Taxation of cross-border inheritances and donations: suggestions for improvement

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CHAPTER 5

The provisions of the OECD IHTMTC and its Commentary that can be improved

In this section, I discuss the provisions of the OECD IHTMTC and its Commentary which, in my view, can be improved having regard to the objectives of the OECD IHTMTC[1] and the proposed inheritance and gift tax. The discussion of these provisions takes place in relation to each problem of cross-border inheritances and donations. The suggested provisions can subsequently form part of an updated OECD IHTMTC. Alternatively, the suggested provisions can be included in a multilateral convention that can amend the existing inheritance and gift tax treaties and form the basis of negotiation of new inheritance and gift tax treaties.[2]

5.1 Double or multiple taxation

As mentioned in section 3.2.1.2, the OECD IHTMTC primarily aims at resolving the double taxation problem of cross-border inheritances and donations due to the parallel and uncoordinated application of the OECD member countries' inheritance and gift tax systems. Nevertheless, I observe that certain cases of double or multiple taxation are not covered by the model or are solved in a manner that does not seem to take into account the elements of the proposed inheritance and gift tax.

In that regard, I note that double or multiple taxation is a problem that severely affects the application of the proposed inheritance and gift tax. More specifically, when the cross-border inheritance and donation is taxed in more than one state, the application of the ability-to-pay-taxes and the windfall justifications – two elements of the proposed inheritance and gift tax – seems to be severely hindered: the above justifications over-apply in a cross-border setting and thus inheritance and gift taxation seems to fail to achieve its objectives. Such over-application does not, however, take place in the event of a domestic inheritance and donation that is not subject to double taxation.

Arguably, inheritance and gift taxation also seem to fail to achieve its objectives even if the model solves the double or multiple taxation problem but in a manner that does not seem to take into account (some of) the elements of the proposed inheritance and gift tax. As a result, the OECD member countries may not easily endorse the model that in certain instances seems to contradict their death and gift tax laws as well as the elements of the proposed inheritance and gift tax. As a result and in the absence of an inheritance

1 See, among others, Commentary on Article 6 of the OECD IHTMTC, para. 13.
2 See in that regard, OECD's BEPS action 15 and the MLI approach.

and gift tax treaty, the cross-border inheritance and donations may be subject to double or multiple taxation.

In the following sections, I will discuss the provisions of the model with regard to double or multiple taxation that can be improved having regard to the objective of the OECD IHTMTC of addressing double or multiple taxation and the elements of the proposed inheritance and gift tax.

5.1.1 Narrow scope and subsidiary taxing rights (Articles 1,4, 7 and 9A and 9B)

Under Article 1 of the OECD IHTMTC, "[t]his Convention shall apply: a) to estates and inheritances where the deceased was domiciled, at the time of his death, in one or both of the Contracting States, and b) to gifts where the donor was domiciled, at the time of the gift, in one or both of the Contracting States." The term "person domiciled in a Contracting State" is further defined in Article 4(1) of the OECD IHTMTC as follows: "For the purposes of this Convention, the term "person domiciled in a Contracting State" means any person whose estate or whose gift, under the law of that State, is liable to tax there by reason of the domicile, residence or place of management of that person or any other criterion of a similar nature. However, this term does not include any person whose estate or whose gift is liable to tax in that State only in respect of property situated there."[3, 4]

It follows that the term "fiscal domicile" is crucial because it determines the scope of the model and the inheritance and gift tax treaties at hand. The model and the treaties apply to estates of or gifts made by persons fiscally domiciled in one or both Contracting States. Under the Commentary on Article 1 of the OECD IHTMTC, "[m]ost Member countries take the view that it is preferable to limit the scope of a double taxation convention by reference to the property of persons who are either domiciled in, or are residents of, one or both of the Contracting States." Furthermore, this person can be either the deceased (in the case of an inheritance or estate tax) or the donor (in the case of a gift tax): "[i]t is considered that, by taking part in the economic life of the State where he has settled, although not possessing its nationality, and by contributing to the public expenditure there like a citizen of the country, the deceased will normally have become sufficiently integrated in the community for it to be proper for him and his heirs to benefit from any international conventions for the avoidance of double taxation which may be concluded by his State of domicile."[5, 6]

Moreover, as the criteria establishing fiscal domicile are listed in Article 4(1) of the model, any other criterion, which under the Contracting States' domestic laws may give rise to inheritance and gift tax liability on a worldwide basis, is, in principle, disregarded. I note, however, that, although the criteria establishing fiscal domicile are listed in Article 4(1) of the model, fiscal domicile is, in essence, a national term. The criteria "residence",

3 On the contrary, the term "fiscal domicile" of Article 4(1) of the 1966 OECD IHTMTC was defined under each Contracting States' domestic laws. Article 4(1) of the 1966 OECD IHTMTC, "For the purposes of this Convention, the question whether a person at his death was domiciled in a Contracting State shall be determined according to the law of that State."

4 See also Frans Sonneveldt and Johan Zuiderwijk, "Harmonization of Inheritance, Estate and Gift Taxes within the EU?,"*EC Tax Review* 4, no. 2 (1995): 95.

5 Commentary on Article 1 of the OECD IHTMTC, para. 1.

6 Therefore, it could be argued that the OECD IHTMTC favours the donor-based taxes (see also section 3.1.1.2).

"domicile", "place of management" and "criterion of a similar nature" are left undefined and are thus defined under the law of each Contracting State. This is derived from Article 3(2) of the model which reads as follows: "as regards the application of the Convention by a Contracting State, any term not defined there shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies."

In addition, I observe that Article 4(1) of the 1982 OECD IHTMTC reflects the wording of Article 4(1) of the 1977 OECD ICTMTC, which, however, refers to a resident of a Contracting State instead of a person domiciled in a Contracting State.[7] Nevertheless, under paragraph 1 of the Commentary on Article 4 of the OECD IHTMTC, "[a]lthough it was felt desirable that the wording [VD: of the two models] should be similar, "domiciled in" has been used instead of "resident of" as this was the term used in the 1966 Estate Tax Draft".

This arguably narrow definition of the term "fiscal domicile" in Article 4(1) of the OECD IHTMTC seems to contradict some OECD member countries' inheritance and gift tax legislations under which the personal nexus of a person is determined under concepts that are not mentioned in Article 4(1) of the model. I refer in that regard to the concept of nationality (section 3.1.1.1.3).

For instance, Goodman noted that the US inheritance and gift tax treaties must deal not only with the criterion of [fiscal] domicile, but also with the priority of taxation of the state of [fiscal] domicile over the state of nationality. For this reason, the US reserved its subsidiary right to impose an estate tax on a residual basis, granting a credit for the foreign tax paid in the state of domicile.[8] Worthy of note is that fiscal domicile in the context of the Denmark – Finland – Iceland – Norway – Sweden Inheritance and Gift Tax Treaty ("Nordic inheritance and gift tax treaty") is established, amongst others, based on the deceased's or the donor's nationality.

Second, the assessment of the fiscal domicile at the level of the deceased or the donor cannot be easily understood by those OECD member countries that assess the personal nexus at the beneficiary, the donee or both the beneficiary and the donee. For example, the application of the OECD IHTMTC based on the deceased's or the donor's fiscal domicile was the reason why Japan reserved its position on the model as a whole,[9] given that under its domestic law, the sole criterion for worldwide tax liability is the domicile (the so-called "jusho") of the beneficiary, legatee, or donee. Inevitably, countries like Japan

7 The sole reference in Article 4(1) of the 1966 OECD IHTMTC to the "domicile" of the deceased or the donor was replaced by the "domicile, residence or place of residence […] or any other criterion of a similar nature", Cf. Guglielmo Maisto, "General Report: Death as a Taxable Event and its International Ramifications," in *Cahier de droit fiscal international 95b,* ed. IFA (The Hague: Sdu Uitgevers, 2010), 46.

8 Wolfe D. Goodman, "The OECD Model Estate Tax Convention," *European Taxation* 34 (October/November 1994): 340.

9 Commentary on Article 1 of the OECD IHTMTC, para. 31.

cannot easily endorse the model and conclude inheritance and gift tax treaties with other OECD member countries.[10]

Nevertheless, I am of the view that the narrow scope of the model does not seem to counter the objective of the model of addressing double taxation and the proposed inheritance and gift tax *in situations involving only two states.*[11] This is because those who drafted the OECD IHTMTC suggested a "subsidiary taxing right" provision to compensate a possible narrow scope in certain instances (paragraphs 70-72 of the Commentary on Articles 9A and 9B of the model). These paragraphs read in conjunction with paragraphs 5-7 of the Commentary on Article 7 and paragraph 5 of the Commentary on Article 1 allow states to depart from the rules of the OECD IHTMTC where there is a compelling reason to do so. Such a reason is the establishment of taxing rights under different rules and concepts than those endorsed in the model with addressing of tax avoidance where the deceased, in contemplation of death, or the donor, in contemplation of making a gift, moved his domicile to the other state with the intention of escaping taxation by his former state of domicile. In these cases, states can maintain their subsidiary rights on the grounds of the deceased's or the donor's nationality/the secondary domicile, or the heir's, legatee's, or donee's nationality/domicile. I note, however, that paragraph 71 of the Commentary on Article 9A and 9B states that these rights can be exercised for a limited period only, and in any event, no longer than ten years after the deceased or the donor has ceased to be domiciled in their territory.

While the provision for subsidiary taxing right counterbalances by some means the narrow scope of the model and the treaties,[12] the ten-year limitation period and the underlying tax-abusive motive are, in my view, two elements that could be perhaps revisited having regard to the objective of the OECD IHTMTC of addressing double taxation and the proposed inheritance and gift tax. Reference is made in that regard to section 6.1.1 of this study.

5.1.2 Multiple taxation (Articles 1 and 4)

The narrow scope of the OECD IHTMTC and the tax treaties has one more significant consequence: the elimination of *multiple* taxation of estates, inheritances and gifts is contingent on an extensive tax treaty network.[13] This is particularly understood in situations where three (or more) states seek to tax the cross-border inheritance and donation. In that regard, paragraphs 9 (example 3) and 10 (example 4) of the Commentary on Article 1

10 Japan has concluded only one inheritance and gift tax treaty with the US, this in 1954. More on the application of this treaty, see Masatami Otsuka, "Intersection of the Japanese Inheritance Tax and the United States Estate Tax-Notes on International Double Taxation of Inheritances and Gifts," *Intertax* 22, no. 2 (1994). See also Frans Sonneveldt, "Application of death taxes in the emigration and immigration countries," in *Inheritance and wealth tax aspects of emigration and immigration of individuals*, ed. IFA (The Hague, London, New York: Kluwer Law International, 2003), 11.

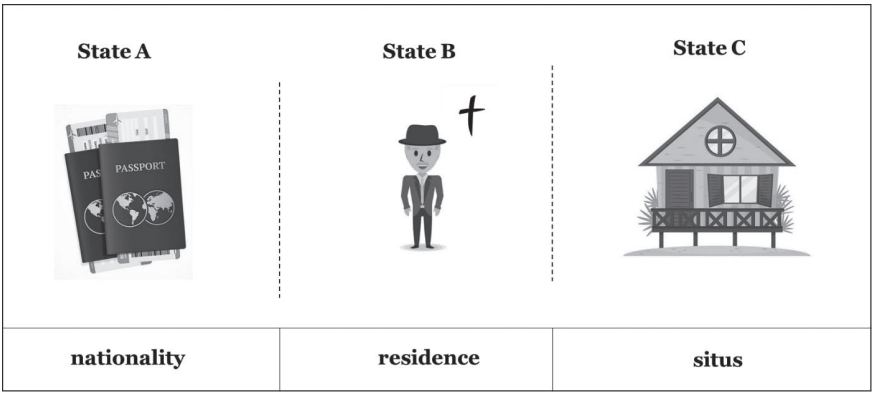
11 On the contrary, it could be argued that the narrow scope of the model may counter the objective of the model of addressing double taxation and the proposed inheritance and gift tax when the cross-border inheritance and donation may be taxed by more than two states (see section 5.1.2).

