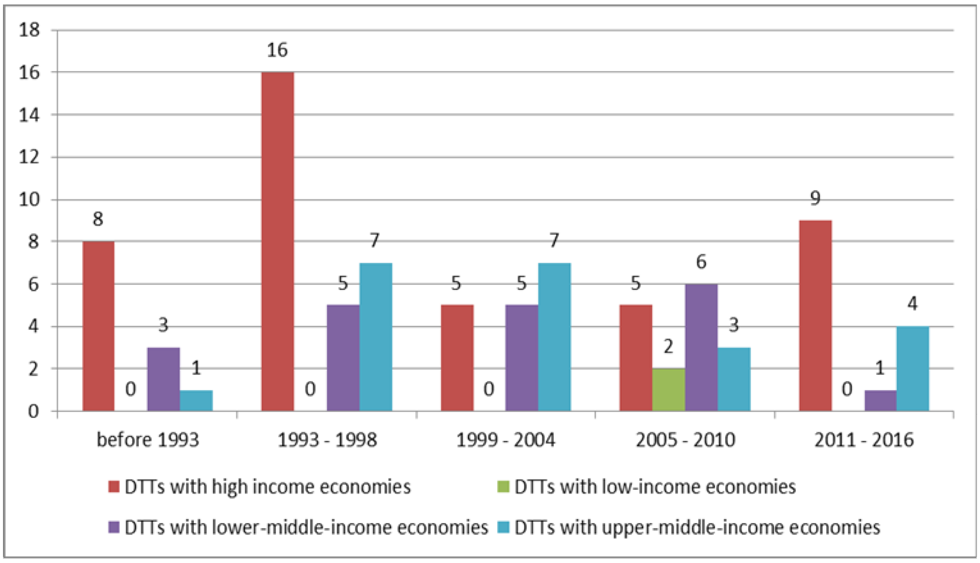
In this respect, the very conservative position of the Czech Republic opting only for the minimum standard is especially worrying as it can leave number of the existing treaties with developing countries subject to abuse. This was the core objective of Actions 6, 7 to limit the abuse of tax treaties and to strengthen the permanent establishment provisions. But the approach of Czech Republic can in fact also cause difficulties to other CEE countries, while it could make the Czech Republic to appear more competitive and attractive for MNEs.

4. Country Chapter ï Czech Republic

4.1. Introduction

At the end of January 2017 the Czech Republic had in force double taxation treaties (DTTs) with 87 countries out of which 44 could be classified as DTTs with developing countries).[61] Graph 4.1 shows that the increase of DTTs is quite stable with exception of the period from 1993 to 1998. This was soon after the fall of the communist regime and split of Czechoslovakia. Need for more intensive building of economic relations with the rest of the world could be a logical explanation for higher number of tax treaties. Share of DTTs with developing countries is approximately one half of total number (44 out of 87). However, there are only 2 treaties with low-income countries, 20 treaties with lower-middle-income countries and 22 treaties with upper-middle income countries.

Graph 4.1: Number of DTTs with different types of countries

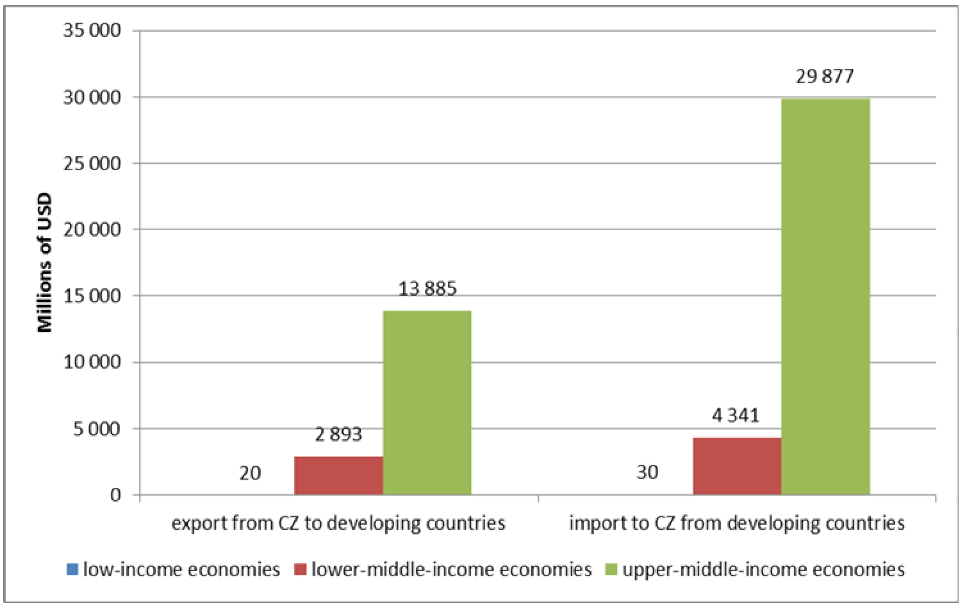


Source: based on statistics published by Ministry of Finance, Czech Republic.
http://www.mfcr.cz/cs/legislativa/dvoji-zdaneni/prehled-platnych-smluv,

Two following graphs show trade and investment flows between the Czech Republic and group of developing countries in 2015. From the Graph 4.2 we can see that the trade exchange between the Czech Republic and low-income countries is very low. The highest trade exchange is with the group of upper-middle-income countries. Results in this category are influenced by statistics with China in which case imports represent two thirds of the whole group of countries. If trade with China is not included then the trade balance with this group of countries will be in surplus (by USD 447 millions). In case of second group of countries (lower-middle-income countries), the trade balance of Czech Republic was in deficit (by USD 1 448 millions). In this case the result is influenced mainly by two countries ï Thailand and Vietnam with big trade surpluses with the Czech Republic.

[61] The category ñdeveloping countriesò covers the countries that fall into the World Bank´s categories of low-income, lower-middle income and upper-middle income countries (which covers the span of GNI per capita from USD 0 to USD 12 235. Please refer to https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

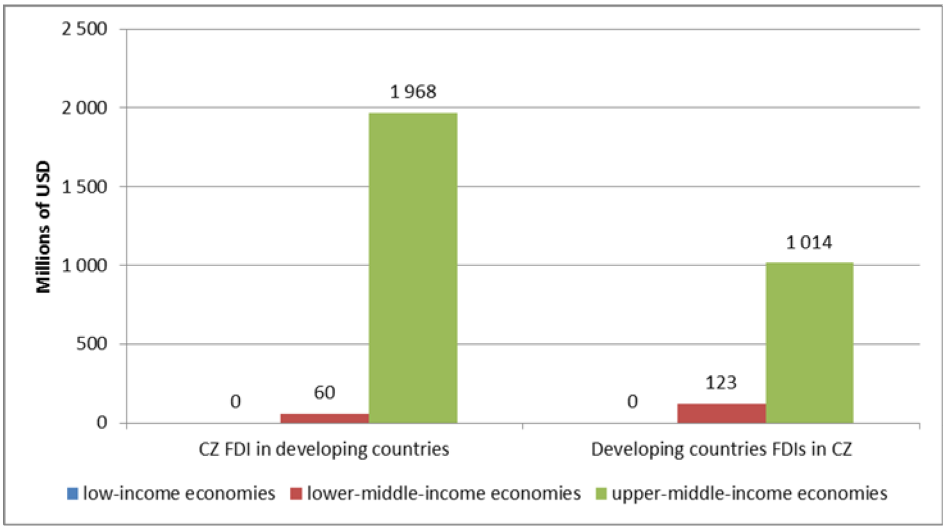
Graph 4.2: Trade exchange of the Czech Republic with different groups of developing countries



Source: based on data available at http://atlas.media.mit.edu/en/profile/country/cze/

Graph 4.3 shows investment flows from the Czech Republic to the developing countries and from these countries to the Czech Republic. In case of low-income countries there are no investment flows. The amount of investment in case of the lower-income countries is also rather low. The highest level of investment flows both outward as well as inward is with the group of upper-middle-income countries. More than half of the outward FDIs go to two EU countries (Bulgaria and Croatia) which are certainly not typical examples of developing countries. Two thirds of inward FDIs in this group of countries comes to the Czech Republic from Russia and one quarter from China.

Graph 4.3: Investment flows between the Czech Republic and different groups of developing countries



Source: based on data available at https://www.cnb.cz/analytics/saw.dll?Portal

The Czech Republic levies taxation on outbound payments in a form of dividends, interest and royalties at the rate of 15%. The same rate of withholding tax applies on the outbound service payments, however only where such services have been performed on the territory of the Czech Republic. There is also an increased tax rate of 35%, which applies to such payments to countries outside of the EU/EEA region, which do not have a tax treaty or other international agreement containing an exchange of information clause.

The received income by the Czech entities in form of interest, royalty and capital gains are taxed under the standard tax rate of 19% and in case investment funds a reduced rate of 5% applies. Furthermore, the dividends constitute a separate tax base taxed at the rate of 15%.

Risky exemptions
Both ï dividends and capital gains can be however exempt, where the dividends or capital gains received by Czech legal entities are:

- Received in form of dividends paid by or from sale of shares in similar type of legal entity established abroad,
- in a country which concluded tax treaty with the Czech Republic and
- where the foreign applicable tax rate is not less than 12%,[62] and
- the receiving Czech company owns at least 10% of capital of foreign entity for
- a period longer than 12 months.

Czech Republic does not eliminate double taxation based on the domestic tax law, with the exception of individual persons ï employees, thus the only way to eliminate double taxation is based on the tax treaties. Tax treaties are therefore critical for elimination of double taxation for any business or enterprise, where they derive income from abroad.

The tax treaties in Czech Republic are negotiated by the Ministry of Finance, which may receive inputs and suggestions for tax treaty negations from other Ministries ï such as the Ministry of Foreign affairs and Embassies of the Czech Republic in foreign countries. Furthermore, suggestions for negotiations do come from foreign governments and companies investing abroad.

National parliament is usually involved only in the stage of ratification of the tax treaty, however it may be informed about the intentions of the Ministry of Finance.

There is no evidence of assuring cohesion of development policies with the tax treaty negotiation policy.

4.2. Tax Treaty Network of the Czech Republic

Czech Republic has concluded tax treaties with 87 countries.[63]

The very first tax treaty was concluded with the Netherlands in 1974 and was followed by tax treaty with France in 1975, followed by other tax treaties concluded during the period of joint state with the Slovak Republic (Czechoslovakia) until 1993.

After separation from Slovakia starting from 1.1.1993, the Czech Republic concluded the first tax treaty, which entered into force in December 1993, with the United States. The most recent treaty, which was ratified and entered into force in December 2016, was with Chile.

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[62] Countries in the EU may have a lower corporate income tax rate than 12% - e.g. Hungary. The dividend received from Hungary will be however still exempt from tax due to the fact that the dividends paid between corporate taxpayers within EU must be exempt due to the provision of EU Parent Subsidiary Directive. For more details see Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[63] Retrieved from: http://www.mfcr.cz/cs/legislativa/dvoji-zdaneni/prehled-platnych-smluv

According to the available information there are three treaties in the process of negotiation or ratification. Treaty with the Republic of Kosovo has been waiting for the final ratification in the House of Representatives since summer 2014.[64] In April 2017 the tax treaty with Ghana was signed by representatives of both countries and the treaty is now in the process of ratification.[65] In the second half of 2016 the Ministry of Finance planned to conclude the tax treaty with Botswana.[66] Kosovo and Ghana belong to group of lower-middle-income countries, Botswana is classified as upper-middle-income country. From the recently available information, the Czech Ministry of Finance is planning to conclude the tax treaties in the next following five years with Cameroon (LMI), Kyrgyzstan (LMI), Senegal (LI),[67] Iraq (UMI), Algeria (UMI), Bangladesh (LMI), Tanzania (LI), Zambia (LMI), Kenya (LMI). It also plans to conclude the protocols to the treaties with Montenegro and Macedonia, as well as to review the tax treaty with Sri-Lanka. Until nowadays, there were no treaties with the low income countries, but recent intentions demonstrate that perhaps soon the Czech Republic will start having the treaties also with the low income countries, such as Tanzania and Senegal.

4.3. Selected Tax Treaties subject to the analysis

The following tax treaties were selected for the analysis. Selection from the group of countries with which the Czech Republic has a tax treaty was based on two factors. First one is if the country belongs according to the World Bank classification to Low income or Lower middle income groups of countries. Based on this factor Ethiopia and Nigeria were included. Second factor reflects if the country was supported during the last ten years from the Czech Official Development Assistance (ODA) funds. Czech ODA Strategy for 2010 ï 2017 includes Moldova, Bosnia-Hercegovina, Ethiopia and Mongolia as priority (program) countries and Georgia as a project country. Vietnam was on the list of priority countries between 2004 ï 2010 and between 2010 ï 2017 was among the specific countries (phase-out countries).[68]

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[64] Retrieved from: http://www.psp.cz/sqw/historie.sqw?o=7&t=123

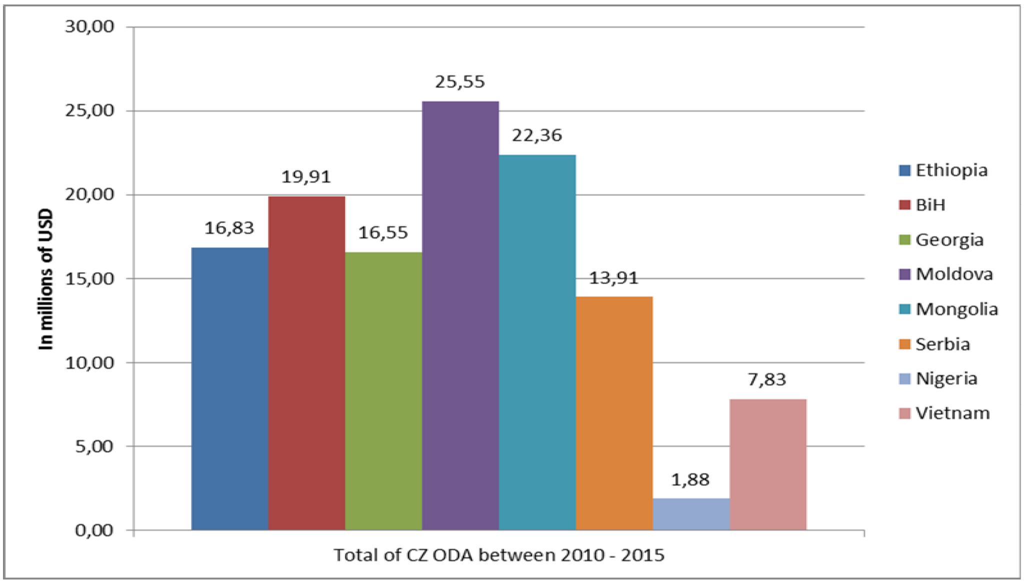
[65] Retrieved from: http://www.mfcr.cz/cs/legislativa/dvoji-zdaneni/zakladni-informace/2017/podpis-smlouvy-o-zamezeni-dvojimu-zdanen-28285

[66] Retrieved from: https://apps.odok.cz/attachment/-/down/RCIAABJEHR5R

[67] Classified as low income country since 2015.

[68] Koncepce ZRS ĻR 2010 ï 2017, available from http://www.mzv.cz/jnp/cz/zahranicni_vztahy/rozvojova_spoluprace/koncepce_publikace/koncepce/koncepce_zrs_cr_2010_2017.html

Graph 4.4: Czech official development assistance to selected tax treaties countries between 2010 ï 2015



Source: calculations are based on official statistical data provided by the Czech Ministry of Foreign Affairs.

We do not want to undermine the benefits of the Official Development Assistance. In case of many countries ODA is a precious financial source for development of local communities. However, it is interesting to compare the data from the graph with the trade and investments flows. As one can see annual volumes of trade exchange are in all countries higher than the totals of ODAs flows for six years. Proper taxation of income from this trade is therefore an important source of domestic resources for these countries. This is the main reason why the agenda of international taxation, including double tax treaties, is so crucial for sustainable development of poorer countries.

Table 4.1: Selected tax treaties for detailed analysis

Selected tax treaties with:	**Signed on**	**Effective from**
Ethiopia	25.7.2007	1.1.2009
Bosnia-Hercegovina	10.11.2007	1.1.2011
Georgia	23.5.2006	1.1.2008
Moldova	12.5.1999	1.1.2001
Mongolia	27.2.1997	1.1.1999
Serbia/ Montenegro	11.11.2004	1.1.2006
Nigeria	31.8.1989	1.1.1991
Vietnam	23.5.1997	1.1.1999

Table 4.2: Trade and FDI balance of Czech Republic with the selected countries (in millions of USD, 2015)

	Ethiopia	BiH	Georgia	Moldova	Mongolia	Serbia	Nigeria	Vietnam	TOTAL
Import from	30	78,8	22,4	34,1	0,356	314	2,45	659	**1141,1**
Export to	19,7	134	58	54,9	11,7	436	72,2	96,8	**883,3**
Balance	-10,3	55,2	35,6	20,8	11,344	122	69,75	-562,2	**-257,8**
Investments of CZ	0	1,5	0	0	0	15,9	0	10,7	
Investments in CZ	0	3,4	0	C	0	-9,1	0	1,2	

Sources: http://atlas.media.mit.edu/en/profile/country/cze/ in case of trade statistics, https://www.cnb.cz/analytics/saw.dll?Portal in case of investments statistics

4.4. Highlights of the key issues in Tax Treaty Network of the Czech Republic

The following sections will map out and analyse specific provisions of the Czech Tax treaties concluded with the developing countries. Each provision will be colour coded based on the extent to which it is favourable toward a country of source, i.e. a developing country (green and light green), problematic (yellow) or harmful (red) in terms of tax base and tax rights allocation.

The following table indicates the key issues in the selected tax treaties of the Czech Republic. For detailed interpretation of various issues identified in the treaties, please see comments below this table.

Table 4.3: Color Map of the Czech Republic

	Ethiopia	**BiH**	**Georgia**	**Moldova**	**Mongolia**	**Serbia/ Montenegro**	**Nigeria**	**Vietnam**
Signed on	25.7.2007	10.11.2007	23.5.2006	12.5.1999	27.2.1997	11.11.200	31.8.198 9	23.5.1997
Effective from	1.1.2009	1.1.2011	1.1.2008	1.1.2001	1.1.1999	1.1.2006	1.1.1991	1.1.1999
Article 5/3 Constructio n PE ï time	>6 months	>12 months	>6 months	>12 months	>12 months	>12 months	>3 months	>6 months
Article 5/3 Supervisory activities	Present	Present	Present	Present	Present	Present	Present	Present
Article 5/3 Services PE	>6 months	>6 months	>6 months	>3 months	>6 months	>9 months	Absent	>6 months
Article 5/4 Delivery	OECD	OECD	OECD	OECD	UN	OECD	OECD	UN
Article 5 ï Agency PE	OECD	OECD	OECD	OECD	UN	OECD	UN	UN
Article 5 ï Insurance PE	Present	Absent	Absent	Absent	Present	Absent	Absent	Present
Article 7 Limited Force of	Only goods	Absent	Absent	Absent	Absent	Absent	Present	Absent

Attraction								
Article 7/3 Limits to deductibility	OECD	OECD	OECD	OECD	OECD	OECD	UN	UN
Article 7/5 No Profit for purchasing	OECD	OECD	OECD	OECD	OECD	OECD	OECD	OECD
Article 8 International Transport	Also lease	OECD	OECD	Also lease	OECD	OECD	Absent ï Art 7 applies	OECD
Article 10 Dividends	10%	5%	5%/10%	5/15%	10%	10%	12.5/15 %	10%
Article 11 Interest	10%/0%	exclusive to residence	8%/0%	5%	10%/0%	10%/ 0% (only gov)	10/0%	10%/0%
Article 12 Royalties	10%	0%/10%	5%/10%	10%	10%	5%/10%	15%	10%
Article 13 Sale of Shares RE	All shares	Absent the rule	Absent the rule	Protocol, OECD	Absent the rule	Absent the rule	Absent the rule	OECD
Technical services	Absent	Absent	Absent	Absent	Absent	Absent	Absent	Absent
Article 14 Indepent Personal Services	Present	Absent	Absent	Present	Present	Present	Present	Present
Article 16 Directorǿs	OECD	OECD	OECD	OECD	OECD	OECD	OECD	OECD
Article 21 Other Income	UN	OECD	OECD	UN	OECD	OECD	UN	OECD

Source: Prepared by authors

4.4.1. Permanent establishment issues

The concept of permanent establishment is important as long as it allows country of source to levy tax on the business profits of the enterprise of a contracting state. The definition of permanent establishment is to be found in Article 5 of DTAs. Where the definition of the permanent establishment is broader ï the country of source (mostly developing country within the context of this report) is allowed to tax more income and where the definition is narrower, the taxing rights of the source country are more limited.

4.4.1.1. Construction Permanent Establishment

Article 5 paragraph 3 contains a special rule for construction activities. The country of source may tax the income of foreign construction company, where the company has a permanent establishment in the source country.

The OECD MTC provides for such permanent establishment to exist only when the construction activities last longer than 12 months. On the other hand, the UN MTC contains a rule, which provides for the permanent establishment to exist already after 6 months. The UN MTC thus provides for a rule that allows the source country to tax profits of foreign construction company faster.

In this respect, only 4 out of 8 reviewed tax treaties contain a period for Construction permanent establishment which is equal to or shorter than 6 months and one of these tax treaties contains a shorter period of 3 months, while remaining 4 out of 8 tax treaties follow the OECD MTC provision, where the time test is 12 months. This provision limits the options of most of tax treaty partners to tax the construction activities of Czech companies performed on their territory if they last less than 12 months and may lead to loss of tax revenue of the less developed countries.

On the other hand, all 8 out of 8 reviewed treaties, contain the supervisory activities as a part of the Construction PE, which is in line with the UN MTC and allows the source countries to also tax the supervisory activities carried out in relation to construction projects.

4.4.1.2. Services Permanent Establishment

In respect of the Services Permanent establishment, which allows the country of source to levy tax on companies, which provide services for a longer period of time in country of source, 7 out of 8 reviewed tax treaties do contain this provision. Out of 8 reviewed treaties, 6 contain the service provision equivalent to the UN MTC, which provides for a permanent establishment to exist, where such services are provided for a period longer than 6 months, while one treaty provides for existence of permanent establishment when the services last longer than 9 months.

