

Art 3(2) OCDE-MC
(lex fori)

Judge Manuel Hallivis, Mexico

Art 3(2) OECD-MC

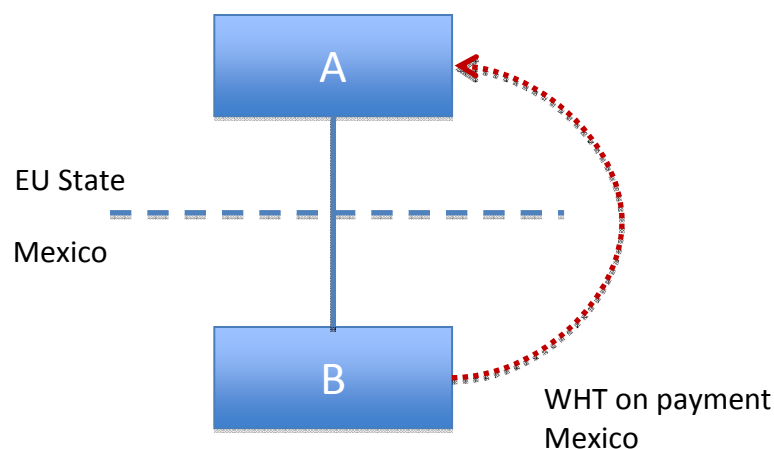
- “As regards the application of the Convention at any time by a Contracting State, *any term not defined* therein shall, *unless the context otherwise requires*, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the *applicable tax laws* of that State *prevailing* over a meaning given to a term under other laws of that State.”

Art 3(2). Difficulties

- *Significance* of VCLT: ¿should we use it first?
- What does *for Domestic Tax purposes* mean?
- ¿“unless the context otherwise requires”?
 - ¿definition of *context*?
 - ¿*requires*?
- Relationship with other domestic laws
- ¿when do we or do not find a domestic definition?
 - Not complete, obscure, broad or lack of definition
- Static or ambulatory (dynamic) approach?

Mexican Royalties Case

- Tax treaty reduces WHT rate from 25% to 10%



Background:

- “A” licensed software (not for computers) to “B”
- Mexico levies WHT on royalties
 - “B” Withheld 10% to “A”,
 - “A” credited tax in its own Country
- “A” filed a Refund Request before Mexican Tax Authorities
 - Mexican Tax Authorities denied it
- “A” filed a lawsuit before the Mexican Federal Tax Court

Issue:

- “A” argues that no WHT should have been levied, because the payments would not be regarded as royalties

Tax Court Methodology

- 1.- ¿Is that income taxed under Mexican law?
- 2.- ¿Is there a DTT?
- 3.- ¿Does it apply in this case?
- 4.- ¿Is “A” a foreign resident? (Art. 5 Income Tax Law)
- 5.- Has it made its choice to be withheld?
- 6.- Application of DTT:
 - Are payments for this kind of software considered royalties?
 - Hierarchy of treaties (art. 133 Mexican Constitution)
 - Vienna Convention (Mexico is part)
 - Art. 12 of Mexico-Sweden Treaty has a broad definition and context does not say anything different
- - Definition of royalties is not clear in referring to different kinds of software
 - - Context does not say anything different
 - - ‘*Royalties/software*’ are undefined terms –
- **use of Article 3(2) of the tax treaty**
 - Domestic Tax Law
 - If necessary, go to any other applicable domestic law
- Art. 15-B Mexican Federal Tax Code & Intellectual Property Laws

DTT & Mexican Law

- DTT, Art 12: “...However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the recipient is the beneficial owner of the royalties the tax so charged shall not exceed 10 percent of the gross amount of the royalties. The term “royalties” as used in this Article means *payments of any kind* received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work...”
- Art 15-B Mexican Tax Code: "royalties *among other things* means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work ...For the purposes of the preceding paragraph, the use ... of copyrights in work of science **includes** programs or computer instruction sets required for the operational process of the same or to perform application tasks, regardless of means by which it is transmitted...”

Methodology to use Art 3(2)

1. First, apply the VCLT
 - In the order of Arts 31 and 32

2. Use domestic law meaning only if there is an undefined term
 - - Use the domestic tax law meaning first

remarks

- We have to begin with domestic tax law,
 - If the facts of the case lead to non-taxable income, there is no point in going any further
 - If there is a meaning in the relevant tax treaty: use it
If the domestic law definition is different, **we should still use the *treaty definition***
- Context meaning prevails over domestic law
 - OECD-Commentaries are part of the context only if those Commentaries were issued before the tax treaty was signed
 - *If necessary*, go to **any other applicable domestic law**

Courts decisions

- **Similar Methodology is always followed in the TFJFA** (Mexican Federal Court of Tax and Administrative Justice)
 - Precedents VI-J-SS-74; VI-J-SS-71. Court rulings: 27939/07; 27938/07 (This ; 27965/07; 28006/07.
 - In others:
 - » (806/03-20-01-3/7404-S2-08-02)
 - » 1974/00-10-01-5/1120/02-S1-04-02
 - » 3410/07-17-01-5/AC1/467/11-S1-03-02
 - Mexican Supreme Court has decided with similar methodology, i.e. 2a CXX/2007
 - » It has decided the nature of the OECD Comments as “soft law”.- P. XXVI/2009;