

The Taxation of Gains derived from the Alienation of Shares in Real Estate Companies

Under the OECD Model Tax Convention

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LIST OF ABBREVIATIONS

Art.	Article
BMF	Bundesministerium für Finanzen (Federal Ministry of Finance, Austria, (BMF))
BFH	Bundesfinanzhof (Federal Tax Court of Germany)
Cf.	confer
Ch.	Chapter
DBA	Doppelbesteuerungsabkommen (Double Taxation Convention)
DTC	Double Taxation Convention
DBG	Bundesgesetz über die direkte Bundessteuer, 14 December 1990, SR 642.11 (Swiss Federal Law on the Federal direct taxes)
DTC	Double Tax Convention
EAS	Express Antwort Service (Ministry of Finance of Austria)
Ed.	Editor
Eds.	Editors
Et seq.	Et sequens
Et seqq.	Et sequentes
Fn.	Footnote
i.e.	id est
IFSt	Institut Finanzen und Steuern
I.R.C.	Internal Revenue Code (US Tax law)
I.T.A.	Income Tax Act (Canadian Tax law)
EStG	Einkommensteuergesetz (German Income tax act)
KStG	Körperschaftsteuergesetz (German Corporation tax law)
m.no.	marginal number
MC	Model Convention
OECD	Organisation for Economic Co-operation and Development
OECD MC	Model Convention on Income and Capital published by the Organisation for Economic Co-operation and Development
p.	page
para.	Paragraph
resp.	respectively
Sec.	Section
US	United States of America

*“Finding the optimal construction for Article 13 is a challenge, but anything less than optimal might eliminate a jurisdiction’s right to tax gains wholly attributable to real property in the country”.*¹

INTRODUCTION

As the above-mentioned citation already implies, Article 13 concerns the taxation of capital gains. More precisely, it refers to Article 13 of the Model Convention on Income and Capital² published by the Organisation for Economic Co-operation and Development³. The question arises whether Article 13⁴ and its Commentary, as drafted by the OECD, are capable of meeting the requirement claimed by *Richard Krever*, i.e. providing a template for states to find the *optimal construction* for Article 13.

Pursuant to Article 13(1) OECD MC, the situs state – i.e. the jurisdiction where the immovable property concerned is located – has the primary taxing right regarding gains derived from the alienation of the immovable property. Apart from such an *asset deal*, real estate may also be alienated indirectly through the sale of the shares of an entity owing the real estate, namely by means of a so-called *share deal*. Before 2003, gains derived from the latter were covered by the catch-all provision in ante-2003 Article 13(4) OECD MC⁵ and thus the resident state had the *exclusive* taxing right. Hence, by interposing a company between the taxpayer and the real estate concerned, the situs state taxation contemplated in Article 13(1) could be circumvented – the real estate could be alienated indirectly through a share deal instead of an asset deal. Consequently, taxpayers could conduct rule shopping⁶ and choose the distributive rule applicable arbitrary.

¹ Krever, *Tax Treaties*, 212 (214).

² Hereinafter referred to as MC.

³ Hereinafter referred to as OECD.

⁴ In the present thesis, unless otherwise indicated, articles without an explicit reference to a certain tax treaty or tax treaty model convention do refer to the OECD Model Convention 2014.

⁵ Which constitutes the current Article 13(5) OECD MC.

⁶ Taxpayers that conduct rule shopping are generally entitled to the benefits of a certain tax treaty while they make a certain distributive rule of that treaty applicable rather than another one by e.g. – in the

Certainly, the difference in tax regimes may constitute an incentive to prefer exclusive residence taxation⁷. Furthermore, gains derived from the sale of shares are exempt in several jurisdictions whereas gains derived from the direct alienation of immovable property are usually taxable⁸.

In 2003, the OECD introduced a new paragraph four in Article 13 in order to render the taxation of the above-mentioned indirect alienation equal to the direct alienation of real estate. The new paragraph reads as follows⁹:

Article 13(4)

“Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.”

Accordingly, Article 13(4) OECD MC allocates the primary taxing right in respect of gains derived from the alienation of shares of real estate companies¹⁰ to the situs state. Although a number of states already included this new paragraph in their double tax conventions, there is little practical experience and still a lot of legal uncertainty in respect of the application thereof. Thus – and especially for the sake of assistance for states which either wish to introduce or amend paragraph four – a review of the current Article 13(4) and its Commentary is needed. In order to find the optimal construction of Article 13 as claimed by *Richard Krever*, the present thesis addresses this real estate company provision and will highlight the legal issues accompanied by it both from a theoretical and practical point of view¹¹.

Initially, it will be elaborated on the history of Article 13(4) OECD MC and on the background and purpose of real estate company provisions. Secondly, the scope of Article 13(4) as drafted in the OECD MC and its Commentary will be examined

case of immovable property – the interposition of a company (cf. De Broe, *International Tax Planning and Prevention of Abuse*, Ch. 1 at m.no. 12).

⁷ Cf. Simontacchi, *Taxation of Capital Gains*, p. 315 et seq.

⁸ Cf. Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661); cf. Simontacchi, *Taxation of Capital Gains*, p. 314 et seq.

⁹ See para. 23 and 28.3 of the OECD Commentary 2014 on Art. 13. In the following, unless otherwise indicated, any references to the OECD Commentary relate to the OECD Commentary 2014.

¹⁰ In the present thesis, companies whose shares derive more than 50 per cent of their value directly or indirectly from immovable property will be referred as *real estate companies* or *immovable property companies* whereby the terms are used as synonyms (cf. in this respect Reimer, in Reimer-Rust (eds.), *Vogel on DTCs*, Art. 13 at m.no. 51).

¹¹ Meanwhile, the elaboration in this thesis will be limited to the – according to the opinion of this author – most important, striking and current issues in respect to the subject matter.

whereby it will be expanded on the possible deviations thereof. Subsequently, the legal consequences of the applicability of Article 13(4) will be pointed out. In order to find the optimal construction of Article 13, the thesis further analyses the open issues inherent with Article 13. In this context – to the extent necessary for the purpose of the present investigation – it will also be touched on domestic law provisions. Finally, the findings of the analysis will be summarised and it will be seen whether Article 13, and especially paragraph four, is able to ensure, expressed in the words of *Richard Krever*, a *jurisdiction's right to tax gains wholly attributable to real property in the country*¹².

¹² Cf. Krever, *Tax Treaties*, 212 (214).

A. GENERAL REMARKS

I. Real Estate Company Provisions

Before the OECD has introduced the real estate company provision in Article 13(4) OECD MC, similar provisions were already known in many national tax laws¹³. Generally, such domestic provisions provide that gains arising from the sale of shares which derive their value principally from real estate located within the territory of a the corresponding jurisdiction are defined as sourced therein¹⁴. Paragraph 23 on Article 13 of the 1977-2003 OECD Commentary acknowledged this by stating that “certain tax laws assimilate the alienation of all or part of the shares in a company, the exclusive or main aim of which is to hold immovable property, to the alienation of such immovable property.” However, the Commentary further explained that Article 13(1) does in itself not allow such practice: only a special provision in the bilateral convention can provide for such assimilation. If contracting states wish to include such a provision, they are free to do so¹⁵. Consequently, it is definite that domestic law provisions allocating the taxing right to the situs state were completely thwarted in cases where the tax convention concerned did not entail a special provision which allowed a situs state taxation, as the taxation right was otherwise exclusively assigned to residence state¹⁶.

Accordingly, numerous of the reservations made by the OECD Member countries and a substantial number of the positions of non-Member countries on Article 13 of the 1963-2000 OECD Models relate to the allocation of taxing rights on gains derived from the sale of interests in real estate companies¹⁷. Several double tax conventions correspondingly deviate from the ante-2003 Article 13(4) OECD MC in order to enable the application of national sourcing rules regarding the sale of shares of real estate companies¹⁸.

¹³ In the present thesis, national and tax treaty provisions similar to Article 13(4) OECD MC will be referred to as *real estate and immovable property company provisions*.

¹⁴ Simontacchi, *Taxation of Capital Gains*, p. 314.

¹⁵ Para. 23 on Art. 13 of the 1977-2003 OECD Commentary.

¹⁶ Cf. Simontacchi, *Taxation of Capital Gains*, p. 316 et seq.

¹⁷ See the reservations of Canada, Finland, France, Japan, Korea, Spain, the United States, Ireland, Mexico, Sweden (Member countries) and the positions of Argentina, Brazil, Estonia, Israel, Latvia, Lithuania, Romania, Thailand and Ukraine (non-Member countries).

¹⁸ For further details see Simontacchi, *Taxation of Capital Gains*, p. 316 et seqq.

Besides the domestic tax law level, several model conventions and even multilateral tax treaties¹⁹ contained similar immovable property company provisions already before 2003²⁰. Akin the current Article 13(4) OECD MC, Article 13(4) of the 1980 version United Nations Model²¹ allowed that “[g]ains from the alienation of shares of the capital stock of a company the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State”. Furthermore, the 1981 United States Model as well as the 1987 Intra-ASEAN Model already contained real estate provisions in their Articles 13(2) resp. 13(4).

II. Addition of Article 13(4) in the OECD Model Convention

In the light of the above-mentioned remarks, it seems that the OECD has introduced Article 13(4) due to the national sourcing provisions in force in various countries and based on the related treaty practice, which was already incorporated in other model conventions²². Alike the domestic and the treaty law real estate company provisions, Article 13(4) OECD MC admittedly pursues an anti-abuse aim²³. This understanding seems to be confirmed by the 1989 OECD Tax Treaty Override Report which stated – commenting on similar (national) real estate company provisions – that “the overriding measure is clearly designed to put an end to improper use of [...] tax treaties”²⁴.

III. Purpose and Nature of Article 13(4) OECD Model Convention

It can be concluded that Article 13(4) OECD MC was introduced based on anti-abuse deliberations. The provision is targeted at preventing rule shopping and reflects the developments conducted for many years by numerous states and their treaty practice.

¹⁹ See e.g. Article 7(1) and Article 7(2) of the *Agreement Among the Governments of the Member States of the Caribbean Community for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Profits or Gains and Capital Gains and for the Encouragement of Regional Trade and Investment*, signed on 6 July 1994 by Antigua and Barbuda, Belize, Grenada, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines and Trinidad and Tobago or Article 13(2) of the *Convention Between the Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital*, signed at Helsinki on 23 September 1996 by Denmark (in conjunction with the Faeroe Islands), Finland, Iceland, Norway and Sweden (cf. Simontacchi, *Taxation of Capital Gains*, p. 311 et seq.).

²⁰ Cf. Simontacchi, *Taxation of Capital Gains*, p. 307 f.

²¹ Hereinafter referred to as UN Model.

²² Cf. Simontacchi, *Taxation of Capital Gains*, p. 319.

²³ Although the anti-abuse aim is not explicitly mentioned in the OECD Commentary as it is in the case regarding the UN Model (United Nations, *Manual for the Negotiations of Bilateral Tax Treaties Between Developed and Developing Countries*, New York, 2003, Observations to Article 13); Simontacchi, *Taxation of Capital Gains*, p. 319.

²⁴ See OECD, *Tax Treaty Override*, Paris 1989, Para. 32.

Further, the aim of Article 13(4) OECD MC is creating an equal tax treaty regime regarding the indirect and direct alienation of real estate²⁵. Although the article should serve as an anti-abuse provision, it is drafted as an autonomous distributive rule, i.e. the application of Article 13(4) is not limited to abusive situations²⁶.

²⁵ Para. 23 and 28.3 of the OECD Commentary on Art. 13.

²⁶ Cf. Simontacchi, *Taxation of Capital Gains*, p. 320 et seq.

B. SCOPE

Article 13(4) OECD MC covers gains realised from the sale of shares deriving more than 50 per cent of their value directly or indirectly from immovable property, i.e. from the sale of shares in real estate companies. Hence, it has to be examined when an enterprise can be regarded as a real estate company within the sense of Article 13(4) OECD MC.

I. Definition of a Real Estate Company

1. Enterprises covered

Unlike the real estate provision of the UN Model, Article 13(4) OECD MC initially does only cover gains from shares²⁷. However, the Commentary mentions that states, which wish that Article 13(4) OECD MC also applies to gains from the alienation of interests in other entities, such as partnerships or trusts, are free to do so and suggests an appropriate amendment to Article 13(4) OECD MC²⁸.

In view of the purpose of Article 13(4), states treating partnerships as opaque for tax purposes are advised to extend the provision to partnerships²⁹. Otherwise, taxpayers may circumvent the provision by holding the immovable property through a partnership. Finally, in order to prevent double taxation and double non-taxation in the context of hybrid partnerships issues, states should mutually consider the treatment of partnerships for tax purposes under the domestic law of the particular contracting state facing during negotiations³⁰.

²⁷ Article 13(4) UN Model covers gains from the alienation of interests in a partnership, trusts and estates.

²⁸ Para. 28.5 of the OECD Commentary on Article 13; cf. also the UN Model, in which gains from the alienation of interests in a partnership, trusts and estates are already included in the provision itself (Article 13(4) UN Model).