Only 1 tax treaty with Nigeria prevents the country of source to levy tax on service providers. The absence of Services Permanent establishment and also technical services provision in this tax treaty can be highlighted as a critical issue, because it significantly limits this country of source to levy tax on service providers. This contradicts the UN MTC, which provides for both ï the Services PE provision and in its most recent recommendation also includes the Technical services provision.[69]

4.4.1.3. Delivery activities as a part of Preparatory and Auxiliary Activities

The country of source taxing rights can be limited by provision, which allows certain preparatory and auxiliary activities to be treated as not giving a rise to permanent establishment. These exceptions from creation of permanent establishment status are frequently abused, where the business activities are structured in a way to take advantage of these exception rules.[70]

In this respect, there is a difference in the list of activities that are considered as auxiliary and preparatory according to the UN and OECD MTCs. In particular, where the ñdeliveryò is considered as preparatory activity under the OECD MTC, it is not considered as such under the UN MTC. Consequently, under the UN MTC, activities of foreign taxpayers consisting of delivery of goods and merchandise to the territory of other country are considered not to qualify as preparatory and auxiliary activities and thus shall constitute a permanent establishment therein.

69 See for instance, Doc. E/C.18/2016/CRP.1, Committee of Experts on International Cooperation in Tax Matters Seventh session dated 11-14 October 2016, Item 3 (a) (vi) of the provisional agenda Taxation of Services, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf
70 See Action 7 of BEPS project: Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, available at: http://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm

However, majority, namely 6 out of 8 of the reviewed tax treaties do not follow the UN MTC, but the OECD MTC, which will allow the Czech companies to escape the permanent establishment status and thus taxable status, even if they have significant presence and deliver goods in these less developed countries.

4.4.1.4. Agency Permanent Establishment

Both OECD and UN MTC contain provision, which deems the existence of PE, where another person, whether the legal or natural person, acts on behalf of enterprise and also has and habitually exercises the right to conclude contracts in the name and on behalf of that enterprise. This type of taxable presence is called agency permanent establishment.

The UN MTC further broadens this notion and thus also taxing rights of the country of source by including into this definition of permanent establishment also the situation, when the person habitually maintains in the source state a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of that enterprise.[71]

In this respect, however, 5 out of 8 of the reviewed tax treaties follow the OECD MTC and does not include the additional provision suggested by the UN MTC.

4.4.1.5. Insurance Permanent Establishment

The UN MTC also contains another provision, which broadens the possibility of country of source to levy taxation on insurance companies collecting insurance premiums on the territory of the source country.

In this respect, vast majority of the reviewed tax treaties - namely 5 out of 8 do not contain such permanent establishment provision.

4.4.2. Business profits

Article 7 contains rules determining the amount of taxable income of foreign enterprise in the country of source derived in a form of business profits. The general principle provides for exclusive taxing right of country of residence of the enterprise to tax such profits, unless the such business enterprise has a permanent establishment in the country of source.

However even where foreign enterprise has such a permanent establishment, provisions of Article 7 can further limit the taxing rights of the country of source. This is where Article 7 of UN MTC contains less restrictive rules than the OECD MTC and works more in favor of the developing countries.

4.4.2.1. Limited Force of Attraction

Article 7 paragraph 1 contains the principle of taxation of business profits, where the OECD MTC only allows the country of source to tax the business profits, which are attributable to the permanent establishment.

On the other hand, the UN MTC contains a rule that allows for broader taxable base in the country of source and next to the profits attributable to the permanent establishment from its direct activities, Article 7, paragraph 1 of the UN MTC allows also for taxation of:

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[71] See Article5, para. b) UN MTC 2011.

- b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or
- c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

As a result, the UN MTC significantly broadens the taxing rights of the country of source.

In this respect however, only 1 out of 8 reviewed tax treaties does contain this UN MTC provision.[72]

4.4.2.2. Limits to separate entity notion and limitation of deductibility of intra-company charges

The last version of the OECD MTC contains a specific notion ï deeming the permanent establishment, which is part of the foreign enterprise, to be a separate entity for the purpose of attribution of profits and allocation of expenses.[73] This leads to allocation of profits and determination of expenses of the permanent establishment on the basis of principles similar to those of transfer pricing.

The UN MTC, contains the same principle. It however also contains a limitation of that principle, where in Article 7 paragraph 3, it specifically provides that there should be no deduction for notional charges between the head office and the permanent establishment for payments, which could otherwise be charged for the use of intangible property, capital or commissions between the two parts of the enterprise. This leads to a bigger tax base of the permanent establishment in the source state, since the tax base cannot be eroded by such notional payments.

In this respect, however, majority ï namely 6 out of 8 reviewed tax treaties contain the OECD MTC rule, which may allow the Czech companies to claim deductible charges for such notional payments between the head office and the permanent establishment in less developed countries.[74]

4.4.2.3. No profit for Purchasing activities

Article 7 paragraph 5 of the OECD MTC contains a restrictive rule, which provides for limitation upon determination of tax base of the permanent establishment. In particular, it says that no profit should be attributed to the permanent establishment for mere purchasing activities by that permanent establishment of goods and merchandise for the enterprise.

On the other hand, the UN MTC does not provide for a such a rule thus limiting this issue to be resolved on a case by case basis between the contracting parties. In theory, the absence of such provision means that the permanent establishment involved in purchasing activities ï e.g. purchasing commodities in developing countries should be actually remunerated by profit for such activities, which is reasonable taken that companies make not only profit as a result of sales activity, but sourcing and purchasing aspects may significantly contribute to the overall profit.

[72] See the tax treaty with Nigeria.
[73] See Article 7 paragraph 2 of OECD and similarly in UN MTC.
[74] See the tax treaties with Nigeria and Vietnam.

In this respect, however, all 8 out of 8 reviewed tax treaties contain the OECD MTC equivalent of this rule, which means the less developed countries in all cases are not entitled to tax these profits attributable to purchasing activities.

4.4.3. International Transport

Article 8 contains rule in respect of taxation of profits derived from international transportation, limited to shipping, inland waterways transport and air transport. The OECD MTC contains provisions, which provide for exclusive taxing rights for country of residence (country where the place of the effective management of the enterprise is located). On the other hand, the UN MTC provides for two different models of article 8 devoted to international transportation: where alternative A reflects the OECD MTC provision, alternative B is slightly different and provides for a limited taxing rights in the country of source in respect of the profits from operation of ships in international traffic, should the shipping activities of foreign enterprise be more than casual in the country of source.

The situation of less developed countries may be further made worse, if the tax treaty contains specific provisions allocating the profits from rental of boats or containers only to the residence country.

In this respect none out of 8 reviewed tax treaties contain the UN MTC provision, where only one of the treaties does not include at all the specific article on taxation of profits from international transportation,[75] and two of the tax treaties include also the provision allocating the profits from rental of boats and containers to the country of residence.[76]

4.4.4. Dividends

Article 10 in both model conventions contains a rule on taxation of dividends, where the country of source is allocated with a limited taxing rights and can tax the distributed profits only up to the maximum rate established by the treaty, taken that the distributed profit falls into the definition of dividends as agreed by the contracting countries and defined by the treaty.

Some tax treaties may reduce the tax rate down to 5% or even zero. In cases, where the tax treaty reduces the rate down to zero, double non-taxation of dividends will arise due to dividend exemption explained in Section 4.1. above.

In this respect, one of the reviewed tax treaty does reduce the withholding tax rate down to 5% without establishing any qualification criteria for the recipient, other than being a resident of the other state and being the beneficial owner of income.[77] Some of the remaining tax treaties do allow the country of source to levy withholding tax in amount up to 5% should the recipients meet the minimum conditions established by the treaty, such as the amount of holding shares and holding period. In all other cases the maximum rate is 10% and rarely higher.[78]

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[75] See the tax treaty of Czech Republic with Nigeria.
[76] See the tax treaties of Czech Republic with Moldova and Ethiopia.
[77] See the tax treaty of Czech Republic with Bosnia and Herzegovina, Art. 10 para. 2.
[78] For more information, see Table 4.1. Colour map above in this chapter.

4.4.5. Interest

Article 11 in both models contains a rule on taxation of interest, where the country of source is allocated with a limited taxing rights and can tax the distributed profits only up to the maximum rate established by the treaty, taken that the distributed profit falls into the definition of interest as agreed by the contracting countries and defined by the treaty.

In some treaties, the tax rates may be reduced down to zero percent, or may be included potentially harmful exceptions to the general rule in the models. This is for instance an example of treaty of the Czech Republic with Bosnia and Herzegovina, where the taxing right for interest income is allocated exclusively to the resident state, leaving the source state without any possibility to tax interest.

Number of treaties contain standard withholding tax rate of 10%, but make an exception and allow exemption in the country of source in case the interest in paid to the state institution set up by the Government of the other state to promote certain activities, such as the trade, foreign investments or export activities.[79] Such provisions are not as harmful as for instance provisions, which exempt from taxation interest paid in connection with the loan or credit merely guaranteed by the Government of the other State. The latter is more likely harmful, because any such interest paid to private entities, which obtain the import/export credit guarantee will get exempt in country of source as a result. The latest is the example of the treaty of Czech Republic with Georgia and Mongolia, which in view of the authors may be somewhat harmful for the developing countries.

4.4.6. Royalties

Article 12 contains article on taxation of royalties, where based on the OECD MTC, the country of source loses the taxing rights, which are allocated exclusively to the country of residence. On the other hand, the UN MTC contains a rule, where the country of source is allocated with a limited taxing rights and is limited with the rate of withholding tax it may impose. In addition, the UN MTC broadens the definition of royalty to include the income from rental of movable property ï scientific, commercial and industrial equipment, which further broadens the taxing rights of the country of source.

In this respect, all 8 out of 8 reviewed tax treaties contain the UN MTC provision, where country of source is allowed to tax the income in form of royalty with more than 10% tax rate and also contain a definition of royalty, which includes the rental of commercial, scientific and industrial equipment, however some treaties do reduce the withholding tax down to 5% or even 0% in respect of the license payments in respect of authorship rights.[80]

4.4.7. Capital Gains from sale of shares of real estate companies

Article 13 in both models contains a rule in respect of taxation of capital gains. Especially important is the provision addressing taxation of capital gains from the sale of shares of companies deriving their value from the real estate.

Both, the UN and the OECD MTC contain a rule, which provides for a taxing right of the country of source ï country where the real estate is located, when the value of shares sold derives from the value of such real estate. It must be pointed out that the UN MTC

[79] See article 11 in the treaties of the Czech Republic with Nigeria, Ethiopia.
[80] See the tax treaty with Georgia, Bosnia and Herzegovina and Serbia/Montenegro.

surprisingly contains a harmful provision, which prevents the source country from taxing income from the sale of shares deriving their value from the real estate, if the real estate is used in the business activities of the company and the company is not engaged in the business of management of the immovable property

In this respect, only 3 out of 8 reviewed tax treaties contain the rule, which grants the taxing rights to the country of source upon sale of shares, which derive their value from immovable property located therein or in general from the sale of shares of company located in the other state.[81] On the other hand, 5 out of 8 tax treaties do not contain neither the OECD nor the UN MTC provision and thus prevent the country of source to tax the income from sale of such shares, restricting thus the taxing rights of the country of source.[82] In cases, where the tax treaty prevents the country of source to levy tax on capital gains, double non-taxation of capital gains will arise due to capital gains exemption explained in Section 4.1. above. This applies to all types of capital gains, which meet the relevant conditions for exemption in the Czech Republic.

There is one tax treaty with Ethiopia, which contains more favorable rule than provided in the models ï allowing country of source to tax all the capital gains from any sale of shares irrespective of the type of company or shares.

4.4.8. Technical services

Some tax treaties may contain a special rule allowing the country of source to levy tax on the technical services, which significantly broadens the taxing right of the developing country. Example of such a rule is contained in the South African Development Community MTC and is currently proposed for introduction in the UN MTC.[83]

Out of the 8 reviewed tax treaties, however, none of the tax treaties contain such a provision.

4.4.9. Independent Personal Services

Article 14 of the UN MTC contains a special rule containing provisions allowing the country of source to levy tax on the income from independent personal services. This rule has been deleted from the OECD MTC and the rules of Article 7 ï business profits should apply instead in case such provision is missing. In fact, the effect achieved by both models is similar ï individual is taxed only if it has permanent (or fixed) place of business in the other state or spends therein more than 183 days.

In this respect, 6 out of 8 reviewed tax treaties do follow the UN MTC rule and thus most of the less developed countries will not be restricted by often changing Article 7 in taxing the income from independent personal services.

[81] See example of tax treaty with Ethiopia, Moldova and Vietnam.
[82] Due to the application of provisions similar to the OECD and UN MTCs incorporated into para. 5 and 6 of article 13 respectively. See example of the tax treaty of the Czech Republic with Nigeria, Bosnia and Herzegovina, Georgia, Mongolia, Serbia/Montenegro.
[83] See for instance, Doc. E/C.18/2016/CRP.1, Committee of Experts on International Cooperation in Tax Matters Seventh session dated 11-14 October 2016, Item 3 (a) (vi) of the provisional agenda Taxation of Services, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf

4.4.10. Director fees

Article 16 of both the OECD and the UN MTC contain the provisions, which regulate taxation of income of directors, which provides for an unlimited taxing right to the country of source. The OECD MTC however restricts the rule only to directors who are members of the board of directors, while the UN MTC broadens this rule also to top managers of companies.

In this respect, none of the tax treaties contains such a rule at all. All of the reviewed tax treaties contain the restricted rule of OECD MTC, rather than extended taxing right contained in the UN MTC.

4.4.11. Other Income

Article 21 contains rules for taxation of other income, which was not addressed specifically in the other articles of the DTAs.

The OECD MTC provides for exclusive taxing right of the country of residence, restricting the country of source, which may tax only such other income as may be attributable to the permanent establishment from the real estate in the other contracting state as defined by article 6 para.2. On the other hand, the UN MTC contains a rule, which allows the country of source to tax any other income, which has a source in the country.

In this respect, only 3 out of 8 reviewed tax treaties contain a rule based on the UN MTC,[84] while the remaining 5 tax treaties contain a rule based on the OECD MTC. Majority of the tax treaties thus limit the taxing rights of the country of source.

4.5. Conclusions and Recommendations

The key issues identified in the tax treaty review are related to Articles 5 and 7, which regulate taxation of business profits, but also additional provisions, such as Article 8, Article 11, 13 and 21. With respect to Article 5, the reviewed Czech treaties are well worded with respect to the definition of permanent establishment arising from construction and related activities, as well service PE provision. However, with respect to other provisions regulating existence of PE, the reviewed treaties mainly follow the OECD model examples, namely in para. 5(4) defining auxilary and preparatory activities, 5(5) defining agency PE and consequently, in large extent, miss the insurance type PE inspired by the UN model. Further on, article 7 Business profits in the reviewed tax treaties contain additional number of limitations for taxation of income in the country of source, and in particular in most treaties it does not inlude the rule on attraction of profits of head office to the PE, does not limit the deduction of intra-company charges and in addition contains the special rule restricting the tax base of permanent establishment in cases of purchase activities.

Furthermore, most tax treaties follow the OECD MTC rather than UN MTC in respect of the provisions dealing with International transport (Article 8) and taxation of directorǿs fees (Article 16) as well as in respect of Article 21 (Other Income). None of the tax treaties do contain technical services provision advocated now by the UN MTC and some tax treaties restrict the taxing rights of less developed countries in respect of the Interest (Article 11) as

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[84] See tax treaties with Ethiopia, Moldova and Nigeria.

well as capital gains from sale of shares of real estate companies (Article 13 paragraph 4), where majority of the tax treaties do not contain the provision that would allow taxation of such capital gains in country of source. Especially, the fact that country of source looses the taxing rights on the capital gains from the sale of shares, combined with the fact that Czech Republic provides for exemption of such capital gains, assuming the specific conditions are met, this creates a potential double non-taxation. This arises where developing or less developed countries loses the taxing rights, because of the absence of special rule contained in OECD and UN MTC and the Czech Republic is exempting the income based on the domestic law.

On the other hand, it should be pointed out that in most reviewed tax treaties, the provisions dealing with taxation of royalties are not significatly less favourable to the less developed countries than they would have been under the UN MTC. Similarly, most of the tax treaties contain the Article 14 of UN MTC ï providing for taxing rights of country of source in respect of income from independent personal services.

What concerns the estimated revenue losses in the develoing countries caused by the Czech Republuc, it would be useful to look into the flows of income coming to the Czech Republic from countries, where the unfavourable treaty provisions were identified based on the review. Namely, these are Article 11 Interest in the treaty with Bosnia and Herzegovina, which allocates exclusive taxing right to the country of residence and treaties with Ethiopia, Mongolia, Nigeria and Vietnam, which provide for exemption in the country of source from withholding tax in case the loan in question was guaranteed by the state or other authorised organization. The data presented by the National Bank of Czech Republic shows the following interst flows to Czech Republic from the selected countries.

Table 4.5: Flow of interst payments to Czech Republic[85]

Country	**2014**	**2015**	**2016[86]**	**Total**
BiH	0	0	0	0
Ethiopia	-	-	-	-
Mongolia	-	-	-	-
Nigeria	-	-	-	-
Vietnam	0	0	0	0

- "-" indicates that country is not included into the statistics.

Source: National Bank of Czech Republic

As indicated from the table above, it looks that there are no significant payments of intersts done from the countries, where were identified favourable tax provisions in the treaties with respect to interst taxation and residence state taxation.

Additionally, the potential significant revenue loss could occur from application of Article 13 Capital gain in some of the Czech treaties, however, with the publicly available information presented by the Czech government, it is impossible to estimate this type of income flows to Czech Republic and consequent revenue loss in the developing countries. What concerns the

[85] National Bank of Czech Republic, data with this respect is available only from 2014.
[86] National Bank of Czech Republic, only the ppreliminary data is available for 2016, accessed on 15 September 2017.

treaty provisions on taxation of dividends and royalties, then in view of the authors, the provisions in general are not harmful

The key recommendation for Czech Republic would include:

- Commit the government and Ministry of Finance to follow the United Nations Model Convention in negotiation of tax treaties with developing countries, which now includes the Technical Services article.
- Where the Ministry of Finance does not agree to follow the UN MTC, it should explain why it did not follow the provisions of UN MTC.
- In renegotiation of tax treaties, the developing countries should be offered to replace the existing provisions with provisions from UN MTC.

5. Country Chapter - Poland

5.1. Introduction

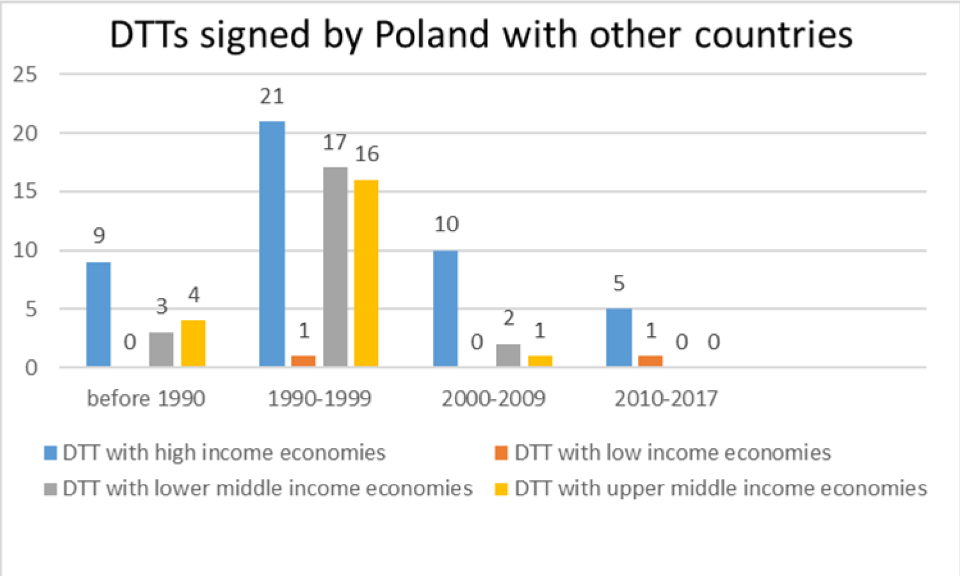
5.1.1. Tax Treaty Network of Poland ï brief statistical data

As of January 2017, Poland is a signatory to 93 tax treaties, out of which 44 are signed with developing countries (according to the updated World Bank classification)[87]. The earliest tax treaties were concluded with counterparts from the 'Communist Blockó(China and former Socialist Republic of Yugoslavia), as well as with the South and South-East Asian partners (Pakistan ï 1974; Malaysia ï 1977; Thailand 1978; Sri Lanka ï 1980 and India - 1989). Almost 75% of current Polish DTTs with developing countries were concluded in the 1990s, which reflects increasing interest of Poland in developing trade relations with Asian, African and the Middle Eastern partners. During this period, Poland also sought to re-establish cooperation on tax matters with former partners from the Communist Block.

New tax agreements, concluded since 2000 include treaties with Algeria (2000), Syria (2001) and Tajikistan (2003). In 2015 Poland signed the most recent treaties with Ethiopia and Sri Lanka, and both are presently under the process of ratification by the respective counterparts. Furthermore, in the 2000s, Poland has renegotiated or updated existing tax treaties with Bosnia and Herzegowina (2014), Iran (2014) and Malaysia (2013).

The graph below illustrates trends in signing double tax treaties by Poland with countries in various income brackets (according to the WB classification).

Graph 5.1: Number of DTTs concluded by Poland with different types of countries



Source: prepared by authors

[87] From 2016 World Bank does not use term ñdeveloping countryò in its classification. For this report, developing country is understood as a country belonging to one of the following categories: Low income, Lower middle income or upper middle income economy. Polish tax treaties were concluded with the following countries as defined above: Albania, Algeria (signed in 2000, not ratified), Armenia, Azerbaijan, Bangladesh, Belarus, Bosnia and Herzegovina, China, Montenegro, Egypt, Ethiopia, Philippines, Georgia, India, Indonesia, Iran, Jordan, Kazakhstan, Kyrgyz Republic, Lebanon, Macedonia, Malaysia, Mexico, Morocco, Moldova, Mongolia, Nigeria (signed but didn't come into effect as of now), Pakistan, South Africa, Russian Federation, Romania, Serbia (signed with Yugoslavia in 1997, Sri Lanka, Syrian Arab Republic, Tajikistan, Thailand, Tunisia, Turkey, Ukraine, Uzbekistan, Vietnam, Zambia, Zimbabwe.