12 Therefore, Goodman's observation that, the OECD IHTMTC disregards any other criterion which, under the domestic law of a member country, may lead to a comprehensive tax liability, may not be completely accurate. Wolfe D. Goodman, "The OECD Model Estate Tax Convention," *European Taxation* 34 (October/November 1994): 338.

13 See also, Timothy Lyons, "Double Taxation of Estates, Inheritances and Gifts in the EU and the Anglo-American Trust," *European Taxation* 37, no. 3 (1997), 76.

of the OECD IHTMTC provide examples of situations where three states may seek to tax the deceased's property.

In example 3 of the Commentary, State A may seek to tax the deceased's worldwide property based on his nationality, State B based on the deceased's residence and State C may seek to tax the deceased's *mortis causa* transferred immovable property because it is located in its territory, as seen below.

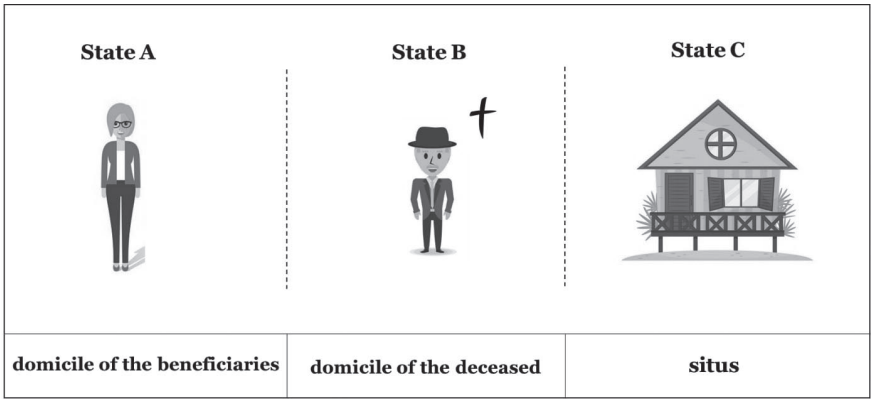


The parallel exercise of tax jurisdiction by States A, B and C may, therefore, result in multiple taxation of the immovable property located in State C.

In addition, under the Commentary, the state of the deceased's residence (State B) has not concluded a tax treaty with either State A or C.[14] Only States A and C have concluded a double tax treaty. However, this is immaterial since this would not be applicable because of its narrow scope: the deceased had, at the time of his death, his fiscal domicile in a third country (State B). In other words, only if the deceased had been fiscally domiciled in either State A or C, would the A-C tax treaty have been applicable. Given, however, that the A-C tax treaty is not applicable and given the fact that State B has not concluded a tax treaty with either State A or C, the deceased's property is eventually taxed by all states involved (setting aside the unilateral relief mechanisms).

In example 4 of the Commentary, State A may seek to tax the beneficiary's worldwide property based on the beneficiary's domicile, State B based on the deceased's domicile and State C may seek to tax the deceased's *mortis causa* transferred immovable property because it is located in its territory, as seen below.

14 If this would be the case, only State B would have been entitled to tax the immovable property in State C under the A-B tax treaty (so State A cannot tax) and State C would have been entitled to tax the immovable property under the B-C tax treaty (with State B providing double taxation relief by means of an exemption or a credit). As a result, the multiple taxation problem of the cross-border inheritance at hand would have been addressed.



As a result, the parallel exercise of tax jurisdiction by States A, B and C may result in multiple taxation of the immovable property.

In addition and similar to the previous example, under the Commentary, the state of the deceased's domicile (State B) has not concluded a tax treaty with either State A or C.[15] Only States A and C have concluded a double tax treaty. However, this is immaterial as this would not be applicable because of its narrow scope: at the time of his death, the deceased had his fiscal domicile in a third country (State B). In other words, only if the deceased had been fiscally domiciled in either State A or C, would the A-C tax treaty have been applicable. This is not the case since there is no link with the fiscal domicile of the deceased in either State A or C. Given therefore that the A-C tax treaty is not applicable and given the fact that State B has not concluded a tax treaty with either State A or C, the deceased's property is eventually taxed by all states involved (setting aside the unilateral relief mechanisms).

It follows from the above two examples of the Commentary that, due to the narrow scope of the OECD IHTMTC,[16] cases of multiple taxation cannot always be addressed. This does not seem to be in line with the primary objective of the OECD IHTMTC, i.e. the allocation of taxing rights for the avoidance of double taxation and the proposed inheritance and gift tax; if double taxation arguably frustrates the application of the ability-to-pay taxes and windfall justifications – two elements of the proposed inheritance and gift tax – in a two-country situation, multiple taxation should have the same effect in situations involving more than two states.

The suggestion of those who drafted the OECD IHTMTC to the multiple taxation concern is stated in paragraph 12 of the Commentary on Article 1: "[t]he Committee on Fiscal Affairs decided not to include […] residual cases within the scope of the Model Convention since such forms of tax liability are found only in a few Member countries. Moreover, in the rare

15 If this would be the case, only State B would have been entitled to tax the immovable property in State C under the A-B tax treaty (so State A cannot tax) and State C would have been entitled to tax the immovable property under the B-C tax treaty (with State B providing double taxation relief by means of an exemption or a credit). As a result, the multiple taxation problem of the cross-border inheritance at hand would have been addressed.

16 That results in the application of the tax treaties only if the deceased or the donor had his fiscal domicile – as determined in Article 4(1) of the OECD IHTMTC – in a Contracting State.

practical cases, double taxation will often be avoided by the unilateral reliefs provided in the countries concerned. Finally, where double taxation does occur, it will be prevented where Member countries adhere to the Council's recommendation and conclude double taxation conventions on the basis of this Model. Accordingly, as the network of double taxation conventions among Member countries becomes more widespread, unrelieved double taxation will become progressively rarer. There seemed therefore to be no need to enlarge the Convention to cover such special cases."[17]

Nevertheless, bearing in mind that the narrow scope of the model is sometimes the reason why states do not conclude inheritance and gift tax treaties,[18] it should be explored whether the inclusion of residual cases to treaties that are not applicable because the deceased is not fiscally domiciled in a Contracting State can potentially address or at least mitigate the multiple taxation problem. Reference is made in that regard to section 6.1.2.2.1 of this study. Furthermore, it should be explored whether the conclusion of a multilateral convention can address the problem as well. Reference is made in that regard to section 6.1.2.2.2 of this study.

5.1.3 The tiebreaker rule for individuals (Article 4(2))

Article 4(2) of the model contains a tiebreaker rule that aims to address dual fiscal domicile conflicts, i.e. situations where both Contracting States consider the deceased or the donor to be fiscally domiciled in their territory. More specifically, "[w]here by reason of the provisions of paragraph 1 an individual is domiciled in both Contracting States, then his status shall be determined as follows:

a) he shall be deemed to be domiciled in the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be domiciled in the State with which his personal and economic relations are closer (centre of vital interests);
b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be domiciled in the State in which he has an habitual abode;
c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be domiciled in the State of which he is a national;
d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement."

It follows that the OECD IHTMTC's tiebreaker rule for individuals is similar to that of the OECD ICTMTC, thereby adopting the same connective criteria (permanent home, centre of vital interests, habitual abode, nationality and mutual agreement procedure) with the latter for the determination of the deceased's or the donor's fiscal domicile, and affording the primary taxing right to the Contracting State which the connective criterion indicates. The fact that the Commentary on Article 4(2) of the OECD IHTMTC closely mirrors that

17 Commentary on Article 1 of the OECD IHTMTC, para. 11.
18 Especially states, which levy inheritance and gift taxes based on principles different from those adopted in the model.

of Article 4(2) of the OECD ICTMTC confirms the above.[19] Both tiebreaker rules, thus, give preference to the Contracting State of the person's permanent home, his centre of vital interests, his habitual abode, his nationality and, as a last resort, to what the Contracting States will decide following a mutual agreement procedure. It follows that through the application of these connective criteria, the Contracting States aim at identifying the *attachment* of the individual with a state and at affording primary taxing rights to the Contracting State with which this person is the most attached. As a result, the attachment of a person with a Contracting State is examined alike in both models as also shown by the similarities of the commentaries on both OECD tiebreaker rules.

Nevertheless, it could be argued that the assessment of the attachment of a person with a Contracting State under the same connective criteria for both inheritance/gift and income tax treaty purposes may be problematic in some cases. In my view, the OECD IHTMTC's tiebreaker rule seems to counter the manner in which certain states establish the lifelong attachment of a person with their territory and the third element of the proposed inheritance and gift tax (connection with civil law). For example, the deceased's or donor's intention to fiscally domicile in a Contracting State – an essential element of some inheritance and gift tax legislations – seems to be deliberately ignored. Under paragraph 22 of the Commentary on Article 4, "[t]he determination of the individual's intention can result in endless disputes and, what is more, to manipulation on the part of the heirs." One would expect, however, that those who drafted the OECD IHTMTC would have explicitly mentioned in the Commentary on Article 4 of the OECD IHTMTC that states are free to insert an intention test into the tiebreaker rule of their inheritance and gift tax treaty.

Likewise, the requirement of a minimum period of presence of a person in a Contracting State – usually forming part of the assessment of his lifelong attachment to the state – does also not seem to be reflected in the wording of the tiebreaker rule. For example, the determination of the fiscal domicile based on the availability of a permanent home *without a minimum period of presence* in a Contracting State seems again to contradict the manner in which certain states establish the lifelong attachment of a person with their territory and the proposed inheritance and gift tax. Sonneveldt (2001) stated in that regard that a minimum period of presence might need to be specified before the individual acquires a fiscal domicile in the Contracting State in which he is living.[20] In that regard, I note that the interpretation of the terms "permanent home" and "habitual abode" under the Commentary on Article 4 seems to favour such an approach.[21]

One could argue that due to the lack of an option for an intention test and of a minimum period of presence in a Contracting State Article 4(2) of the OECD IHTMTC, the tie-breaker rule counters a) the manner in which certain states aim to establish the lifelong attachment of a person with their territory and b) the third element of the proposed inheritance and gift tax (connection with civil law). In that regard, I observe that the tax treaty practice seems to have already recognised the lack of these two elements from the OECD IHTMTC's tiebreaker rule of individuals. Some treaties, thus, include a specific tiebreaker rule that takes precedence over the general one. This rule includes, amongst others, an intention and

19 Alexander Rust, "The Concept of Residence in Inheritance Tax Law," in *Residence of Individuals under Tax Treaties and EU Law*, ed. Guglielmo Maisto, (Amsterdam: IBFD, 2010), 92.

20 Frans Sonneveldt, "General Report: Avoidance of Multiple Inheritance Taxation within Europe," *EC Tax Review* 10, no. 2 (2001): 95.