²⁹ Cf. in this respect also Wassermeyer, in Wassermeyer-Lang-Schuch (eds.), *OECD-Musterabkommen*, Art. 13 at m.no. 21, 79 and 123 c. According to Wassermeyer's opinion, the decision if partnerships fall within the scope of Article 13(4) OECD MC depends on whether the interest in a partnership owing real estate is regarded as movable or immovable property under the domestic law of the situs state. However, this understanding may lead to unsatisfactory results in cases of hybrid partnerships and should therefore be rejected.

³⁰ See for further information about issues in international tax law in the context of partnerships, OECD Partnershipreport; BEPS Report on hybrids; Barenfeld, *Taxation of Cross-Border Partnerships*, p. 331 et seqq.

2. 50 Per Cent Threshold

Based on the OECD MC, companies whose shares derive more than 50 per cent of their value directly or indirectly from immovable property are identified as real estate companies for tax treaty purposes.

Therefore, the concept of a real estate company within the meaning of Article 13(4) OECD MC deduces from the relative contribution of the value of the immovable property that the company holds in a certain state to the value of the shares – and not, as provided for in some domestic laws, according to the principal and actual target a company pursues³¹. Hence, the origin of the value of the shares is essential for the tax treaty concept of real estate companies.

a. Property to recognise

One may expect that the value of the shares should be ascertained by deducting the debts and liabilities of a company from the value of the company's net assets. However, the OECD Commentary states in Paragraph 28.4 on Article 13 that the determination whether shares reach the 50 per cent threshold “will normally be done by comparing the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property)”³². Hence, since debts and other liabilities are excluded in the calculation, the 50 per cent test has to be determined based on the ratio between the value of the relevant real estate and the value of all the property owned by the company.

This approach is welcome especially from a practical standpoint due to the fact that a specific attribution of financial resources to its various assets would open the possibility to subjective evaluations and thus manipulations³³. If debts and other liabilities could be taken into account for the purposes of Article 13(4) OECD MC, a shareholder controlling a real estate company could arrange that the company concerned will take out a loan just before the point of time of the alienation of the shares of the real estate

³¹ See for instance Switzerland (cf. e.g. the decision of the Federal Supreme Court of Switzerland BGer 21 January 2010, 2C_641/2009, Para. 5.1; cf. Riedweg-Suter, in Zweifel-Beusch-Matteotti (eds.), *Kommentar Internationales Steuerrecht*, Art. 13 at m.no. 59).

³² Para. 28.4 of the OECD Commentary on Art. 13. Cf. Simontacchi, *Taxation of Capital Gains*, p. 359 et seq. for the question whether Article 3(2) OECD MC is applicable in respect of the term „property“.

³³ Simontacchi, *Taxation of Capital Gains*, p. 361 et seq.

company. Therewith, the company could lower the relative contribution of the value of the real estate to the value of the shares and thus may not fall within the scope of Article 13(4) OECD MC. This would finally render the applicability of the provision and thus the tax regime applicable in the power of the shareholder.

Moreover, this method seems to be reasonable since the decision to exclude debts and liabilities from the calculation – even when secured by mortgages on the relevant immovable property – stems most probably from the economic principle according to which financial resources of a company pertain to the whole company and cannot be unambiguously attributed to its different assets³⁴. Finally, it should be noted that the OECD Commentary merely describes how the determination of the 50 per cent threshold will *normally* be done.

b. Variations regarding the Threshold

The Commentary explains that the 50 per cent threshold is not set and states may increase or reduce it³⁵. Given the fact that Article 13(4) allows the taxation of the entire gain attributable to the shares to which it applies – even where part of the value of the shares is derived from property other than immovable property located in the source state³⁶ – it is questionable why the situs state should be allowed to tax the entire gain, for instance in cases where merely 20 or 30 per cent of the value of the relevant shares is derived from real estate located in the situs state. Hence, it would be desirable to have the OECD amend this statement and set a minimum, reasonable level regarding the threshold, which states should not undercut³⁷.

3. Valuation of the Shares

The value of the shares may be either assessed based on the net book or fair market value of the immovable property concerned. In most cases, the book value is easy to ascertain as it is listed in accounting books and on balance sheets. At the same time, the reference to the book value carries the risk of circumvention of Article 13(4) since the book value is subject to depreciations and thus opens the possibility to subjective

³⁴ Cf. Simontacchi, *Immovable Property Companies*, Tax Treaty Monitor 2006, 29 (33).

³⁵ Para. 28.6 of the OECD Commentary on Art. 13.

³⁶ Para. 28.4 of the OECD Commentary on Art. 13.

³⁷ The floor does not have to be 50 per cent. However, a floor under 30 per cent would not seem to be reasonable anymore. Cf. in this respect also the critique from Simontacchi, *Immovable Property Companies*, Tax Treaty Monitor 2006, 29 (30).

evaluations and manipulations. In addition, the net book value often does not reflect the actual value of real estate due to the appreciation over the years. This might lead to an underestimation of the value of the shares³⁸.

In contrast, the market value of the immovable property is most suitable to reflect the value of the shares but requires an extensive valuation process and is costly and complex. Hence – despite being economically reasonable and thus desirable³⁹ – the assessment of the value of the shares at market value is hardly feasible in reality and therefore may not be advisable as reference⁴⁰. This can be seen as confirmed by the fact that national real estate company provisions usually call on the market value of immovable property, as for instance the US and Canadian Tax laws do⁴¹.

The arguments in favour of the net book value as a reference for the valuation of the shares are even stronger in view of the fact that Article 13(4) OECD covers also the indirect derivation of value⁴². States are therefore advised to refer to the net book value of the immovable property for the purpose of Article 13(4).

4. Direct or Indirect Derivation of Value

The scope of Article 13(4) OECD MC covers both the direct and indirect derivation of value from immovable property. The Commentary does not give any guidance on the understanding of indirect derivation of value. Starting from the wording of Article 13(4), the inclusion of indirect derivation of value means that in order to determine whether a company is regarded as a real estate company for treaty purposes, it has to be examined whether the company under examination holds shares in other companies which in turn own real estate. Without this inclusion, Article 13(4) could be circumvented as another company could be simply interposed between the shareholder and the company holding the real estate⁴³. Consequently, the inclusion of the indirect derivation of value is inevitable in view of the purpose of Article 13(4).

³⁸ Cf. Simontacchi, *Taxation of Capital Gains*, p. 363 et seq.

³⁹ Cf. Wassermeyer, in Wassermeyer-Lang-Schuch (eds.), *OECD-Musterabkommen*, Art. 13 at m.no. 123 d.

⁴⁰ Cf. Reimer, in Reimer-Rust (eds.), *Vogel on DTCs*, Art. 13 at m.no. 114.

⁴¹ See in respect of the US law I.R.C. Sec. 897(c)(2)(B) and I.R.C. Sec. 897(g); Canadian law Para. 248(1)(e) I.T.A.; cf. Simontacchi, *Taxation of Capital Gains*, p. 364 et seq.

⁴² Cf. the following chapter B.I.4.

⁴³ Cf. Simontacchi, *Taxation of Capital Gains*, p. 367.

a. The Lamesa Case

The necessity of an explicit reference to the indirect derivation of value has become evident in the Australian case *Lamesa*⁴⁴ in 1997. In this case, the interposition of a company between a foreign shareholder and an Australian mining company enabled that the gains derived by the foreign shareholder fell outside the scope of the real estate company provision in the Australia-Netherlands tax treaty⁴⁵. Australia's Federal Court clarified that "[w]hen legislation speaks of the assets of one company it invariably does not intend to include within the meaning of that expression assets belonging to another company, whether or not held in the same ownership group". Although the result of this decision might not have been satisfying in the end, it was the only correct one, as another conclusion would have been problematic in view of the principles of legality and legal certainty. Therefore, the explicit reference to the indirect derivation of value in the wording of the provision itself – and not only in the Commentary – is indispensable to achieve the aim of Article 13(4) and to be compatible with fundamental legal principles. However, although this broad coverage of the provision is desirable, it may lead to numerous issues in practice.

b. Calculation

Starting from Article 13(4) and the Commentary, the term indirect derivation of value is not limited in any way. In addition, the OECD Commentary does not give any guidance on how the indirect derivation of value should be taken into account. Hence, the computation of the value of the shares in a top holding company with a chain of subsidiaries might often be almost impossible in practice, all the more in cases where the subsidiaries are resident in different states⁴⁶.

a. Separate Determination Approach

One possibility to take the indirect derivation of value into account is simply to define the shares in a real estate company as immovable property for tax treaty purposes. This

⁴⁴ *Federal Commissioner of Taxation v. Lamesa Holdings BV*, [1997] 785 FCA (20 August 1997), NG 225 of 1997, Sydney, 20 August 1997 in the Federal Court of Australia, New South Wales District Registry No. NG 225 of 1997.

⁴⁵ Cf. Simontacchi, *Taxation of Capital Gains*, p. 367; cf. Sasseville, *Definitional Issues Related to Article 13 (Capital Gains)*, in Maisto (ed.), *Taxation of Companies on Capital Gains on Shares*, 71 (82). See for further details about the *Lamesa* case Kobetsky, *Lamesa Case*, *Tax Treaty Monitor* 2005, 236 et seqq.

⁴⁶ Cf. Simontacchi, *Taxation of Capital Gains*, p. 367 et seq.

approach can be found for instance in the 1981 US Model and the 1976 Canada-Spain tax treaty. Accordingly, the shares designated as immovable property are that case regarded as located in the situs state of the immovable property concerned. Meaning in a two-tier group, the computation of the value of the shares under examination would consist of a two-step process. This so-called *separate determination* method process would look in a two-tier group as follows⁴⁷:

- (1) Firstly, the value test, namely whether the shares of a subsidiary⁴⁸ are regarded as immovable property, has to be applied separately to each subsidiary of the holding company under examination (i.e. whose shares are alienated).
- (2) Subsequently, the value test has to be applied at the holding company level by taking into account the value of the participations held in the subsidiaries either as immovable property (in cases the shares of the subsidiary are regarded as real estate according to the value test), or as movable property (if the shares are considered as movable property pursuant to the value test)⁴⁹.

For the sake of clarity, the separate determination method will be illustrated by the following two-tier group example⁵⁰.

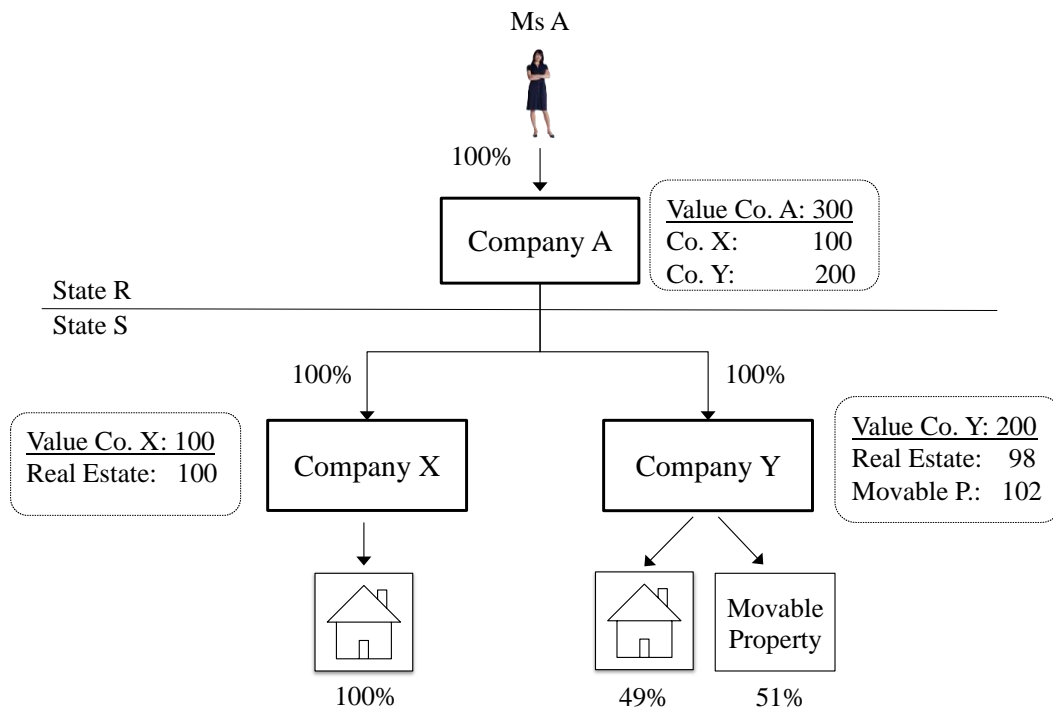
⁴⁷ See the Diagram on the next page. Cf. also Simontacchi, *Taxation of Capital Gains*, p. 368 et seq.

⁴⁸ For the sake of convenience, it is assumed that the companies owing the real estate concerned are subsidiaries of the company whose shares are alienated. However, Article 13(4) does not only cover subsidiaries but also non-substantial shareholdings in other companies.

⁴⁹ Cf. Simontacchi, *Taxation of Capital Gains*, p. 368 et seq.

⁵⁰ A two-tier holding structure with solely two subsidiaries located in the same jurisdiction is chosen since it demonstrates the concept of the separate determination method but is still clear.