The aim of this study is to analyse to what extent the tax treaties signed between Poland and developing countries provide favorable terms for the developing countries. It will be achieved by mapping out of selected treaty provisions and the extent to which such provisions allow the countries of source to broaden their tax base or the taxing rights. This study will seek to review tax treaties of Poland with selected lower income countries, namely, with Bangladesh (LMI), Ethiopia (LI), Mongolia (LM),[88] Nigeria (LMI), Sri Lanka (LMI), Vietnam (LMI), Zambia (LMI) and Zimbabwe (LI).

5.1.2. Economic relations of Poland with developing countries

The overall trade balance in 2015 between Poland and the countries selected for this study is negative, with the total value of imports from partner countries exceeding Polish exports by USD 1 888 million (See Graph 5.2 below). Of this, the imports from Vietnam are the highest in value (USD 1 458 million), which effectively contributes to the highest negative trade balance (USD 1 218 million) for Poland in this sample group. The key Vietnamese imports include machinery, transport equipment, and manufactured articles, while major Polish exports to Vietnam are food products, chemicals and machinery. Moreover, Vietnam is the only country in the sample group where Poland made the highest equity investment in 2015 (USD 13,02 million) and provided debt instruments at a value of USD 0,26 million. It is worth noting that Vietnam secured the most favorable tax treaty conditions with Poland, as compared to the other countries studied in this chapter (see highlights on the key issues, and the Conclusions and Recommendations sections). Worth mention is the fact that Vietnam has been a strong economic partner of Poland for several decades now and it has recently strengthened its trade relations with the EU by signing the EU-Vietnam free trade agreement[89].

The second largest importer of goods and services to Poland in this sample group is Bangladesh, with total imports amounting to USD 833million in 2015. The main imports come from the textiles and apparel industries (fabrics, clothes and footwear).

On the other hand, Poland was the net exporter to Nigeria (USD 101 million) in 2015, with the key exports being mineral fuels, and manufactured goods. Moreover, in the recent years Poland ramped up FDI in the extractive, petrol and energy sectors in Nigeria.

Poland has surpluses of USD 41million and USD 60 million in the trade balance with Mongolia and Ethiopia respectively. The key Polish exports to Mongolia are food produce and live animals, while Ethiopia receives largely machinery and transport equipment. In the backdrop of finalizing double tax treaty with Ethiopia (2015), Polish tractor producer Ursus signed in 2016 a USD 30,672 million deal to provide Ethiopia with tractors, spare parts of tractors and trailers.[90] However, it should be pointed out that the tax treaty signed with Ethiopia is one of the least favorable from a developing country perspective in the studied sample, with restrictive clauses referring to the definition of permanent establishment and business profits in particular (see relevant sections in Highlights of the key issues).

Poland has also negative trade balance with Sri Lanka and Zimbabwe, and insignificantly positive balance in trade relations with Zambia (see Table 5.1. below).

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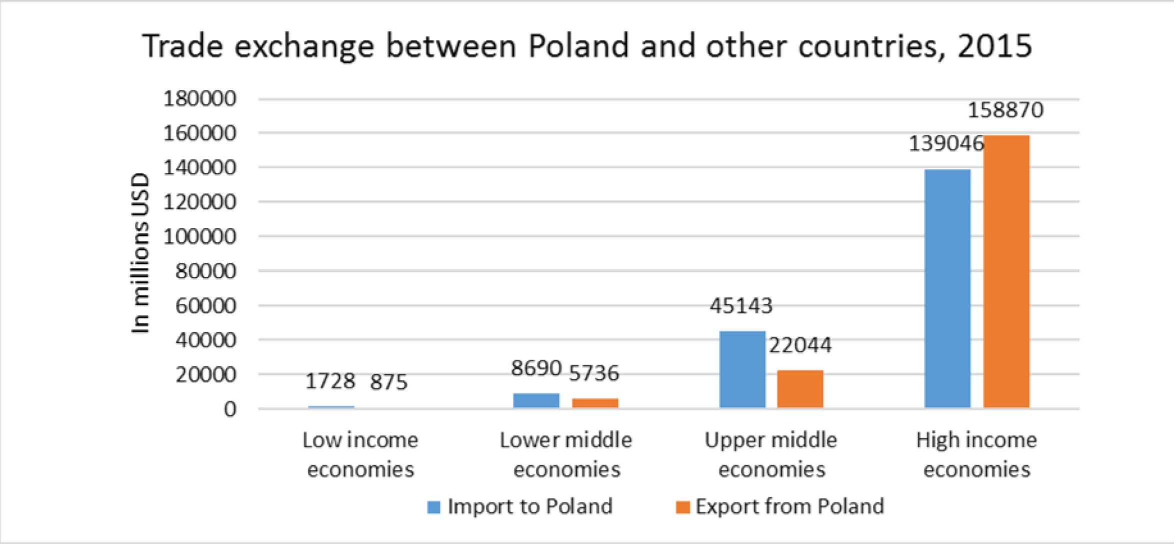
[88] Until 2015 Mongolia was classified as upper-middle income country.
[89] Available at: http://trade.ec.europa.eu/doclib/press/index.cfm?id=1449. See also: http://english.vietnamnet.vn/fms/business/161850/vietnam-among-five-promising-markets-for-poland.html
[90] Available at: http://en.ursus.com.pl/News/URSUS-CONQUERS-AFRICA-%E2%80%93-NEXT-IMPORTANT-CONTRACT-FOR-DELIVERING-AGRICULTURE-MACHINERY-TO-ETHIOPIA

Graph 5.2: Trade exchange of Poland with different groups of countries



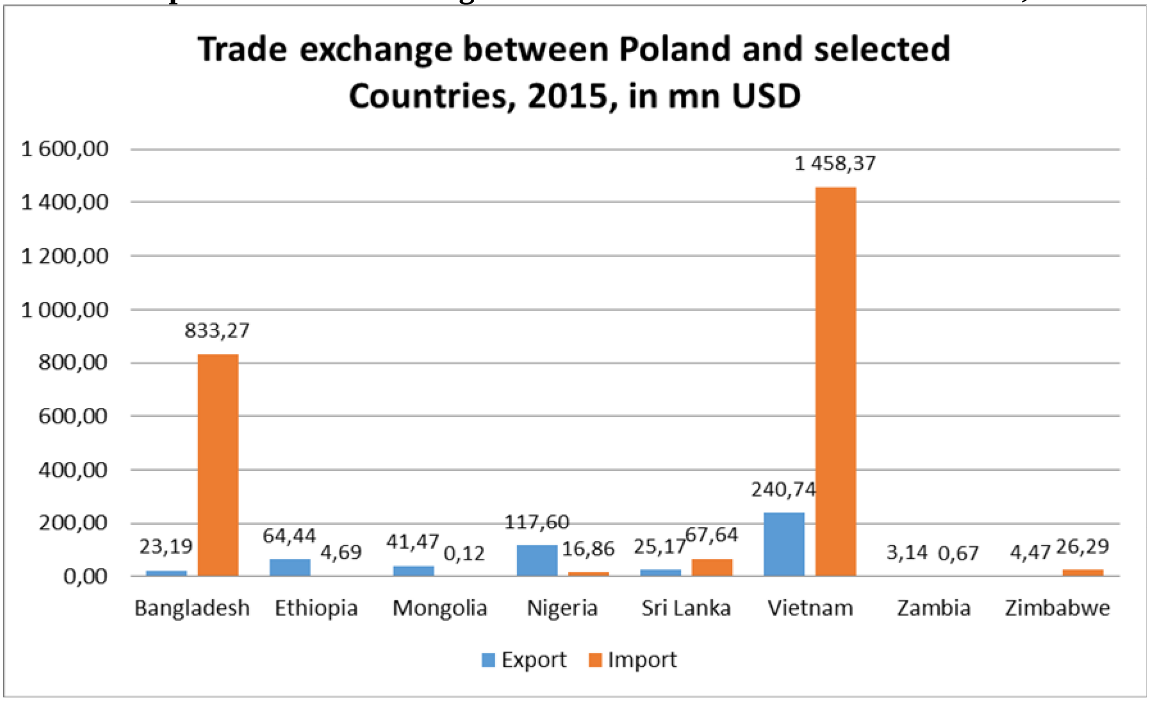
Source: Prepared by authors, National Bank of Poland, http://www.nbp.pl/home.aspx?f=/publikacje/pib/pib.html

Table 5.1: Poland Trade and Outward FDI with selected countries

Export and Import flows				***Outward FDI***			
in millions USD				Equity and Shares	Debt Instruments		Total
	Export	Import	Trade balance		Assets	Liabilities	
Bangladesh	23	833	-810	0,00	0,00	0,00	0,00
Ethiopia	64	5	60	0,00	0,00	0,00	0,00
Mongolia	41	0	41		0,05		0,05
Nigeria	118	17	101	0,74	2,72		3,46
Sri Lanka	25	68	-42	0,18			0,18
Vietnam	241	1 458	-1 218	13,02	0,26		13,28
Zambia	3	1	2				0,00
Zimbabwe	4	26	-22				0,00
Total	520	2,408	-1 888	13,94	3,02	0,00	16,97

Source:Prepared by authors, National Bank of Poland, http://www.nbp.pl/home.aspx?f=/publikacje/pib/pib.html

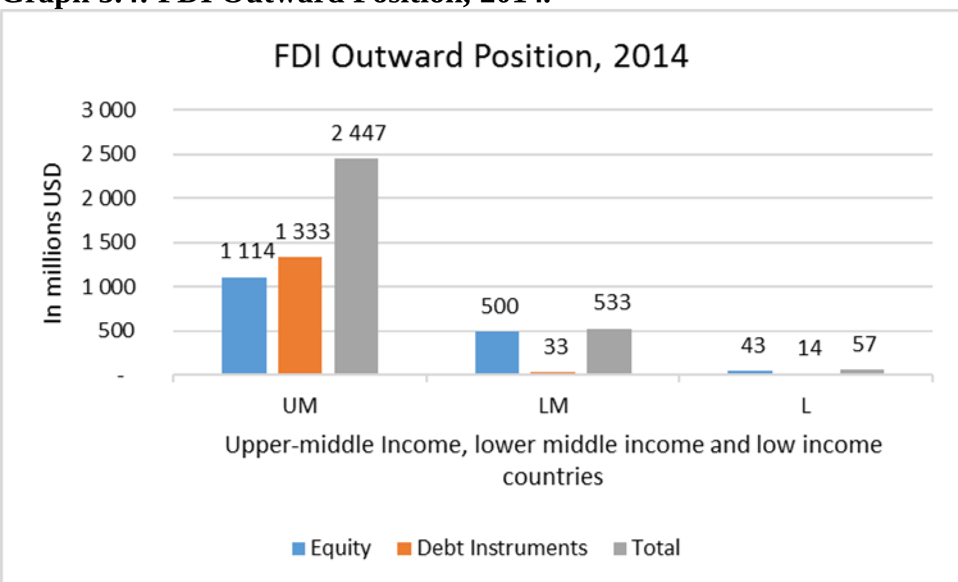
Graph 5.3: Trade exchange between Poland and selected countries, 2015



Source: prepared by authors, based on data available at http://atlas.media.mit.edu/en/profile/country/pln/

In relation to FDI positions, the authors used the data available for 2014 for the purposes of this work. From the Graph 5.4 below it can be observed that the total FDI outward position is caclulated on the basis of the totals for the equity capital and reinvested earnings, and also for the debt instruments. Similarly to all other CEE countries analysed in this report, Polish investments to the developing countries is geared to a major extent towards the upper-middle income countries, while only a small portion of investments go to the lower-middle income economies, with only insignificant level of investments being directed to the low income countries.

Graph 5.4: FDI Outward Position, 2014.



Source: prepared by authors, National Bank of Poland, *http://www.nbp.pl/home.aspx?f=/publikacje/pib/pib.html*

Among the upper-middle income countries, the major recipients of investments from Poland in 2014 were Russia (USD 793,1 million), Romania (USD 594,4 million) and Turkey (USD 258,1 million).

Among the lower-income countries, the investments were mainly carried out in a form of equity, where the major recipients were India (USD 256,8 millions), Liberia (USD 111,8 million) and Ukraine (USD 83,0 million). Among the low income countries, only Senegal received direct investments from Poland amounting to USD 56,7 million.

5.1.3. Domestic income taxation in Poland - background

Polish tax system has evolved since the early 1990s with the purpose of encouraging inward foreign investment. Currently, the Corporate Income Tax and the general withholding tax are at the rate of 19%.

The general domestic withholding tax (WHT) rate for dividends is also 19%. The withholding tax (WHT) rate on interest and royalties paid to non-residents is at the level of 20% (10% in regards to the maritime or air transportation). These WHT rates may be reduced by DTTs as applicable, however, if a treaty rate is higher than a domestic one, the latter should apply.

Similarly, a 20% WHT is levied on payments made to non-residents for intangible services (such as consulting services). However, if a payment is made to a country which has a DTT with Poland, the level of withholding tax may be decreased in accordance with the provisions of such treaty (e.g. article on Technical services fee). Such procedure can be employed if certain administrative conditions are met, i.e. the payer obtains a valid certificate of a fiscal residence of the payment recipient/beneficial owner.[91]

Nevertheless, it is worth noting that very few treaties allow payments for technical services to be taxed in the country of source. In the tax treaties reviewed in this report, only the tax treaties with Sri Lanka and Vietnam stipulate such provision.

Tax Treaty Adoption process

The procedures on concluding tax treaties by the Polish government are regulated by the Act on International Agreements from 14 April 2000.

The leading agency responsible for DTTs is the Ministry of Finance. After drafting of Polish and English version of the agreement, the MoF consults it internally with the relevant departments and externally with other ministries and the Governmental Centre for Legislation. This is followed by approval from the Prime Minister of the negotiation process, which allows for approaching authorities of the other contracting state with the proposal to negotiate/renegotiate the agreement.[92]

Once an agreement has been reached, and before the bill is submitted for approval to the President, the Parliament is notified about the draft bill. The Parliament directs such a bill to the relevant Commission for discussions.[93] If the Parliament submits negative opinion about the treaty within 30 days from notification, the Council of Ministers is required to review the treaty again. After approvals of the treaty by the President, the Ministry of Foreign Affairs authorises signing of the tax agreement. If the negotiated language version of the treaty is not Polish, it is translated into Polish, and sent again for internal and external consultantions and

[91] Retrieved from: http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Poland-Corporate-Withholding-taxes
[92] See Article 14 of the Act on International Agreements from 14 April 2000.
[93] Details of draft bills submitted to the Parliament are available here: http://www.sejm.gov.pl/Sejm8.nsf/proces.xsp?view=2

for approvals of the Prime Minister. The Council of Ministers signs a bill approving this treaty and submits it to the President for ratification.[94]

Finally, once both countries sign and ratify the treaty, the Ministry of Foreign affairs exchanges ratification notes with the country in question. After the ratification, the agreement is officially translated into Polish and subsequently is published in the Dziennik Ustaw (Legislative Journal) and in official administrative journal (Dziennik urzńdowy Monitor Polski).[95] The treaty is effective in 30 days after having been announced and published.[96]

5.2. Tax Treaty Network of Poland

According to the website of the Ministry of Finance, Poland has concluded tax treaties with 93 countries[97]. The historical first tax treaty was concluded with the USA in April 1974, and was followed by the tax treaties with Pakistan, France, Spain and Norway.

The most recent treaties are with Ethiopia, Sri Lanka and Taiwan (the first two pending ratification by their respective governments). The bill ratifying a new tax treaty with Taiwan has been signed in October 2016 in Taipei and has come into effect on 1st January 2017. The agreement with Ethiopia has been signed on 13 July 2015 and has been ratified in the end of May 2016 by the Polish government. To enter into force, the treaty must be ratified by Ethiopia.

These agreements (like most of the tax treaties concluded by Poland) include exchange of information clause, which ensures better transparency and effective tax collection for both parties.

While only a small part of tax treaties of Poland (mostly with high income economies) have ever been renegotiated, the Ministry of Finance of Poland has recently formulated plans for 2017 to tackle tax avoidance and money laundering, and to ensure policy coherence towards the developing countries.

The Ministry of Finance is currently taking the following steps:

- analyzing all treaties signed by Poland, identifying provisions that might be used for the purpose of aggressive tax planning;
- removing sparing credit provision from all of the treaties (this is planned for negotiations with - Philippines, Thailand);
- introducing a clause on real estate in new treaties. This is an anti-abusive provision assuring that the capital gains from sale of shares deriving their value from real estate are taxed in the country of source.
- introducing anti-abuse clause in all newly negotiated treaties. This is especially planned for the tax treaties with South Africa, France, Russia, Philippines, Thailand, Kuwait, Spain, Morocco, Brazil.
- signing to MIL (multilateral instrument). In June 2017 Poland has signed Multilateral Instrument that will modify bilateral tax treaties through one multilateral mechanism as a part of OECDôs BEPS project (Base Erosion Profit Shifting).

[94] See Article 15 of the Act on International Agreements from 14 April 2000.
[95] See Article 18 of the Act on International Agreements from 14 April 2000.
[96] The information in this section is based on the Act on International Agreements and email exchange with the Ministry of Finance.
[97] Retrieved from the website of the Ministry of Finance of Poland, available at: http://www.finanse.mf.gov.pl

These are reasonable plans in respect to enhancing of the tax treaty policy towards developing countries. Nevertheless, the authors wish to point out that from the perspective of cohesion of development aid policy, it is concerning that no spill-over analysis has so far been conducted to investigate the financial impact of tax agreements between Poland and developing countries. Such analysis would be recommended in order to provide evidence of whether and to what extent tax agreement are aligned with the Polish international development commitments.

It is worth pointing out that Polish international tax policy relies strongly on the OECD BEPS project, which demonstrates limited efforts to address the needs of developing countries. The OECD BEPS project bases the tax policy on the OECD Model Tax Convention (MTC), which, as explained further in the report, includes more favorable provisions for the country of residence (usually ï a developed country), and is more restrictive towards the country of source (usually a developing country).

While the current Multilateral instrument (MIL) is based on OECD MTC, the authors appreciate some potential benefits that the developing countries could obtain from the MLI as many of the bilateral tax treaties may contain even more harmful provisions than the OECD MTC does.

5.3. Analysis of selected tax treaties

The following sections will map out and analyse specific provisions of tax treaties concluded between Poland and the developing countries. Each provision will be color coded based on the extent to which it is favorable toward a country of source (i.e. a developing country, marked with green and light green)), problematic (yellow) or harmful (orange or red) in terms of tax base and tax rights allocation.

The following tax treaties were selected for the analysis.

Table 5.2. Selected tax treaties of Poland with the developing countries

Country	**Signed on**	**Effective from**
Bangladesh	08.07.1997	01.01.2000
Ethiopia	13.07.2015	Under ratification process by Ethiopia
Mongolia	18.04.1997	01.01.2002
Nigeria	12.02.1999	Not ratified
Sri Lanka	6.10.2015[98]	Under ratification process by Sri Lanka
Vietnam	31.08.1994	01.01.1996
Zambia	19.05.1995	Not ratified
Zimbabwe	09.07.1993	01.01.1995

While most of these agreements came into effect by the time of writing this report, the tax treaties with Ethiopia and Sri Lanka are under ratification by the respective governments. It is worth noting that the Double Tax Treaty signed with Nigeria and Zambia has not been ratified up until now. Gazeta Prawna (Legal Newspaper) quotes lack of constitutional conditions of both countries for carrying out the ratification[99] as potential reason for such state of affairs.

[98] The first Treaty signed between Poland and Sri Lanka was in 25.04.1986. The treaty was subsequently renegotiated in 2015. This analysis is based on the tax treaty signed in 2015.
[99] Available at: http://podatki.gazetaprawna.pl/porady/633210,nie-wszystkie-podpisane-umowy-podatkowe-funkcjonuja-w-obrocie.html

5.4. Highlights of the key issues in Tax Treaty Network of Poland

The following table indicates the key issues in the selected tax treaties of Poland. For detailed interpretation of various issues identified in the treaties, please see comments below this table.

Table 5.3: Color Map of Poland

	Bangladesh	Ethiopia	Mongolia	Nigeria	Sri Lanka	Vietnam	Zambia	Zimbabwe
Signed on	8.7.1997	13.7.2015	18.4.1997	12.2.1999	6.10.2015	31.8.1994	19.5.1995	09.07.1993
Effective from	1.1.2000	14.6.2016	1.1.2002	Not ratified	Not ratified	1.1.1996	Not ratified	1.1.1995
Article 5/3 Construction PE ï time	>6 months	> 9 months	>12 months	>3 months	>6 months	>6 months	>9 months	>9 months
Article 5/3 Supervisory activities	Absent	Absent	Absent	Present	Present	Present	Present	Present
Article 5/3 Services PE	Absent	Absent	Absent	Absent	>6 months	>6 months	Absent	Absent
Article 5/4 Delivery	UN	OECD	OECD	OECD	UN	UN	OECD	OECD
Article 5 ï Agency PE	UN	OECD	OECD	UN	UN	UN	OECD	OECD
Article 5 ï Insurance PE	Absent	Present	Absent	Absent	Present	Present	Absent	Absent
Article 7 Limited Force of Attraction	Absent	Absent	Partially present	Present	Absent	Present	Absent	OECD
Article 7/3 Limits to deductibility	OECD	OECD	OECD	UN	OECD	UN	OECD	OECD
Article 7/5 No Profit for purchasing	OECD	OECD	OECD	OECD	OECD	UN	OECD	OECD
Article 8 International Transport	UN	OECD, Includes rents	OECD	UN	UN	OECD	OECD	OECD
Article 10 Dividends	10/15%	10%	10%	10%	10%	10%/15%	10%/15%	10%/15%
Article 11 Interest	10%/0%	10%	10%, 0%	10%	10%/0%	10%	10%	10%
Article 12 Royalties	10%	10%	5%	10%	10%	10%/15%	10%	10%
Article 13 Sale of Shares RE	Absence of the rule	OECD	OECD	OECD	Mix OECD and UN	Better than OECD	OECD	OECD
Technical services	Absent	Present, 10%	Absent	Absent	Present, 10%	Absent	Absent	Absent
Article 14 Indepent Personal	Present	Present	Present	Present	Present	Present	Present	Present

Services								
Article 16 Director's	OECD	OECD	OECD	OECD	OECD	OECD	OECD	OECD
Article 21 Other Income	UN	UN	UN	UN	UN	UN	OECD	OECD
Other articles		Contains LoB clause			Contains LoB clause			

Source: Prepared by authors

The key issues in the selected tax treaties of Poland can be summarised as follows:

5.4.1. Permanent establishment definition

The concept of permanent establishment is important in that it allows country of source to levy tax on the business profits of the enterprise of a contracting state. In case of absence of permanent establishment of non-resident in the country of source of an income, the taxing rights with respect to the business profits earned by such non-resident are allocated exclusively to its country of residence. The definition of permanent establishment can be found in Article 5 of DTAs. Where the definition of the permanent establishment is broader – the country of source (mostly developing country) is allowed to tax more income and where this definition is narrower, the taxing rights of the source country are further limited. Permanent establishment is generally considered to arise when the business activities of non-resident continues on the territory of the state from fixed business premises for a certain period of time. In addition, there are special rules regulating creation of permanent establishment in particular sectors of business, such as in construction and related activities, provision of services, insurance and other types of activities.