21 Commentary on Article 4(2) of the OECD IHTMTC, paras. 19 and 28.

minimum presence test. Furthermore, other treaties include a requirement for a minimum period of presence in a Contracting State in the existing tiebreaker rule for the assessment of whether the deceased or the donor has maintained a permanent home there. Reference is made in that regard to section 6.1.3 of this study.

5.1.4 Overlaps with the OECD ICTMTC (Article 2)

One of the most essential problems of the OECD IHTMTC relates to the possible overlaps of its subjective scope with that of the OECD ICTMTC. According to Brandstetter, "[i]t seems that there lies a key reason why so few [inheritance tax] treaties have been concluded."[22] At first sight, there seems to be no overlap between the two models, but a closer look shows that this is possible, especially if the states involved apply different kinds of taxes to the same transfer of property. These overlaps can give rise to double taxation or double non-taxation.[23] Lang provided the example of a donation from an Austrian foundation to its foreign-located beneficiaries after 1993.[24, 25] In 1993, Austria amended its inheritance and gift tax laws and introduced a gift tax exemption for donations from an Austrian foundation to its beneficiaries.[26] On the other hand, the Austrian income tax rules were amended to include an income tax liability at the level of the beneficiaries. In Lang's example, Austria has concluded both an income and capital tax treaty and an inheritance and gift tax treaty with the state of the beneficiaries' residence.

Lang noted first that "[o]ne could question whether the income tax liability in respect of these donations is identical or at least similar to the tax liability under the other taxes listed in the bilateral equivalents to [Article] 2(3) of the [OECD ICTMTC]." If, however, Austria taxes the transfer from the Austrian foundation under its income tax rules, it will seek to apply the income tax treaty with the state of the non-resident beneficiaries[27] and, more specifically, Article 21 ("other income") of the *income and capital tax treaty*. Consequently, the state of the beneficiaries' residence has exclusive taxing rights. Austria is thus precluded from taxing the donation in the hands of the non-resident beneficiaries. However, if the state of the beneficiaries' residence regards the transfer from the Austrian foundation to its resident beneficiaries as a gift, it will apply Article 7 of the *inheritance and gift tax treaty,* which grants exclusive taxing rights to Austria, the Contracting State of

22 Patricia Brandstetter, *"Taxes Covered": A Study of Article 2 of the OECD Model Tax Conventions* (Amsterdam: IBFD, 2011), 182.

23 Nevertheless, I note that this type of double taxation is not the outcome of two states qualifying the same transfer of property differently. On the contrary, it is the outcome of two states applying different tax *treaties*. Therefore, this type of double taxation could not be easily reflected in section 3.1 of this study. Considering, however, that in this situation both states would levy a different type of tax on the same transfer of property, one could argue that this situation of double taxation is covered in section 3.1.1.4 of this study.

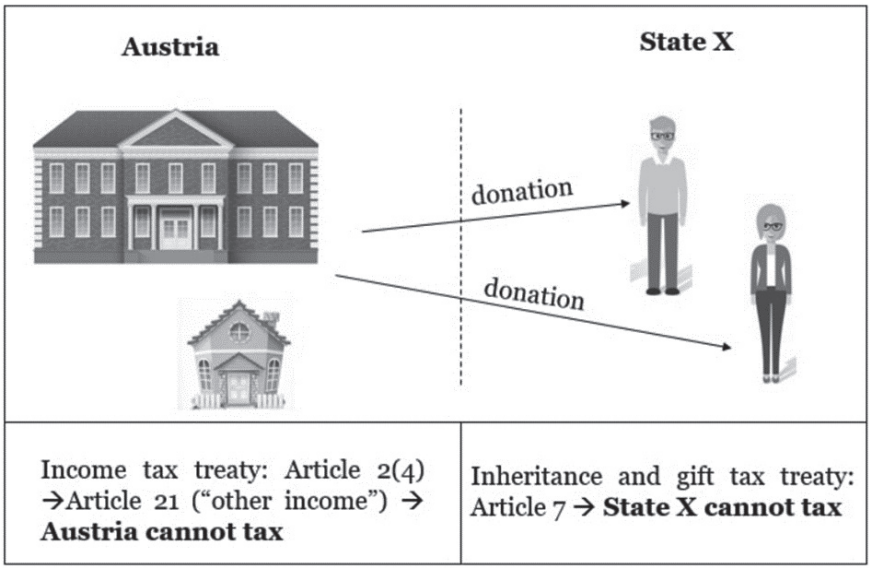
24 Michael Lang, ""Taxes Covered" in What is a "Tax" According to Article 2 of the OECD Model?," *Bulletin for International Taxation* 59, no. 6 (2005): 223.

25 In that regard, I note that the example works only if the donated asset is not located in the state where the beneficiaries reside (see example below).

26 Please note that Austria abolished its inheritance and gift tax laws in 2008.

27 Either using the list of Article 2(3) of this treaty, which lists income taxes as existing taxes to which the treaty applies, or using applying Article 2(4) of the inheritance and gift tax treaty and concluding that the income tax is not substantially similar to the previously levied gift tax.

the fiscal domicile of the donor, the Austrian foundation.[28] The state of the beneficiaries' residence will thus not seek to levy tax on the gift concerned also given that the immovable property is located in Austria.[29]This leads to double non-taxation.



Moreover, I observe that, reversing the legal systems of the Contracting States, the donation from the Austrian foundation to its non-resident beneficiaries may be subject to double taxation. If Austria applies gift taxes to the *inter vivos* transfer of property, it may seek to apply the inheritance and gift tax treaty with the Contracting State of the non-resident beneficiaries. More specifically, it may seek to apply Article 7 of this treaty that grants exclusive rights to Austria with regard to immovable property located in Austria. On the other hand, the Contracting State of beneficiaries' residence that levies income taxes on gifts, may seek to apply the income tax treaty with Austria and more specifically Article 21 ("other income"). This Article allocates exclusive taxing rights to this State since the beneficiaries are resident in its territory. As a result, the Contracting State of the beneficiaries' residence may also seek to levy tax on the *inter vivos* transfer of property at hand under the income and capital tax treaty concluded with Austria. It follows that the same *inter vivos* transfer of property is taxed by both Austria and the state of the beneficiaries' residence under two different tax treaties.[30]

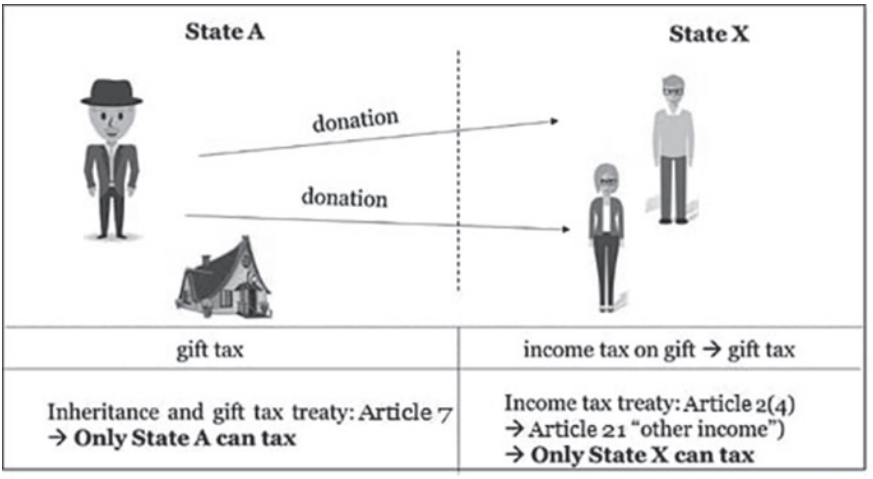
28 Patricia Brandstetter, *"Taxes Covered": A Study of Article 2 of the OECD Model Tax Conventions* (Amsterdam: IBFD, 2011), 198.

29 Therefore, State X cannot apply Article 5 of the inheritance and gift tax treaty and tax the immovable property.

30 In the same vein, Martín Jiménez refers to possible overlaps with regard to life insurances or private pension plans if the person who entered into the contract is different from the beneficiary and the company paying the benefit is a resident in the state of the objective nexus. See Martín Jiménez, "Defining the objective scope of income tax treaties: the impact of other treaties and EC law on the concept of tax in the OECD Model," *Bulletin for International Taxation* 59, no. 10 (2005): 437-438.

Lang's example shows, in my view, that there are situations in which it is difficult to determine whether a certain tax liability shall be covered by an income and capital tax treaty or an inheritance and gift tax treaty.[31] More importantly, it shows that the application of a different type of tax treaty by each Contracting State can lead to double taxation, or double non-taxation (as it will be discussed in section 5.2.1).

Similar problems may arise if a Contracting State amends its income tax legislation, introduces an inheritance and gift tax liability at the level of the beneficiaries and, *subsequently*, concludes an inheritance and gift tax treaty with another state. Considering that it may lose its taxing rights or have limited taxing rights in the case of a *mortis causa* or *inter vivos* transfer of property (not located in its territory) from a non-resident donor/deceased to his resident beneficiaries/donees, it may seek to safeguard its taxing rights arguing that the recently introduced inheritance or gift tax is substantially similar to the previously levied income tax. Therefore, it will seek to apply Articles 2(4) and 21 of the income and capital tax treaty and tax the resident beneficiaries/donees on their received inheritance or donation based on Article 21 of the income tax treaty.[32] On the other hand, the Contracting State of the fiscal domicile may invoke Article 7 of the inheritance and gift tax treaty and tax the deceased's or the donor's worldwide property apart from the property that is listed in Articles 5 and 6 of the treaty and is located in the other Contracting State. Once again, the application of a different type of tax treaty by each Contracting State can give rise to double taxation of the same transfer of property, as seen by the example below.



In my view, the overlaps between the two models and types of tax treaties can be addressed by improving the OECD IHTMTC and especially Article 2 of the model. In my view, more taxes than those mentioned in Article 2 of the OECD IHTMTC can be included in the scope of the model as arguably, this would be in line with the proposed inheritance and gift tax

31 Michael Lang, ""Taxes Covered" in What is a "Tax" According to Article 2 of the OECD Model?," *Bulletin for International Taxation* 59, no. 6 (2005): 223.

32 Patricia Brandstetter, *"Taxes Covered": A Study of Article 2 of the OECD Model Tax Conventions* (Amsterdam: IBFD, 2011), 198.

and the objective of the model of addressing double taxation. Improvements to Article 2 of the model in relation to this point are presented in section 6.1.4 of this study.

5.1.5 Estate and inheritance taxes (Articles 2 and 9B)

In line with Article 2(1) of the OECD IHTMTC, a tax treaty applies to taxes on estates and inheritances and on gifts. In this section, I will focus on the interaction between "the taxes on estates" and "the taxes on inheritances". As noted in the previous section, Article 2(2) of the OECD IHTMTC defines these taxes: taxes on estates are taxes imposed by reason of death on the corpus of the estate and taxes on inheritance tax are "taxes on inheritances" that are levied "on the parts of the estate as devolved on different heirs or legatees".[33]

In section 2.2.1, I discussed the differences between inheritances and estate taxes. Civil law states usually levy an inheritance tax, which is an acquisition-based transfer tax applicable to the share of the inherited property received by each beneficiary (and, thus, not on the estate as a whole). Its taxable event is the enrichment of the beneficiary upon the deceased's death. The taxable person is each beneficiary who receives an inheritance. On the contrary, the taxable event of an estate tax is the *mortis causa* transfer of property, in which case the deceased's whole estate (or sometimes the deceased) is regarded as being the taxable person. As a result, the estate as a whole, rather than the property received by each particular beneficiary, becomes the point of departure.[34] Moreover, the estate is often treated as a legal person under both domestic and tax treaty law, and the tax is often determined based on progressive tax rates that depend on the value of the estate and usually the degree of kinship between the deceased and the beneficiaries.