Diagram I⁵¹



Ms A is a resident of State R and holds 100 per cent of the shares in company A⁵². Company A in turn holds all shares of company X and company Y, which are both resident in state S. The only asset of company X is a building worth 100 located in state S. On the other hand, company Y has a value of 200 and holds both immovable and movable property, whereby the former has a value of 98 and the latter of 102.

If Ms A alienates the shares in company A, under the separate determination method, at the first step, the value test has to be applied separately for each subsidiary. As the only asset of company X is a building, all shares of company A will be regarded as immovable property under this approach. On the contrary, the shares of company Y constitute movable property, since 51 per cent of the value is derived from movable property⁵³. Company A does not have any other assets than the shares in company X and Y. Hence, a third of the total value of the shares of company A is derived from

⁵¹ Cf. the similar Diagram in Simontacchi, *Taxation of Capital Gains*, p. 369.

⁵² In this example, company A is also resident in State R. However, this fact is irrelevant for the purpose of the application of Article 13(4) OECD MC. The same holds true for company X and Y (see chapter B.II. regarding the bilateral scope of Article 13(4) OECD MC).

⁵³ 102 of the total value of 200.

immovable property (the 100 from company X) and two-thirds per cent from movable property (the 200 from company Y). Thus, the separate determination method would lead to the result that less than 50 per cent of the value of the shares of company A are derived from immovable property situated in state S and Article 13(4) would therefore not be applicable. Instead, Article 13(5) would be applicable and the resident state would have the exclusive taxation right.

If company A would hold the assets directly, i.e. without the interposition of company X and Y, it would hold immovable property worth 198 and movable property 102. In this case, Article 13(4) would be applicable and the situs state would have the primary taxation right. The same holds true if Ms A would own the assets concerned directly. Hence, the separate determination method misses the target of Article 13(4) – the equalisation of the tax regimes regarding the direct and indirect alienation of real estate for tax treaty purposes⁵⁴. Accordingly, the application of the separate determination method would open a loophole for taxpayers to circumvent any taxation in the situs state.

b. Proportional Consolidation Approach

Apart from the separate determination method, the indirect derivation of value might alternatively be taken into account based on the *proportional consolidation* approach⁵⁵. The proportional consolidation method consists also of a two-step process, which presents itself as follows:

- (1) Primarily, the values of the assets owned by the subsidiaries are attributed proportionately to the shares under examination (i.e. the shares that are alienated) with respect to the level of participation. This proportional consolidation of all companies involved may follow the accounting standards for drafting a consolidated balance sheet⁵⁶.
- (2) In a second step, the properties from which the shares concerned derive their value have to be examined based on the consolidated situation under (1).

⁵⁴ See para. 23 and 28.3 of the OECD Commentary on Art. 13.

⁵⁵ Cf. Simontacchi, *Taxation of Capital Gains*, p. 368 et seqq.; cf. also Sasseville, *Definitional Issues Related to Article 13 (Capital Gains)*, in Maisto (ed.), *Taxation of Companies on Capital Gains on Shares*, 71 (82).

⁵⁶ Cf. Simontacchi, *Taxation of Capital Gains*, p. 368.

Thereby, all exceptions and rules applicable in order to confirm the fulfilment of the requirement are applied in respect of all subsidiaries⁵⁷.

If applying the proportional consolidation method to the example in Diagram I, the computation would lead to the result that 198 of the value of the shares of company A are derived from immovable property situated in state S⁵⁸ and 102 from movable property. Hence, the shares of company A would derive more than 50 per cent of their value from immovable property located in state S and Article 13(4) OECD would be applicable.

Therefore, the proportional consolidation method leads to the same outcome as if Ms A or company A would hold the assets directly, i.e. without the interposition of company X and Y. As the tax regimes regarding the indirect and direct alienation of real estate are equated under this method, the proportional consolidation method serves the purpose of Article 13(4) and is thus compatible with the OECD MC⁵⁹.

However, the application of the proportional consolidation method is complex, time-consuming and costly in practice. Especially in cases where domestic laws concerned refer to the net market value of properties to be taken into account for the consolidation process and all the more when the contracting states involved do apply different accounting principles⁶⁰.

As seen earlier in this chapter, without deviation from the OECD MC, the term indirect derivation of value is not limited in any way. Inter alia, this means that all shareholdings, even a minority shareholding, falls within the scope of Article 13(4) in a case of the alienation of the shares. In view of the proportional consolidation method, a minority shareholder might have difficulties in determining whether the shares in large companies carrying on business and owing real estate in several jurisdictions derive more than 50 per cent of their value from immovable property situated in a certain state⁶¹. Concurrently, it may also be far from simple for tax authorities and administration of the situs state to ascertain and monitor the alienation of real estate company shares in cases where the company, the alienator and the acquirer are non-

⁵⁷ Cf. Simontacchi, *Taxation of Capital Gains*, p. 368.

⁵⁸ $100\% \times 100$ (company X) + $100\% \times 98$ (company Y) = 198.

⁵⁹ See para. 23 and 28.3 of the OECD Commentary on Art. 13.

⁶⁰ Cf. Simontacchi, *Taxation of Capital Gains*, p. 368.

⁶¹ Cf. Sasseville, *Definitional Issues Related to Article 13 (Capital Gains)*, in Maisto (ed.), *Taxation of Companies on Capital Gains on Shares*, 71 (82 et seq.).

residents. If they are residents of different jurisdictions, the consolidation process might be even more burdensome, costly and time-consuming, especially in respect of minority shareholdings in in a multi-tier holding company⁶².

c. Interim Findings

Due to the fact that the separate determination method is not in line with the purpose of Article 13(4) OECD MC and leaves loopholes for abusive structures, the proportional consolidation method seems to be the only method compatible with the OECD MC. Consequently, it is suggested that states should apply the proportional consolidation method⁶³. As the OECD Commentary leaves room for several limitations and exceptions, the practical issues inherent in the proportional consolidation approach might be mitigated or even eliminated therewith and thus might render it more appealing than it may seem at a first glance.

5. Possible Limitations

Apart from the possibility of including other entities in the scope of Article 13(4)⁶⁴ and the variation of the 50 per cent threshold⁶⁵, the OECD Commentary mentions further potential deviations from the OECD MC⁶⁶.

a. Minority Shareholdings

The Commentary points out in Paragraph 28.6 on Article 13 that states may agree to restrict the application of Article 13(4) to cases where the alienator holds a certain level of participation in the entity. In view of the only possible method to include the indirect derivation of value, i.e. the proportional consolidation approach, the alienation of minority shareholdings in real estate companies should indeed be excluded from the scope of Article 13(4). Rather, given the anti-abuse intention of the provision – that shareholders should not be able to circumvent a situs state taxation by interposing a company – only shareholdings that allow to participate and play a significant role in the

⁶² Cf. Sasseville, *Definitional Issues Related to Article 13 (Capital Gains)*, in Maisto (ed.), *Taxation of Companies on Capital Gains on Shares*, 71 (82 et seq.).

⁶³ In cases states do not apply the proportional consolidation approach, it is major that they at least agree on a uniform method and do not apply different approaches to consider the indirect derivation of value.

⁶⁴ See chapter B.I.1.

⁶⁵ See chapter B.I.2.

⁶⁶ Within the framework of this thesis, background and further details about possible limitations and broadenings will only be discussed where necessary.

decision making process regarding the company structure should be covered by Article 13(4)⁶⁷. This understanding seems to be shared by several states as showed in their tax treaties concluded. For instance, the tax treaty between Canada and Germany (2001) excludes shareholdings amounting less than 10 per cent from the scope of Article 13(4)(a) of the treaty concerned⁶⁸.

In the light of (the other) purpose of Article 13(4) OECD MC, the equalisation of treaty regimes regarding direct and indirect alienation of real estate, a limitation based on the relative participation in a company⁶⁹ might be linked to a defined threshold expressed in a certain currency which the shareholding under examination must reach in order to fall within the scope of the provision⁷⁰.

Additionally, limitations regarding the participations taken into account in the proportional consolidation process do seem advisable with regards to the indirect derivation of value and the practical issues of the computation thereof. Participations that the company concerned holds in other entities should only be taken into account when a certain threshold, expressed as a relative participation and/or a defined amount of money, is exceeded. Consistent with *Simontacchi*, non-substantial participations should be regarded as movable property for the purpose of the proportional consolidation process, irrespective of the nature of the underlying asset⁷¹.

b. Shares listed on an approved Stock Exchange

As Article 13(4) should discourage from the interposition of a company between taxpayers and the real estate owned by them for the sole reason of circumventing situs state taxation, it is reasonable to exclude the alienation of shares of companies that are listed on an approved stock exchange as provided in Paragraph 28.7 of the OECD Commentary on Article 13. However, it is still advisable to set a threshold regarding the level of the participation above which the exception should not be applicable, namely

⁶⁷ Cf. Simontacchi, *Taxation of Capital Gains*, p. 348; cf. Riedweg-Suter, in Zweifel-Beusch-Matteotti (eds.), *Kommentar Internationales Steuerrecht*, Art. 13 at m.no. 244.

⁶⁸ See similar provisions in other treaties, e.g. the DTC between Austria and Canada (2002) or the DTC between Italy and Canada (2002); cf. Simontacchi, *Taxation of Capital Gains*, p. 348.

⁶⁹ I.e. expressed as a percentage of the total shares of the company under examination.

⁷⁰ As although the shareholder may not have the power to circumvent the provision, the situs state nevertheless might be interested in taxing high amounts relating to real estate located in its territory.

⁷¹ Cf. Simontacchi, *Taxation of Capital Gains*, p. 368.

for shareholdings that allow to participate and play a significant role in the decision making process of the company concerned⁷².

It is striking that the OECD Commentary does refer to shares of companies listed on an approved stock exchange *of one of the states*. As seen above, it is irrelevant whether the real estate company concerned is a resident of one contracting state or of a third country for the purpose of Article 13(4)⁷³. Accordingly, the same should hold true for the stock exchange exception. Therefore, states should implement the exception while referring to approved stock exchanges of whichever state⁷⁴. Exceptions for gains derived from the sale of listed shares are found in tax treaty practice for many years⁷⁵.

c. Corporate Reorganisations

The Commentary further provides for an exception for gains derived from the alienation of shares in the course of corporate reorganisations in Paragraph 28.7 on Article 13. Non-recognition rules for tax purposes regarding corporate reorganisations such as mergers or consolidations are found not only in domestic tax laws⁷⁶ but also in European law as within the context of the common system of value added tax⁷⁷. Under these provisions, reorganisation transactions may not be recognised for tax purposes in order that tax burden considerations do not deter from reorganisations. Hence, the exception for gains derived from the sale of shares in the course of corporate reorganisations from the scope Article 13(4) follows the general understanding that reorganisations have a positive effect from a business perspective. Since the non-recognition of the transactions concerned merely leads to a deferral of taxation⁷⁸, nothing speaks against this exception and thus it is advised to consider this exception when adding Article 13(4) to tax treaties in practice.

⁷² See for instance the US and Canadian national law, under which gains derived from the alienation of shares of real estate companies listed on an approved stock exchange are tax-exempt unless certain thresholds of participation are exceeded (see for further details Simontacchi, *Taxation of Capital Gains*, p. 349).

⁷³ The Commentary thus seems to be inconsistent in this respect in Para. 28.7 on Article 13.

⁷⁴ Cf. Simontacchi, *Taxation of Capital Gains*, p. 348 et seq. However, it should be noted that the limitation to shares listed on an approved stock exchange of the contracting states is found in some double tax conventions in practice (see for instance Article 13(4)(a) of the tax treaty between Canada and Germany (2001)).

⁷⁵ See for instance the Austria-Canada treaty (1976); the Netherlands-Canada treaty (1986) or the Switzerland-Canada treaty (1997).

⁷⁶ As for instance under Swiss tax law (Article 19 and 61 DBG (*“Bundesgesetz über die direkte Bundessteuer”*)).

⁷⁷ See Article 19 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

⁷⁸ Cf. Simontacchi, *Taxation of Capital Gains*, p. 351.

d. Real Estate in which a Business is carried on

The Commentary further points out in Paragraph 28.7 on Article 13 that states may consider that Article 13(4) should not apply to cases where the immovable property from which the shares derive their value is immovable property in which a business is carried on⁷⁹. Admittedly, the assumption that a corporate veil has been interposed between a shareholder and a real estate is questionable in cases where the company carries on its business in the real estate concerned⁸⁰.

The Commentary mentions a mine or a hotel as examples for immovable properties in which a business is carried on. Hence, the nature of the business activity has to be taken into account. For instance, the immovable property of a company, which rents apartments, may only qualify for the exception regarding the buildings in which the rental business is managed – and not in respect of the apartments rented⁸¹. This in turn raises the question how the exception should be dealt with when a company holds immovable property in which it carries on business but also real estate merely as capital investment. Assuming that the exception only applies to companies whose shares derive more than 50 per cent of their value from real estate in which the business is carried on, for instance, a hotel that owns real estate that represents 2 per cent of the value of its shares while the building in which the business is carried on constitutes 49 of the value thereof, could thus not qualify for the exception⁸². It is questionable whether such outcome would be in line with the rationale of this exception.

