PERSPECTIVE

Georgia's Double Taxation Agreements from the Viewpoint of the OECD

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1. Introduction

Baker, in the introduction to his book, Double Taxation Agreements and International Tax Law, which was published in 1991,[1] wrote: "This book is about a treaty which does not exist. No two states have ever concluded a treaty identical to the OECD Model Double Taxation Convention on Income and Capital." Some twenty-five years later, the author points out that the vast majority of specific DTCs are now commonly patterned on the OECD model.[2] The truth is that the OECD Model Convention (hereafter also MC) becomes broadly applicable not only by OECD members but by non-member countries as well. *Jones* believes that there is little need for a separate model for developing countries. All that is needed is for OECD countries to accept the needs of developing countries for more source tax.[3] Not to mislead the readers of this paper, it should be mentioned that the OECD Model Convention is not an international treaty as such which binds member countries.[4] It was adopted by a recommendation of the OECD Council and its main purpose is to provide a basis for the negotiations of bilateral conventions between the states. *Vogel*, however, adheres to the opinion that member states of the OECD are in principle legally obliged to follow the Model Convention and its Commentaries. He states that "the legal importance of recommendations is even greater" in OECD practice. In fact, filed "reservations" or "observations" to the convention regarding the particular interpretation of the member countries declare the common consent on the application of the model and its commentaries. *Vogel* concludes, therefore, that there is at least a "soft" obligation of applying both of these parts unless there is material reason, such as the "peculiarities of the domestic law with regard with individual treaty provision,"[5] to do otherwise. Relying upon this reality, some of the commentators argue the existence of an international

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1 *Baker*, Double Taxation Agreements and International Tax Law, Sweet & Maxwell, London, 1991.

2 *Baker,* Double Taxation Conventions, Sweet & Maxwell, London, 2007.

3 *Jones*, The David R. Tillinghast Lecture, "Are Tax Treaties Necessary?", Tax Law Review, 1, 1999-2000, 1-38.

4 *Op.cit.* note 2, paragraph A-5.

5 *Vogel*, Klaus Vogel on Double Taxation Conventions, Kluwer Law International, 1997, 3 ed., paragraph 80, 44.

tax regime that is embodied in a remarkably similar treaty network.[6] As far as in most countries treaties override internal laws, it could be said that countries are bound by those treaties. The author of this idea argues that the network of more than 2,000 bilateral tax treaties that are "largely similar in policy, and even in language, constitutes an international tax regime."[7] Indeed, it is more likely that the states – especially non-industrial countries – could not be free to adopt any of the international rules which they please. Instead, they have to operate in the context of the existing international tax regime that has already been established by the bigger players. It is hardly doubtable that there are clearly international tax practices that are widely followed such as, for instance, non-discrimination and avoiding double taxation through either of two methods, the arm's length standard and etc. That said, however, it does not mean that this regime is static and does not adopt changes. On the contrary, it poses permanent challenges such as tax arbitration which will be discussed later in this article.

My intention herein is not to go into more details in exploring the abovementioned although it should be stated that *Baker's* idea in principle does not contradict *Vogel's* position. The OECD MC is not an international agreement under international public law that binds sovereign states by its obligations although there is an international consensus of the member states[8] to bind themselves in their international fiscal practices by commonly accepted rules. This common acceptance has moved beyond the member states and so the international tax regime is now a current contemporary reality.

This brief overview of the status of the OECD MC was necessary in order to turn from the general to the particular, let us say, which is the specific object of this article. The research presented herein aims at exploring Georgian tax agreements which will be accomplished by studying all the tax agreements of Georgia which have been currently concluded.[9] The measurement for assessments represents the OECD MC with Respect to Taxes on Income and on Capital[10] together with its Commentaries. I will proceed from the idea that treaties based upon the MC should be given the same interpretation by the contracting states as far as possible whether or not one of the contracting states represents the OECD Member State. A co-ordinated interpretation of the agreements is most likely available if the OECD Commentaries are used despite the party's being a member state. The article is structured around the OECD MC articles but will be selective and choose only those issues which appear to illustrate the main problems of the application of Georgian tax agreements. Further, it will also involve some discussions about the peculiarities of Georgian tax law. As was mentioned in the