Despite the remarkable differences between these two types of death taxes (taxable event, tax base, taxpayer), I observe that states have already concluded treaties which apply to both of them. For example, the US has signed 16 inheritance and estate tax treaties, most of them with states which levy an inheritance tax (e.g. France, Netherlands and Germany). In most of these treaties, the Contracting State of the fiscal domicile credits the estate tax levied by the US in its capacity as the other Contracting State on the property that it may tax under Articles 5 and 6 of the treaty. Likewise, the US, when taxing in its capacity as the Contracting State of the fiscal domicile, provides a credit against its estate tax for the foreign inheritance tax levied in the other Contracting State. Similarly, the UK that levies an estate tax (called "inheritance tax") has concluded 13 inheritance and gift tax treaties most of them with states which levy an inheritance tax (e.g. France, Italy and the Netherlands).

The credit method for the elimination of double taxation is described in Article 9B of the OECD IHTMTC. Under this Article, "[t]he Contracting State in which the deceased was domiciled at his death, or the donor was domiciled at the time of the gift, shall allow as a deduction from the tax calculated according to its law an amount equal to the tax paid in the other Contracting State on any property which, *in relation to the same event* and in accordance with the provisions of this Convention, may be taxed in that other State." (Italics, VD). In that regard, I note that the term "in relation to the same event" is left undefined in the Commentary. Nevertheless, the Commentary makes particular reference

33 Commentary on Article 9B of the OECD IHTMTC, para. 78.

34 Frans Sonneveldt, "General Report: Avoidance of Multiple Inheritance Taxation within Europe," *EC Tax Review* 10, no. 2 (2001): 83.

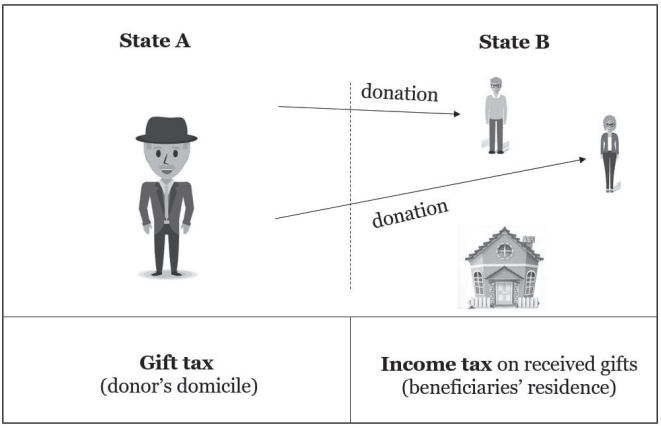
to the application of the credit method between States applying different forms of death duties (and in particular an inheritance tax and an estate tax). Under paragraph 78 of the Commentary on Article 9B of the OECD IHTMTC, "[t]he application of the credit method may become difficult between the Contracting States where one of them imposes an estate tax […] whereas the other State imposes an inheritance tax […]". In addition, the Commentary states in paragraph 80 that "[i]f the State of domicile is the one which levies the estate tax, it may have to decide to what extent it has to give credit against its uniformly levied tax for the taxes which have been levied in the State of situs *on different persons at different rates*. Vice versa, if the State of domicile levies the inheritance tax, it may have to decide which taxes levied in a lump sum on the estate in the State of situs have to be attributed to the different heirs who have taken possession of the different parts of the estate. Member countries are free to settle these difficulties in bilateral negotiations." (Italics, VD).

As per Maisto's observation, "[t]he wording of Article 9B restricts the credit to foreign taxes levied 'in relation to the same event' without making restrictions on whether the tax is borne by a different person by virtue of differences in the domestic laws of the two states."[35] I agree with Maisto's observation and am of the view that the wording of Commentary on Article 9B on the application of the credit method between States with different forms of death duties (and, in particular, inheritance taxes and estate taxes) can be improved on this point having regard to the objective of the OECD IHTMTC of addressing double taxation and the elements of the proposed inheritance and gift tax.

5.1.6 Inheritance/estate/gift taxes and income/capital gains taxes (Articles 2 and 9B)

As mentioned above, death is an event that can trigger a variety of taxes in the event of a cross-border inheritance. Although most of the OECD member countries levy either an estate tax or an inheritance tax, there are still some states, which levy *mortis causa* income taxes on the beneficiaries or capital gains taxes upon the future alienation of the inherited assets. Some other states impose a capital gains tax liability assessed at the level of the deceased on the deemed distribution of his property as noted in chapter 2. Furthermore, a donation can be subject to a gift tax in a state and to an income tax in another state, as seen below.

35 Guglielmo Maisto, "General Report: Death as a Taxable Event and its International Ramifications," in *Cahier de droit fiscal international 95b,* ed. IFA (The Hague: Sdu Uitgevers, 2010), 49.



Because of the wording of Article 2(2) of the OECD IHTMTC, it is unclear whether the model and the treaties apply to *inter vivos* or *mortis causa* income or capital gains taxes. If not, these taxes cannot be credited against the inheritance or the estate tax or gift tax and *vice versa* as the treaty would not cover these taxes.[36] More specifically, if the deceased was fiscally domiciled in a state which levies income tax on the beneficiaries' income from inheritance and part of the inherited property is located in a state that levies inheritance tax at the beneficiaries, the state of the deceased's fiscal domicile will most probably not grant a credit for the foreign paid inheritance tax because a) under its domestic laws the latter tax is not of the same nature with the income tax, and b) it will not apply the inheritance and gift tax treaty as the income tax is not covered by the inheritance and gift tax treaty. In the same vein, a state may not allow for a credit of a foreign paid income tax against its gift tax as a) it may consider the former tax not of the same nature with its gift tax, and b) it may not apply the inheritance and gift tax treaty. Double taxation of the same *inter vivos* or *mortis causa* transferred property is thus very likely in these cases.

The discussion on whether other types of *mortis causa* or *inter vivos* taxes can be covered by the model and the treaties is included in the section concerning the overlaps between the two OECD models. Therefore, I refer to section 5.1.4 of this study concerning this issue. If, however, other types of *mortis causa* or *inter vivos* taxes *should* be covered by the model and the inheritance and gift tax treaties, the question arises whether the OECD IHTMTC effectively addresses the double taxation problem arising from the parallel application of different forms of death and gift taxes. It could be argued that this is not the case given the restrictive interpretation of the phrase "in relation to the same event" as laid down in the Commentary on Article 9B of the model. I refer in that regard to the previous section in which I argued that the wording of the Commentary on Article 9B of the OECD IHTMTC can be improved having regard to the objective of the OECD IHTMTC of addressing double taxation and the elements of the proposed inheritance and gift tax with reference to the application of the credit method between States applying different types of death duties.

36 Guglielmo Maisto, "The pursuit of harmonisation regarding taxes on death and the international implications," *Bulletin for International Taxation* 65, no. 4/5 (2011): 255.

5.1.7 Lack of common valuation rules (Articles 9A and 9B)

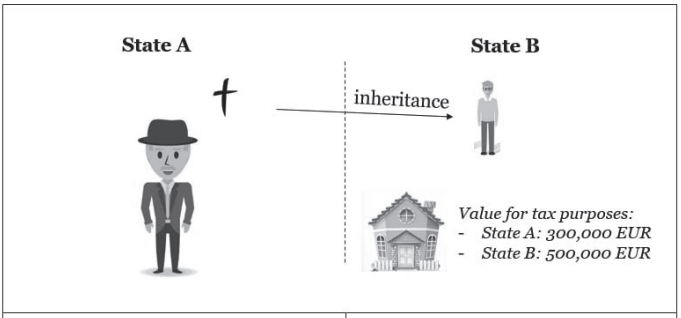
As noted in section 2.2.1, although most inheritance and gift tax laws refer to the market value of the inherited or donated assets and rights at the time of the death or the donation, the rules on the valuation of these assets – even at a market value – vary considerably from state to state. For instance, even though the value of the listed shares is often based on their listing value, there are discrepancies in domestic rules as to the reference date (the date of death, one day prior to it or the average computed over a specified period). Furthermore, some states apply special valuation rules regarding certain types of property, e.g. agricultural property, or rights, e.g. usufruct. In some other states, the cadastral value of the property is the starting point for its valuation for inheritance and gift tax purposes. It follows that the tax value of a property or a right may often differ from its market value at the time of the death or the donation.[37]

Under paragraph 25 of the Commentary on Articles 9A and 9B of the OECD IHTMTC, "[t]he value of the property to be exempted from tax by the State of domicile is the amount which, but for the Convention, would be subject to its estate, inheritance or gift tax according to its domestic law. This value may differ from the amount subject to tax in the State of situs according to its domestic law."[38] As a result, each Contracting State applies its domestic valuation rules to value the property that is entitled to tax based on the inheritance and gift tax treaty. Treaty practice is consistent with this approach. For example, under Article 9(1) of the Nordic inheritance and gift tax treaty, "[i]n determining the amount on which tax is to be computed, each Contracting State shall value property according to its own laws […]."

The non-application of the OECD IHTMTC to the property valuation rules can often result in valuation mismatches that may affect the amount of the double taxation relief. More specifically, Articles 5 and 6 of the OECD IHTMTC are called "open distributive rules". The other Contracting State may also tax the property listed there with the Contracting State of the fiscal domicile providing relief for the inheritance and gift tax paid in the former state under Articles 9A or 9B of the OECD IHTMTC and the treaty. It follows that the Contracting State of the fiscal domicile levies an inheritance or gift tax on the deceased's or donor's worldwide property, which is then valued based on its domestic valuation rules. Accordingly, double taxation may occur if the Contracting State of the fiscal domicile places a lower value on the property than that applied by the other Contracting State, as seen below.

37 Guglielmo Maisto, "General Report: Death as a Taxable Event and its International Ramifications," in *Cahier de droit fiscal international 95b,* ed. IFA (The Hague: Sdu Uitgevers, 2010), 31.

38 Commentary on Articles 9A and 9B of the OECD IHTMTC, para. 25.



Inheritance tax (personal nexus)	**Inheritance tax** (objective nexus)
Exemption (Article 9A of the OECD IHTMTC): 300,000 EUR	**Taxation** (Article 5 of the OECD IHTMTC): 500,000 EUR

Maisto noted in that regard that "[i]t is odd that valuation of property is not covered by the OECD IHTMTC since this is an important cause for double taxation". Nevertheless, I observe that also the OECD ICTMTC does not cover valuation rules. Paragraph 25 of the Commentary on Articles 9A and 9B of the OECD IHTMTC mirrors paragraph 39 of the Commentary on Articles 23A and 23B of the OECD ICTMTC which states that "[t]he amount of income to be exempted from tax by the State of residence is the amount which, but for the Convention, would be subjected to domestic income tax according to the domestic laws governing this tax. It may, therefore, differ from the amount of income subjected to tax by the State of source according to its domestic laws". I also note that also for the application of Article 22 of the OECD ICTMTC (taxation of capital) the determination of the value of the assets rests entirely with the domestic law of each Contracting State.[39]

In my view, it is not odd that the OECD IHTMTC does not cover property valuation rules. Although the differences in these rules can often result in double taxation of the inheritance or donated property, it should be borne in mind that tax treaties allocate taxing rights between the Contracting States and do not coordinate or harmonise their inheritance and gift tax systems. It follows that the non-application of the OECD IHTMTC to property valuation rules does not seem to contradict the objective of the OECD IHTMTC of addressing double taxation and the proposed inheritance and gift tax. Although this can give rise to double taxation of the cross-border inheritance and donation at hand, the application of different valuation rules by the Contracting States is a mere *disparity* between the tax systems of the Contracting States that can only be addressed through harmonising legislation or coordination.[40] On the contrary, the OECD IHTMTC does not aim at harmonising the legislation of the Contracting States. Reference is made in that regard to section 3.2.1.2 of this study in which the objectives of the model were discussed.