Alternatively, the exception could be understood as covering shares that derive their value from immovable property in which *principally* business is carried on. Accordingly, the shares of the hotel in the example mentioned above would fall within the scope of the exception.

Finally, it could also be argued that real estate in which business is carried on does not have to be taken into account for the purpose of the 50 per cent test. According to this approach, Article 13(4) would not be applicable to the hotel mentioned above since only

⁷⁹ See also the similar exception in the UN Model whereby the exception concerned is contained in the provision itself (Art. 13(4)(a) UN Model).

⁸⁰ Cf. Simontacchi, *Taxation of Capital Gains*, p. 357.

⁸¹ Cf. for instance Article 13(4) of the Germany-Canada double tax convention (2001) that explicitly excludes rental property from the exception.

⁸² Cf. Simontacchi, *Taxation of Capital Gains*, p. 357.

2 per cent of the value of the shares would be regarded as derived from immovable property⁸³.

The exception regarding shares deriving their value from real estate in which business is carried can be found in several tax treaties in practice⁸⁴. This shows the practical relevance of this limitation of the scope of Article 13(4). However, the example with the hotel demonstrated, depending on the method used, that the same case might result in different outcomes. Consequently, in order to avoid misunderstandings and disputes, states are advised to clarify in their treaties which method is applicable⁸⁵.

e. Shares held by Pension Funds and Similar Entities

In line with the newly introduced Paragraph 69 on Article 18 OECD Commentary that deals with the taxation of pension funds, the OECD added a corresponding statement to the Commentaries on Article 13⁸⁶. This new Paragraph 28.8 on Article 13 points out that due to the fact that pension funds and similar entities are generally exempt from tax on their investment income under the domestic law of many states, contracting states may provide for a corresponding exemption in the context of Article 13(4) and exempt shares held by such entities from situs state taxation. In this way, neutrality of treatment as regards domestic and foreign investments by pension funds and similar entities can be safeguarded⁸⁷.

f. Shares in a Real Estate Investment Trust

Finally, corresponding to the OECD Report⁸⁸ and subsequent amendments to the OECD Commentary in 2008⁸⁹, the OECD introduced new paragraphs to the Commentary on Article 13 stating that an exception to Article 13(4) for the alienation of a small investor's interest in a real estate investment trusts⁹⁰ may be considered to be

⁸³ Cf. Simontacchi, *Taxation of Capital Gains*, p. 357.

⁸⁴ See for instance the DTC between Germany and Canada (2001), the DTC between Switzerland and Canada (1997) or the DTC between Argentina and the Netherlands (1996).

⁸⁵ Certainly, states may also agree to apply another method than one of the above-mentioned.

⁸⁶ Para. 28.8 of the OECD Commentary on Art. 13 (added in 2005).

⁸⁷ Cf. Para. 28.8 of the OECD Commentary on Art. 13.

⁸⁸ OECD of 20 June 2008, Tax Treaty Issues related to REITs.

⁸⁹ Para. 67.1 to 67.7 of the OECD Commentary on Art. 10.

⁹⁰ Hereinafter referred to as REITs.

appropriate⁹¹. In view of the special tax treatment of REITs under several domestic laws, such exemption does seem reasonable.

g. Interim Findings

As discussed in chapter B.I.4., due to the fact that Article 13(4) covers both direct and indirect derivation of value, the scope of the provision is rather broad which is not suitable to all situations⁹² and may lead to almost insurmountable practical obstacles⁹³. This may not only be undesirable from the viewpoint of taxpayers but also for tax authorities as administration, monitoring, obtaining information and the collection of taxes in the context of Article 13(4) might be burdensome, time consuming and costly. Yet, it should be adhered to the inclusion of the indirect derivation of value as the purpose of real estate provisions might otherwise be undermined⁹⁴.

In view of the several possible limitations and exceptions to Article 13(4) OECD provided in the OECD Commentary, it seems that the OECD acknowledges these issues⁹⁵. According to the opinion of the author of this thesis, in particular the exceptions regarding minority shareholdings and listed shares on approved stock exchanges – implemented as described above – are of great relevance in practice. Therewith, the issues in consequence of the broad scope of Article 13(4), especially in respect of the feasibility and complexity of the proportional consolidation method⁹⁶, might be mitigated in practice. Hence, it is strongly advised to consider these limitations and exceptions when reviewing or introducing Article 13(4) OECD MC.

II. Geographical Scope

Article 13(4) OECD MC applies to gains derived by a *resident of a contracting state* from the sale of shares of deriving more than 50 per cent of their value directly or indirectly from real estate located in *the other contracting state*. Hence, Article 13(4)

⁹¹ Cf. Para. 28.9 to 28.11 of the OECD Commentary on Art. 13. See for further details Reimer, in Reimer-Rust (eds.), *Vogel on DTCs*, Art. 13 at m.no. 119; para. 28.9 to 28.11 of the OECD Commentary on Art. 13 and para. 67.1 to 67.7 of the OECD Commentary on Art. 10.

⁹² For instance in cases where shareholders clearly do not have abusive intents.

⁹³ Especially in the context of the method taking the indirect derivation of value into account as seen above in chapter B.I.4.

⁹⁴ As the taxpayer could simply interpose a second company between the real estate concerned and himself (cf. chapter B.I.4).

⁹⁵ Cf. Simontacchi, *Taxation of Capital Gains*, p. 347.

⁹⁶ As the only method compatible with the purpose of Article 13(4) and the OECD MC.

OECD MC does unequivocally have a bilateral scope⁹⁷. Consequently, cases where the real estate concerned is situated in a third state or in the contracting state of which the alienator is a resident would fall outside the scope Article 13(4) OECD MC⁹⁸. On the other hand, both the provision itself and the Commentary are silent about the location of the immovable property company, i.e. it is immaterial whether the company is a resident of the situs state, the resident state of the alienator or even of a third state for the applicability of Article 13(4) OECD MC.

The bilateral scope of Article 13(4) OECD MC requires that more than 50 per cent of the value of the shares under examination derive their value from real estate located *in the other contracting state*. Consequently, triangular cases where a company owns real estate located in the other contracting state but also in a third state would fall outside the scope of Article 13(4) if less than 50 per cent of the property is situated in the other contracting state – even if the company does not have any other assets besides the real estate⁹⁹. Accordingly, shares of companies that own real estate spread over different countries while the 50 per cent threshold is not reached within any of these countries, are not covered by Article 13(4)¹⁰⁰. As a consequence, Article 13(5) would be applicable and none of situs countries involved would be allowed to tax a part of the gain derived from the sale of the relevant shares. Clearly, this effect of the bilateral scope of the provision may be used by taxpayers to circumvent the application of Article 13(4) and therewith a situs taxation. However, this issue could only be solved by multilateral tax conventions concluded between the countries involved.

III. Conclusion on the Scope of Article 13(4)

The analysis of the scope of Article 13(4) OECD MC revealed the initial broad scope of the real estate company provision as drafted in the OECD MC and its Commentary. In particular the inclusion of the indirect derivation of value leads to the extensive coverage of real estate provisions following the OECD MC.

⁹⁷ Instead of a global scope as e.g. Article 13(5) OECD MC does have.

⁹⁸ Cf. Simontacchi, *Taxation of Capital Gains*, p. 324 et seq., which deduces the bilateral scope of Article 13(4) OECD MC from the subsidiarity of Article 13(4) to Article 13(1) and para. 22 of the OECD Commentary on Art. 13.

⁹⁹ And thus clearly would be regarded as an immovable property company within a broader sense.

¹⁰⁰ Cf. Riedweg-Suter, in Zweifel-Beusch-Matteotti (eds.), *Kommentar Internationales Steuerrecht*, Art. 13 at m.no. 246; Danon/Faltin, in Danon et al. (eds.), *Commentaire Modèle De Convention fiscale OCDE*, Art. 13 at m.no. 19; Ženatý, *The Abuse Concept of Art. 13(4)*, 431 (438).

States may even extend the scope by covering additional gains from the alienation of interests in other entities, such as partnerships or trusts¹⁰¹, as is provided for in the corresponding provision of the UN Model¹⁰². Moreover, the scope might further be broadened through a reduction of the 50 per cent threshold requirement, as more companies would thereby be classified as real estate companies for tax treaty purposes¹⁰³. Whereas the extension to other entities is advisable since this might be necessary to close possible loopholes, it does not seem reasonable to leave room for unlimited variations of the threshold. In view the fact that Article 13(4) allows the taxation of the entire gain – even where part of the value of the shares concerned deduces from property other than immovable property located in the source state – it is doubtful why the situs state should be allowed to tax the entire gain in cases where only a small proportion of the value of the shares concerned derives from real estate. According to the opinion of this author, it is thus advisable to set a minimum, reasonable level regarding the threshold, which states should not undercut¹⁰⁴.

At the same time, the Commentary does also leave considerable room for limitations and exceptions to the scope of Article 13(4). The reverse possibility of deviating from the 50 per cent threshold, i.e. the increase of it, is one of the numerous ways to narrow the scope of the provision¹⁰⁵. Furthermore, states may exempt minority shareholdings¹⁰⁶, shares listed on approved stock exchanges¹⁰⁷, held by pension funds¹⁰⁸ and (or) in REITs¹⁰⁹ from the scope of Article 13(4). Besides that, it may be provided that gains derived from the alienation of shares in the course of corporate reorganisations fall outside the scope of the provision¹¹⁰. Finally, states may consider that Article 13(4) should not apply to cases where the immovable property from which the shares derive their value is immovable property in which a business is carried on¹¹¹.

In the context of most of these possible limitations and exceptions, abusive intents, namely that a corporate veil has been interposed between the shareholder and a real

¹⁰¹ Para. 28.5 of the OECD Commentary on Art. 13.

¹⁰² Article 13(4) UN Model.

¹⁰³ Para. 28.6 of the OECD Commentary on Art. 13.

¹⁰⁴ See chapter B.I.2.b.

¹⁰⁵ Para. 28.6 of the OECD Commentary on Art. 13.

¹⁰⁶ Para. 28.6 of the OECD Commentary on Art. 13.

¹⁰⁷ Para. 28.7 of the OECD Commentary on Art. 13.

¹⁰⁸ Para. 28.8 of the OECD Commentary on Art. 13.

¹⁰⁹ Para. 28.9 to 28.11 of the OECD Commentary on Art. 13.

¹¹⁰ Para. 28.7 of the OECD Commentary on Art. 13.

¹¹¹ Para. 28.7 of the OECD Commentary on Art. 13.

estate for tax purposes, hardly would be found due to a lack of power of decision making of the shareholder and other circumstances inherent to these cases in reality. As Article 13(4) is drafted as an autonomous distributive rule and includes non-rebuttable presumptions¹¹², the mentioned limitations to the scope of Article 13(4) are reasonable and thus advisable to consider.

Besides the possibility to provide for limitations and exceptions to the provisions, the scope of Article 13(4) could be narrowed by deleting the inclusion of the indirect derivation of value. However, this inclusion is necessary as otherwise, Article 13(4) could be easily circumvented. As seen in the *Lamesa*¹¹³ case, the explicit reference to the indirect derivation of value is indispensable. As the analysis showed, the inclusion of indirect derivation of value entails several difficulties in practice. The only approach to consider the indirect derivation of value compatible with the OECD MC is the proportional consolidation method, which is complex, costly and time-consuming in practice. However, states may address this by implementing limitations and exceptions to the scope of Article 13(4) as suggested above.

Hence, the limitations and exceptions to the scope of real estate provisions are of great relevance both as they serve as a counterbalance to the nature of the provision that also covers cases without any abusive intent and in order to increase the feasibility of the computation of the value of the shares concerned – especially the value derived indirectly.

Finally, the bilateral scope of Article 13(4) may lead to undesired outcomes since it could be used to circumvent the application of Article 13(4) and therewith a situs taxation¹¹⁴. However, cases where more than two states are involved include the fiscal sovereignty of all the states concerned. Hence, these kinds of issues, as seen regarding the consequence of the bilateral scope in the context of real estate company provisions, cannot be solved by double tax conventions but only by corresponding domestic laws and multilateral tax conventions.

¹¹² As Article 13(4) does also apply to cases without abusive intent and assumes that transactions falling within the scope of the provision stand for a sale of the underlying immovable property (cf. Simontacchi, *Taxation of Capital Gains*, p. 390).

¹¹³ *Federal Commissioner of Taxation v. Lamesa Holdings BV*, [1997] 785 FCA (20 August 1997), NG 225 of 1997, Sydney, 20 August 1997 in the Federal Court of Australia, New South Wales District Registry No. NG 225 of 1997.

¹¹⁴ See chapter B.II.

C. LEGAL CONSEQUENCES

If the conditions of Article 13(4) OECD are met and no exceptions are applicable, the application of the provision will entail the following consequences.

I. Taxation of Total Profit

As already mentioned in the context of the possible variations of the 50 per cent threshold¹¹⁵, the OECD Commentary explicitly states that Article 13(4) allows the taxation of the *entire* gain attributable to the shares to which it applies – even where part of the value of the shares is derived from property other than immovable property located in the situs state¹¹⁶.