5.4.1.1. Construction Permanent Establishment

A half (4 out of 8) of the reviewed tax treaties signed by Poland stipulate the minimum period for Construction permanent establishment to be defined as equal or shorter than 6 months.[100] Such minimum period is in line with the United Nations Model Tax Convention. Other three reviewed tax treaties stipulate the threshold of 9 months, while one of the treaties (with Mongolia) contains the OECD MTC provision, where the time test is 12 months.[101] The provision limits Mongolia's capacity to tax the construction activities of Polish companies performed on its territory and may lead to a loss of tax revenue. Additionally, tax treaty with Mongolia does not include supervisory activity as within the definition of Construction PE.

On the other hand, 5 out of 8 reviewed treaties include supervisory activities as a part of the Construction PE definition. This provision is recommended by the UN MTC and it allows countries of source to also tax the supervisory activities carried out in relation to construction projects. Thus, the prevailing tendency of the Polish DTA's in respect to the construction PE is generally positive, with exception of the Mongolian treaty.

5.4.1.2. Services Permanent Establishment

The Services Permanent establishment provision allows the country of source to levy tax on companies providing services for a longer period of time. In this study, 6 out of 8 reviewed tax treaties do not contain such provision, thus preventing the countries in question to levy tax

[100] See tax treaties of Poland with Bangladesh, Nigeria Sri Lanka and Vietnam.
[101] Tax Treaty between Poland and Mongolia.

on services.[102] Special provision on technical services, while being favorable from developing country perspective, is only included in tax treaties with Sri Lanka and Vietnam.

The absence of Services Permanent establishment and also technical services provision in most of the tax treaties reviewed can be highlighted as a critical issue, because it significantly limits rights for the country of source to levy tax on international providers of services established in the country of source. This is in contradiction with the UN MTC recommendations, which provides for both provisions ï the Services PE provision and the Technical services provision (the most recent recommendation).[103]

5.4.1.3. Delivery activities as a part of Preparatory and Auxiliary Activities

The taxing rights for the country of source can be further limited by provision allowing certain preparatory and auxiliary activities to be treated as not giving a rise to a permanent establishment. Such exceptions for creation of a permanent establishment status are frequently abused, whereby the business activities are structured in a way to take advantage of these provisions.[104]

In this respect, the UN MTC restricts the use of such exception, whereby the activities consisting of delivery of goods and merchandise are considered as not qualifying as preparatory and auxiliary activities.

However, 5 out of 8 tax treaties reviewed in this study do not follow the UN MTC provision. Instead OECD MTC is pursued, which effectively allows the Polish companies to escape the PE status, even if they deliver goods in the given developing countries. The only countries that managed to negotiate favorable conditions under this article are Bangladesh, Sri Lanka and Vietnam.

5.4.1.4. Agency Permanent Establishment

Both Model Tax Conventions, the OECD and the UN ones contain provision stipulating the PE status, where another person acts on behalf of an enterprise and also has and habitually exercises the right to conclude contracts in the name and on behalf of the enterprise. This type of taxable presence is called the agency permanent establishment.

The UN MTC further broadens this notion and, consequently, also the taxing rights of the country of source, by including into the definition of PE status to situations where another person delivers goods and merchandise belonging to the enterprise.

In this respect, only 4 out of 8 of the reviewed tax treaties include such extended notion.[105] Thus, in the other half of the tax treaties the taxing rights of the country of source are limited.

5.4.1.5. Insurance Permanent Establishment

The UN MTC also contains another provision broadening the possibility of country of source to levy taxation on insurance companies, who collect insurance premiums on the territory of the source country.

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[102] See tax treaties of Poland with Bangladesh, Ethiopia, Mongolia, Nigeria Zambia and Zimbabwe.
[103] See for instance, Doc. E/C.18/2016/CRP.1, Committee of Experts on International Cooperation in Tax Matters Seventh session dated 11-14 October 2016, Item 3 (a) (vi) of the provisional agenda Taxation of Services, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf
[104] See for instance OECD report on Action 7 of BEPS project: Avoidance of PE Status
[105] See the tax treaties with Bangladesh, Nigeria, Sri Lanka and Vietnam.

In this respect, majority of the reviewed tax treaties - namely 5 out of 8 do not contain such a provision extending PE definition. However, Ethiopia, Sri Lanka and Vietnam were able to include this clause into their tax treaties with Poland.

5.4.2. Business profits

5.4.2.1. Limited Force of Attraction

The Article 7 paragraph 1 contains the principle to tax business profits. Under the OECD MTC, this article permits the country of source to tax the business profits attributable only to the permanent establishment.

On the other hand, the UN MTC contains a rule that allows for broader taxing rights of the country of source. In addition to the profits attributable to the permanent establishment, the Article 7, paragraph 1 of the UN MTC allows also for taxation of profits earned by the non-resident enterprise directly from the sources of the same state if such profits constitute:

- the sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or
- other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

As a result, the UN MTC significantly broadens the taxing rights of the country of source.

In this respect however, only 3 out of 8 reviewed tax treaties (Mongolia, Nigeria and Vietnam) contain this extended UN MTC provision. Herewith, the tax treaty with Mongolia is only partially following the UN Model, because it includes only the profits of the non-resident enterprise from the sale of goods that should be attributable to the PE, but not the profits it may earn from other types of activities. The remaining five treaties under the review include the terms of OECD MTC, which grants limited taxing rights for the country of source.

5.4.2.2. Limits to separate entity notion and limitation of deductibility of intra-company charges

The OECD MTC contains another specific notion deeming the permanent establishment being a part of the foreign enterprise to be treated as a separate entity when it is dealing with other parts of the enterprise for the purpose of attribution of profits.[106] This leads to allocation of profits to the permanent establishment on the basis of separate entity principle ï similar to the armôs length principle used in transfer pricing.[107]

While the UN MTC, contains the same terms in paragraph 1 and 2 as OECD MTC prior the changes in 2010, it is nevertheless limited by a further provision of Art 7 paragraph 3. It provides that there should be no deduction for notional charges between the head office and the permanent establishment for payments, which could be otherwise charged for the use of intangible property, capital or commissions between the two parts of the enterprise. This leads to a bigger tax base allowed for the permanent establishment, since the tax base cannot be eroded by such notional payments.

Out of 8 reviewed tax treaties, however only 2 tax treaties (with Nigeria and Vietnam) contain this UN MTC limitation, which may restrict the Polish companies from claiming deductible charges for such notional payments between the head office and the permanent establishment.

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[106] See Article 7 paragraph 2 of OECD and similarly in UN MTC.

[107] See OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2010.

5.4.2.3. No profit for Purchasing activities

Article 7 paragraph 5 under the OECD MTC contains a restrictive rule, which can limit the tax base of the country at source for profits attributed to a permanent establishment in respect to purchasing activities that it performs for the enterprise. The OECD MTC stipulates that no profit should be attributed for mere purchasing activities.

On the other hand, the UN MTC does not provide for such limitation of the tax base. This means that the permanent establishment involved in purchasing activities, for instance buying commodities in developing countries should be actually remunerated with profit for purchasing these goods in the developing country. Such provision would be reasonable, given that companies make not only profit as a result of sales activity. Sourcing and purchasing of commodities may also significantly contribute to the overall profit.

In this regard, however, 7 out of 8 tax treaties in question contain the limiting rule suggested in OECD MTC, which means that developing countries in most cases are not entitled to attribute the profits to the PE for the purchasing activities it carries out for non-resident. In this case, again Vietnam was successful in stipulating less restrictive UN MTC clause in its agreement with Poland.

5.4.3. International Transport

Article 8 contains rule in respect to taxing profits from operations on international transport (land, air and maritime), where the OECD MTC gives exclusive taxing rights to the country of residence of the transport enterprise (i.e. the country where the place of the effective management of the enterprise is located). On the other hand, the UN MTC provides some limited taxing rights to the country of source in respect to the profits from operation of ships.

Additionally, the situation of developing countries may be made even worse, if the tax treaty allows for allocation of the profits from rental of boats or containers only to the country of residence.

In this case, only 3 out 8 tax treaties reviewed (namely, Bangladesh, Nigeria and Sri Lanka) contain the UN MTC provision and the remaining 5 contain the OECD MTC provision and one (Ethiopia) includes also the more restrictive provision allocating the profits from rental of boats and containers to the country of residence.

5.4.4. Dividends

Article 10 contains a rule on limitations of taxes levied on dividends, where the country of source is allocated limited taxing rights. While OECD MTC recommends 5% tax rates on companies holding shares of the enterprise and 15% on all other dividends, the UN MTC proposes similar limitations without specifying the applicable tax rate ï that is to be determined in bilateral negotiation.

In the sample group studied, all the tax treaties include 10% tax or even more on the dividends distributed to the shareholders of the enterprise. However, tax treaties with 3 countries include 10% rate as the sole rate for dividends,[108] without thus distinguishing whether the shareholder is a major or portfolio investor. On one hand, the reduced rate provided to kinds of shareholders may be a positive sign since it minimises the effect of

[108] See the tax treaties with Ethiopia, Mongolia and Sri Lanka.

economic double taxation, from another point of view as long as the tax base of the developing country is at stake, it may be harmful taken that domestic tax rules (both for determination of tax base and tax rate) may not be strong enough to assure proper taxation of corporate profits at the level of the payee company and the higher rate reserved in the treaty may slightly improve the situation for the developing country.

Additionally, even the OECD is currently recommending to limit the provision of the reduced rate on dividends only to qualified shareholders, whose qualifications are based on the percentage of shares owned by a shareholder, as well as the duration of such ownership.[109] The authors of the report however do not see this as a critical issue, because the 10% tax rate is relatively high, and falls in between the commonly employed 5% and 15% rates.

5.4.5. Interest

Article 11 stipulates taxation of interest, where the taxing rights of the country of source are diminished by provision on the maximum tax rates that can be levied on the interest. Similarly, to the case of dividends, OECD MTC sets a ceiling on tax rate on interest rate at 10%, while the UN MTC does not specify specific rate limits.

In this study, 6 out of 8 tax treaties contain provisions, which are considered as not harmful to the country of source, while 2 tax treaties[110] contain provisions, which could be potentially harmful and would limit the taxing rights of the country of source. For instance, the interest paid to any kind of resident of the other state on debt or loans guaranteed by certain state institutions of that state may be except from withholding taxation in the country of source. These exemptions may be abused in practice and country of source may lose the taxing rights.

5.4.6. Royalties

Article 12 contains provisions on taxation of royalties. As per the OECD MTC, the taxing rights for payments of royalties on various artistic, scientific and commercial work are given exclusively to the country of residence, which deprives the country of source of its taxing rights. Contrary to this rule, the UN MTC allows for allocation of limited taxing rights to the country of source. whereby the maximum tax rate that can be levied. In addition, the UN MTC broadens the definition of royalty to include the income from rental of movable property ï scientific, commercial and industrial equipment, which further broadens the taxing rights of the country of source.

In case of the royalty provisions, all the tax treaties concerned contain broader and more favorable UN MTC provision, where country of source is allowed to tax the income in the form of royalty at the tax rate of 10%, however one of the tax treaties (Mongolia) contains a reduced tax rate of 5% only.

5.4.7. Capital Gains from sale of shares of real estate companies

Article 13 contains a rule in respect to taxation of capital gains. Especially important is a provision addressing taxation of capital gains from sale of shares of companies deriving value from a real estate.

Both, the UN and the OECD MTC contain a rule, which provides for a taxing right of the country at source ï where the real estate is located, when the value of shares sold is derived

[109] See the OECD recommendations as part of final report on Action 6 Prevent and limit abuse of tax treaties.
[110] See tax treaties with Bangladesh, Mongolia and Sri Lanka.

from this real estate. It must be pointed out however, that the UN MTC surprisingly contains a harmful provision, which may restrict the taxing right of the country of source, where the real estate is used in business activities of the company.

In this regard, 7 out of 8 tax treaties reviewed contain the OECD provision without a harmful element suggested in the UN MTC. Thus, in most tax treaties studied, the developing countries in question are not restricted in exercising their taxing rights. Interestingly, the tax treaty with Vietnam contains more favorable provision than the one suggested by the OECD, allowing the country of source to tax all the capital gains from sale of any type of company shares.

However, one of the reviewed tax treaties (Bangladesh) does not contain any specific rule on taxation of capital gains from the sale of shares.[111] This, consequently leads to taxation of the capital gains solely in the country of residence due to the provision included in that treaty. This provision is similar to MTC OECDôs paragraph 5 in article 13, which allocates exclusive taxing right to the country of residence in all cases, for which the special rule is not provided under article 13.

5.4.8. Technical services

Some tax treaties may contain special rule allowing the country of source to levy tax on the technical services, which significantly broadens the taxing right of the developing country. Example of such a rule is contained in the South African Development Community MTC. Most recently, it has been introduced to the UN MTC.

Out of the 8 reviewed tax treaties, however, only two tax treaties, i.e. Ethiopia and Sri Lanka contain such a provision.

5.4.9. Independent Personal Services

Article 14 of the UN MTC stipulates a special rule allowing the country of source to levy tax on the income from independent personal services (including amongst others activities of physicians, lawyers, engineers, accountants etc.). This rule has been deleted from the most updated OECD MTC (2014). As a result, OECD MTC provides that the Article 7 on business profits should apply instead, which consequently provides for limited taxing rights for a country of source.

In terms of the sample studied, all the reviewed tax treaties contain favorable provision as recommended in the UN MTC, whereby the developing country is not restricted by the Article 7 in taxing the income from independent personal services.

5.4.10. Director fees

Article 16 of both OECD and UN MTC contains the provisions regulating taxation on directorôs income. In both Model Conventions this article provides for taxing right to the country of source. The OECD MTC however restricts this rule only to directors who are members of the board of directors, while the UN MTC broadens this rule also to incorporate the top managers of companies.

[111] See the tax treaty with Bangladesh.

In this respect, all 8 reviewed tax treaties contain the restricted rule of OECD MTC, rather than an extended version as per the UN MTC.

5.4.11. Other Income

Article 21 contains rules for taxation of other income, which was not addressed specifically in the other articles of the DTAs. The OECD MTC provides for exclusive taxing right of the country of residence, restricting the country of source to levy tax only income attributable to the permanent establishment. On the other hand, the UN MTC contains a rule, which allows the country of source to tax any other income, which has a source in the country.

In this respect, 6 out of 8 reviewed tax treaties contain a rule based on the UN MTC,[112] while 2 out 8 tax treaties contain the rule based on the OECD MTC.[113]

5.5. Conclusions and Recommendations

Analysis of the above tax treaties suggests divergent results in negotiating the tax treaties between Poland and the selected developing countries (Bangladesh, Ethiopia, Mongolia, Sri Lanka, Vietnam, Nigeria, Zambia, Zimbabwe). While in many cases Poland tended to include more restictive MTC OECD clauses in tax treaties with its developing country counterparts (as it is the case for Article 7 Business Profits and some parts of the Article 5 ï Permanent establishment rules), in other circumstances more favourable MTC UN rules are generally followed. Most notably the clauses suggested by MTC UN on Dividend (Art. 10), Sale of Shares (Art 13.), and Independent Personal Services (Art 14) have been included in all of the studied agreements.

Herewith, the authors believe that the use of UN MTC provisions in some articles may be explained by several factors. For instance, the presence of article 14 on Independent Personal Services in all reviewed treaties may be explained by the fact that it was for a long time present in the OECD MTC, and thus is not the UN inspired provision, and therefore it may have been included in the Polish national model for negotiation of tax treaties. Secondly, the use of more favourable provisions in terms of Article 13 Capital gains again may have not been intended by Poland, but rather it has been accidental and simply used by Poland from the template of the OECD MTC. Finally, in exeptional cases, some of the UN inspired provisions included in the Polish tax treaties, are likely the result of negotiation efforts on the part of the developing country counterpart, rather than being an initiative of Poland.

Key research findings

The reviewed tax treaties of Poland contain number of restrictive provisions, which limit taxing rights of the developing countries. Such restrictive provisions include the following:

- The key issues identified in the tax treaty review are related to Articles 5 and 7, regulating taxation of business profits.
- Restrictive definitions of Permanent Establishment. This further limits capacity of source countries to levy tax on enterprise established in the country, which does not fall under the definition of the PE.
- Long time tests thresholds (at least 9 to 12 months) given for construction or installation project to constitute the Permanent Establishment. This clause prevents

[112] See the tax treaties with Bangladesh, Ethiopia, Mongolia, Nigeria, Sri Lanka and Vietnam.
[113] See the tax treaties with Zambia and Zimbabwe.

the country of source from taxing construction projects lasting below this minimum threshold in half of the treaties examined.

- Absence of supervisory activities clause in the Construction PE provision in 3 out of 8 of the treaties.
- Absence of services permanent establishment clause in 75% of the reviewed tax treaties.
- Absence of agency PE provision in cases where agent delivers goods and merchandise on behalf of the enterprise for half of the treaties investigated.
- Delivery of goods and merchandise being considered a preparatory, and thus non-taxable activity in 63% of the treaties studied.
- Absence of limited force of attraction clause in Article 7 in 5 treaties examined.
- Absence of clause limiting deductibility of intra-company charges in 75% of the tax treaties.
- Presence of a special clause restricting the tax base of permanent establishment in cases of carrying out purchasing activities (Article 7 para 5).
- Most tax treaties follow the OECD MTC rather than UN MTC in respect of the provisions dealing with International transport (Article 8) and taxation of directorôs fees (Article 16).
- Most tax treaties do not contain technical services provision advocated now by the UN MTC and some tax treaties restrict the taxing rights of developing countries in respect of the Other income.

Nevertheless, some favourable provisions from the developing country perspective can be also found in the treaties:

- Poland followed consistently favourable line towards developing countries in regards to clauses on Dividend (Art. 10), Sale of Shares (Art 13.), and Independent Personal Services (Art 14).
- In most reviewed tax treaties, the provisions dealing with taxation of royalties follow similar definitions to those under UN MTC.

Differences in negotiated terms across the countries

Interestingly, the sample group of signatory countries also exhibits differing capacities to negotiate advantageous terms. It emerges that Vietnam was able to negotiate the best terms of agreement with Poland, followed by Sri lanka, Nigeria, and Bangladesh. While Ethiopia has only recently signed a tax treaty with Poland, the treaty outcome may have mixed implications for its taxing capacity, with a number of clauses being based on MTC OECD and some of them on MTC UN framework.

The most harmful tax agreements from developming country point of view were concluded with Mongolia, Zambia and Zimbabwe. Interestingly, these restrictive treaties have been signed around the mid 1990s, at almost similar time when the tax treaty between Poland and Vietnam has been concludedc (1994), which gave Vietnam the most favourable terms of agreement in this sample. This may imply that Poland follows MTC OECD as a default template, however is able to change that in exceptional circumstances, when the counterpart is successful at negotiating better terms.It emerges from this analysis that the likelihood of having a favourable tax treaty concluded with Poland depends largely on the political economy factors, such as negotiation capacities and strengths of the counterpart, as well as a history of political and trade relations beetwen Poland and the given country.

To illustrate the case, Poland has enjoyed strong political and economic relations with Vietnam since 1950s, turning Vietnam one of the most important trade partners of Poland in this region. Both, exports to and imports from Vietnam have noted double digit growth in 2014 (16% and 13% accordingly[114]) and it is a largest net exporter to Poland within the sample group. In addition, some Polish investors have provides some substantial FDI inflows to Vietnam. Vietnam has been also active in negotiating numerous tax treaties on avoidance of double taxation and it boasts portfolio of over 60 such treaties concluded with other countries. Furthermore, most recently Vietnam has signed Free Trade Agreement with the European Union, which will further enhance the position of Vietnam as country exporting its products into Poland. Consequently, it can be implied that over the years, Vietnam has prioritised and developed capacity to negotiate favourable trade and tax agreements with its important trading partners, Poland included.

On the other hand, in 2015 Ethiopia signed a tax treaty with Poland, which was prevalently based on less advantageous MTC OECD framework from Ethiopiaǿs perspective. The provisions on permanent establishment are more restrictive while the clauses on Business Profits (Article 7) and International Transport (Article 8) include provisions that may significantly limit Ethiopiaǿs taxing rights. Perhaps an explanation for such development may attributed to limited experience and capacities of Ethiopiaǿs tax administratin to conclude favourable tax agreements. Until recently[115], Ethiopia concluded only more than a dozen of double tax treaties. This can also indicate the tendency of Poland to use the OECD MTC when negotiating tax treaties with developing countries "by default", which should be perhaps addressed as a part of potential spill-over analysis.