39 Alexander Rust, "Article 24. Non-discrimination," in *Klaus Vogel on Double Taxation Conventions*, eds. Reimer Ekkehart and Alexander Rust (Alphen aan den Rijn: Kluwer Law International, 2015), 1573.

40 For example, the tax authorities of the Contracting State of the fiscal domicile may agree to voluntarily recognise the value that the other Contracting State applied to assess its inheritance or gift claim.

The above does not mean, however, that double taxation arising from the different valuation rules of each Contracting State *a priori* falls outside the scope of the inheritance and gift tax treaty. To address this type of double taxation, the Contracting States can initiate the mutual agreement procedure of Article 11 of their treaty. The mutual agreement procedure is discussed in section 5.1.10 of this study. In that regard, I observe that under Article 11(3) "the competent authorities may consult together for the elimination of double taxation in cases not provided for in the Convention". Although the property valuation rules fall outside the scope of the model, it could be argued that double taxation arising from the application of different valuation rules can be addressed in the framework of a mutual agreement procedure.

5.1.8 Conflicts of qualification (Articles 3 and 5-7)

Although the three distributive rules of the OECD IHTMTC seem to be easily applicable, several conflicts of qualification may arise when the Contracting States apply these rules. This type of conflicts, however, seems to counter the objective of the OECD IHTMTC of addressing double taxation and the proposed inheritance and gift tax.

I observe that there are three types of conflicts of qualification. There are conflicts due to i) the interpretation of the treaty rules, ii) the differences in treaty application to the facts at hand, and iii) the differences in domestic law classifications.

More specifically, the Contracting States may apply different definitions to a treaty term. For example, under Article 5(3) of the OECD IHTMTC, "[i]mmovable property shall have the meaning which it has under the law of the Contracting State in which the property in question is situated." Therefore, the Contracting State of the fiscal domicile is bound by the interpretation of the other Contracting State. The question arises, however, as to whether the reference to the domestic law of the other Contracting State concerns only its tax law or its laws in general, including its civil laws (as Article 3(2) of the OECD IHTMTC seems to suggest). This is an essential issue in the area of death taxation which, by its nature, is closely related to civil law. If thus the two Contracting States define the term "immovable property" differently, double taxation may arise. To elaborate on this point, the other Contracting State may define the term "immovable property" broadly based on its civil law whereas the Contracting State of the fiscal domicile may define it under the tax law of the other Contracting State, which provides a narrow definition of the term.[41] Thus, under Article 5 of the OECD IHTMTC, the other Contracting State may levy an inheritance tax, for instance, on five assets whereas the Contracting State of the fiscal domicile will consider that the other Contracting State is allowed to levy inheritance tax on only three assets and thus, will levy inheritance tax on the remaining two.

Furthermore, a conflict of qualification due to the differences in treaty application to the facts occurs, for example, in the case of the movable property that forms part of a PE. If the Contracting State of the fiscal domicile considers that there is no PE in the other Contracting State, it will seek to apply Article 7 of the inheritance and gift tax treaty and, thus, tax the movable property. On the contrary, if the other Contracting State considers that there is a PE in its territory, it will seek to apply Article 6 of the treaty and tax the

41 Marc Walter, "Conflicts of Qualification and International Inheritance Cases," in *Conflicts of Qualification in Tax Treaty Law,* ed. Michael Lang (Vienna: Linde Verlag, 2007), 301–302.

movable property forming part of this PE. The parallel application of Articles 6 and 7 of the treaty results in double taxation.

Finally, the tax treatment of partnerships is an illustrative example of conflicts of qualification arising from the differences in domestic law classifications. If the Contracting State of the fiscal domicile considers the partnership established in the other Contracting State opaque and the latter state considers it transparent, such different treatment may give rise to double taxation. More specifically, the former Contracting State may seek to apply Article 7 of the inheritance and gift tax treaty and thus, tax the interest in the partnership, which is treated as a separate legal entity under its law. On the other hand, the other Contracting State might seek to apply Article 5 of the treaty and tax the immovable property owned by the "transparent" partnership. The parallel application of Articles 5 and 7 of the treaty leads to double taxation.

I observe that the OECD IHTMTC Commentary discusses only the last category of the conflicts of qualification, i.e. conflicts arising due to differences in domestic law classifications. More specifically, the Commentary on Article 7 of the OECD IHTMTC refers to the following four examples of these conflicts:[42]

a) The interests in partnerships,
b) The undistributed estates,
c) The property held in a trust, and
d) The companies holding immovable property.

The above conflicts can give rise to double taxation, as presented in paragraphs 17-23 of the Commentary on Article 7 of the OECD IHTMTC. In that regard, paragraph 24 of the Commentary suggests that the Contracting States insert the following paragraph in their treaties, thereby avoiding conflicts arising due to differences in domestic law classifications:

"If by the law of a Contracting State any right or interest is regarded as property not falling under Article 5 or 6, but by the law of the other Contracting State that right or interest is regarded as property falling under either of those Articles, then the nature of the right or interest shall be determined by the law of the State which is not the State of the deceased's or the donor's domicile".[43]

Under the suggested wording, the Contracting State of the fiscal domicile must follow the classification that the other Contracting State gives to the right or interest at hand. Therefore, if the Contracting State of the fiscal domicile applied Article 7 of the treaty and sought to tax the right or interest at hand, and the other Contracting State applied Articles 5 or 6 of the treaty and sought to tax that right or interest as well, the former state had to recognise the classification which the latter Contracting State gave to this right or interest. Therefore, the Contracting State of the fiscal domicile is required to grant double

42 The Commentary does not use the term "conflicts of qualification" but the term "conflicts of treatment".

43 It should be noted, however, that under paragraph 27 of the Commentary on Article 7 of the OECD IHTMTC, "[i]f Member countries consider that the solution proposed in paragraph 24 does not resolve all conflicts of treatment satisfactorily, they are free to adopt an alternative solution. For example, in the case of partnerships, they may resolve this problem in bilateral negotiations by determining the nature of the property by reference to the law of the State under which the partnership is established."

taxation relief so that double taxation is avoided.[44] The proposed wording of paragraph 24 seems to effectively address double taxation arising from conflicts of qualification due to differences in domestic law classifications. Furthermore, it is in line with the so-called "new approach", which the 1999 OECD's report "The application of the OECD Model Tax Convention to partnerships" ("the partnership report") brought to the paragraphs 32.2 and 32.4 of the Commentary on Articles 23A and 23B. Under paragraph 32.3, "[w]here, due to differences in the domestic law between the state of source and the State of residence, the former applies, with respect to a particular item of income or capital, provisions of the Convention that are different from those that the State of residence would have applied to the same item of income, the income is still being taxed in accordance with the provisions of the Convention, as interpreted and applied by the State of source. In such case, the two Articles require that relief from double taxation be granted by the State of residence notwithstanding the conflict of qualification resulting from these differences in domestic law".

As a result, in my view, double taxation due to conflicts of qualification arising due to differences in domestic law classifications is adequately addressed. The same in my view, however, cannot be said regarding the other types of conflicts of qualification. In that regard, I refer to section 6.1.7 of this study.

5.1.9 The special features of the law of the Contracting States (Article 1)

The OECD IHTMTC Commentary makes particular reference to several civil or common-law arrangements such as trusts, usufruct, fideicommissum, and foundations. Paragraph 26 of the Commentary on Article 1 of the OECD IHTMTC, in combination with paragraph 28 of the Commentary on Article 1 of the OECD IHTMTC, states that Article 1 of the OECD IHTMTC covers the charges of setting up these arrangements.

According to the Commentary and Sonneveldt (2001), difficulties may arise concerning the identity of the transferor in the case of taxable events following the original transfer of the property to the arrangement at hand. This is because states may regard different persons as the transferor of the property.[45] For instance, under paragraph 22 of the Commentary on Article 1 of the OECD IHTMTC, section C (fideicommissum), the successor (ultimate beneficiary) is usually considered to have acquired the property from the creator of the fideicommissum. However, some OECD member countries may regard the property as being acquired for tax purposes from the previous beneficiary and, thus, not from the creator of the arrangement.

The identification of the transferor in such legal arrangements is critical for the application of the inheritance and gift tax treaty: the treaty applies to estates, inheritance, and gifts where the *transferor* – the deceased or the donor – was domiciled in one or both of the Contracting States. In the course of my research, I observed that a disagreement on the identity of the transferor in the case of a fideicommissum may result in the application of more than one inheritance and gift tax treaties with the state of the ultimate beneficiary, the treaty with the Contracting State of the fiscal domicile of the creator and that of the

44 See also, Marc Walter, "Conflicts of Qualification and International Inheritance Cases," in *Conflicts of Qualification in Tax Treaty Law,* ed. Michael Lang (Vienna: Linde Verlag, 2007), 298 – 299.

45 Frans Sonneveldt, "General Report: Avoidance of Multiple Inheritance Taxation within Europe," *EC Tax Review* 10, no. 2 (2001): 95.

previous beneficiary. This can give rise to double taxation of the property concerned. If both the state of the fiscal domicile of the creator of the arrangement and the state of the previous beneficiary apply the inheritance and gift tax treaty with the Contracting State of the ultimate beneficiary, they both will seek to tax the property falling under Article 7 of the treaty. The same seems to apply even if the ultimate beneficiary resides in either the state of the fiscal domicile of the arrangement's creator or in that of the previous beneficiary or even in a third state since the deceased's or the donor's fiscal domicile in a Contracting State is critical to the application of the treaty at hand. Similar problems arise regarding arrangements such as trusts, usufruct and foundations. For example, a state may regard the trust as the donor of the property while the state of the settlor's residence may regard the settlor as the relevant donor. As a result, both states may seek to apply different inheritance and gift tax treaties. This may result in double taxation of the same transfer of property from the trust to the trustees by both the state where the trust is established and the state where the settlor is fiscally domiciled.

To solve the difficulties regarding the application of the inheritance and gift tax treaty on the aforementioned legal arrangements, paragraph 27 of the Commentary on Article 1 of the OECD IHTMTC suggests three approaches. The tax treaty at hand could be made to apply on one of the following bases:

a) to a trust, foundation, fideicommissum or usufruct created by a person domiciled in one or both of the Contracting States;
b) to a trust, foundation, fideicommissum or usufruct where the beneficiary, on whose death (or at some other event) tax is imposed, is domiciled in one or both of the Contracting States; or
c) to a trust or foundation established under the law of one of the Contracting States.

Furthermore, under Article 28 of the Commentary on Article 1 of the OECD IHTMTC, "[m]oreover, the Article may have to be modified to cover charges imposed by some States on events occurring subsequent to the creation of a trust, usufruct, fideicommissum or foundation because some States may take the view that the terms "estate" and "gift" are not sufficiently comprehensive to cover such charges (see paragraph 6 of the Commentary on Article 3)."