Certainly, it would be desirable to apportion the gain and the taxation right thereto to the particular property from which the shares concerned derived their value. However, as already seen in the discussion of the scope of Article 13(4), the feasibility of several methods and approaches in the context of real estate company provisions often founders on the various practical obstacles inherent in the system of these provisions. This holds true with regards to the allocation of the taxation right. An apportionment of the gain limited to the part of the value of the shares that is derived from immovable property located in the situs state may often be too burdensome and not practical in reality. Furthermore, provided that the remarks and suggestions made in the chapter about the threshold¹¹⁷ will be taken into account and in view of the purpose of Article 13(4), the allocation of the taxation right comprising the entire gain to the situs state can be accepted.

Meanwhile, it should be kept in mind that Article 13(4) does solely allocate the primary taxation right to the situs state. The residence state may still tax the gain concerned but has to provide relief from double taxation according to Article 23 A or Article 23 B OECD MC.

II. Credit Method

If a residence country follows the exemption method according to Article 23 A OECD MC, the inclusion of Article 13(4) entails the risk of double non-taxation in cases where

¹¹⁵ See chapter B.I.2.b.

¹¹⁶ Para. 28.4 of the OECD Commentary on Art. 13.

¹¹⁷ See chapter B.I.2.b.

the situs state does not tax the gains allocated to it under Article 13(4). The Commentary acknowledges this and points out that these states, as residence states, may wish to exclude the gains falling under Article 13(4) from exemption and apply the credit method according to Article 23 B OECD MC¹¹⁸. As the introduction of Article 13(4) by no means should lead to a double non-taxation, exemption states are strongly advised to switchover to the credit method in the context of Article 13(4).

¹¹⁸ Para. 28.12 of the OECD Commentary on Art. 13 and para. 35 of the OECD Commentary on Art. 23A and 23B.

D. OUTSTANDING ISSUES

Although it has been more than a decade since the introduction of paragraph four to Article 13 OECD MC and the provision has been added to various tax treaties in the meantime, there is still little practical experience and a lot of legal uncertainty in respect of the application thereof¹¹⁹. Hence, as will be seen in the following, investigation and clarification in the context of real estate companies provisions is not only necessary in respect of their scope as discussed in the previous chapters.

I. Hierarchy within Art. 13 OECD MC

Occasionally, a certain tax event initially falls within the scope of more than only one article of a tax treaty. Hence, the interaction and hierarchies between the different provisions contained in a tax treaty are often clarified in the provisions itself¹²⁰. In the context of the taxation of capital gains, these concerns are dealt with in respect of Article 13(5) OECD MC¹²¹ and Article 13(3) OECD MC¹²². Unfortunately, this is not the case regarding the real estate company provision, as neither a textual priority indicator nor a hint in the Commentary on Article 13(4) regarding a potential precedence conflict exists. As will be shown in the following analysis, this lack of coordination might especially in cases where a permanent establishment is involved lead to problems.

1. Interaction between Article 13(2) and 13(4)

In respect of the interaction between paragraph two and four of Article 13, the following problem occurs: article 13(2) only deals with movable property – which is defined as all property other than immovable property as dealt with in Article 13(1) – forming part of the business property of a permanent establishment of an enterprise¹²³. As the introduction of Article 13(4) merely equalised the treaty regime of indirect alienations

¹¹⁹ Although real estate companies provisions have also been subject to numerous discussions and studies meanwhile; see for instance the 59th IFA Congress, Seminar F, *Capital gains dealing with shares of real estate companies*, Buenos Aires, 21 September 2005.

¹²⁰ See for instance Art. 7(4) OECD MC that clarifies its subsidiarity to other provisions by stating that in cases where profits including items of income which are dealt with separately in other articles of the convention, the provisions of those articles shall not be affected by the provisions of article 7.

¹²¹ Article 13(5) OECD MC reads as follows: “Gains from the alienation of any property, *other than* that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident”; para. 29 and 30 of the OECD Commentary on Art. 13; cf. Pijl, *Capital Gains*, *World Tax Journal* 2013, 3 (70).

¹²² Cf. para. 28 of the OECD Commentary on Art. 13.

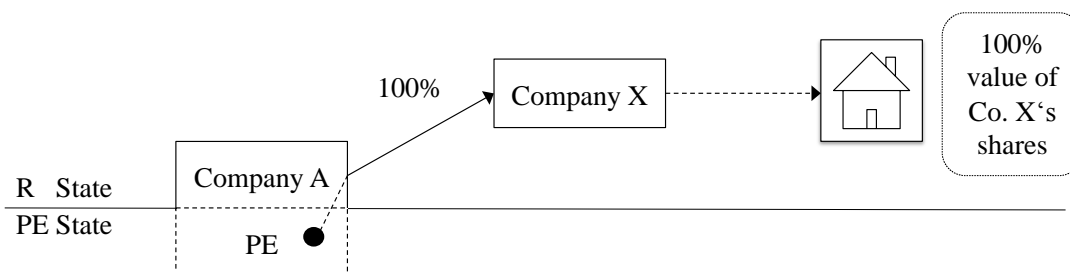
¹²³ Para. 24 of the OECD Commentary on Art. 13.

of immovable property with the direct sale thereof, shares of a real estate company are still considered as movable property and thus their alienation falls within the scope of Article 13(2) OECD MC¹²⁴. Pursuant to Article 13(2), the primary taxing right is allocated to the state of the permanent establishment and not to the situs state of the immovable property – as it would have been the case had the gains been derived from the direct sale of the underlying real estate¹²⁵.

This difference becomes important in cases where an enterprise (situated in state R¹²⁶) holds real estate through the interposition of a real estate company (situated somewhere¹²⁷) whose shares form part of the business property of a permanent establishment, which the enterprise has in the other state (permanent establishment state). Depending on where the relevant immovable property is situated, the interaction between paragraphs two and four of Article 13 OECD MC might lead to undesirable results to a greater or lesser extent. The following three situations are conceivable¹²⁸.

a. Real Estate situated in the Residence State

Diagram II¹²⁹



In the case depicted in Diagram II, the relevant immovable property lies in the residence state of the enterprise and, provided that the shares to be sold form part of the business property of the permanent establishment, Article 13(2) of the treaty between the

¹²⁴ Cf. Simontacchi, *Taxation of Capital Gains*, p. 330; cf. also Reimer, who holds a different opinion in this respect (Reimer, in Vogel-Lehner (eds.), *DBA Kommentar*, Art. 13 at m.no. 73).

¹²⁵ Since Article 13(1) would then be applicable as the scope of Article 13(2) is limited to movable property; cf. Simontacchi, *Taxation of Capital Gains*, p. 330 et seq.

¹²⁶ State R means the residence state of the company that holds immovable property either directly or indirectly.

¹²⁷ As it is irrelevant where the real estate company is located (see chapter B.II.).

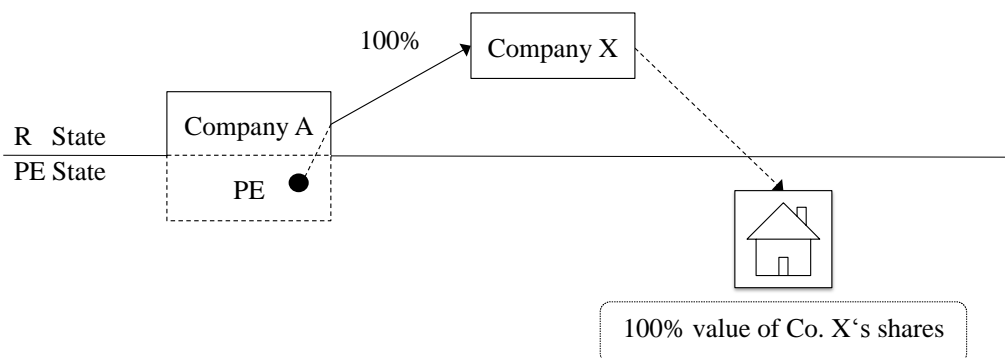
¹²⁸ It is assumed that all tax treaties involved follow the OECD MC 2014.

¹²⁹ Cf. the similar Diagram in Simontacchi, *Taxation of Capital Gains*, p. 334.

residence state and the state of the permanent establishment¹³⁰ is applicable as the shares constitute movable property¹³¹. Consequently, the state of the permanent establishment has the primary taxing right, whereas the residence state may still tax the gain but has to provide relief from double taxation pursuant to Article 23 A or Article 23 B of the R-PE treaty. Due to its bilateral scope¹³², Article 13(4) of the R-PE treaty would not be applicable since the real estate lies in the residence state of the enterprise. Thus, a competition between Article 13(2) and 13(4) will not occur in those cases. However, it should be noted that the target pursued by the OECD – i.e. to equalise the tax regimes of direct and indirect alienations of immovable property – is not achieved, since in cases where the real estate is hold directly, Article 13(5) of the R-PE treaty would be applicable which allocates the exclusive taxing right to the residence state¹³³.

b. Real Estate situated in the State of the Permanent Establishment

Diagram III¹³⁴



Where, in the same situation, except that the concerned immovable property is situated in the state of the permanent establishment, any gain derived from the sale of the shares of the immovable property company would be covered again by Article 13(2) of the R-PE treaty – assuming that the shares formed part of the business property of the

¹³⁰ Hereinafter referred to as R-PE treaty.

¹³¹ The scope of Article 7(1) OECD MC would be fulfilled as well, however, pursuant to Article 7(4) OECD MC, Article 13(2) OECD MC takes precedence over Article 7(1) OECD MC.

¹³² See chapter B.II.

¹³³ Para. 22 and 24 of the OECD Commentary on Art. 13. See also Simontacchi, which concludes that while “the situs rule prevails in the case of direct alienation, the permanent establishment rule prevails in the case of indirect alienation.” (Simontacchi, *Taxation of Capital Gains*, p. 335).

¹³⁴ Cf. the similar Diagram in Simontacchi, *Taxation of Capital Gains*, p. 332.

permanent establishment. Additionally, Article 13(4) R-PE treaty would be simultaneously applicable since the bilateral scope is fulfilled in this scenario¹³⁵. At first sight, it seems that a simultaneous application of both provisions would not lead to any unsatisfactory results, as both provisions allocate the primary taxing right to the same state – the state of the permanent establishment which coincides with the situs state of the real estate¹³⁶. However, the question whether Article 13(2) or 13(4) should be (only) applicable becomes crucial when it is seen in the context of the non-discrimination rule regarding permanent establishments: discriminatory taxation on a permanent establishment is only prohibited by Article 24(3) of the R-PE treaty when Article 13(2) applies. Article 24(3) OECD MC does not apply if Article 13(4) of the R-PE treaty is the applicable Article¹³⁷. Hence, a clear precedence between Article 13(2) and 13(4) OECD MC is imperative for the right of non-discriminatory treatment on permanent establishments, which can be crucial in the case of the taxation of gain derived from the alienation of immovable property.

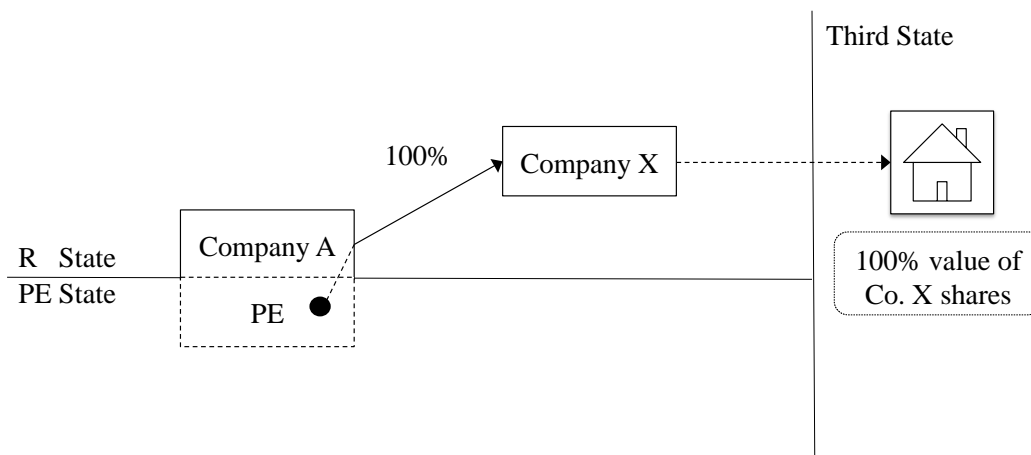
¹³⁵ As in the scenario at **a.**, the scope of Article 7(1) OECD MC would be fulfilled as well, however, pursuant to Article 7(4) OECD MC, Article 13(2) and 13(4) OECD MC takes precedence over Article 7(1) OECD MC.

¹³⁶ Cf. e.g. Simontacchi, which concludes that there does not seem to be a conflict in the simultaneous application of the two provisions, since both allocate the primary taxing right to the same state and only hypothesises that it “would have been different if Article 13(2) had followed the wording of the other permanent establishment proviso in the OECD Model, by referring to the attribution of taxation rights provided for by Article 7. In such a case, Article 13(1) would have attributed primary taxation rights to the source state on the entire gain, while Article 13(2) would have attributed primary taxation rights to the source state only to the extent of the portion of the gain attributable to the permanent establishment.” (Simontacchi, *Taxation of Capital Gains*, p. 332). Although Simontacchi is correct in stating that, he does miss the difference in application of the two provisions in respect of the non-discrimination provision in Article 24(3) OECD MC.