The key recommendation for Poland

The following recommendations may be considered and explored:

- Commit the government and Ministry of Finance to carry out spill-over analysis of its existing and negotiated treaties against its likely impact on poverty reduction and revenue-raising potential of the developing counterparst.
- The spill-over analysis should also include the impact analysis of the recently signed OECD Multilateral Instrument on the tax arrangement with its signatories from the Global South.
- Develop a consistent policy for tax treaty negotiations and consider poverty reduction and revenue raising of the southern partners as one of the key goals.
- Ensure that the Polish negotiators follow the United Nations Model Convention as the "default" convention in negotiation of tax treaties with developing countries.
- Where the Ministry of Finance does not agree to follow the UN MTC, it should provide justification for such decision.
- Consider weaker capacities of the counterpart and ensure that the developing country partner is aware of what implications and impact each clause bears on its ability to maintain taxing rights.
- Consider provision of technical capacity building for the tax revenue administration of the developing country partner as a part of its development policy, for instance through funding of tax expert provision and promoting

[114] Retrieved from: http://hanoi.msz.gov.pl/pl/p/hanoi_vn_a_pl/c/MOBILE/aktualnosci/65_lat_temu_polska_nawiazala_stosunki_dyplomatyczne_z_wietnamem

[115] Retrieved from: http://fortuneofafrica.com/ethiopia/2014/01/22/double-taxation-agreements-in-ethiopia/

knowledge exchange on this issue between the univeristies/tax administration in both countries.

- In renegotiation of tax treaties, the developing countries should be offered to replace the existing provisions with provisions from UN MTC.
- Include anti-abuse clauses, such as Limitation of Benefits Clause in all tax treaties.

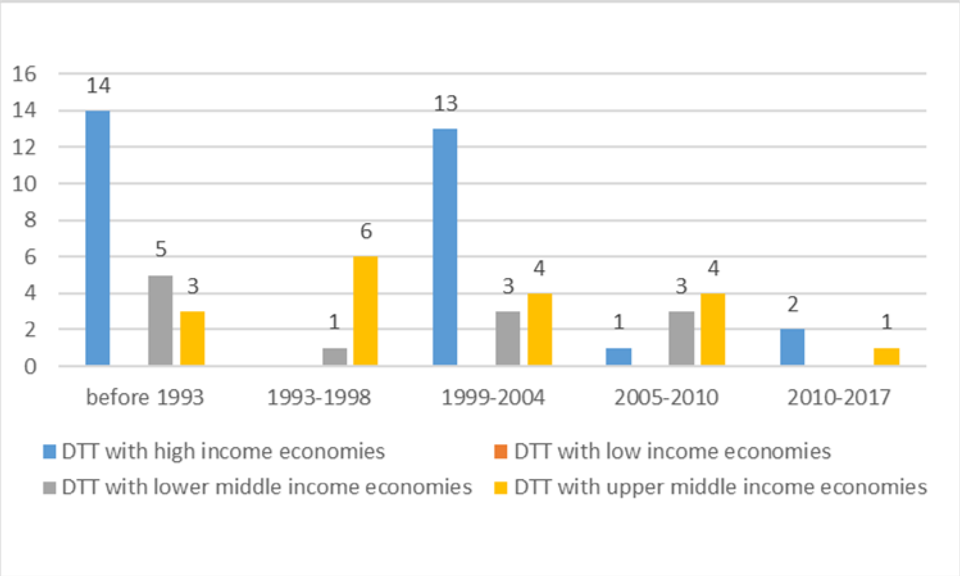
6. Country Chapter - Slovakia

6.1. Introduction

6.1.1. Tax Treaty Network of Slovakia ï brief statistical data

By the end of 2016 Slovakia had 66 tax treaties signed and entered into force.[116] Out of 66 enforced treaties, 30 may be classified as treaties with developing countries in accordance with the World Bank Classification.[117] The review of the existing network of treaties has indicated that Slovakia has no single treaty with the low income country such as countries of East and Central Africa or South Asia. The half of the treaties Slovakia has concluded are with the developed or high income counties, the majority of which were signed before 2004. In general, tendency shows that vast majority of treaties were concluded before 2004, where part was concluded when Slovakia and Czech Republic were the single state and another half in the first 10 years of the independence of the Slovak Republic. The significant number of treaties concluded during that period may be explained by expansion of economy of the former Czechoslovakia and later on, after the separation of states, by the will of Slovakia to attract foreign investors into the independent economy. The absence of treaties with low income countries and high number of treaties with developed economies may actually signify the fact that treaties in Slovakia are concluded on a need basis caused by economic and financial factors, rather than the will of the state to facilitate treaty shopping. The same may be supported by the low number of treaties concluded by the country after 2004 and only with selected jurisdictions. Further on in this report, the author will aim to support or oppose this view with further examination and review of statistical information on trade exchange and income flows between the contracting countries.

Graph 6.1: Number of DTTs with different types of countries



Source: created by authors

[116] See the statistics available at the webpage of the Ministry of Finance of Slovak Republic, available at: http://www.mfsr.sk/Default.aspx?CatID=8688 as of 29 December 2016.

[117] The category ñdeveloping countriesò covers the countries that fall into the World Bank´s categories of low-income, lower-middle income and upper-middle income countries (which covers the span of GNI per capita from USD 0 to USD 12 235. Please refer to https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

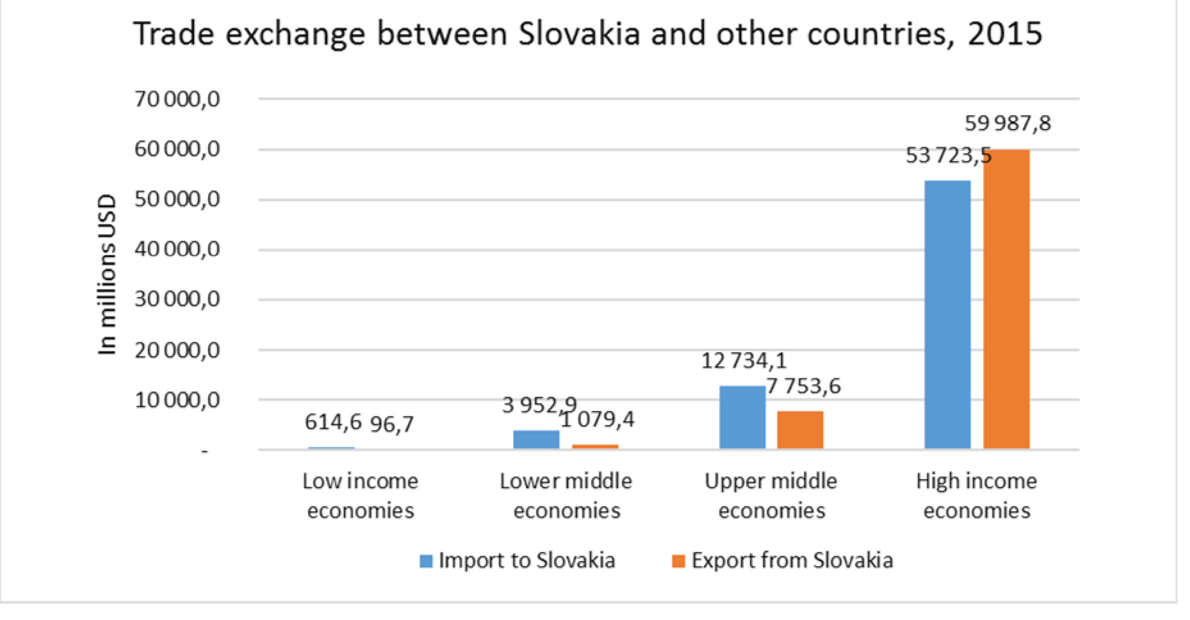
6.1.2. Economic relations of Slovakia with developing countries

Slovakia is the 40th largest exporter in the world with the top export products being the cars, video displays, vehicle parts, refined petroleum and vehicle bodies.[118] In 2015, the export from Slovakia amounted to USD 68,9 billion, while import amounted to USD 71 billion, making Slovakia a net importer with a negative trade balance of USD 2,11 billions.[119] The top export destinations of Slovakia are Germany (USD 15,2 billions), the Czech Republic (USD 7,66 billions), Hungary (USD 4,22 billions), Poland (USD 4,18 billions) and France (USD 4,13 billions).[120] The top import origins are Germany (USD 12,5 billions), the Czech Republic (USD 11,5 billions), China (USD 5,92 billions), South Korea (USD 4,55 billions) and Poland (USD 4,39 billions).[121]

As illustrated by the graph 6.2. below, with developing countries the majority of trade exchange comes with the upper midde income countries, where the amount of import to Slovakia is significantly impacted by China (USD 5,92 billions), Russia (USD 3,5 billions) and Romania (USD 1 billion).What concerns export from Slovakia, then the top destinations among upper middle economies are China (USD 1,4 billions), Russia (USD 1.69 billions) and Turkey (USD 0,9 billions). Among the lower middle income economies the leader importer to Slovaia is Vietnam with the share of USD 2,2 billions, and the top destination for export is Ukraine (USD 0,3 billions). With the low income economies the trade exchange is very low and in total import from these countries to Slovakia amounts to USD 0,6 billions and export from Slovakia therein roughly amounts to a bit less than USD 0,1 billions.

An interesting observation is that Slovaia results in net importer only because of the exceeding amount of import from developing countries over export from Slovakia therein, whereas in the relations with the high income (developed) countries export from Slovakia exceeds import by USD 6 billions.

Graph 6.2. Trade exchange of Slovakia with different groups of countries

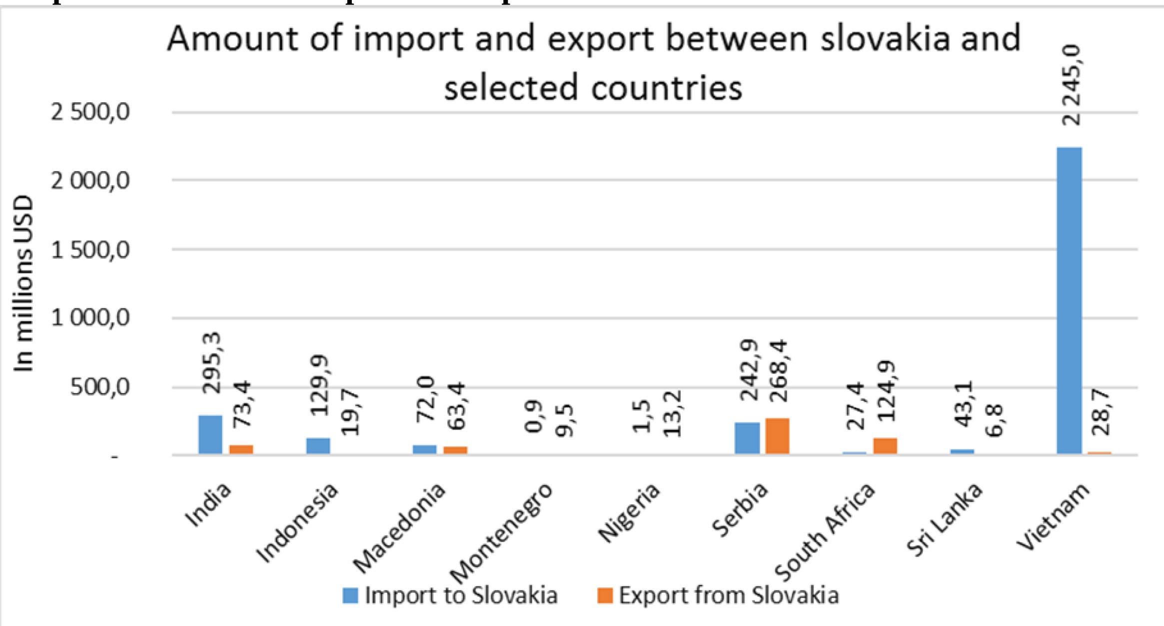


[118] Information is retrieved from http://atlas.media.mit.edu/en/profile/country/svk/ last accessed 2 August 2017.
[119] See Ibid.
[120] See Ibid.
[121] See Ibid.

Source: based on data available at http://atlas.media.mit.edu/en/profile/country/svk/

For the detailed treaty analysis were selected 8 tax treaties with developing countries, including: India (LMI), Indonesia (LMI), Macedonia (UMI), Nigeria (LMI), Serbia/Montenegro (UMI), South Africa (UMI), Sri Lanka (LMI) and Vietnam (LMI), out of which five represent lower middle income countries and three are representatives of the upper middle countries. In the graph below, the authors present an overview of trade exchange between Slovakia and these countries. The obvious leading importer among them is Vietnam, followed by India and Serbia. The top export destinations among these countries are Serbia, South Africa and India.

Graph 6.3: Amount of import and export between Slovakia and selected countries

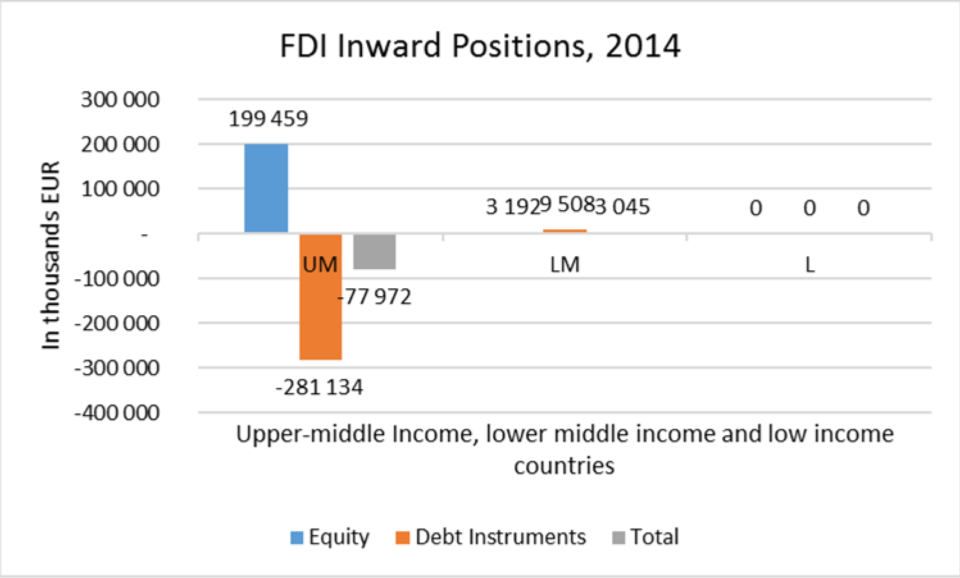


Source: based on data available at http://atlas.media.mit.edu/en/profile/country/svk/

What concerns FDI positions, then for the purposes of this work the authors used the data available for 2014. From the Graph 6.4 below it can be observed that the total FDI inward position in caclulated on the basis of amonts of equity capital and reinvested earnings, which in most cases in a positive number, and also the amount of debt instrumets, which in many cases is repsented by the negative amounts ï indicating that the amounts of intercompany loans given from Slovakia to the direct investor exceed the respective amounts given by that investor to Slovakia. Additionally, for some countries, the breakdown per types of direct investment is confidentail and only the total number of FDI is avalable.[122]

[122] Although, for some countries also the total inward FDI position is confidential. For instance, Albania, Montenegro, Mauritius, Belize, Azerbaijan, Lebanon, Jordan and Kazakhstan.

Graph 6.4: FDI inward positions, 2014[123]



Source: based on data available at: The National Bank of Slovakia, www.nbs.sk/en/

The study indicates that inward FDI from developing countries come to Slovakia mainly from countries, which are classified as upper-middle income countries. The inward FDI in this group are strongly influenced by positive equity investments from Argentina (EUR 99,6 million), Russia (EUR 37,02 million), Malaysia (EUR 32,9 million) and China (EUR 15,2 million), as well as negative debt flows from Slovakia to Russia (EUR -346,3 million). Much lower FDI amount comes from lower-middle income countries (mainly in a form of debt instruments from Vietnam) and zero FDI comes to Slovakia from low income countries.

With respect to outward investments, then again, the investments flow only to the lower-middle and high-middle income countries, with zero indicators for low income countries. Herewith, the outward FDI flows to lower middle income countries exceed the amounts to upper-middle income countries and on this graph are exclusively represented by FDIs to Ukraine, because for other lower-middle income countries, such as Morocco, Tunisia, Georgia, India and Vietnam the data is confidential. Among the upper-middle income countries, the major recipient of investments from Slovakia are Russia (EUR 17,3 million), Serbia (EUR 12,99 million) and China (EUR 18,5 million), whereas for some other countries of this group selected for analysis the data is protected as confidential ï e.g. Montenegro and Macedonia.

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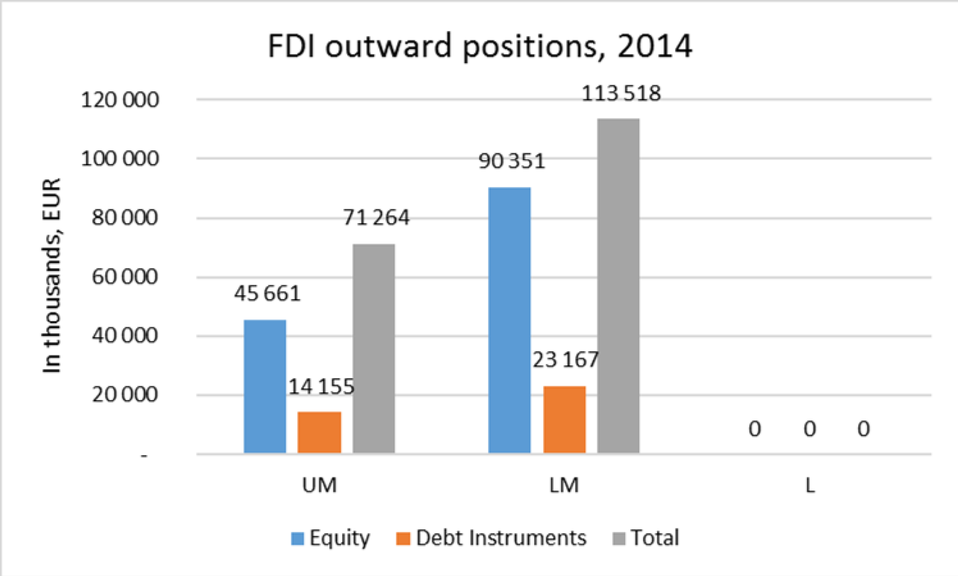
[123] UM (Equity)- does not include confidential data for Albania, Belarus, Bosnia and Herzegovina, Macedonia, Montenegro, Mauritius, Belize, Costa Rica, Panama, Colombia, Azerbaijan, Jordan, Lebanon and Kazakhstan.
UM (Debt)- does not include confidential data for Albania, Belarus, Bosnia and Herzegovina, Macedonia, Montenegro, Mauritius, Belize, Costa Rica, Panama, Colombia, Azerbaijan, Jordan, Lebanon and Kazakhstan.
UM (Total) - does not include confidential data for Albania, Montenegro, Mauritius, Belize, Azerbaijan, Lebanon, Jordan and Kazakhstan.
LM (Equity, debt and total) - does not include confidential data for Moldova, Nigeria and Armenia.

Graph 6.5: FDI outward positions, 2014



Source: based on data available at: The National Bank of Slovakia, www.nbs.sk/en/

6.1.3. Particularities of domestic income taxation in Slovakia

Slovakia levies taxation on outbound payments in form of interest and royalties at the rate of 19%. Slovakia however does not levy tax on outbound payments on dividends, as dividends have not been subject to tax until the end of 2016. Starting from 1.1.2017, dividends paid to or received from jurisdictions, which do not have tax treaty or other agreement containing provisions on exchange of information are subject to increased tax rate of 35%.

Slovakia also does levy withholding tax on the service payments where such services have been performed on the territory of Slovakia. Slovakia does levy taxation on capital gains from sale of shares at the rate of 22% from 2016, and 21% from the 2017.

Slovakia does not eliminate double taxation based on the domestic tax law, with the exception of individual persons ï employees, thus the only way to eliminate double taxation is based on the tax treaties. Tax treaties are thus critical for elimination of double taxation for any business or enterprise, where they derive income from abroad.

The tax treaties in Slovakia are negotiated by the Ministry of Finance, which may receive inputs and suggestions for tax treaty negations from other Ministries ï such as Ministry of Foreign affairs and Embassies in foreign countries. Furthermore, suggestions for negotiations do come from foreign governments and companies investing abroad.

National parliament is usually involved only in the stage of ratification of the tax treaty, however it may be informed about the intentions of the Ministry of Finance.

There is no evidence of assuring cohesion of development policies with the tax treaty negotiation policy.

6.2. Tax Treaty Network of Slovakia

Slovakia has concluded tax treaties with more than 66 countries. The very first tax treaty was concluded with the Netherlands in 1974 and was followed by tax treaty with France in 1975, followed by other tax treaties concluded during the period of joint state with Czech Republic (Czechoslovakia).

After separation and independence of Slovakia, starting from 1.1.1993, the first tax treaty concluded was the tax treaty with the USA (1993) followed by the tax treaties with the neighboring states Hungary (1995), Poland (1995) as well as Ukraine (1996). The tax treaty with the closest economic partner at that time, the Czech Republic, was also concluded in 1992, but was later terminated and replaced by the new treaty in 2002.

The most recent treaty, which was ratified and entered into force is with the UAE in 2017 with effective date from 1 January 2018, with Malaysia in 2016 with effective date from 1 January 2017 and with Armenia in 2017 with effective date from 1 January 2018. [124] Among the treaties, which were ratified by Slovakia, but are not applicable yet is the treaty with Iran.[125] Additionally, there is number of tax treaties currently being negotiated or being in the process of signature and ratification, out of which some of them are with the least developed countries ï such as Cuba, Ethiopia, Barbados.

6.3. Selected Tax Treaties subject to the analysis

The following sections will map out and analyse specific provisions of the Slovak tax treaties concluded with the developing countries. Each provision will be colour coded based on the extent to which it is favourable toward a country of source, i.e. a developing country (green and light green), problematic (yellow) or harmful (red) in terms of tax base and tax rights allocation.

The following tax treaties were selected for the analysis.

Table 6.1: Treaties selected for detailed analysis

		Signed on	Effective from
Vietnam		27.10.2008	1.1.2010
Sri-Lanka		26.7.1978	1.1.1979
South-Africa		28.5.1998	1.9.1999
Serbia/Montenegro (FYR)		26.2.2001	1.1.2002
Nigeria		31.8.1989	1.1.1991
Macedonia		5.10.2009	1.1.2011
Indonesia		12.10.2000	1.1.2002
India		27.1.1986	1.1.1985

6.4. Highlights of the key issues in Tax Treaty Network of Slovakia

The following table indicates the key issues in the selected tax treaties of Slovakia. For detailed interpretation of various issues identified in the treaties, please see comments below this table.