However, under paragraph 29 of the Commentary, "[d]ue to the differences in the civil and taxation laws of Member countries, it was not possible to insert in the Convention provisions which would be acceptable to all States. It is easier to decide in bilateral negotiations whether and to what extent two States may need special rules. The Contracting States are, therefore, left free to insert special provisions in their bilateral conventions to deal with these problems."

It follows that the application of the inheritance and gift tax treaty to the above legal arrangements and property transfers to and from them is a particularly complicated issue. The differences in domestic laws of the OECD member countries did not allow the formulation of a general rule in the OECD IHTMTC. Nevertheless, I submit that the deliberate non-inclusion of a general rule applicable to situations involving transfers to and from the above legal arrangements and the double taxation issues that may arise does not counter the objective of the model of addressing double taxation and the proposed inheritance and gift tax. The model does not aim at harmonising the legislation of the

Contracting States and, therefore, it is up to them to include a tailor-made provision on the application of their treaty to the legal arrangements of their laws. Besides, the OECD IHTMTC Commentary already suggests three approaches to the application of a treaty to the above legal arrangements.

As a final point, I observe that the mutual agreement procedure of Article 11 of the OECD IHTMTC may facilitate the resolving of disputes regarding the application of an inheritance and gift tax treaty to a legal arrangement and the taxation of the transfer of a property to and from a trust. For example, Article 12 of the Germany – US Inheritance and Gift Tax Treaty (1980) covers issues arising from the taxation of property held by a trust. Under paragraph 2 of this Article, "[w]here differences in the laws of the Contracting States lead to taxation at different times of transfers of property to and from an estate or trust, the competent authorities may discuss the case under Article 13 [mutual agreement procedure] with a view to avoiding hardship, provided that the difference in timing of taxation does not exceed five years."

5.1.10 Mutual agreement procedure (Article 11)

The mutual agreement procedure framework is provided in Article 11 of the OECD IHTMTC. Under Article 11(1), "[w]here a person considers that the actions of one or both of the Contracting States result, or will result for him in taxation, not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic laws of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention."

Furthermore, the mutual agreement procedure can be initiated if the tax authorities of each Contracting State need to agree on the interpretation or the application of the treaty (Article 11(3) first sentence). Under paragraph 8 of the Commentary on Article 11 of the OECD IHTMTC, "[i]n practice, the procedure applies to cases, likely to be the most numerous, where the tax charges in question lead to double taxation which it is the specific purpose of the Convention to avoid. Among the most common cases mention must be made of the following: a) differences of interpretation by the two Contracting States as to the determination of domicile (paragraph 2 of Article 4) or the existence of a [PE] or a fixed base (Article 6); b) questions relating to the allocation of debts (Article 8); c) conflicts between the domestic laws of the Contracting States as to whether property falls under Articles 5 and 6 or Article 7."[46]

Finally, under Article 11(3) second sentence, the competent authorities may consult together for the elimination of double taxation in cases not provided for in the Convention.

It follows from the above that the mutual agreement procedure of the OECD IHTMTC is, in substance, similar to that of the 2017 version of the OECD ICTMTC (Article 25) with the exception that in the OECD IHTMTC there is no arbitration provision, which can be explained by the non-update of the model. The arbitration provision was added to the OECD ICTMTC in the 2008 update. Nevertheless, the Commentary on Article 11 of the OECD IHTMTC reproduces the well-known fact that the mutual agreement procedure provision includes a duty to negotiate, but the competent authorities are required only to use their

46 Commentary on Article 11 of the OECD IHTMTC, para. 8.

best endeavours to resolve the case. The Commentary suggests that the Contracting States could agree on a more far-reaching mechanism to produce a solution. In the case the domestic tax laws and provisions of the treaty preclude an agreement between the competent authorities, it could be reasonable, alternatively, to have regard to considerations of equity.[47] The Commentary also notes that it appears to be reasonable that the implementation of a mutual agreement procedure should be subject to the acceptance of the taxpayer and that the taxpayer withdraws his suit of law regarding matters that are resolved in the mutual agreement.[48]

Considering the above, I am of the opinion that the OECD IHTMTC's mutual agreement procedure can be improved, having regard to the objective of the model i.e. the allocation of taxing rights between the Contracting States for the avoidance of double or multiple taxation. What happens, for example, if the competent authorities of each Contracting State, cannot resolve the cases submitted to the mutual agreement procedure? Under the current wording of Article 11 of the OECD IHTMTC, the issue seems to remain unsettled and the cross-border inheritance and donation is possibly taxed twice. As a matter of comparison, the OECD ICTMTC's mutual agreement procedure includes an obligatory referral of the unresolved issues to arbitration upon a person's request (Article 25(5) of the OECD ICTMTC).

In section 6.1.8.2 I will suggest the inclusion of an arbitration clause in Article 11 of the OECD IHTMTC for the purpose of addressing the double taxation problem in the context of the mutual agreement procedure.

5.2 Double or multiple non-taxation

As mentioned, the objective of the OECD IHTMTC is to allocate taxing rights between the Contracting States for the avoidance of double taxation of cross-border inheritances and donations that takes place due to the parallel and uncoordinated application of the OECD member countries' inheritance and gift tax systems. Nevertheless, I observed in section 3.2.2 that the model deals in some parts with the problem of double or multiple non-taxation as well.

In that regard, double or multiple non-taxation is a problem that severely affects the application of the proposed inheritance and gift tax. More specifically, when the cross-border inheritance and donation is not taxed anywhere, the application of the ability-to-pay-taxes and the windfall justifications – two elements of the proposed inheritance and gift tax – seems to be severely hindered: the above justifications do not apply in a cross-border setting and thus inheritance and gift taxation seems to fail to achieve its objectives. Such non-application of the above-mentioned justifications, however, does not seem to take place in the event of a domestic inheritance and donation.

5.2.1 Overlaps with the OECD ICTMTC (Article 2)

As mentioned in section 5.1.4 of this study, overlaps between the OECD IHTMTC and the OECD ICTMTC are conceivable. These overlaps can give rise to double taxation or double

47 Commentary on Article 11 of the OECD IHTMTC, para. 24.
48 Commentary on Article 11 of the OECD IHTMTC, para. 27.

non-taxation. Nevertheless, I note that this type of double non-taxation is not the outcome of two states qualifying the same transfer of property differently. On the contrary, it is the outcome of two states applying different tax treaties. Therefore, this type of double non-taxation could not be reflected in section 3.1.2 of this study.

More specifically, in section 5.1.4, I referred to Lang's example of the donation by the Austrian foundation to its non-resident beneficiaries in a situation where Austria has concluded both a gift tax treaty and an income tax treaty with the state of the non-resident beneficiaries. Lang noted in that regard that "[o]ne could question whether the income tax liability in respect of these donations is identical or at least similar to the tax liability under the other taxes listed in the bilateral equivalents to [Article] 2(3) of the [OECD ICTMTC]."[49] If, however, Austria taxes the transfer from the Austrian foundation under its income tax rules, it will seek to apply the income tax treaty with the state of the non-resident beneficiaries and more specifically Article 21 ("other income") of the treaty. Consequently, the state of the beneficiaries' residence has exclusive taxing rights. Austria is thus precluded from taxing the donation in the hands of the non-resident beneficiaries. However, if the state of the beneficiaries' residence taxes the transfer from the Austrian foundation under its gift tax rules, it will apply Article 7 of the inheritance and gift tax treaty, which grants exclusive taxing rights to Austria, the Contracting State of the fiscal domicile of the donor, the Austrian foundation. The state of the beneficiaries' residence, thus, will not seek to levy a tax on the gift concerned given that the immovable property is located in Austria. As a result, the *inter vivos* transfer of property from the Austrian foundation to its non-resident beneficiaries is not taxed anywhere.

Lang's example shows, in my view, that there are situations in which it is difficult to determine whether a certain tax liability is to be covered by an income and capital tax treaty or an inheritance and gift tax treaty.[50] More importantly, it shows that the application of a different type of tax treaty by each Contracting State can lead to double non-taxation. According to Lang, double non-taxation may be perfectly in line with the object and the purpose of tax treaties if a certain treaty precludes a Contracting State from exercising taxing rights and the other Contracting State does not exercise its taxing rights for domestic reasons.[51, 52] Nevertheless, double non-taxation cannot be accepted, in Lang's view, if it is merely the result of the application of a different treaty (inheritance and gift tax treaty on the one hand and income and capital tax treaty on the other hand).[53]

In my view, the overlaps between the two models and types of tax treaties seem to counter the objective of the OECD IHTMTC of addressing double non-taxation. This can be

49 Michael Lang, ""Taxes Covered" in What is a "Tax" According to Article 2 of the OECD Model?," *Bulletin for International Taxation* 59, no. 6 (2005): 223.

50 Michael Lang, ""Taxes Covered" in What is a "Tax" According to Article 2 of the OECD Model?," *Bulletin for International Taxation* 59, no. 6 (2005): 223.

51 Michael Lang, ""Taxes Covered" in What is a "Tax" According to Article 2 of the OECD Model?," *Bulletin for International Taxation* 59, no. 6 (2005): 223.

52 However, I observe that even in such a case, paragraph 33 of the Commentary on Article 7 of the OECD IHTMTC (avoidance of factual non-taxation) recommends that the other Contracting State can still safeguard its taxing rights for the avoidance of double non-taxation due to the non-collection of the tax by the Contracting State of the fiscal domicile if the latter state does not exercise its taxing rights due to an exemption/deduction/allowance/credit.

53 Michael Lang, ""Taxes Covered" in What is a "Tax" According to Article 2 of the OECD Model?," *Bulletin for International Taxation* 59, no. 6 (2005): 223.

addressed, in my view, by improving the wording of Article 2 of the model. Improvements to Article 2 of the model are presented in section 6.2.1 of this study.

5.2.2 Conflicts of qualification (Articles 3 and 5-7)

As mentioned in section 5.1.8, although the three distributive rules of the OECD IHTMTC seem to be easily applicable, several conflicts of qualification may arise when the Contracting States apply these rules. This type of conflicts seems to counter the objectives of the OECD IHTMTC of addressing double non-taxation. In that regard, the OECD IHTMTC does not provide an effective solution to double non-taxation that may arise where double taxation is avoided through an exemption by the Contracting State of the fiscal domicile (Article 9A of the OECD IHTMTC).

For instance, conflicts of qualification due to differences in treaty application to the facts may occur if the Contracting States disagree on the existence of a PE. More specifically, if the Contracting State of the fiscal domicile considers that there is a PE in the other Contracting State, it may refrain from taxing the movable property forming part of this PE (double taxation relief by means of an exemption). This is because it expects that the other Contracting State will tax such property based on Article 6 of the treaty. However, if the latter state considers that there is no PE in its territory, it will not tax the movable property at hand. As a result, the movable property is not taxed anywhere.

In the same vein, the tax treatment of interests in partnerships is an illustrative example of double non-taxation due to conflicts of qualification arising from the differences in domestic law classifications as mentioned in paragraph 20 of the Commentary on Article 7 of the OECD IHTMTC. If the Contracting State of the fiscal domicile (that applies the exemption method for the avoidance of double taxation under Article 9A of the OECD IHTMTC) considers the partnership that is established in the other Contracting State transparent and the latter state opaque, such a different treatment can give rise to double non-taxation. More specifically, the Contracting State of the fiscal domicile will refrain from taxing the interest because, under its domestic law, the interest is considered to be property belonging to a PE situated in the other Contracting State. On the other hand, the other Contracting State (that considers the partnership a separate legal entity under its law) may also refrain from taxing the interest because, under its domestic law, the deceased left property falling under Article 7 (such as in the case of shares in a company). The parallel application of Articles 5 and 7 of the treaty, therefore, leads to double non-taxation.