¹³⁷ Pijl, *Capital Gains*, World Tax Journal 2013, 3 (72).

c. Real Estate situated in a Third State

Diagram IV¹³⁸



In the third scenario as demonstrated in Diagram IV, the immovable property is situated in a third state. Again, if the company sells the shares, Article 13(2) of the R-PE treaty is applicable. The shares of the real estate company are regarded as movable property forming part of the business property of the permanent establishment, which the company has in the other state. Thus, the bilateral scope of Article 13(2) R-PE treaty is fulfilled and the primary taxing right is allocated to the state of the permanent establishment. However, the same gain would be covered concurrently by Article 13(4) of the treaty between the residence state and the third state¹³⁹, since the gain is derived by a resident of one contracting state (the R state) from the sale of shares deriving more than 50 per cent of their value directly or indirectly from real estate situated in the other contracting state (the third state). Article 13(4) R-Third State treaty allocates the primary taxation right to the third state. Hence, both the state of the permanent establishment and the third state are allowed to claim the primary taxation right regarding the same gain – while only the residence state has to provide relief for double taxation.

Obviously, this allocation of taxation rights in such triangular cases may lead – depending on the methods for avoidance of double taxation chosen by the countries involved and the interaction between the relief obligations provided for by the R-PE and

¹³⁸ Cf. the similar Diagram in Simontacchi, *Taxation of Capital Gains*, p. 337.

¹³⁹ Hereinafter referred to as R-Third State treaty.

the R-third State treaties – not only to double but also to triple taxation¹⁴⁰. As in scenario **b.** above, the non-discrimination provision is of great relevance. Regarding the treaty between the residence state and the state of the permanent establishment, Article 24(3) is applicable since Article 13(2) of the same treaty concerns the taxation on a permanent establishment. Consequently, the taxation on the permanent establishment “shall not be less favourably levied” in the state of the permanent establishment than the taxation levied on enterprises of the permanent establishment state carrying on the same activities. In order that the company can benefit from this Article – i.e. that the multiple taxation can be avoided – there has to be a domestic law provision or a treaty between the permanent establishment state and the situs state which contains a provision that allocates the primary taxation right on this gain to the situs state¹⁴¹. Virtually, the treaty between the permanent establishment state and the situs state would then apply indirectly as the state of the permanent establishment has to give relief to the permanent establishment as if it had applied this tax treaty¹⁴². Consequently, the state of the permanent establishment has to grant relief for the tax levied in the third state¹⁴³ and thus triple taxation should be avoided. However, even if the state of the permanent establishment grants such tax credit, enterprises facing such scenarios may still bear administrative expenditures, legal uncertainty and other impediments, which are inherent regarding a lack of coordination like the one between Article 13(2) and 13(4) OECD MC.

2. Interim Findings

The analysis of the three scenarios above clearly showed that there is an unsolved competition between Article 13(2) and 13(4) OECD MC. Even though there is no conflict between the provisions in the first scenario, where the real estate is situated in the same state as the residence state of the enterprise, the target pursued by the OECD – i.e. to equalise the tax regimes of direct and indirect alienations of immovable property

¹⁴⁰ Cf. Simontacchi, *Taxation of Capital Gains*, p. 337.

¹⁴¹ E.g. a similar provision as Article 13(4) OECD MC (cf. Simontacchi, *Taxation of Capital Gains*, p. 337); cf. Para. 67 and 69 et seqq. of the OECD Commentary on Art. 24.

¹⁴² Cf. Yong, *Triangular Treaty Cases*, Bulletin for International Taxation 2010, 152 (153).

¹⁴³ Para. 69 et seqq. of the OECD Commentary on Art. 24; cf. Avery Jones-Bobbett, *Triangular Treaty Problems*, Bulletin for International Fiscal Documentation 1999, 16 et seq.; cf. Simontacchi, *Taxation of Capital Gains*, p. 337.

– is not achieved, as the allocation of the taxing rights do not coincide in permanent establishment cases of direct and indirect ownership of real estate¹⁴⁴.

Regarding the other two permanent establishment cases, both provisions are simultaneously applicable and a conflict of precedence occurs – which may either lead to an issue regarding the non-discriminatory provision¹⁴⁵ or in triangular cases to a triple taxation¹⁴⁶. Agreeing with *Hans Pijl*, Article 13(2) OECD MC should probably be given precedence over Article 13(4) OECD MC in the case where the real estate is situated in the state of the permanent establishment¹⁴⁷. This approach is supported by the principle of symmetry¹⁴⁸. Additionally, this solution is certainly welcomed by the taxpayers, since Article 24(3) OECD MC is then applicable¹⁴⁹. However, a clear hierarchy within Article 13 OECD MC is still more than welcome – especially in view of the possible triple taxation in cases where the real estate is located in third states and in order to safeguard the target of Article 13(4) OECD MC.

3. Possible Solutions

A clarification may be achieved either by a change or explanation in the Commentary or the OECD MC itself. One suggestion is to make Article 13(2) OECD MC subject to Article 13(4) OECD MC (2003-2015)¹⁵⁰. Another solution is to change Article 13(4) OECD MC itself by altering it from an autonomous distributive provision to a definitional one, as provided for in the US Model Convention¹⁵¹. In order to achieve the pursued aim – the equality of tax regimes regarding direct and indirect ownership of real estate – Article 13(4) could be drafted as follows:

¹⁴⁴ See chapter D.I.1.a. Real estate situated in the residence state.

¹⁴⁵ See chapter D.I.1.b. Real estate situated in the state of the permanent establishment.

¹⁴⁶ See chapter D.I.1.c. Real estate situated in a third state.

¹⁴⁷ Pijl, *Capital Gains*, World Tax Journal 2013, 3 (73).

¹⁴⁸ The principle of symmetry generally means that the allocation of taxing rights on capital gains according to Article 13 and capital in Article 22 follows the allocation of taxing right on income as provided for in Articles 6, 7 and 8 OECD MC (cf. Pijl, *Capital Gains*, World Tax Journal 2013, 3 (6 et seq.)). See e.g. Para. 4 of the OECD Commentary on Art. 13, which points out that it “is normal to give the right to tax capital gains on a property of a given kind to the state which under the convention is entitled to tax both the property and income derived therefrom.” See for further details in this respect Pijl, *Capital Gains*, World Tax Journal 2013, 3 et seqq.

¹⁴⁹ Cf. Pijl, *Capital Gains*, World Tax Journal 2013, 3 (73).

¹⁵⁰ Pijl, *Capital Gains*, World Tax Journal 2013, 3 (73); see also Simontacchi, *Taxation of Capital Gains*, p. 340 et seq.

¹⁵¹ See Article 13(2)(b) and (c) of the 1996 and 2006 US Model; cf. Simontacchi, *Taxation of Capital Gains*, p. 340.

“For the purpose of the application of Article 13, shares deriving more than 50 per cent of their value directly or indirectly from immovable property are defined as immovable property”¹⁵².

Consequently, such shares would be regarded as immovable property for the purpose of Article 13 and Article 13(1) OECD MC would be the relevant distributive rule and thus the tax regimes regarding the direct and indirect alienation of real estate would be equalised¹⁵³.

4. Conclusion on the Hierarchy within Article 13

In the light of the above-mentioned elaborations, it seems that when introducing Article 13(4) OECD MC, the coordination between this new provision and the residual Articles has been forgotten. The inconsistency, which results due to this lack of coordination, has to be removed – especially regarding the interaction with Article 13(2) OECD MC. As seen above, this could be done by altering either Article 13(2) or Article 13(4) OECD MC¹⁵⁴. In the case of the latter, it has to be kept in mind that in order to take into account the indirect derivation of value, the proportional consolidation approach has to be applied¹⁵⁵.

In view of the analysis of the three scenarios above, it is evident that states should consider this lack of coordination within Article 13 and provide clarification thereto when inserting Article 13(4) OECD MC or reviewing a tax treaty.

¹⁵² Simontacchi, *Taxation of Capital Gains*, p. 340.

¹⁵³ In order to achieve this result, it is also possible to delete Article 13(4) entirely and incorporate the definitional provision above as an addition to Article 13(1) OECD MC (cf. Simontacchi, *Taxation of Capital Gains*, p. 340).

¹⁵⁴ Cf. Simontacchi, *Taxation of Capital Gains*, p. 339.

¹⁵⁵ See chapter B.I.4.b.bb.

II. Potential Tax if Treaty is changing

As already seen in the introduction, the inclusion of Article 13(4) leads to a change in the allocation of taxation rights; while the residence state had the exclusive taxation right about all kind of shares pursuant to Article 13(5) OECD MC, the situs state has the primary taxation right regarding the alienation of shares of real estate companies when the tax treaty applicable included Article 13(4) OECD MC. Hence, states – from the viewpoint of residence states – may fear that they will lose the taxation right due to an addition of Article 13(4) OECD MC in their treaties. Consequently, some states levy a tax on unrealised gains “when loosing the taxation right” due to a treaty amendment¹⁵⁶. However, the question arises whether this approach in line with international tax law¹⁵⁷. In order to examine the above, a qualification of this kind of tax is necessary.

1. Qualification of the Tax

States often levy taxes in order to ensure that an amount of previously untaxed income, such as unrealised gains, which is attributable to their jurisdictions, is taxed before the taxation right is restricted or lost due to international tax law. It is common use to name these kinds of taxes exit taxes¹⁵⁸.

¹⁵⁶ See for instance the EAS 3157, 26 May 2010 of the Austrian Ministry of Finance, according to which an amendment or conclusion of a tax treaty constitutes a *circumstance* that leads to the deprivation of the Austrian taxation right and thus triggers a so-called “Entstrickung” and therefore a taxation of unrealised gains (Austrian Ministry of Finance, 26 May 2010, EAS 3157; cf. also 19 February 2013, EAS 3315). However, this view is challenged by several scholars, see for instance Lang, *Wegzugsbesteuerung durch Änderung oder Abschluss eines DBAs?*, SWI 2014, 206 et seqq.; Kanduth-Kristen, *Neuabschluss oder Änderung von DBA als Auslöser für die „Exit Tax“*, SWI 2014, 166 et seqq.; Wagner, *Wegzugsbesteuerung*, SWI 2014, 103 et seqq. Cf. regarding the similar discussion in the context of a potential “Entstrickung” under German Law Wagner-Lievenbrück, *Die Grundbesitzklausel gemäss Art. 13 Abs. 4 OECD-MA*, IStR 2012, 593 (600); Bron, *Zum Risiko der Entstrickung*, IStR 2012, 904 et seqq.; Käshammer-Schümmer, IStR 2012, 362 et seqq.; Reiter, *Entstrickung*, IStR 2012, 357 et seqq.; Schnitger, *Entstrickung im Steuerrecht*, IFSt Nr. 487 (2013), 5 et seqq.; Wassermeyer, *Wegzugsbesteuerung*, IStR 2007, 833 et seqq.; Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661 et seqq.). Since this is a question in the field of domestic tax law, the present thesis does only expand on domestic law provisions where it is necessary to examine the compatibility of the national law provisions with international tax law or by way of illustration in order to explain the international tax law issues.

¹⁵⁷ The question whether states might be restricted by international law in levying a tax due to a treaty amendment is rather a general issue as it does not only arise in the context of Article 13(4) OECD MC (cf. also Carramaschi, *Exit taxes and the OECD Model Convention*, Tax Notes International 2008, 283 et seqq.). However, due to its importance in the context of Article 13(4), it will be nevertheless discussed in detail in the context of the present thesis.

¹⁵⁸ E.g. Schuch-Pinetz, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 20 et seqq.; Lang, *Wegzugsbesteuerung durch Änderung oder Abschluss eines DBAs?*, SWI 2014, 206 et seqq.

However, strictly speaking, exit taxes presuppose a cross-border element as the emigration of companies or individuals¹⁵⁹ or a cross-border transaction¹⁶⁰. In contrast, the restriction or deprivation of taxation rights due a change in tax treaty provisions, as described above, does not involve a cross-border element in this sense, but merely a shift in allocation of taxing rights¹⁶¹.

Certainly, an exact definition of these taxes is not possible since their characteristics depend on the domestic law that provides them and thus their concepts may differ among jurisdictions. It is important to emphasise the difference between them to the concept of exit taxes. However, as some principles and arguments referable to exit taxation might also hold true in the context of these kinds of taxes, the following discussion will take these into account and will base on them where applicable.

2. Compatibility with the OECD Model Convention

In order to determine whether the states are restricted by international tax law in levying the taxes described above, it firstly has to be assessed if such taxes are covered by the tax treaties concluded. For the purpose of this analysis, it is assumed that all tax treaties follow the OECD MC¹⁶².

Starting from the OECD MC and its Commentary, it seems that the tax concerned is covered by Article 13 OECD MC. Article 13 does not specify to what kind of tax it applies. Due to the broad wording of Article 2 OECD MC, all kinds of taxes levied by a contracting state on capital gains are covered by Article 13. This includes also special taxes on capital gains¹⁶³.