Table 6.2: Color Map of Slovakia

	Vietnam	**Sri-Lanka**	**South-Africa**	**Serbia/ Montenegro**	**Nigeria**	**Macedonia**	**Indonesia**	**India**
Signed on	27.10.2008	26.7.1978	28.5.1998	26.2.2001	31.8.1989	5.10.2009	12.10.2000	27.1.1986
Effective from	1.1.2010	1.1.1979	1.9.1999	1.1.2002	1.1.1991	1.1.2011	1.1.2002	1.1.1985

[124] See tax news update available at www.ibfd.org
[125] See tax news update available at www.ibfd.org

Article 5/3 Construction PE ï time	>6 months	>6 months	>12 months	>12 months	>3 months	>12 months	>6 months	>6 months
Article 5/3 Supervisory activities	Present	Absent	Present	Absent	Present	Absent	Present	+ 10% rule for sale
Article 5/3 Services PE	>6 months	Absent	Absent	Absent	Absent	>6 months	>3 months	Absent
Article 5/4 Delivery	UN	mostly OECD	OECD	OECD	OECD	OECD	UN	UN (but spare parts)
Article 5 ï Agency PE	UN	OECD	OECD	OECD	UN	OECD	UN	UN
Article 5 ï Insurance PE	Present	Absent	Absent	Absent	Absent	Absent	Absent	Absent
Article 7 Limited Force of Attraction	Present	Absent	Absent	Absent	Present	Absent	Present	Present
Article 7/3 Limits to deductibility	UN	OECD	OECD	OECD	UN	OECD	OECD	UN
Article 7/5 No Profit for purchasing	OECD	OECD	OECD	OECD	Mostly OECD	OECD	OECD	OECD
Article 8 International Transport	Includes rental	Mostly UN	Includes rental	OECD	Absent ï Art 7 applies	OECD	OECD	OECD, includes interest
Article 10 Dividends	5/10%	15%[126]	5/15%	5/15%	12,5/15 %	5%	10%	15/25%
Article 11 Interest	10%/0%	10%/0%	Exclusive to residence	10%	15%	10%, 0% only for governent	10%, 0% only for government	15%/0%
Article 12 Royalties	15/10/5 %	10%/0%	10%	10%	15%	10%	15/10%	30%
Article 13 Sale of Shares RE	OECD	Absent article	Absent article	Absent the rule	Absent the rule	OECD	Absent the rule	All shares
Technical services	Present,7 .5%	absent	Absent	absent	Absent	Absent	absent	Present, 30%
Article 14 Indepent Personal Services	present	Present	present	present	Present	Absent	3 months	3 months
Article 16 Directorśs	OECD	Absent	OECD	OECD	OECD	OECD	worse than OECD	UN
Article 21 Other Income	UN	Absent	OECD	OECD	UN	Only winnings	OECD (only some income)	UN

Source: Prepared by authors

The key issues in the selected tax treaties of Slovakia can be summarised as follows:

[126] There is a special rule for the contributions done to the companies of Sri Lanka before entry into force of this treaty.

6.4.1. Permanent establishment issues

The concept of permanent establishment is important in that it allows country of source to levy tax on the business profits of the enterprise of a contracting state. The definition of permanent establishment is to be found in Article 5 of DTAs. Where the definition of the permanent establishment is broader ï the country of source (mostly developing country) is allowed to tax more income and where this definition is narrower, the taxing rights of the source country are more limited.

6.4.1.1. Construction Permanent Establishment

Article 5 paragraph 3 contains a special rule for construction activities. The country of source may tax the income of foreign construction company, where the company has a permanent establishment in the source country, which is deemed to exist after certain period of time.

The OECD MTC provides for construction permanent establishment to exist only when the construction activities last longer than 12 months. On the other hand, the UN MTC contains a rule, which provides for the permanent establishment to exist already after the 6 month period of activities. The UN MTC thus provides for a rule that allows a lower time threshold for the country of source to tax the income of foreign company from the construction activities.

In this respect, only 5 out of 8 reviewed tax treaties contain a period for Construction permanent establishment which is equal or shorter than 6 months[127] and one of the 5 tax treaties contains a shorter period of 3 months,[128] while 3 out of 8 of the treaties contains the OECD MTC provision, where the time test is 12 months.[129] This provision limits the options of most of tax treaty partners to tax the construction activities of Slovakian companies performed on their territory and may lead to loss of tax revenue of the less developed countries.

On the other hand, 5 out of 8 reviewed treaties, contain the supervisory activities as a part of the Construction PE, which is in line with UN MTC and allows these countries to also tax the supervisory activities carried out in relation to construction projects.[130] In addition, one of the tax treaties also allows the taxation of such activities, which are incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery or equipment.[131]

Furthermore, 1 of 8 tax treaties reserve the special right for the country of source to tax the income derived in connection with exploration activities,[132] which in contrast to the extraction activities are not suggested as place of permanent establishment by either model. This option is only mentioned in the Commentaries to the OECD MTC.[133] Such provision allowing country of source to tax income from exploration activities is important for developing countries, where often the exploration activities are carried out and foreign service providers ï exploration companies carry out significant projects ï ranging in tens or even hundreds of millions for exploration services., If such a provision is absent, it may be argued by the

[127] See the tax treaty of Slovakia with India, Indonesia, Nigeria, Sri Lanka and Vietnam.
[128] See tax treaty of Slovakia with Nigeria, also for supervisory activities.
[129] See tax treaty of Slovakia with Macedonia, Serbia and Montenegro, South Africa.
[130] See the tax treaty of Slovakia with India, Indonesia, Nigeria, South Africa and Vietnam.
[131] See the tax treaty of Slovakia with India, article 5, paragraph 2(g).
[132] See the tax treaty of Slovakia with Indonesia.
[133] See the commentaries to the OECD MTC 2008 to the article 5 paragraph 2 in subparagraph 15.

taxpayer that exploration activity is only auxiliary to the main extraction activities and thus shall not lead to creation of permanent establishment.

6.4.1.2. Services Permanent Establishment

In respect of the Services Permanent establishment, which allows the country of source to levy tax on foreign companies, which provide services for certain period of time in country of source even in absence of a fixed place of business, 5 out of the 8 reviewed tax treaties do not contain this provision, which prevents most of these countries to levy tax on service providers.[134]

Alternative provision, which provides for even more taxing rights to source country in relation to provision of services is the technical services article, which is contained only in 2 of the 8 tax treaties,[135] including one, which also includes provision on services PE.[136]

The absence of Services Permanent establishment in 5 out of 8 reviewed tax treaties and also the technical services provision in most of the reviewed tax treaties can be highlighted as a critical issue, because it significantly limits the countries of source rights to tax the foreign service providers. This contradicts to the approach in the UN MTC, which provides for both ï the Services PE provision and also in its most recent recommendations includes the Technical services provision.[137]

6.4.1.3. Delivery activities as a part of Preparatory and Auxiliary Activities

The country of source taxing rights can be limited by provision, which allows certain preparatory and auxiliary activities to be treated as not giving a rise to permanent establishment. These exceptions from creation of permanent establishment status are frequently abused, where the business activities are structured in a way to take advantage of these exception rules.

In this respect, there is a difference in the list of activities that are considered as auxiliary and preparatory according to the UN and OECD MTCs. In particular, where the ñdeliveryò is considered as preparatory activity under the OECD MTC, it is not considered as such under the UN MTC. Consequently, under the UN MTC, activities of foreign taxpayers consisting of delivery of goods and merchandise to the territory of other country are considered not to qualify as preparatory and auxiliary activities and thus shall constitute a permanent establishment therein.

However, majority, namely 5 out of 8 of the reviewed tax treaties do not follow the UN MTC, but OECD MTC,[138] which shall in theory allow Slovak companies to escape the PE status abroad, while still having significant presence therein and deliver the goods in the less developed countries as part of their commercial sales and profitable business.

6.4.1.4. Agency Permanent Establishment

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[134] See the tax treaties of Slovakia with Indonesia, Macedonia and Vietnam.
[135] See the tax treaties of Slovakia with India and Vietnam.
[136] See the tax treaty with Vietnam, which contains both types of provisions - in article 5 paragraph 4 and article 13.
[137] See for instance, Doc. E/C.18/2016/CRP.1, Committee of Experts on International Cooperation in Tax Matters Seventh session dated 11-14 October 2016, Item 3 (a) (vi) of the provisional agenda Taxation of Services, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf
[138] See the tax treaties with Macedonia, Nigeria, Serbia/Montenegro, South Africa and Sri Lanka (partially).

As was noted earlier, both the OECD and the UN MTC contain provision, which deems the existence of PE, where another person, whether the legal or natural person, acts on behalf of enterprise and also has and habitually exercises the right to conclude contracts in the name and on behalf of that enterprise. This type of taxable presence is called agency permanent establishment.

The UN MTC contains broader definition of agency permanent establishment and also deems its existence when the person habitually maintains in the source state a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of that enterprise.[139]

In this respect only half ï namely 4 out of 8 of the reviewed treaties follow the UN MTC and include additional provision suggested therein.[140]

6.4.1.5. Insurance Permanent Establishment

With respect to permanent establishment of insurance companies, vast majority of the reviewed tax treaties - namely 7 out of 8 do not contain such permanent establishment provision and therefore almost exclusively follow the OECD model on this matter.[141]

6.4.2. Business profits

Article 7 contains rules determining the amount of taxable income of foreign enterprise in the country of source derived in a form of business profits. The general principle provides for exclusive taxing right of country of residence of the enterprise to tax such profits, unless such business enterprise has a permanent establishment in the country of source.

However even where foreign enterprise has such a permanent establishment in the country of source, the provisions of Article 7 can further limit the taxing rights of the source country. This is where Article 7 of the UN MTC contains less restrictive rules than the OECD MTC and works more in favor of the developing countries. Below the authors consider the peculiarities of this article in the Slovak treaties with selected countries.

6.4.2.1. Limited Force of Attraction

In this respect only half ï namely 4 out of 8 of the reviewed tax treaties follow the UN MTC provision and include the limited force of attraction rule,[142] which in addition to profits derived by the permanent establishment, allow also for taxation of profits derived from:

- b) sales in that source country of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or
- c) other business activities carried on in the source country of the same or similar kind as those effected through that permanent establishment.

The other half of the reviewed treaties provide for the OECD MTC, which provides only for the limited taxing rights of the country of source.

6.4.2.2. Limits to separate entity notion and limitation of deductibility of intra-company charges

[139] See Article5, paragraph b) UN MTC 2011.
[140] See the tax treaties of Slovakia with India, Indonesia, Nigeria and Vietnam.
[141] See the tax treaty with Vietnam, which is the only one out of selected, which includes the insurance PE and follow the UN MTC.
[142] See the tax treaties of Slovakia with India, Indonesia, Nigeria and Vietnam.

The OECD MTC contains a specific notion ï deeming the permanent establishment, which is part of the foreign enterprise to be a separate entity for the purpose of attribution of profits.[143] This leads to allocation of profits to the permanent establishment on the basis of principles ï similar to those of transfer pricing.

The UN MTC, contains the same principle. It however also contains a limitation of that principle, where in Article 7 paragraph 3, it specifically provides that there should be no deduction for notional charges between the head office and the permanent establishment for payments, which could be otherwise charged for the use of intangible property, capital or commissions between the two parts of the enterprise. This leads to a bigger tax base of the permanent establishment in the country of source, since the tax base cannot be artificially eroded by such notional payments.

In this respect, however, majority ï namely 5 out of 8 reviewed tax treaties contain the OECD MTC rule,[144] which may allow the Slovak companies to claim deductible charges for such notional payments between the head office and the permanent establishment in less developed countries.

6.4.2.3. No profit for Purchasing activities

Article 7 paragraph 5 of the OECD MTC contains a restrictive rule, which provides for limit of tax base, which could be attributed to a permanent establishment in respect of purchasing activities that it performs for the enterprise. In fact, the rule of the OECD MTC provides for principle that no profit should be attributed for mere purchasing activities.

On the other hand, the UN MTC does not provide for a such a rule. This means that the permanent establishment involved in purchasing activities ï e.g. purchasing commodities in developing countries should be actually remunerated by profit for such activities, which is reasonable taken that companies make not only profit as a result of sales activity, but sourcing and purchasing aspects may significantly contribute to the overall profit.

In this respect, however, all 8 out of 8 reviewed tax treaties contain the OECD MTC equivalent of this rule, which means the less developed countries in all cases are not entitled to tax these profits attributable to purchasing activities.

6.4.3. International Transport

Article 8 contains rule in respect of international transport. The OECD MTC contains provisions, which provide for exclusive taxing rights for country of residence (country where the place of the effective management of the enterprise is located). On the other hand, the UN MTC provides for two different models of article 8 devoted to international transportation: where model A reflects the OECD MTC provision, model B is slightly different and provides for a limited taxing rights in the country of source in respect of the profits from operation of ships in international traffic, should the shipping activities of foreign enterprise be more than casual in the country of source.

The situation of less developed countries may be further made worse, if the tax treaty contains specific provisions allocating the profits from rental (leasing) of boats or containers only to the residence country. Such a provision may be harmful, because while many developing

[143] See Article 7 paragraph 2 of the OECD MTC and similarly in the UN MTC.
[144] See the tax treaties of Slovakia with India, Nigeria and Vietnam.

countries may seek to reserve the taxing rights from the rental of equipment ï through extended definition of royalty, which includes also payment for industrial, commercial and scientific equipment, the version of Article 8, which includes the income from rental of boats and containers basically restricts country of source from taxing the income from such rentals.

In this respect only 1 out 8 of reviewed tax treaties contain the UN MTC provision[145] and one of the conventions does not contain this provision at all,[146] while the remaining 6 tax treaties follow the OECD MTC provision and three of them include also the provision allocating the profits from rental of boats and containers to the country of residence.[147] In addition one of the treaties also contain additional restrictive provision on country of source, which includes into the scope of Article 8 also income from interest.[148] This inclusion of interest into the scope of article 8 (International transport) further limits taxing rights of the country of source where the interest relates to funds used to purchase the airplane.

The absence of Article 8 in the tax treaty with Nigeria actually may allow country of source to exercise more taxing rights, because it could tax the profits based on Article 7, which in case of existence of permanent establishment would allow the country of source to tax the profits from transportation of activities even if these are from international transport.

6.4.4. Dividends

Article 10 contains a rule on taxation of dividends, where the country of source is allocated limited taxing rights in a way of limitation of tax rate. Some tax treaties may reduce taxation at source country down to 5% or even zero. In this respect, 1 tax treaty can reduce the withholding tax rate down to 0% but only in exceptional cases for contributions done before entry into force of that treaty, four - down to 5% for intercompany dividends,[149] while 3 of the 8 reviewed tax treaties allow the country of source to levy the withholding tax at the rate up to at least 10% on the distributed intercompany dividends paid to the shareholder, who is the beneficial owner.[150] The tax treaty with India keeps quite high rates, providing for minimum rate of 15% in case of qualified shareholder and 25% in all other cases.

In general, the provisions in the Slovak treaties with respect to dividends tax rate are not necessarily bad, because they all, although establishing the reduced rate of 5%, include the minimum conditions to be satisfied by the recipient ï such as, the beneficial ownership requirement and, in most cases, specify the amount of shares to be hold by the recipient. And the reduced rate of withholding tax on dividends contribute towards elimination of economic double taxation of corporate profits.

6.4.5. Interest

Article 11 contains a rule on taxation of interest, where the country of source is allocated limited taxing rights in a way of limitation of tax rate. Some tax rates may reduce the tax rate down to zero, or may contain potentially harmful exceptions to the main rule, as for instance the tax treaty of Slovakia with the South Africa, which provides for exclusive right of the residence state to tax interest income.

[145] See the tax treaty of Slovakia with Sri Lanka.
[146] See the tax treaty of Slovakia with Nigeria.
[147] See the tax treaties of Slovakia with Indonesia, South Africa and Vietnam.
[148] See the tax treaty of Slovakia with India, art. 8 paragraph 3.
[149] See the tax treaty of Slovakia with Macedonia, South Africa, Serbia/Montenegro and Vietnam.
[150] See the tax treaty with Indonesia, India, Nigeria.

With exception of tax treaty with the South Africa, all other Slovak treaties with selected countries provide for stable 10% or 15% withholding tax rate, which is standard and high enough.

However, 4 of the 8 reviewed tax treaties allow exemption from taxation at source should the interest in question be paid in relation to debt approved by the government of the contracting states or to their state institutions or such loans are approved or guaranteed by the state.[151] In theory such provisions may be abused, because in case government approves certain loan, the related interest paid thereof may be exempt from source taxation, while in fact it is paid to the commercial entity, which provokes unfair competition between taxpayers and also erosion of tax base in the source country. Among the 4 above mentioned treaties 3 may facilitate the same, namely: the tax treaties with India, Sri Lanka and Vietnam, whereas tax treaty with Nigeria only covers interest paid to state institutions with special purpose or state banks.

6.4.6. Royalties

Article 12 contains article on taxation of royalties, where based on the OECD MTC, the country of source loses the taxing rights, which are allocated exclusively to the country of residence. On the other hand, the UN MTC contains a rule, where the country of source is allocated limited taxing rights in a way of limitation of tax rate. In addition, the UN MTC broadens the definition of royalty to include the income from rental of movable property ï scientific, commercial and industrial equipment, which further broadens the taxing rights of the country of source.

In this respect, 6 out of 8 reviewed tax treaties contain the UN MTC provision, where country of source is allowed to tax the income in form of royalty with more than 10% tax rate and also contain a definition of royalty, which includes the rental of commercial, scientific and industrial equipment. The 2 other treaties, namely with Sri Lanka and Vietnam, provide for several rates depending on the type of royalty being paid. In case of Vietnam, it is 5%,[152] 10% and 15%, whereas the treaty with Sri Lanka also provides for exemption from taxation at source in case royalties are paid in relation to the use of, or for the right to use, any copyright or cinematograph films.

With exception of tax treaties which partially decrease the tax rates to 0 or 5%, the Slovak tax treaties are quite generous in respect of selected developing countries and it hard to say that any of them could facilitate erosion of tax base in developing countries through royalty payments.

6.4.7. Capital Gains from sale of shares of real estate companies

Article 13 contains a rule in respect of taxation of capital gains. Especially important is a provision addressing taxation of capital gains from the sale of shares of companies deriving their value from real estate. Both, the UN and the OECD MTC contain a rule, which provides for a taxing right of the country of source ï country where the real estate is located, when the value of shares sold derives the value from such real estate.

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[151] See the tax treaties of Slovakia with Vietnam, Sri Lanka, Nigeria and India.

[152] Applies only in case of consideration paid for the use of, or the right to use, any patent, design or model, plan, secret formula or process, or for information concerning industrial or scientific experience, or for the use of, or the right to use industrial, commercial or scientific equipment. See art. 12 paragraph 2(a) of the Slovak-Vietnam tax treaty.

It must be pointed out that the UN MTC surprisingly contains a harmful provision, which may restrict the taxing right of the country of source, where the real estate is used in business activities of the company.

In this respect, only 6 out of 8 reviewed tax treaties in general contain the special rule on taxation of capital gains, but only 3 of them includes specific provision on taxation of capital gain from shares, which derive their value from immovable property and in substance they follow the OECD MTC, allowing the source to tax the same irrespective of additional conditions.[153] On the other hand, 3 treaties contain the article but do not contain this specific provision on taxation of capital gain from shares deriving their value from the immovable property, which automatically grants the taxing right exclusively to the country of residence and restrict the country of source.[154]

One of the tax treaties, namely with the South Africa, does not contain article 13 at all, which leaves it for the discrepancy of the member state to qualify the income in a form of capital gains either as business profits in case of presence of PE or as other income, which in accordance with the given treaty provides for exclusive taxing right of the residence state.[155] Furthermore, the tax treaty with Sri Lanka also misses an article on taxation of capital gains, but in addition to this it also does not have an article on taxation of other income, which is not discussed under the treaty. In this case, the national legislation of the member states shall apply with respective types of income, providing no benefits, since nothing is envisaged in the treaty.

6.4.8. Technical services

Some tax treaties may contain a special rule allowing the country of source to levy tax on the technical services, which significantly broadens the taxing right of the developing country. Example of such a rule is contained in the South African Development Community MTC and also most recently was introduced in the UN MTC.[156]

Out of the 8 reviewed tax treaties, however, only 2 tax treaties contain such a provision.[157]

6.4.9. Independent Personal Services

Article 14 of the UN MTC contains a special rule containing provisions allowing the country of source to levy tax on the income from independent personal services. This rule has been deleted from the OECD MTC and the rules of Article 7 ï business profits should apply instead in case such provision is missing, which provides for limited taxing rights of country of source.

In this respect, 7 out of 8 reviewed tax treaties contain such a UN MTC and thus some of the less developed countries will not be restricted by Article 7 in taxing the income from

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[153] See the tax treaty between Slovakia and Vietnam, Slovakia and India and Slovakia and Macedonia.
[154] Due to the application of provisions similar to the OECD and UN MTCs incorporated into paragraph 5 and 6 of article 13 respectively.
[155] See the tax treaty of Slovakia with the South Africa, article 21.
[156] See for instance, Doc. E/C.18/2016/CRP.1, Committee of Experts on International Cooperation in Tax Matters Seventh session dated 11-14 October 2016, Item 3 (a) (vi) of the provisional agenda Taxation of Services, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf
[157] See the tax treaties of Slovakia with India and Vietnam.

independent personal services.[158] In addition, 2 out of these treaties also contain a shorter 3 month period,[159] compared to the UN MTC and 6 months threshold, which gives country of source additional taxing rights.

6.4.10. Director fees

Article 16 of both, the OECD and the UN MTC contain the provisions, which regulate taxation of income of directors, which provides for an unlimited taxing right to the country of source. The OECD MTC however restricts the rule only to directors who are members of the board of directors, while the UN MTC broadens this rule also to top managers of companies.

In this respect, 1 of the tax treaties does not contain such a rule at all[160]. And 5 out of the 7 remaining reviewed tax treaties contain the restricted rule of OECD MTC, rather than extended taxing right contained in the UN MTC.[161] The UN MTC rule is contained in the tax treaty with India, whereas tax treaty with Indonesia contains the provision, which is different from the models, but in fact may be even more harmful for the country of source than OECD because it excludes the directors who carry out day to day management activities from the scope of article 16 and restricts the rights of the country source.