As mentioned above, the OECD IHTMTC Commentary only deals with conflicts arising due to differences in domestic law classifications. More specifically, the Commentary on Article 7 of the OECD IHTMTC refers to the following four examples of these conflicts:[54]

a) The interests in partnerships,
b) The undistributed estates,
c) The property held in a trust, and
d) The companies holding immovable property.

54 The Commentary does not use the term "conflicts of qualification" but the term "conflicts of treatment".

To address possible double taxation and double non-taxation issues, paragraph 24 of the Commentary suggests that the Contracting States insert in their treaties the following paragraph, thereby avoiding conflicts arising due to differences in domestic law classifications:

"If by the law of a Contracting State any right or interest is regarded as property not falling under Article 5 or 6, but by the law of the other Contracting State that right or interest is regarded as property falling under either of those Articles, then the nature of the right or interest shall be determined by the law of the State which is not the State of the deceased's or the donor's domicile".[55]

Under the suggested wording, the Contracting State of the fiscal domicile must follow the classification that the other Contracting State gives to the right or interest at hand. Therefore, if the Contracting State of the fiscal domicile applied Article 7 of the treaty and sought to tax the right or interest at hand, and the other Contracting State applied Articles 5 or 6 of the treaty and sought to tax that right or interest as well, the former state had to recognise the classification which the latter Contracting State gave to this right or interest. Therefore, the Contracting State of the fiscal domicile has to grant double taxation relief whatsoever so double taxation is avoided.[56]

I observe, however, that priority to the classification of the other Contracting State is given even if this state applied Article 7 of the treaty and, thus, did not tax the right or interest at hand whereas the Contracting State of the fiscal domicile refrained from taxing the right or interest concerned under Article 9A of the model. This situation could result in double non-taxation[57] in situations where the Contracting State of the fiscal domicile applies the exemption method for the avoidance of double taxation. This is also confirmed in paragraph 25 of the Commentary on Article 7 that reads as follows: "Under the Convention (without the provision in paragraph 24) State B would lose its right to tax since it regards the interest as falling under Article 7. If State A is a country using the exemption method, it would lose its right to tax the share of the immovable property and of the permanent establishment situated in State B. *Double non-taxation would therefore arise*." (Italics, VD).

The insufficient addressing of the double non-taxation in the case of the conflicts of qualifications shows, in my view, that the model does not address (aspects of) the jurisdictional double non-taxation issue as presented in section 3.1.2.1.

5.2.3 Termination of the tax treaty (Article 16)

Under Article 16 of the OECD IHTMTC, "[t]his Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year... In such event, the Convention shall cease to

55 It should be noted, however, that under paragraph 27 of the Commentary on Article 7 of the OECD IHTMTC, "[i]f Member countries consider that the solution proposed in paragraph 24 does not resolve all conflicts of treatment satisfactorily, they are free to adopt an alternative solution. For example, in the case of partnerships, they may resolve this problem in bilateral negotiations by determining the nature of the property by reference to the law of the State under which the partnership is established."

56 See also, Marc Walter, "Conflicts of Qualification and International Inheritance Cases," in *Conflicts of Qualification in Tax Treaty Law,* ed. Michael Lang (Vienna: Linde Verlag, 2007), 298 – 299.

57 See also, Wolfe D. Goodman, "The OECD Model Estate Tax Convention," *European Taxation* 34 (October/November 1994): 342.

have effect: a) (in State A)... b) (in State B)..." I note that Article 16 of the OECD IHTMTC cites *verbatim* Article 31 of the OECD ICTMTC. In brief, an inheritance and gift tax treaty cannot be terminated for some years following its entry into force. This is because, according to paragraph 5 of the Commentary on Article 16, "[i]t is of advantage that the Convention should remain in force at least for a certain period."

Nevertheless, in my view, the *verbatim* citing of Article 31 of the OECD ICTMTC is problematic. The problem lies with the fact that the termination of an income and capital tax treaty, on the one hand, and an inheritance and gift tax treaty, on the other, is often based on opposite reasons. The exclusion of a state to tax a particular type of income is often the reason why this state may seek to terminate the income and capital tax treaty, which it has concluded with the other Contracting State. For example, Denmark terminated the Denmark – France Income and Capital Tax Treaty (1957) to safeguard the taxation of Danish pensioners.[58] On the contrary, tax treaty practice has shown that precisely the opposite reason has triggered the termination of an inheritance and gift tax treaty: the abolition of the inheritance and/or gift tax laws by a Contracting State. For example, when Norway abolished its inheritance tax legislation as per 1 January 2015, it terminated the inheritance and estate tax treaties that it had concluded with the US, Switzerland and with the other Scandinavian states.

I observe that the application of a minimum period for the application of the inheritance and gift tax treaty may not always be an advantage for the Contracting States, as the Commentary on Article 16 suggests, but, on the contrary, a disadvantage. To elaborate on this, I note that many inheritance and gift tax treaties provide for a minimum application period of five years. If, however, a Contracting State repeals its inheritance or gift tax laws within the five years, the other state is precluded from taxing the assets that it would have been entitled to do under its domestic law. This is true if double taxation is eliminated under the exemption method. Hence, the Contracting State of the fiscal domicile (which still levies inheritance and gift taxes and relieves double taxation by means of an exemption) will exempt the property mentioned in Articles 5 and 6 of the treaty irrespective of whether or not this property is taxed in the other Contracting State.[59] As this property is not taxed in the latter state (which has abolished its inheritance and gift tax laws), double non-taxation is possible.[60] The Contracting State of the fiscal domicile can terminate the treaty only after the lapse of the minimum application period.

It could be argued that double non-taxation may be perfectly in line with the object and purpose of tax treaties in a situation where the other Contracting State is not allowed to tax under Article 7 and the Contracting State of the fiscal domicile does not exercise its taxing rights. Nevertheless, double non-taxation due to the compulsory application of the inheritance and gift tax treaty by each Contracting State following the abolition of the inheritance and/or gift tax laws by a Contracting State seems to counter the objective of the OECD IHTMTC of addressing double non-taxation. As a result, if a tax treaty must apply for a certain number of years, double non-taxation (due to the tax relief by the state of the personal nexus), as discussed in section 3.1.2.2 of this study, is conceivable.

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58 Wendy Singer and Jérôme Delaurière, "News Analysis: Why Is Denmark Terminating Tax Treaties?," *Tax Notes International*, no. 1 (2008): 13.

59 Commentary on Article 9A of the OECD IHTMTC, para. 22.

60 See also Massimo Antonini, "Abolition of the Italian Inheritance and Gift Tax," *European Taxation* 42, no. 3 (2002): 138.

5.3 Discriminatory treatment of cross-border inheritances and donations

5.3.1 Introduction

As noted in section 3.2, discrimination is the third problem of cross-border inheritances and donations. States tend to justify the application of less favourable provisions to cross-border inheritances and donations maintaining that their cross-border element differentiates them from the domestic ones. Such a cross-border element can be, for instance, the foreign location of the transferred assets, a foreign-located deceased or a foreign-located beneficiary.

Those who drafted the OECD IHTMTC had already recognised the problem of the application of discriminatory provisions to cross-border inheritances and donations. However, the current language of the non-discrimination provision of the model puts in doubt its effectiveness in dealing with common discriminatory situations. Unfortunately, the 2015 inheritance tax report does not address the issue of discrimination of cross-border inheritances and donations.

Under Article 10 of the OECD IHTMTC, "1. Nationals of a Contracting State, wherever they are domiciled, shall not be subjected in the other Contracting State to any taxation, or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that State in the same circumstances are or may be subjected. 2. The term "nationals" means a) all individuals possessing the nationality of a Contracting State; b) all legal persons, partnerships and associations deriving their status as such from the law in force in a Contracting State. 3. Stateless persons who are domiciled in a Contracting State shall not be subjected in either Contracting State to any taxation, or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances are or may be subjected. 4. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description."

I observe that Article 10(1) cites to a large extent Article 24(1) of the 1977 OECD ICTMTC's nationality non-discrimination provision.[61] Under this Article, "[n]ationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States."[62] Furthermore, under the Commentary on Article 10 of the model, "[i]t was decided not to include paragraphs 4 to 6 of Article 24 of the 1977 Income Tax Model [at the OECD IHTMTC non-discrimination provision], since the provisions of those paragraphs relate, more or less exclusively, to taxes on income and capital and are not appropriate in the concept of this Model."[63]

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61 Guglielmo Maisto, "General Report: Death as a Taxable Event and its International Ramifications," in *Cahier de droit fiscal international 95b,* ed. IFA (The Hague: Sdu Uitgevers, 2010), 51.

62 The last sentence is reflected in the wording of the OECD IHTMTC's provision with the phrase "wherever they are domiciled".

63 Commentary on Article 10 of the OECD IHTMTC, para. 2 (preliminary remarks).

The non-discrimination provision is accorded a stand-alone status within the treaty through the expression "wherever they are domiciled", which refers to the nationals of each Contracting State who can rely on it. This observation is consistent with the general understanding of the non-discrimination principle of the OECD Tax Committee, which takes the position that this principle should apply to nationals of the Contracting States, irrespective of their residence.[64] Nevertheless, only residents of each of the Contracting States can invoke the non-discrimination provision in some inheritance and gift tax treaties.

Furthermore, it derives from the common understanding of the non-discrimination principle of the OECD Tax Committee that indirect discrimination does not fall within the scope of the non-discrimination provision. This applies to the non-discrimination provisions of both models. Under paragraph 3 of the Commentary on Article 10 of the OECD IHTMTC, "[t]his paragraph establishes the principle that, for the purposes of taxation, discrimination on the grounds of nationality is forbidden […]".[65] Moreover, paragraph 1 of the Commentary on Article 24 of the OECD ICTMTC states as follows: "The Article should not be unduly extended to cover so-called 'indirect discrimination' and […] it could not be argued that non-residents of a given State include primarily persons who are not nationals of that State."[66] Therefore, the OECD's non-discrimination provisions do not apply to the indirectly discriminatory tax legislation of the Contracting States, i.e. legislation whose differentiating criterion is not the nationality of the persons but another criterion the application of which, however, results in covert discrimination on the grounds of nationality. Nevertheless, I note that the extension of the scope of the non-discrimination to cover indirectly discriminatory tax legislation would counter the general understanding of the OECD's non-discrimination principle.

Discriminatory treatment of cross-border inheritances and donations is a problem that severely affects the application of the proposed inheritance and gift tax. When the cross-border inheritance and donation is discriminated, the application of the ability-to-pay-taxes and the windfall justifications – two elements of the proposed inheritance and gift tax – seems to be severely hindered. More specifically, discriminatory tax provisions increase the beneficiaries' tax liability on behalf of the acquired property which, in its turn, results in an *over-application* of the ability-to-pay-taxes and the windfall justifications in a cross-border setting, which does not seem to happen in the event of a domestic inheritance and donation.