In view of the wording of Article 13 OECD MC, one may assume that an *alienation* of an asset is a requirement for the levying of a capital gain tax. However, according to the OECD Commentary, taxes on capital appreciation of an asset that has not been alienated, i.e. taxes increment taxes, are covered by the OECD MC pursuant to Article

¹⁵⁹ Cf. the term „exit tax“ as defined in the IBFD International Tax Glossary.

¹⁶⁰ Such as the transfer of an asset from the head office of a corporation to a permanent establishment which the corporation has in another jurisdiction.

¹⁶¹ As for instance according to the EAS 3157, 26 May 2010 of the Austrian Ministry of Finance, the amendment or conclusion of a tax treaty constitutes a *circumstance* that leads to the deprivation of the Austrian taxation right and thus triggers a taxation of unrealised gains (Austrian Ministry of Finance, 26 May 2010, EAS 3157).

¹⁶² Although the list of taxes in Article 2(3) is purely declaratory, states are advised to include these kinds of taxes in Article 2(3) of their treaties in order to avoid misunderstandings (cf. Para. 6 et seqq. of the OECD Commentary on Art. 2).

¹⁶³ Para. 3.1 of the OECD Commentary on Art. 13.

2¹⁶⁴. Pursuant to a different view, the term alienation requires a change in ownership of the asset and would rather subsume such taxes under Article 21 OECD MC¹⁶⁵.

It can therefore be concluded that according to either view, the taxes described above are within the scope of the OECD MC. They are either covered by the catch-all clause Article 13(5)¹⁶⁶ or Article 21(1)¹⁶⁷ OECD MC. Since both provisions allocate the exclusive taxation right to the residence state, this dissent is not of practical significance in the context of the present thesis¹⁶⁸. Rather, it is crucial that at the moment when the conditions which trigger the tax event according to the domestic law provision¹⁶⁹ – i.e. the taxation of unrealised gains due to a treaty amendment – the residence state is not restricted to do so by tax treaty provisions¹⁷⁰. Accordingly, the residence state may tax the unrealised gains accrued until the treaty amendment according to its domestic tax law¹⁷¹.

3. Risk of Double Taxation

After two contracting states added Article 13(4) OECD MC to their tax treaty, the situs state has the primary taxation right regarding the alienation of shares in a real estate company. It is left to the domestic law of the contracting states how capital gains should

¹⁶⁴ Para. 7 et seq. of the OECD Commentary on Art. 13; cf. Reimer, in Reimer-Rust (eds.), *Vogel on DTCs*, Art. 13 at m.no. 162.

¹⁶⁵ See for instance Lang, *Zeitliche Zurechnung*, in Klein et al. (eds.), *Festschrift für Hans Flick*, 895 (902); Austrian BMF 12 January 1995, EAS 563, 5 SWI 85 (1995); Toifl, *Wegzugsbesteuerung*, p. 128 et seqq.; cf. Toifl, *Tax Treatment of Transfer of Residence by Individuals*, IFA Cahiers 2002, 149 (171)).

¹⁶⁶ Since the tax clearly does not fall within the scope of para. 1, 2, 3 or 4 of Article 13.

¹⁶⁷ The author takes the view that although there might be strictly speaking no “income arising” as mentioned in Article 21(1) OECD MC, Article 21(1) is nevertheless applicable if the domestic tax law provides for such tax on (fictitious) income, i.e. without a realisation of the income (cf. Para. 6 of the OECD Commentary on Art. 13).

¹⁶⁸ See for further information Toifl, *Wegzugsbesteuerung*, p. 128 et seqq.; Brugger, *Wegzugsbesteuerung und Abkommensrecht*, SWI 2007, 510 et seqq.

¹⁶⁹ Cf. Dürschmidt, in Vogel-Lehner (eds.), *DBA Kommentar*, Pre Art. 6-22 at m.no. 8.

¹⁷⁰ Cf. Article 13(4) of the pre-2003 OECD MC (which is the current Article 13(5) OECD MC); cf. Reimer, in Vogel-Lehner (eds.), *DBA Kommentar*, Art. 13 at m.no. 201 et seqq.; Schuch-Pinetz, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 22.

¹⁷¹ See in this respect the deliberations in the context of the compatibility of exit taxes with the OECD MC that may be applicable by analogy at this point. Although there is a disagreement whether Art. 13(5) or Art. 21 OECD MC is the relevant distributive rule, most scholars agree that exit taxes are in line with the OECD MC (cf. Reimer, in Reimer-Rust (eds.), *Vogel on DTCs*, Art. 13 at m.no. 161; Riedweg-Suter, in Zweifel-Beusch-Matteotti (eds.), *Kommentar Internationales Steuerrecht*, Art. 13 at m.no. 31 and 299 et seq.; Danon/Faltin, in Danon et al. (eds.), *Commentaire Modèle De Convention fiscale OCDE*, Art. 13 at m.no. 5 and 32; Wassermeyer, in Wassermeyer-Lang-Schuch (eds.), *OECD-Musterabkommen*, Art. 13 at m.no. 23; Reimer, in Vogel-Lehner (eds.), *DBA Kommentar*, Art. 13 at m.no. 23 and 201 et seqq.).

be taxed and computed¹⁷². Hence, the question arises whether in the case of the alienation of the shares the gain thereof (or at least a part thereof) might be taxed twice since the part of the gain that accrued before the treaty amendment was already taxed by the residence state.

In this context, the 2014 addition to Paragraph 3.1 on Article 13 OECD Commentary has to be considered, which reads as follows:

“Also, where the Article allows a Contracting State to tax a capital gain, this right applies to the entire gain and not only to the part thereof that has accrued after the entry into force of a treaty (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.”

Accordingly, the taxation rights are allocated only to the state to which Article 13 OECD MC allocates the taxation rights at the time of the realisation of the gain¹⁷³, meaning in the case of Article 13(4) OECD MC that the situs state is allowed to tax the gain accrued before Article 13(4) has been added. As this part of the gain might have already been subject to tax in the residence state before the treaty amendment, following the approach of the OECD in Paragraph 3.1 may lead to juridical double taxation¹⁷⁴.

As two different taxable events – the treaty amendment and the subsequent sale of the shares – triggered the taxes, the double taxation cannot be eliminated by the exemption or the credit method according to Article 23 A resp. Article 23 B OECD MC¹⁷⁵.

¹⁷² Para. 3 and 12 of the OECD Commentary on Art. 13. The Commentary only mentions that capital gains are usually calculated by deducting the cost from the selling price. Para. 12 further explains that in order to arrive at cost all expenses incidental to the purchase and all expenditure for improvements are added to the purchase price and that in some cases the cost after deduction of the depreciation allowances already given is taken into account (Para. 12 of the OECD Commentary on Art. 13).

¹⁷³ Cf. Schuch-Pinetz, according to which these assertions rather constitute a clarification of the current legal situation than an amendment (cf. Schuch-Pinetz, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 20 et seq.).

¹⁷⁴ However, it has to be kept in mind that the double taxation only occurs when the domestic law of the residence state does provide for such taxation. For instance, the Federal Fiscal Court of Germany decided that the amendment of a tax treaty does not cause this so-called “Entstrickung” and thus does not trigger a taxation (BFH, 16 December 1975, VIII R 3/74, BStBl II 1976). However, as the protocol regarding the tax treaty between Germany and Liechtenstein (2012) does provide rules for the case where the entry into force of a DTC does lead to an “Entstrickung”, it seems that the negotiators concerned assumed that a treaty amendment might nevertheless entail an “Entstrickung” (cf. Protocol, DTC between Germany and Liechtenstein, Art. 13 at Nr. 4; Bron, *Zum Risiko der Entstrickung*, IStR 2012, 904 (905 et seq.)). Hence, there does seem to be still legal uncertainty in this respect in the context of German Law.

¹⁷⁵ Cf. the discussion of a similar problem in the context of the tax treatment of partnerships, OECD, *Partnership Report* (1999), para. 134 et seqq.

Therefore, as there is no elimination of this kind of double taxation provided for in the tax treaty, the competent authorities of the contracting states might consult together for elimination of double taxation pursuant to Article 25(3) of the treaty applicable. Otherwise, Article 25(5) should be applicable. However, due to the fact that there is no obligation binding the authorities to agree on a solution¹⁷⁶, this is far from a satisfactory outcome.

Moreover, the approach of the OECD in Paragraph 3.1 might further entail the risk of double non-taxation. If Paragraph 3.1 would be understood – based on an *argumentum e contrario* of Paragraph 3.1 – as restricting the residence state in taxing the unrealised gain accrued before the treaty amendment, the gain might not even be taxed once in cases gains within the meaning of Article 13(4) are tax-exempt under the domestic law of the situs state¹⁷⁷. Therefore, it is questionable whether it should be adhered to the assertions in Paragraph 3.1 of the Commentary on Article 13.

4. Analysis and Suggestions

Initially, it is important to emphasise that, as a rule, the Commentary to the OECD MC is neither legally binding on the contracting states nor on courts¹⁷⁸. Hence – especially regarding tax treaties concluded before 2014 – the assertions in Paragraph 3.1 on Article 13 are not binding at all. Admittedly, the view of the OECD in Paragraph 3.1 is shared by some scholars¹⁷⁹ and national courts as well¹⁸⁰. Nevertheless, this approach does not take into account the past¹⁸¹ and leads to legal uncertainty. One may object that the initial origin of the gain has always been the immovable property and thus the situs state

¹⁷⁶ Except in cases the treaty provides for arbitration regarding such issues (cf. para. 37 and 64 of the OECD Commentary on Art. 25).

¹⁷⁷ The distributive rules of tax treaties do only allocate the taxation rights and restrict domestic tax laws; they do not serve, form or replace national legal bases (cf. Para. 34 and 56.1-56.3 of the OECD Commentary on Art. 23). However, it should be noted that the Commentary in Para. 3 on Art. 13 points out that Article 13 can in no way be construed as giving a state the right to tax gains if such right is not provided for in its domestic law.

¹⁷⁸ This might be different when a protocol or memorandum of understanding to a treaty provides that the treaty is to be interpreted based on the OECD Commentaries (Ward, *Role of the Commentaries on the OECD Model*, Tax Treaty Monitor 2006, 97 (99 et seq.)). See for further information Vogel-Prokisch, *Interpretation of Double Tax Conventions*, General Report, 55 (64 et seq.); Vogel, *Influence of the OECD Commentaries*, Tax Treaty Monitor, 2000, 612 et seqq.

¹⁷⁹ See for instance Lang, *Zeitliche Zurechnung*, in Klein et al. (eds.), *Festschrift für Hans Flick*, 895 (901); cf. Schuch-Pinetz, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 20 et seq.

¹⁸⁰ In respect of Germany e.g. BFH, 30 March 1993, IStR 1994, 77; 19 March 1996, BB 1996, 1258; regarding Austria e.g. BMF, 1 March 1999, EAS 1423; BMF, 7 February 2000, EAS 1595.

¹⁸¹ Cf. Schuch-Pinetz, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 21; Lang, *Zeitliche Zurechnung*, in Klein et al. (eds.), *Festschrift für Hans Flick*, 895 et seqq.

should not be restricted in taxing the entire gain pursuant to Article 13(4) OECD MC. However, double tax treaties are also based on political considerations and it would be contradictory to the principals of ex post facto and the protection of legitimate expectation to allow a taxation of a part of the gain that was allocated to the residence state before the treaty amendment. Therefore – and in view of the unsatisfactory consequences¹⁸² – contracting states should be sceptical about Paragraph 3.1 of the OECD Commentary on Article 13. In order to express their disagreement with Paragraph 3.1 and to prevent misunderstandings and disputes, states may enter reservations and observations on the Commentaries¹⁸³, as Austria and Germany did¹⁸⁴.

In the light of the above-mentioned analysis, it can be concluded that the residence state is not restricted in taxing the unrealised gains accrued before a treaty amendment by tax treaties following the OECD MC¹⁸⁵. Deviating from the assertions in the OECD Commentary, this author follows the understanding that Article 13, when allocating the taxing right to a contracting state, should be interpreted in not allowing this state to tax the entire gain but only the part thereof that has accrued after the treaty amendment, i.e. after the introduction of Article 13(4) OECD MC¹⁸⁶. For the sake of legal certainty and in order to avoid disputes, states are advised to implement provisions into their tax treaties clarifying the allocation¹⁸⁷ and – as suggested by this author – agree on an apportionment of taxation rights in this context.

III. Consequences of the Real Estate Company Definition

As seen above, the concept of a real estate company within the meaning of Article 13(4) OECD MC deduces from the relative contribution of the value of the immovable property which the company holds in a *certain* state to the value of the shares – and not,

¹⁸² The risk of double taxation or double non-taxation.

¹⁸³ See for further information regarding observations recorded on the Commentaries: Ward, *Role of the Commentaries on the OECD Model*, Tax Treaty Monitor 2006, 97 (100 et seq.).

¹⁸⁴ Para. 32.1 of the OECD Commentary on Art. 13. Cf. Jirousek, who considers this approach of Austria and Germany as compatible with Article 13(5) OECD MC (Jirousek, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 204).

¹⁸⁵ Provided that such tax is based on and compatible with the domestic law provisions concerned (cf. the ongoing controversy thereto regarding Austrian and German domestic law, chapter D.II., Fn. 156).