6.4.11.Other Income

Article 21 contains rules for taxation of other income, which was not addressed specifically in the other articles of the DTAs. The OECD MTC provides for exclusive taxing right of the country of residence, restricting the country of source, which may tax only such other income as may be attributable to the permanent establishment or real estate. On the other hand, the UN MTC contains a rule, which allows the country of source to tax any other income, which has a source in the country.

In this respect, only 3 out of 8 reviewed tax treaties contain a rule based on the UN MTC,[162] while two of the tax treaties, although following the OECD approach, contains the rule, which allows taxation of some limited types of income in country of source.[163] The remaining 2 tax treaties contain a rule based on the OECD MTC.[164] One of the treaties, namely with Sri Lanka does not contain an article on other income at all.

Majority of the tax treaties thus limit the taxing rights of the country of source.

6.5. Conclusions and Recommendations

The key issues identified in the tax treaty review are related to Articles 5 and 7, which determine the existence of permanent establishment and regulate taxation of its business profits. In most of the reviewed treaties the authors detected an absence of provisions leading to creation of permanent establishment in case of provision of services, as well as the prevalence use of OECD model convention in paragraph 4 (the function of "delivery" is included), paragraph 5 (limited scope of activity leading to existence of depedent agency PE)

[158] The Slovak tax treaty with Macedonia and Sri Lanka do not include article on taxation of independent personal services.
[159] See the tax treaties with India, Indonesia.
[160] See the tax treaty with Sri Lanka.
[161] For extended taxing right see the tax treaties with India.
[162] See the tax treaties with India, Nigeria, Vietnam.
[163] See the tax treaties with Macedonia and Indonesia.
[164] See the tax treaties with Indonesia, Serbia/Montenegro, South Africa.

and absence of insurance PE provision inspired by the UN model. Similalry, OECD model provisions are prevailing upon drafting articles 7 in the Slovak treaties, mainly force of attraction rule is often missing, as well as the OECD approach is preferred for deduction of expenses and treatment of purchasing activities by the PE.

In general, the review also demonstrates that Slovakia mainly uses the OECD model tax convention for negotiation of its tax treaties also in other articles. The UN model provision are used occasionally with some countries, which is perhaps the intention of those countries, rather than Slovakia.

What concerns articles on taxation of dividends, interst and royalties, then Slovakia does not seem to have an aggressive approach towards developing countries and in general is moderate (within the recommended threshold) upon determination of withholding tax rates and definitions of passive income and therefore it is not possible to say that there is a revenue loss in the developing countries due to unfavorable provisions of tax treaties with Slovakia. The only negative provision noticed by authors in this respect is the treaty of Slovakia with the South Africa, which grants exclusive taxing right to the country of residence upon taxation of interest. However, with respect to South Africa, statistics presented by the National Bank of Slovakia for the years 2003-2014,[165] indicates that there is no flow of interest payments from South Africa to Slovakia, which may indicate that perhaps there is no tax revenue loss at this point of time due to the discussed provision in the treaty.

Based on further research, authors also identified that it was actually the standard tax treaty policy of South Africa to include this limitation into its tax treaties until recently, so it does not seem to be specifically requested by Slovakia.[166]

Only two of the tax treaties do contain technical services provision advocated now by the UN MTC and some tax treaties restrict the taxing rights of less developed countries in respect of the dividend (Article 10), Interest (Article 11) as well as capital gains from sale of shares of real estate companies (Article 13 paragraph 4), where majority of the tax treaties do not contain the provision that would allow taxation of such capital gains in country of source. However, there is no data available from the National Bank of Slovakia on the income received from the South Africa in a form of capital gains and therefore it is difficult to estimate the potential revenue loss due to the absence of special provision on taxation of gains from the sale of shares.

Most of the tax treaties contain the Article 14 of UN MTC ï providing for taxing rights of country of source in respect of income from independent personal services.

The key recommendation for Slovakia would include:

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[165] Retrieved from the National Bank of Slovakia, available at: http://www.nbs.sk/sk/statisticke-udaje/statistika-platobnej-bilancie/priame-zahranicne-investicie There is no data for the South Africa for the year 2003, 2004, 2005, 2006, 2007.

[166] See for instance the summary table on the rates of withholding tax on interest in the South African tax treaties. In many treaties concluded before 2000s there is a tendency for no taxation of interest in the source states: e.g. Austria (1997), Croatia (1997), Cyprus (1998), Czech Republic, (1997), Denmark (1995), Finland (1995) and other countries. Available at: http://www.sars.gov.za/AllDocs/Documents/Withholding%20Tax%20on%20Interest/Summary%20of%20the%20DTA%20Rates%20-%20Withholding%20Tax%20on%20Interest%20-%20Rest%20of%20the%20World.pdf

- Commit the government and Ministry of Finance to follow the United Nations Model Convention in negotiation of tax treaties with developing countries, which now also includes the Technical Services article.
- Where the Ministry of Finance does not agree to follow the UN MTC, it should explain why it did not follow the provisions of UN MTC.
- In renegotiation of tax treaties, the developing countries should be offered to replace the existing provisions with provisions from UN MTC.

7. Country Chapter - Slovenia

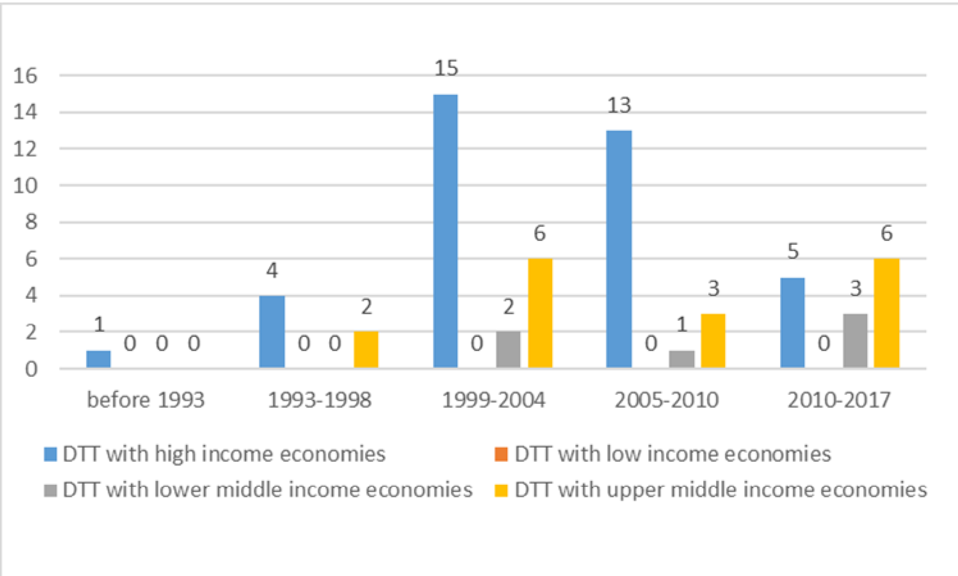
7.1. Introduction

7.1.1. Tax Treaty Network of Slovenia ï brief statistical data

Slovenia has concluded tax treaties with 60 countries. There are 3 tax treaties, which are signed but not in force[167] and 57 are in force and effective. Among them, 23 double tax treaties are concluded with the developing countries according to the World Bank list. Those are treaties with Albania, Armenia, Azerbaijan, Belarus, Bosna and Herzegovina, Bulgaria, China, Egypt, Georgia, India, Iran, Kazakhstan, Kosovo, Macedonia, Moldova, Romania, Russia, Serbia/Montenegro, Thailand, Turkey, Ukraine and Uzbekistan. The three double tax treaties, which are not in force yet ï namely the treaties with Egypt (signed in 2010), Morocco (signed in 2016) and Japan (signed in 2017), have been ratified in Slovenia, but they have not yet entered into force because the ratification process and the exchange of notes on ratification did not take place at the time of writing this report.

The graph below illustrates the tendency of conclusion of double tax treaties by Slovenia. Three DTTs with developing countries were concluded before 2000, 10 between 2000 and 2010 and other 9 DDTs with developing countries were concluded after 2010. That means that the number of DDTs with developing countries is increasing. However, Slovenia does not seem to conclude tax treaties with low income countries at all and has only limited number of treaties with the low-middle income countries.

Graph 7.1: Number of DTTs with different types of countries



Source: created by authors

7.1.2. Economic relations of Slovenia with developing countries

Slovenia is the 62nd largest export economy in the world.[168] In 2015, the export from Slovenia amounted to USD 27,4 billion, while import amounted to USD 27 billion, resulting in a positive trade balance of USD 392 million.[169] The top export destinations of Slovenia are

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[167] These are the tax treaties with Egypt, Morocco and Japan.

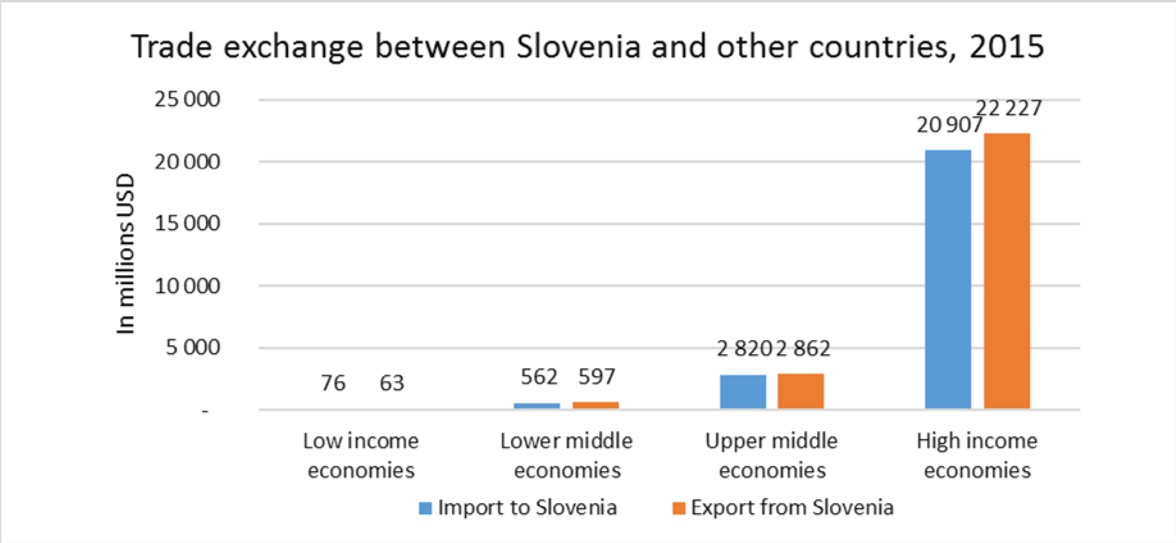
[168] Information is retrieved from http://atlas.media.mit.edu/en/profile/country/svn/ last accessed 9 September 2017.

[169] Ibid.

Germany (USD 5,44 billion), Italy (USD 3,05 billion), Croatia (USD 2,15 billions), Austria (USD 2,15 billions) and France (USD 1.32 billions).[170] The top import origins are Germany (USD 4,55 billion), Italy (USD 3,84 billion), Austria (USD 2,37 billion), China (USD 1,7 billion) and Croatia (USD 1,39 billions).

As illustrated by the graph 7.2. below, out of the developing countries the majority of trade exchange comes with the upper midde income countries, where the amount of import to Slovena is dominated by China (USD 1,7 billions).What concerns export from Slovenia, then the top destinations among upper middle economies are Russia (USD 0,89 billions), followed by Serbia (USD 0,76 billions). Among the lower middle income economies the leader importer to Slovenia is India with the share of USD 0,35 billions, and the top two destinations for export are Ukraine (USD 0,140 billions) and India (USD 0,125 billions). With the low income economies the trade exchange is very low and in total import from these countries to Slovenia amounts to USD 0,76 billions and export from Slovenia therein amounts to USD 0,63 billions.

Graph 7.2: Trade exchange of Slovenia with different groups of countries

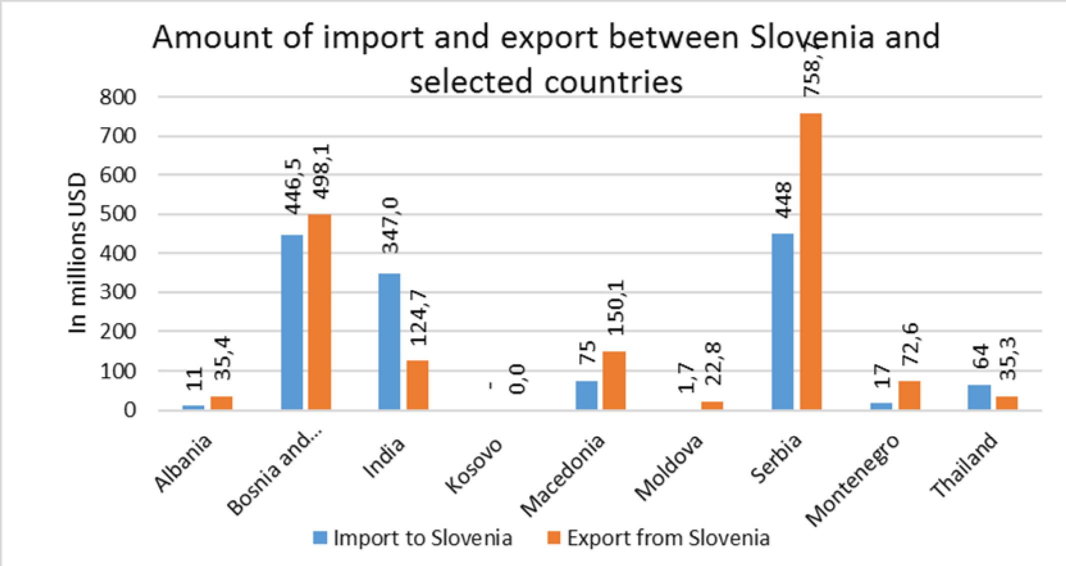


Source: based on data available at http://atlas.media.mit.edu/en/profile/country/svn/

For the detailed treaty analysis authors selected 8 tax treaties with developing countries, including: Albania (UMI), Bosnia and Hercegovina (UMI), India (LMI), Kosovo (LMI), Macedonia (UMI), Moldova (LMI), Serbia/Montenegro (UMI), Thailand (UMI), out of which five represent upper middle income countries and three are representatives of the lower middle countries. In the graph below, the authors present an overview of trade exchange between Slovenia and these countries. The leading importers are Bosnia and Herzegovina, India and Serbia. The top export destinations among these countries are also Serbia and Bosnia and Herzegovina.

[170] Ibid.

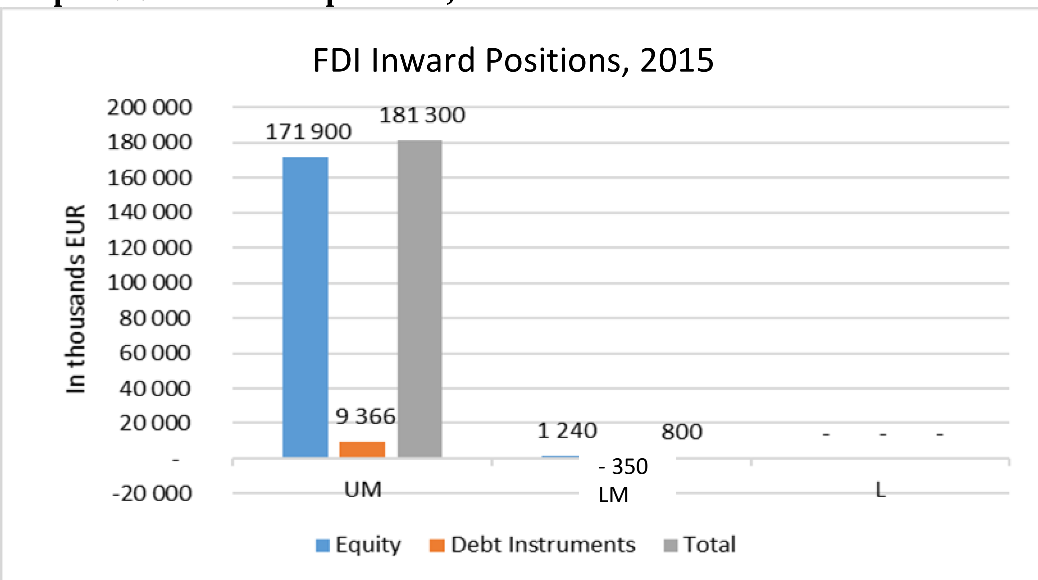
Graph 7.3: Amount of import and export between Slovenia and selected countries



Source: based on data available at http://atlas.media.mit.edu/en/profile/country/svn/

What concerns FDI positions, then for the purposes of this work the authors used the data available for 2014. From the Graph 7.4 below it can be observed that the total FDI inward position in caclulated on the basis of amonts of equity capital and reinvested earnings, which in most cases in a positive number, and also the amount of debt instruments, which in case of investments from lower-middle income countries is a negative value of EUR 0,35 millions, indicating that the amounts of intercompany loans given from Slovenia to the direct investor exceed the respective amounts given by that investor to Slovenia.

Graph 7.4: FDI inward positions, 2015



Source: based on data available at Bank of Slovenia, www.bsi.si/en/

The study indicates that inward FDI from developing countries come to Slovenia mainly from countries, which are classified as upper-middle income countries. The inward FDI in ths group are strongly influenced by positive equity investments from Serbia (EUR 73,2 million), Russia (EUR 42,8 million), Bosnia and Herzegovina (EUR 38,6 million), as well as positive debt flows to Slovenia from Russia (EUR 27,8 million) and negative debt flows from

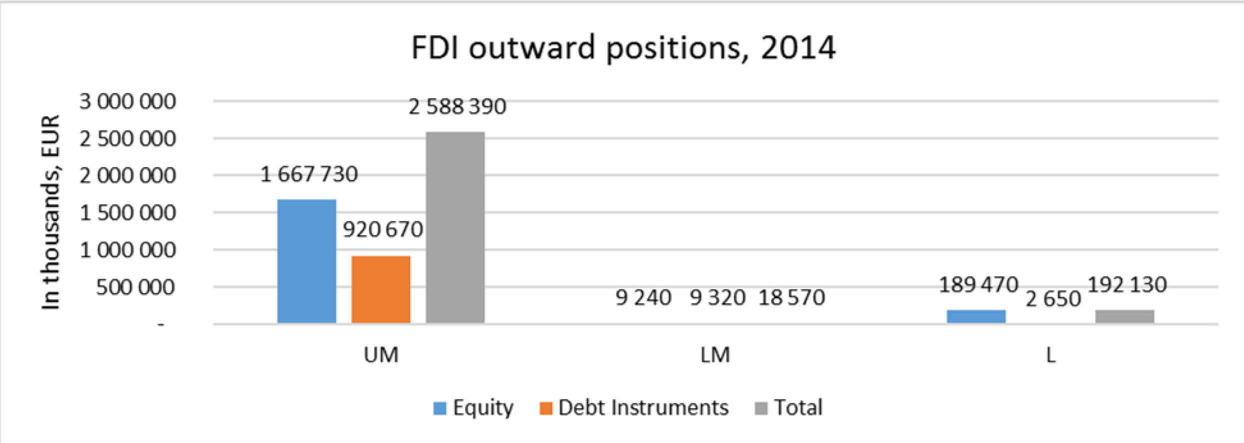
Slovenia to Serbia (EUR -22,9 million). FDI from lower-middle income countries come to Slovenia solely from Egypt in total amount of EUR 14,9 million. Zero amount of FDI comes to Slovenia from low income countries.

What concerns outwards FDI from Slovenia, then again, the investments mainly flow to the upper-middle income countries, with very low flow to the lower-middle and low income countries. Among the major recipients of investments from Slovenia are Serbia with total investments of EUR 1185 million, accounting for 22.3% of total outward FDI. According to the latest figures for 2014, companies from the following activities held the largest investments in Serbia:

- retail trade except motor vehicles (20.5%),
- financial services except insurance and pension funding (18.5%),
- telecommunications (10.3%), and
- activities of head offices, management consultancy activities (9.8%).[171]

Next in terms of recipients of Slovenian FDI is Bosnia and Herzegovina with total investments of EUR 457.4 million or 8.6% of total outward FDI, followed by Macedonia with total of investments of EUR 402 million or 7.5% of total outwards FDI. Investments to the lower-middle income countries are represented exclusively by investments to Ukraine, similarly as investments to low income countries are represented exclusively by investments to Liberia.

Graph 7.5: FDI outward positions, 2014



Source: based on data available at Bank of Slovenia, www.bsi.si/en/

7.1.3. Particularities of domestic income taxation in Slovenia

The payments of dividends, interest and royalties that are having source in Slovenia are subject to 15% withholding tax. There is withholding tax due on the technical or consulting services. The rate of withholding tax applicable to payments made to individuals (residents and non-residents) is 25% and it is considered as final tax.

Capital gains from sale of shares are taxed in the hands of resident and non-resident individuals at the rate of 25%. In addition to above, the income tax rate on capital gains may be gradually reduced every five years of holding period for individuals:

- during the first five years of holding period applies 25% income tax rate;
- during the holing period from 5 to 10 years applies the rate of 15%;
- during the holding period between 10 and 15 years applies tax rate of 10%;

[171] Retrieved from the Bank of Slovenia, available at: http://www.bsi.si/iskalniki/ekonomski-odnosi-s-tujino-en.asp?MapaId=714 last accessed 11 September 2017.

- for holding between 15 and 20 years applies tax rate of 5%.
Income tax is not paid (is exempt) on capital gains made from the disposal of shares after 20 years of ownership.
Capital gains in the hands of legal entities are subject to 17% income tax rate, unless 8% of shares and more belonged to the taxpayer for at least 6 months before the realization and there was at least one employee in the company. In this case, only 52.5% of capital gain from realization of shares is taxable.

Slovenian Personal Income Tax Act and Corporate Income Tax Act include provision for elimination of double taxation both, in cases where there is a double tax treaty in place and also unilaterally. Where a resident receives income from a country with which Slovenia has not concluded any tax treaty and the income of a resident is taxed abroad, such resident may claim a tax credit in Slovenia against its final tax liability in Slovenia. The amount of such tax credit may not, however, exceed either the foreign tax paid or the amount that would be due in Slovenia on that foreign income (whatever is lower).