5.3.2 The OECD IHTMTC's nationality non-discrimination provision

In the course of my research, I observed that the wording of the OECD IHTMTC's nationality non-discrimination provision seems to contradict the scope of the model. More specifically, despite the desire for an interaction between the two non-discrimination provisions of each OECD model, the scope of each model differs. The OECD ICTMTC applies to a person who is a resident of one or both Contracting States[67] whereas the OECD IHTMTC applies to

64 Patricia Brandstetter, *"Taxes Covered": A Study of Article 2 of the OECD Model Tax Conventions* (Amsterdam: IBFD, 2011), 19.
65 Commentary on Article 10 of the OECD IHTMTC, para. 3.
66 Commentary on Article 24 of the OECD ICTMTC, para. 1.
67 See, Article 1 of the OECD ICTMTC.

estates and inheritances and gifts (and thus not to persons) in one or both Contracting States where the deceased or the donor was domiciled at the time of his death or the donation.[68]

Based on the above, one can argue that the wording of the OECD IHTMTC's nationality non-discrimination provision could be revisited considering the objective of the OECD of addressing discrimination of cross-border inheritances and donations and the proposed inheritance and gift tax. The provision seems first to be centred on the person's eligibility to invoke the non-discrimination provision and not the estates to which the model applies. Under paragraph 3 of the Commentary on Article 10(1) of the OECD IHTMTC, "[i]n the case of taxes on estates, inheritances and gifts, [the non-discrimination] principle must be applied with regard to the deceased or to the donor, and to the heirs and legatees or to the donees".[69] Furthermore, the wording of the provision gives the impression that the discriminatory element of the legislation of a Contracting State may only refer to the nationals of each Contracting State. It is therefore unclear whether the provision can be invoked in the case of discriminatory property valuation and debt deduction rules.

5.4 Administrative difficulties

5.4.1 Introduction

Administrative difficulties of cross-border inheritances and donations is a problem that seems to severely affect the application of the proposed inheritance and gift tax. When the cross-border inheritance and donation is subject to administrative difficulties in more than one state, the application of the ability-to-pay-taxes and the windfall justifications – two elements of the proposed inheritance and gift tax – seems to be severely hindered. More specifically, discriminatory administrative tax provisions increase the beneficiaries' tax liability on behalf of the acquired property which, in its turn, results in an over-application of the ability-to-pay-taxes and the windfall justifications in a cross-border setting, something that does not seem happen in the event of a domestic inheritance and donation.

Nevertheless, I note that the OECD IHTMTC does not include provisions aiming at addressing the administrative difficulties of cross-border inheritances and donations that were presented in chapter 3 of this study. More specifically, the mutual agreement procedure of Article 11 of the OECD IHTMTC does not seem to address the difficulties that the beneficiaries may encounter in the state of the objective nexus (section 3.1.4.2.1) or the state of the personal nexus (section 3.1.4.2.2). The same is true for the exchange of information framework of Article 12 of the OECD ITCMTC that refers to exchange of information between the competent authorities of each Contracting State for the application of the specific treaty. Therefore, this study does not cover improvements to the mutual agreement procedure and the exchange of information frameworks in relation to this point.

68 See, Article 1 of the OECD IHTMTC. Furthermore, under paragraph 13 of the Commentary on Article 1 of the OECD IHTMTC, "although the Article contains what could be called the "personal scope" of the Convention, it should be stressed that it does not apply to "persons" but to estates of, or gifts made by, persons domiciled in one or both of the Contracting States."

69 Commentary on Article 10(1) of the OECD IHTMTC, para. 3.

5.4.2 The OECD IHTMTC's nationality non-discrimination provision (Article 10)

Under Article 10 of the OECD IHTMTC, "[n]ationals of a Contracting State, wherever they are domiciled, shall not be subjected in the other Contracting State to any taxation, or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected." Under paragraph 12 of the Commentary on Article 10 OECD IHTMTC "[t]he words 'shall not be subject…to any taxation or any requirement connected therewith which is other or more burdensome…' mean that when tax is imposed on nationals and foreigners in the same circumstances, it must be the same form for both, its basis of charge and method of assessment must be the same, its rate must be the same, and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals."

It follows from the above paragraph that the non-discrimination provision of the model and the treaties apply to both substantive and procedural tax provisions of the Contracting States. In other words, the OECD member countries agreed that the nationals of each Contracting State could invoke the non-discrimination provision of an inheritance and gift tax treaty also in the case of discriminatory procedural tax provisions, the so-called "formalities connected with the taxation".

For instance, the domestic laws of a Contracting State may provide that the non-national beneficiaries must file the inheritance or gift tax return or pay the inheritance or gift tax within a shorter deadline than that applicable to national beneficiaries. Such a shorter deadline creates an additional administrative burden on the non-national beneficiaries who must also deal with a foreign tax administration and procedure with which they may not be familiar. The same is true if a Contracting State requests the non-national beneficiary to provide a guarantee before the actual payment of the inheritance or gift tax. Finally, a Contracting State may prescribe higher penalties and fines to non-national beneficiaries – for example, due to the late or inaccurate filing of the initial or amending tax return – than those applicable to national beneficiaries. In all these cases, the non-national beneficiary may be able to invoke the non-discrimination provision of the treaty against procedural tax provisions of a Contracting State that discriminates the beneficiary concerned on the grounds of his nationality.

In section 5.3.2, I argued that the OECD IHTMTC's nationality non-discrimination provision could be improved. Therefore, the proposed improvements to the wording of the scope of the nationality non-discrimination provision can arguably improve the application of the non-discrimination provision by offering treaty protection against discriminatory *procedural* tax provisions of the Contracting States.

5.5 Conclusion of Chapter 5

In this chapter, I discussed the provisions of the OECD IHTMTC that, in my view, can be improved having regard to the objectives of the OECD IHTMTC and the elements of the proposed inheritance and gift tax. More specifically, the discussion of these provisions takes place concerning each problem of cross-border inheritances and donations.

Furthermore, I noted that all the problems of cross-border death and gift taxation which are discussed in this study, seem to severely affect the application of the proposed

inheritance and gift tax. More specifically, when the cross-border inheritance and donation is taxed in more than one state/is not taxed anywhere/is discriminated against/subject to many administrative difficulties, the application of the ability-to-pay-taxes and the windfall justifications – two elements of the proposed inheritance and gift tax – seems to be severely hindered: the above justifications *over-apply* or *under-apply* in a cross-border setting and thus death and gift taxation seems to fail to achieve its objectives. Such over-application or under-application does not, however, seem to take place in the event of a domestic inheritance and donation. Arguably, death and gift taxation also seems to fail to achieve its objectives even if the model solves the problem but in a manner that does not seems to take into account (some of) the elements of proposed inheritance and gift tax. As a result, the OECD member countries may not easily endorse the model which, in certain instances, seems to contradict their death and gift tax laws as well as the elements of the proposed inheritance and gift tax.

More specifically, in relation to the double or multiple taxation problem, I observed that the ten-year limitation period for the exercise of the subsidiary taxing right provision and the underlying tax-abusive motive could be revisited having regard to the objective of the OECD IHTMTC of addressing double taxation and the proposed inheritance and gift tax. Furthermore, I noted that the model does not seem to deal with common cases of multiple taxation which are addressed only if the state of the deceased's fiscal domicile has concluded a treaty with all the other states. This situation can be improved, in my view, by an extension of the scope of the term "fiscal domicile" or a suggestion of a multilateral convention. Moreover, the tiebreaker rule for individuals seems to disregard the deceased's or the donor's intention to fiscally domicile in a Contracting State and does not require a minimum period of presence in a Contracting State. The tie-breaker rule, therefore, may be viewed as being counter to a) how some states determine the connection of the deceased or the beneficiary with their territory, and b) the third element of the proposed inheritance and gift tax (connection with civil law). In addition, I observed that overlaps between an inheritance and gift tax treaty and an income and capital tax treaty are conceivable. These overlaps can give rise to double taxation of the cross-border inheritance and donation. Such an outcome, however, seems to contradict the objective of the OECD IHTMTC of avoiding double taxation. Furthermore, the double taxation relief of Article 9B (credit method) does not seem to be broadly described in the OECD IHTMTC Commentary. As a result, I am of the view that the interaction between a) estate and inheritance taxes, and b) the different types of death and gift taxes becomes a challenging issue. In my view, the wording of the Commentary to Article 9B of the OECD IHTMTC can be improved having regard to the objective of the OECD IHTMTC of addressing double taxation and the elements of the proposed inheritance and gift tax. In addition, I observed that the lack of common valuation rules could often give rise to double taxation. Nevertheless, the non-application of the model to property valuation rules does not seem to contradict the objectives of the model as the model does not aim at harmonising the Contracting States' legislation. Moreover, conflicts of qualification due to the differences in domestic law classifications, the differences in treaty application to the facts at hand and the interpretation of the treaty rules are conceivable. Those conflicts, however, seem to counter the objective of the OECD IHTMTC of addressing double taxation and the proposed inheritance and gift tax. Moreover, I observed that double taxation could arise concerning

the special features of the Contracting State, namely civil or common law arrangements such as trusts, usufruct, fideicommissum, and foundations. Nevertheless, I argued that the deliberate non-inclusion of a general rule applicable to situations involving transfers to and from the above legal arrangements does not seem to counter the objectives of the model and the elements of the proposed inheritance and gift tax. This is because the model does not aim at harmonising the Contracting States' legislations. Finally, I observed that the mutual agreement procedure can be improved having regard to the objective of the model of addressing double taxation.

Concerning the double or multiple non-taxation problem, I observed that the model deals in a few sections with cases of double non-taxation. Therefore, one could argue that the model aims at the avoidance of double non-taxation as well. However, I observed that overlaps between OECD IHTMTC and the OECD ICTMTC could give rise to double non-taxation in certain situations. This situation, however, seems to counter the objective of the OECD IHTMTC of avoiding double non-taxation and can be addressed by improving the wording of Article 2 of the model. In addition, certain conflicts of qualification could give rise to double non-taxation. This situation, however, seems to contradict the objective of the model of addressing double non-taxation. Finally, I noted that double non-taxation due to the compulsory application of the inheritance and gift tax treaty by each Contracting State – even following the abolition of the inheritance and/or gift tax laws by a Contracting State – also seems to contradict the above-mentioned objective of the model.

Concerning the discrimination problem, I observed that the OECD IHTMTC's nationality non-discrimination provision is centred on the persons eligible to invoke the non-discrimination provision and not the estates to which the model applies. Furthermore, the wording of the provision gives the impression that the discriminatory element of the legislation of a Contracting State may only refer to the nationals of each Contracting State. It is therefore unclear, in my view, whether the provision can be invoked in the case of discriminatory property valuation and debt deduction rules. As a result, the provision seems to fail to address the discrimination problem of cross-border inheritances and donations in certain instances. As a result, it can be improved having regard to the objective of the OECD IHTMTC of addressing certain cases of discrimination of cross-border inheritances and donations, and the elements of the proposed inheritance and gift tax.

Finally, concerning the administrative difficulties of the cross-border inheritances and donations, I observed that Articles 11 and 12 of the OECD IHTMTC does not seem to address the administrative difficulties that beneficiaries may encounter in the state of the objective nexus or the state of the personal nexus. Therefore, this study did not discuss the mutual agreement procedure and the exchange of information frameworks from this perspective. Nevertheless, I argued that the proposed improvements to the wording of the scope of the nationality non-discrimination provision can arguably improve the application of the non-discrimination provision also to discriminatory procedural tax provisions of the Contracting States.

In the next chapter, I will address the above provisions of the model and its Commentary which, in my view, can be improved in the light of the objectives of the OECD IHTMTC and the elements of the proposed inheritance and gift tax.