¹⁸⁶ Cf. Jirousek, in Lang et al. (eds.), *The OECD MC and its Update 2014*, p. 204 who might come to a similar conclusion; cf. Dürschmidt, in Vogel-Lehner (eds.), *DBA Kommentar*, Pre Art. 6-22 at m.no. 10.

¹⁸⁷ Certainly, this is only necessary in cases the domestic tax laws concerned provide for these kinds of taxes. As the issue described in this chapter similarly arise in the context of exit taxes, states are advised to clarify the issue during negotiations of tax treaties regardless of a possible addition of Article 13(4) OECD MC. See for instance Article 13(6) of the Austria-Germany DTC.

as some domestic law regimes provides, according to the principal target a company pursues¹⁸⁸. This leads inter alia to the consequence that the qualification of a potential real estate company within the meaning of Article 13(4) OECD MC may change each time the company alienates or acquires immovable property and thus may lead to a shift of the allocation of taxation rights. Depending on the domestic law of the countries involved, the change in treaty qualification of a real estate company may trigger a tax event¹⁸⁹.

1. Possible Taxation

Resembling the taxes analysed in chapter D.II., the taxes described in the following fall also within the concept of an “Entstrickung”¹⁹⁰. In the light of the above-mentioned remarks and due to the similarities between these taxes, the analysis given above in respect of the compatibility with the OECD MC applies likewise here¹⁹¹. Therefore, it can be assumed that the applicability of Article 13 OECD MC is given in this point as well.

In addition, these taxes might also have certain similarities with exit taxes. Consequently, the following discussion will consider principles regarding exit taxes and refer to them where applicable. However, as the taxes discussed in the following do not entail a cross-border element as exit tax regimes do¹⁹², it is important to keep in mind that – strictly speaking – they cannot be classified as exit taxes in the strict sense. Compared to the taxes explained above in chapter D.II., the restriction or deprivation of the taxation rights of states in the following discussion is caused by a change in classification of the company concerned and not of a treaty amendment. By way of illustration, the tax will be examined on the basis of an example under German law.

2. Example: Germany

Assuming a shareholder X, resident of state Y, holds shares in a German company, which in turn owns immovable property located in Germany (year 1). The shares of the

¹⁸⁸ See for instance Switzerland (cf. e.g. the decision of the Federal Supreme Court of Switzerland BGer 21 January 2010, 2C_641/2009, Para. 5.1; cf. Riedweg-Suter, in Zweifel-Beusch-Matteotti (eds.), *Kommentar Internationales Steuerrecht*, Art. 13 at m.no. 59).

¹⁸⁹ See for instance in respect of Germany, Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661 et seqq.).

¹⁹⁰ Cf. Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661 et seqq.).

¹⁹¹ See chapter D.II.2.

¹⁹² Cf. chapter D.II.1.

company derive 100 per cent of their value from the German immovable property. Hence, the company concerned constitutes a real estate company within the meaning of Article 13(4) of the tax treaty between Germany and state Y¹⁹³. If the company alienates the immovable property in year 2, the gain thereof will be subject to a corporate income tax at the level of the company in Germany¹⁹⁴. Simultaneously, the alienation of the real estate leads to a change of the treaty qualification of the company, i.e. the company is not a real estate company anymore. Accordingly, instead of Article 13(4), Article 13(5) will be the distributive rule applicable and thus state Y, as the residence state of the shareholder X, will have the exclusive taxation right regarding subsequent sales of the shares in the German company¹⁹⁵.

Therefore, it may be said that Germany loses the primary taxation right about a possible gain from a subsequent sale of the shares and will not even have a secondary taxation right in respect thereof. If the shares in the German company are held as business assets by shareholder X, the deprivation of the German taxation right might trigger an “Entstrickung” according to § 4(1) EStG¹⁹⁶ resp. § 12(1) KStG¹⁹⁷. Due to the “Entstrickung”, the gain derived from the alienation of the German real estate would – besides at the level of the German company – also be subject to German tax at the level of the foreign shareholder¹⁹⁸.

If the shareholder alienates its shares in the German company in year 3, state Y has the exclusive taxation right about the gain thereof pursuant to Article 13(5) of the tax treaty between Germany and state Y. Neither Article 13 nor Article 23 of this treaty would restrict state Y in its taxation right. Hence, state Y may tax the entire gain derived from the alienation of the shares, i.e. including the part of the gain that accrued before state Y

¹⁹³ It is assumed that the treaty between Germany and state Y follows the OECD MC. Since Germany has introduced Article 13(4) OECD MC to several of its tax treaties, the theoretical example is also of great relevance in practice (cf. Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660).

¹⁹⁴ The gain will be subject to the “Körperschaftsteuer” and possibly to the “Gewerbsteuer” according to § 15(1) Nr. 1 EStG and § 8 (2) KStG (cf. Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661)). In this respect, it is worth mentioning that also in cases where the company would not be a resident of Germany, Germany would have the primary taxation right according to Article 13(1) OECD MC.

¹⁹⁵ See for the dissenting opinion according to which Art. 21 OECD MC would be the applicable provision above, Fn. 171. Similarly as in the context of Fn. 171, the question whether Art. 13 or Art. 21 is the applicable rule is not of great importance in the present discussion since both Articles allocate the exclusive taxation to the residence state.

¹⁹⁶ EStG („*Einkommensteuergesetz*“) means the German Income Tax Act.

¹⁹⁷ KStG („*Körperschaftsteuergesetz*“) means the German corporation tax law.

¹⁹⁸ Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661).

had the taxation right and which has already been taxed by Germany in year 2. Unless the domestic tax law of Y takes the tax paid in Germany into account, the shareholder will suffer a double taxation in respect of the part of the gain that was already subject to German tax¹⁹⁹.

3. Interim Findings and Recommendations

Similar to the issue caused by Paragraph 3.1 on Article 13 of the OECD Commentary, no elimination of this kind of double taxation is provided for in the tax treaty in the case under consideration²⁰⁰. Hence, the competent authorities of the contracting states may consult together for elimination of double taxation pursuant to Article 25(3) of the treaty applicable. Otherwise, Article 25(5) should be applicable. However, the difficulty is once again that there is no obligation binding the authorities to reach an agreement²⁰¹ and thus the double taxation might remain unrelieved.

However, many domestic tax laws, such as German tax law, allow for preferential treatments for shareholders that are only subject to limited tax liability²⁰². Therefore, shareholder X in the example above would not be subject to tax in respect of the entire gain derived by the company through the sale of the immovable property in Germany in year 2²⁰³. Moreover, if the shareholder X is an individual and holds the shares as personal assets, the German “Entrückung” tax event would not even be applicable²⁰⁴. Similar exceptions and limitations are also known in other domestic tax laws²⁰⁵.

In respect of the sale of the shares in year 3, it is important to emphasise that gains derived from the sale of shares are exempt in several jurisdictions such as in the Netherlands, Luxembourg and Switzerland²⁰⁶. Consequently, the risk of double taxation

¹⁹⁹ Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661).

²⁰⁰ However, different from the foregoing analysis of the taxes in chapter III, Para. 3.1 of the OECD Commentary on Art. 13 is in the present discussion of lesser relevance, as the double taxation in the present chapter occurs because of a change of classification and not a treaty amendment.

²⁰¹ Except in cases the treaty applicable provides for arbitration regarding such issues (cf. para. 37 and 64 of the OECD Commentary on Art. 25).

²⁰² Pursuant to § 8b(2) and (3) KStG.

²⁰³ However, this would only mitigate a possible double taxation but would not avoid it.

²⁰⁴ Cf. Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (661).

²⁰⁵ As for instance under Swiss tax law (Article 16(3) DBG (“*Bundesgesetz über die direkte Bundessteuer*”)).

²⁰⁶ Pietrek-Busch-Mätzig, *Weitreichende Konsequenzen der Grundbesitzklausel*, IStR 2014, 660 (662); cf. Wagner-Lievenbrück, *Die Grundbesitzklausel gemäss Art. 13 Abs. 4 OECD-MA*, IStR 2012, 593 (594).

caused by a lack of coordination in international tax law might be mitigated or removed by way of domestic tax law provisions.

IV. Interim Findings

In the course of the analysis of the open issues, it became evident that there are still various outstanding problems in the context of Article 13(4) OECD MC, which may lead to unsatisfactory results and may cause double or even triple taxation of the same amount of gain.

Whereas the question of the interaction between the real estate company provision and the other provisions contained in Article 13, especially with paragraph two, could in all probability be easily solved by altering either Article 13(2) or Article 13(4) OECD MC, this is not the case in respect of the other two discussed issues.

The issue of the potential tax in a case of a treaty amendment and the possible tax triggered by a change of classification of a company both stem from a lack of coordination between domestic tax laws which international tax law is unable to solve – at least until now. The newly introduced paragraph 3.1 of the OECD Commentary on Article 13 does even exacerbate the problem. Although the outcomes in respect of both issues may be relieved in many cases due to certain domestic law exemptions and limitations, the legal uncertainty caused by these issues does still remain²⁰⁷. This is not only adverse for taxpayers but also for the countries concerned, as the legal uncertainty and the risk of double taxation might deter taxpayers from investing in real estate companies that own immovable property located in these countries.

Consequently, states are strongly advised to clarify these issues of potential taxes both under their domestic laws and when they negotiate or review their tax treaties. It is recommended to incorporate a separate provision into tax treaties dealing with these subjects. According to the opinion of this author, it should be tried to agree on an apportionment of taxation rights.

²⁰⁷ Cf. in respect of the issue of the potential tax in the case of a treaty amendment, chapter D.II.3. Fn. 174; cf. regarding the potential taxation due to a change of classification of the company, chapter D.II.3.

As seen in the analysis, some deliberations in the context of the examined problems are related to the issue of exit taxes²⁰⁸. In this respect, a clarification on the issues discussed is required in general and not limited to real estate company provisions.

²⁰⁸ However, it should still dealt with them separately as only exit taxes entail a cross-border transaction resp. element in this sense.

E. CONCLUSION

In the course of the analysis of Article 13(4) OECD MC it became evident that there are still numerous legal and practical issues related to this real estate company provision. The provision as drafted by the OECD was introduced based on anti-abuse deliberations and is targeted at preventing rule shopping. The aim of Article 13(4) OECD MC is to create an equal tax treaty regime regarding the indirect and direct alienation of real estate²⁰⁹. Although the article should serve as an anti-abuse provision, it is drafted as an autonomous distributive rule and not limited to abusive situations²¹⁰.

Apart from the outstanding issues challenging Article 13(4) OECD, there are various concerns in respect of the initial broad scope of the provision and its feasibility. The broad scope stems inter alia from the inclusion of the indirect derivation of value, which is inevitable in view of the purpose of the provision. As seen in the investigation of the possible deviations from the draft of the OECD, the concerns regarding the broad scope might be mitigated by means of exceptions and limitations to the scope²¹¹. As most exceptions concern situations where abusive intents are hardly found and since they make the calculation of the indirect derivation of value more feasible, it is recommended to consider these limitations and exceptions when reviewing or introducing Article 13(4) OECD MC. Apart from that, states may also broaden the initial scope of Article 13(4) OECD MC by reducing the 50 per cent threshold and incorporating gains from the alienation of interests in other entities, such as partnerships or trusts, in the scope of the provision²¹². In respect of the former, this author holds the view that it would be preferable to set a minimum, reasonable level regarding the threshold, which states should not undercut. In contrast, the extension of the scope by means of including the sale of interests in partnerships in the scope of the provision seems to be reasonable, as the provision could be otherwise circumvented.

Unlike the problems related to the broad scope of Article 13(4) OECD MC, the status quo of the OECD Model Convention and its Commentary does not provide solutions or

²⁰⁹ Para. 23 and 28.3 of the OECD Commentary on Art. 13.

²¹⁰ See chapter A.III.

²¹¹ Cf. chapter B.I.

²¹² Para. 28.5 of the OECD Commentary on Article 13; cf. also the UN Model, in which gains from the alienation of interests in a partnership, trusts and estates are already included in the provision itself (Article 13(4) UN Model).

remedies in respect of the outstanding issues discussed²¹³. While the lack of coordination between paragraph two and four of Article 13 can be rather easily solved²¹⁴, the other two problems discussed require need for action both in the field of international and national tax laws²¹⁵.

In light of the results of the analysis presented in this thesis, it can be concluded that it is advisable to introduce real estate company provisions into tax treaties in order to prevent rule shopping and to enforce domestic immovable property company provisions. Therefore, Article 13(4) OECD MC can be used as a starting point. However, states should develop their own provisions whilst taking the above-mentioned issues and the recommendations thereto into account. By doing so, they may find *the optimal construction for Article 13*.

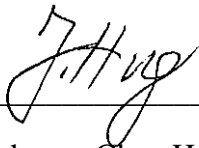
²¹³ See chapter D.

²¹⁴ Cf. chapter D.I.3.

²¹⁵ Cf. chapter D.II.4. and D.III.3.

Declaration of Originality

I hereby declare that this thesis represents my original work and that I have used no other sources except as noted by citations. All data and text citations, which have been reproduced from any other source, including the Internet, have been explicitly acknowledged as such.



Johanna Clara Hug

Zurich, 31 August 2015

Place, Date