In case when Slovenia has the tax treaty in place with the country, from where foreign income is sourced, the elimination of double taxation is limited to cases, where the foreign country had the taxing right based on the tax treaty and similarly the maximum credit is limited with the amount of domestic tax liability.

The process to conclude treaties is governed by the Law on Foreign Affairs (Official Gazette of RS, no. 45/01 et seq.), in Chapter V "the International Treaties". The procedure also applies in the case of double tax treaties. The Procedure for the conclusion of the international treaties on tax matters begins with the initiative of the Ministry of Finance. The decision on the same is adopted by the Government of the Republic of Slovenia. The government initiative is submitted for approval to the Committee on Foreign Affairs of the National Assembly. The Government shall report on the completion of negotiations and to determine the person empowered to sign the agreement. The ratification process in the National Assembly is started by the Ministry of Foreign Affairs, on the proposal of the Ministry of Finance. In the context of the ratification procedure, the agreement may be considered at the session of the Commission of the National Council for International Relations and the European Affairs.

In the procedure for concluding international agreements are also involved relevant ministries, the Government of the Republic of Slovenia, the National Assembly and the National Council.

The proposal to conclude an agreement with a particular country (with a description of relevant issues) could be submitted by the interested public, namely to the Ministry of Finance. In practice, however, such proposals are given to the Ministry of Foreign Affairs in the context of economic diplomacy, performed by the Ministry.

7.2. Tax Treaty Network of Slovenia

Slovenia has concluded tax treaties with 60 countries. There are 3 ratified tax treaties, which are not valid and do not apply[172] and 57 valid and applicable. Slovenia became independent through the passage of the appropriate acts on 25 June 1991. The historical first tax treaty of independent Slovenia was concluded with China in 1995, however some of the tax treaties of former Yugoslavia were succeeded into by Slovenia and the oldest of these tax treaties is the tax treaty with Sweden, which was concluded in 1985 and it is still applicable. The most

[172] For details refer to the section 7.1 of this chapter.

recent treaty, which was ratified and entered into force is the tax treaty with the United Arab Emirates. There is no information about tax treaties currently being negotiated.

7.3. Selected Tax Treaties subject to the analysis

The following sections will map out and analyse specific provisions of the Slovenian Tax treaties concluded with the developing countries. Each provision will be colour coded based on the extent to which it is favourable toward a country of source, i.e. a developing country (green and light green), problematic (yellow) or harmful (red) in terms of tax base and tax rights allocation.

The following tax treaties were selected for the analysis: Albania, Bosnia and Hercegovina, India, Kosovo, Macedonia, Moldova, Serbia and Montenegro, Thailand. The choice of countries for analysis was based on the basis of economic and diplomatic relations and investments. Taken the significant amounts of investments coming from Slovenia to Liberia, it would be useful to analyse the potential tax treatment of such investments under the relevant treaty, but so far no tax treaty was concluded between Slovenia and Liberia. Taken that Liberia is known for its specific tax regime, the authors suspect that this is the result of tax avoidance schemes.[173]

7.4. Highlights of the key issues in Tax Treaty Network of Slovenia

The following table indicates the key issues in the selected tax treaties of Slovenia. For detailed interpretation of various issues identified in the treaties, please see comments below this table.

The following sections will map out and analyse specific provisions of the Polish Tax treaties concluded with the developing countries. Each provision will be colour coded based on the extent to which it is favourable toward a country of source, i.e. a developing country (green and light green), problematic (yellow) or harmful (orange or red) in terms of tax base and tax rights allocation.

Table 7.1: Color Map of Slovenia

	Albania	**BiH**	**India**	**Kosovo**	**Macedonia**	**Moldova**	**Serbia/ Montenegro**	**Thailand**
Signed on	27.2.2008	16.5.2006	13.1.2003	26.6.2013	15.5.1998	31.5.2006	11.6.2003	11.6.2003
Effective	29.4.2009	10.11.2006	5.5.2004	28.12.2013	3.4.1999	10.11.2006	31.12.2003	1.5.2004
Article 5/3 Construction PE ï time	>12 months	>12 months	>12 months	>12 months	>12 months	>12 months	>12 months	>6 months
Article 5/3 Supervisory activities	Present	Present	Absent	Absent	Absent	Present	Absent	Present
Article 5/3 Services PE	>6 months	Absent	Absent	Absent	Absent	>6 months	Absent	>6 months
Article 5/4 Delivery	Present	Present	Present	Present	Present	Present	Present	Present
Article 5 ï	OECD	OECD	UN	OECD	OECD	OECD	OECD	UN

[173] See for instance, http://www.theafricareport.com/West-Africa/liberia-africas-unknown-tax-haven-with-much-to-lose.html

Agency PE								
Article 5 ï Insurance PE	Absent	Absent	Present	Absent	Absent	Present	Absent	Absent
Article 7 Limited Force of Attraction	Absent	Absent	Absent	Absent	Absent	Absent	Absent	Absent
Article 7/3 Limits to deductibility	Absent	Absent	Absent	Absent	Absent	Absent	Absent	Absent
Article 7/5 No Profit for purchasing	OECD	OECD	OECD	OECD	OECD	OECD	OECD	OECD
Article 8 International Transport	OECD	OECD	Includes interest & lease	OECD	OECD	OECD	OECD	UN
Article 10 Dividends	5/10%	5/10%	5/15%	5/10%	5/15%	5/10%	5/10%	10%
Article 11 Interest	7/0%	7/0%	10/0%	5%/0%	10%	5/0%	10/0%	10/15/0%
Article 12 Royalties	7%	5% OECD Definit.	10%	5% OECD Definit.	10%, OECD definit.	5% OECD Definit	5/10%	10/15%
Article 13 Sale of Shares RE	OECD	Absent	OECD	OECD	Absent	OECD	Absent	OECD
Technical services	Absent	Absent	10%	Absent	Absent	Absent	Absent	Absent
Article 14 Indepent Personal Services	UN	Absent	UN	Absent	UN	Absent	UN	UN
Article 16 Directorós	OECD	OECD	OECD	OECD	OECD	OECD	OECD	OECD
Article 21 Other Income	OECD	OECD	OECD Only lottery	OECD	OECD	UN	OECD	OECDs

Source: Prepared by authors

The key issues in the selected tax treaties of Slovenia can be summarised as follows:

7.4.1. Permanent establishment issues

The concept of permanent establishment is important in that it allows country of source to levy tax on the business profits of the enterprise of a contracting state. The definition of permanent establishment is to be found in Article 5 of DTAs. Where the definition of the permanent establishment is broader ï the country of source (mostly developing country) is allowed to tax more income and where this definition is narrower, the taxing rights of the source country are more limited.

7.4.1.1. Construction Permanent Establishment

Article 5 paragraph 3 contains a special rule for construction activities. The country of source may tax the income of foreign construction company, where the company has a permanent establishment in the source country.

The OECD MTC provides for such permanent establishment to exist only when the construction activities last longer than 12 months. On the other hand, the UN MTC contains a rule, which provides for the permanent establishment to exist already after 6 months. The UN MTC thus provides for a rule that allows more possibilities to tax the profits of construction companies.

In this respect, only 1 out of 8 reviewed tax treaties contain a period for Construction permanent establishment which is equal or shorter than 6 months,[174] while 7 out of 8 of the treaties contains the OECD MTC provision, where the time test is 12 months. This provision limits the options of most of the tax treaty partners to tax the construction activities of Slovenian companies performed on their territory and may lead to loss of tax revenue of the less developed countries.

On the other hand, 4 out of 8 reviewed treaties, contain the supervisory activities as a part of the Construction PE,[175] which is in line with the UN MTC and allows these countries to also tax the supervisory activities carried out in relation to construction projects.

The prevailing tendency of the Slovenian DTAôs in respect of the construction PE is that OECD MTC provisions are prevailing, which limits the country of source in its taxing rights.

7.4.1.2. Services Permanent Establishment

In respect of the Services Permanent establishment, which allows the country of source to levy tax on companies, 5 out of 8 reviewed tax treaties do not contain this provision, which prevents most of these countries to levy tax on service providers, in absence of a special provision ï technical services article, which is contained only in 1 of the tax treaties.[176]

The absence of Services Permanent establishment and also technical services provision in most reviewed tax treaties can be highlighted as a critical issue, because it significantly limits the countries of source to levy tax on service providers. This contradicts the UN MTC, which provides for both ï the Services PE provision and most recent recommendation also includes the Technical services provision.[177]

7.4.1.3. Delivery activities as a part of Preparatory and Auxiliary Activities

The country of source taxing rights can be limited by provision, which allows certain preparatory and auxiliary activities to be treated as not giving a rise to permanent establishment. These exceptions from creation of permanent establishment status are frequently abused, where the business activities are structured in a way to take advantage of these exception rules.[178]

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[174] See the tax treaty of Slovenia with Thailand.
[175] See the tax treaties of Slovenia with Albania, Bosnia and Herzegovina, Moldova and Thailand.
[176] See section 7.4.8. of this report below.
[177] See for instance, Doc. E/C.18/2016/CRP.1, Committee of Experts on International Cooperation in Tax Matters Seventh session dated 11-14 October 2016, Item 3 (a) (vi) of the provisional agenda Taxation of Services, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf
[178] See Action 7 of BEPS project: Avoidance of PE Status.

In this respect, the UN MTC provides only such restricted exception rules, where the activities consisting of delivery of goods and merchandise are considered not to qualify as preparatory and auxiliary activities.

However, all 8 out of 8 of the reviewed tax treaties do not follow the UN MTC, but OECD MTC, which will allow the Slovenian companies escaping the PE status, even if they deliver goods in the less developed countries.

7.4.1.4. Agency Permanent Establishment

Both, the OECD and the UN MTC contain provision, which deems the existence of PE status, where another person acts on behalf of enterprise and also has and habitually exercises the right to conclude contracts in the name and on behalf of the enterprise. This type of taxable presence is called agency permanent establishment.

The UN MTC further broadens this notion and thus also taxing rights of the country of source by including into this definition of permanent establishment status also situations, where another person delivers goods and merchandise belonging to the enterprise.

In this respect only 2 out of 8 of the reviewed tax treaties include this notion and thus in most of the tax treaties the taxing rights of the country of source are limited.[179]

7.4.1.5. Insurance Permanent Establishment

The UN MTC also contains another provision, which broadens the possibility of country of source to levy taxation on insurance companies collecting insurance premiums on the territory of the source country.

In this respect, vast majority of the reviewed tax treaties - namely 6 out of 8 do not contain such permanent establishment provision.[180]

7.4.2. Business profits

Article 7 contains rules determining taxation of income in form of business profits. The general principle provides for exclusive taxing rights of country of residence, unless the foreign business enterprise has a permanent establishment in the country of source.

However even where foreign enterprise has such a permanent establishment, provisions of Article 7 can further limit the taxing rights of the country of source. This is where Article 7 of UN MTC contains less restrictive rules than the OECD MTC.

7.4.2.1. Limited Force of Attraction

Article 7, paragraph 1 contains the principle of taxation of business profits, where the OECD MTC only allows the country of source to tax the business profits, which are attributable to the permanent establishment.

On the other hand, the UN MTC contains a rule that allows for broader taxing rights of the country of source and next to the profits attributable to the permanent establishment, Article 7, paragraph 1 of the UN MTC allows also for taxation of:

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[179] See the tax treaties of Slovenia with Thailand and India.

[180] See the tax treaties of Slovenia with India and Moldova.

- b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or
- c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

As a result, the UN MTC significantly broadens the taxing rights of the country of source.

In this respect however, all 8 out of 8 reviewed tax treaties do not contain this UN MTC provision. All 8 reviewed treaties provide for the OECD MTC, which provides only for limited taxing rights of the country of source.

7.4.2.2. Limits to separate entity notion and limitation of deductibility of intra-company charges

The OECD MTC contains a specific notion ï deeming the permanent establishment, which is part of the foreign enterprise to be a separate entity for the purpose of attribution of profits.[181] This leads to allocation of profits to the permanent establishment on the basis of principles ï similar to those of transfer pricing.

The UN MTC, contains the same principle. It however also contains a limitation of that principle, where in Article 7 paragraph 3, it specifically provides that there should be no deduction for notional charges between the head office and the permanent establishment for payments, which could be otherwise charged for the use of intangible property, capital or commissions between the two parts of the enterprise. This leads to a bigger tax base of the permanent establishment, since the tax base cannot be eroded by such notional payments.

In this respect, however all 8 out of 8 reviewed tax treaties contain the OECD MTC rule, which may allow the Slovenian companies to claim deductible charges for such notional payments between the head office and the permanent establishment in less developed countries.

7.4.2.3. No profit for Purchasing activities

Article 7 paragraph 5 of the OECD MTC contains a restrictive rule, which provides for limit of tax base, which could be attributed to a permanent establishment in respect of purchasing activities that it performs for the enterprise. In fact, the rule of the OECD MTC provides for principle that no profit should be attributed for mere purchasing activities.

On the other hand, the UN MTC does not provide for a such a rule. This means that the permanent establishment involved in purchasing activities ï e.g. purchasing commodities in developing countries should be actually remunerated by profit for such activities, which is reasonable taken that companies make not only profit as a result of sales activity, but sourcing and purchasing aspects may significantly contribute to the overall profit.

In this respect, however, all 8 out of 8 reviewed tax treaties contain the OECD MTC equivalent of this rule, which means the less developed countries in all cases are not entitled to tax these profits attributable to purchasing activities.

7.4.3. International Transport

Article 8 contains rule in respect of international transport. The OECD MTC contains provisions, which provide for exclusive taxing rights for country of residence (country where

[181] See Article 7 paragraph 2 of OECD and similarly in UN MTC.

the place of the effective management of the enterprise is located). On the other hand, the UN MTC provides for a limited taxing rights in respect of the country of source in respect of the profits from operation of ships.

The situation of less developed countries may be further made worse, if the tax treaty contains specific provisions allocating the profits from rental of boats or containers only to the residence country.

In this respect only 1 out 8 of reviewed tax treaties contain the UN MTC provision[182] and the remaining 7 tax treaties contain the OECD MTC provision and one includes also the provision allocating the profits from rental of boats and containers to the country of residence as well as interest earned on funds earned from shipping business.[183]

7.4.4. Dividends

Article 10 contains a rule on taxation of dividends, where the country of source is allocated limited taxing rights in a way of limitation of tax rate.

Some tax treaties may reduce the tax rate down to 5% or even zero, however all the 8 reviewed tax treaties allow the country of source to levy up at least 5% on inter-company dividends and most more than 10% or even more tax rate on the distributed dividends paid to individuals. All of the reviewed treaties contain the requirement on the beneficial ownership and most contain the threshold requirement in case of qualified dividends.

7.4.5. Interest

Article 11 contains a rule on taxation of interest, where the country of source is allocated limited taxing rights in a way of limitation of tax rate.

Some tax rates may reduce the tax rate down to zero, or may contain potentially harmful exceptions to the main rule.

In this respect, only 3 out of 8 tax treaties contain provisions, which are not potentially harmful to the country of source,[184] while 5 tax treaties contain provisions, which could be potentially harmful and limiting the taxing rights of the country of source, where the interest paid on debt or loans guaranteed by certain institutions may be except from withholding taxation in the country of source and in three tax treaties the reduced tax rate is less than that in OECD MTC.[185]

These exemptions may be abused in practice and country of source may lose the taxing rights.

7.4.6. Royalties

Article 12 contains article on taxation of royalties, where based on the OECD MTC, the country of source loses the taxing rights, which are allocated exclusively to the country of residence. On the other hand, the UN MTC contains a rule, where the country of source is allocated limited taxing rights in a way of limitation of tax rate. In addition, the UN MTC broadens the definition of royalty to include the income from rental of movable property ï

[182] See the tax treaty of Slovenia with Thailand.
[183] See the tax treaty of Slovenia with India.
[184] See the tax treaties of Slovenia with India, Macedonia, Serbia and Montenegro.
[185] See the tax treaties of Slovenia with Bosnia and Herzegovina, Kosovo and Moldova.

scientific, commercial and industrial equipment, which further broadens the taxing rights of the country of source.

In this respect, only 3 out of 8 reviewed tax treaties contain the UN MTC provision, where country of source is allowed to tax the income in form of royalty with more than 10% tax rate,[186] while 5 out 8 of the tax treaties contains a reduced tax rate of 7% or 5% only and 4 out of the 8 tax treaties contain a definition of royalty, which excludes the rental of commercial, scientific and industrial equipment.[187]

7.4.7. Capital Gains from sale of shares of real estate companies

Article 13 contains a rule in respect of taxation of capital gains. Especially important is a provision addressing taxation of capital gains from sale of shares of companies deriving value from real estate.

Both UN and OECD MTC contain a rule, which provides for a taxing right of the country of source ï country where the real estate is located, when the value of shares sold derives the value from such real estate.

It must be pointed out that the UN MTC surprisingly contains a harmful provision, which may restrict the taxing right of the country of source, where the real estate is used in business activities of the company.

In this respect, 5 out of 8 reviewed tax treaties contain this rule, without including the harmful element, therefore some of the less developed countries will not be restricted in exercising its taxing rights. However, 3 out of 8 tax treaties do not contain neither the OECD nor UN MTC provision,[188] which means that the taxing rights are allocated exclusively to the country of residence.

7.4.8. Technical services

Some tax treaties may contain a special rule allowing the country of source to levy tax on the technical services, which significantly broadens the taxing right of the developing country. Example of such a rule is contained in the South African Development Community MTC and also most recently was introduced in the UN MTC.

Out of the 8 reviewed tax treaties, however, only 1 tax treaty contain such a provision.[189]

7.4.9. Independent Personal Services

Article 14 of the UN MTC contains a special rule containing provisions allowing the country of source to levy tax on the income from independent personal services. This rule has been deleted from the OECD MTC and the rules of Article 7 ï business profits should apply instead in case such provision is missing, which provides for limited taxing rights of country of source.

In this respect, 5 out of 8 reviewed tax treaties contain such a UN MTC and thus some of the less developed countries will not be restricted by Article 7 in taxing the income from

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[186] See the tax treaties of Slovenia with India, Serbia and Montenegro and Thailand.
[187] See the tax treaties with Bosnia and Herzegovina, Kosovo, Moldova and Macedonia.
[188] See the tax treaties of Slovakia with Bosnia and Herzegovina, Macedonia and Serbia and Montenegro.
[189] See the tax treaty of Slovenia with India.

independent personal services. On the other hand, 3 out of 8 tax treaties do not contain Article 14 of UN MTC provision and thus those countries will be restricted in their taxing rights.[190]

7.4.10. Director fees

Article 16 of both the OECD and the UN MTC contain the provisions, which regulate taxation of income of directors, which provides for an unlimited taxing right to the country of source. The OECD MTC however restricts the rule only to directors who are members of the board of directors, while the UN MTC broadens this rule also to top managers of companies.

In this respect, all 8 out of 8 reviewed tax treaties contain the restricted rule of OECD MTC, rather than extended taxing right contained in the UN MTC.

7.4.11. Other Income

Article 21 contains rules for taxation of other income, which was not addressed specifically in the other articles of the DTAs.

The OECD MTC provides for exclusive taxing right of the country of residence, restricting the country of source, which may tax only such other income as may be attributable to the permanent establishment or real estate. On the other hand, the UN MTC contains a rule, which allows the country of source to tax any other income, which has a source in the country.

In this respect, only 1 out of 8 reviewed tax treaties contain a rule based on the UN MTC, while one more of the tax treaties contain the rule, which allows taxation of some limited types of income in country of source,[191] while the remaining 6 tax treaties contain a rule based on the OECD MTC.[192]

7.5. Conclusions and Recommendations

The key issues identified in the tax treaty review are related to Articles 5 and 7, which regulate taxation of business profits and existence of permanent establishment. The reviewed tax treaties of Slovenia mainly follow the OECD Model tax convention and contain number of restrictive provisions in these articles, which limit taxing rights of the developing countries. These provisions include the following issues:

- Limited and restrictive definitions of permanent establishment;
- Long time tests in Construction PE provision, in most cases exceeding 12 months threshold;
- Absence of supervisory activities in the Construction PE provision of half of the reviewed treaties;
- Absence of services permanent establishment in most of the reviewed tax treaties;
- Absence of agency PE provision in cases where agent delivers goods and merchandise on behalf of the enterprise;
- Delivery activity being considered a preparatory activity, not creating taxable presence;
- Absence of limited force of attraction in Article 7;
- Absence of limitation of deductibility of intra-company charges;

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[190] See the tax treaties of Slovenia with Bosnia and Herzegovina, Kosovo and Moldova.
[191] See the tax treaty of Slovenia with India.
[192] See the tax treaty of Slovenia with Moldova.

- Presence of special rule restricting the tax base of permanent establishment in cases of purchase activities.

Furthermore, most tax treaties follow the OECD MTC rather than UN MTC in respect of the provisions dealing with International transport (Article 8) and taxation of directorꞌs fees (Article 16) as well as in respect of Article 21 (Other Income).

Only one of the tax treaties do contain technical services provision advocated now by the UN MTC and some tax treaties restrict the taxing rights of less developed countries in respect of the Royalties, rental income (Article 12), capital gains from sale of shares of real estate companies (Article 13 paragraph 4) and independent personal services (Article 14 of UN MTC).

On the other hand, it should be pointed out that in the reviewed tax treaties, the provisions dealing with taxation of dividends are not less favourable to the less developed countries than they would have been under UN MTC. The qualified intergroup dividends are subject in all cases to at least 5% tax rate, whereas rate for other dividends varies from 10 to 15%. Therefore, although there are regular profit distribution, especially from the ex-Yugoslavian countries to Slovenia, it is not possible to say that there is a revenue loss caused consequently.[193]

The key recommendation for Slovenia would include:

- Commit the government and Ministry of Finance to follow the United Nations Model Convention in negotiation of tax treaties with developing countries, which now includes the Technical Services article.
- Where the Ministry of Finance does not agree to follow the UN MTC, it should explain why it did not follow the provisions of UN MTC.
- In renegotiation of tax treaties, the developing countries should be offered to replace the existing provisions with provisions from UN MTC.

[193] For amounts of profit distributions to Slovenia see reports prepared by the Bank of Slovenia, available at: http://www.bsi.si/iskalniki/ekonomski-odnosi-s-tujino-en.asp?MapaId=714 last accessed on 11 September 2017.