[6] Based upon the OECD and the UN models. My point of view, however, is that the UN model of the Double Taxation Convention between the developed and developing countries is wholly based upon the OECD's version and consists of only slight variations of the former.
[7] See *Reuven*, Tax Competition and International Tax Regime, Bulletin for International Taxation, April 2007, 130-138.
[8] Supported by recommendations of the Council of the OECD and its Fiscal Committee.
[9] Data are confirmed by the Ministry of Foreign Affairs of Georgia of March 2008. Some have not yet been ratified and, consequently, have not acquired the legal effect. This article, however, covers them nonetheless.
[10] Read on 15 July 2005.

title, this research is intended to be analysed from the viewpoint of the OECD. I will be honoured, however, if this paper will also be of interest to Georgian practitioners, negotiators and tax authorities.

2. General Overview and Organisation of Treaties

After the collapse of the Soviet Union, in 1991, the Newly Independent States were legally allowed to form their international legal relations. Double Taxation Agreements, however, were not vital agreements from the very beginning of their acquiring of independence but their time has now come. The latest trend of making these kinds of agreements with more and more countries makes this reality clear. The very first Double Taxation Agreement of Georgia was concluded with Ukraine in 1995[11] but came into effect only after four years.[12] The latest or newest one for Georgia has been concluded with Turkey in November 2007.[13] Within these 12 years, 28 international agreements were concluded by Georgia amongst which are (in chronological order): Ukraine, Azerbaijan, Armenia, Turkmenistan, Uzbekistan, Kazakhstan, Russia, Romania, Bulgaria, Iran, the Hellenic Republic, Poland, the Czech Republic Latvia, Lithuania, Estonia, China, Belgium, the Netherlands, Italy, Germany, Austria, the UK, France, Denmark, Finland, Luxembourg and Turkey.

There is no draft model of a Double Taxation Agreement of Georgia that Georgian authorities have been using in bilateral negotiations with countries or with groups of countries.[14] All of the existing agreements are based upon the OECD Model Convention including those with non-member countries. According to some features discovered in Georgian tax treaties, these agreements could be divided into a) those made with Western industrial nations, b) those made with developing countries and c) those entered into with countries of the former Soviet Union. Regardless of the fact that all the treaties are based upon the OECD Model, the place of a particular treaty within the abovementioned groups could serve as some indication for the interpretation of a particular treaty. This difference is also well illustrated in the definitions of the terms that are involved in the treaties and are defined differently in different tax agreements such as, for instance, the “actual place of management” instead of the “effective place of management,” amongst others.

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[11] The perfection of tax treaties can be measured by their number and history as well. The history of negotiating some issues of avoidance of double taxation upon bilateral agreements date to the second half of the 19th century. See *op.cit.* note 5. The very first comprehensive tax treaty of the UK was concluded with the US in 1945 and the first 50 treaties were concluded between 1945 and 1951. See *op.cit.* note 3. Germany entered into its Double Tax Agreement with Italy in 1925. The US first comprehensive treaty with Sweden and France is from 1939.

[12] Was ratified by the Parliament of Georgia in 1999.

[13] Ratified by the Parliament of Georgia in December 2007.

[14] For instance, the US Treasury Department published its own model treaty in 1976 to serve as the basis for US treaty negotiations. The model has been revised several times. On 15 November 2006, the US Treasury released a new model. For more details, see *Reuven/Title*, The New United States Model Income Tax Convention, IBFD, June 2007, 224-235.

The titles of previous versions (1963, 1977) of the OECD Model Convention included a reference to the elimination of double taxation. In 2003, the following sentence was added to Paragraph 7 of the commentary of Article 1: “It is also a purpose of tax conventions to prevent tax avoidance and evasion.” The subsequent version still uses the shorter title which does not include any of these references. In my opinion, if contracting states would be willing to add the additional purpose to tax agreements – and they are free to do so – they will still have to include the limitation of benefits clauses in the treaties. In practice, many of countries’ agreements include all the references to the objectives in the titles; that is, they are larger than the OECD version’s former title. In some instances, the title remains the same but with reference to the elimination of double taxation. Georgian DTAs share both practices and no special policy considerations have been discovered herein. There is, however, no tax avoidance prevention measures involved in the agreements excluding those Agreements with the UK and Luxembourg where treaty shopping prohibition provisions already exist.[15]

The Georgian DTAs, likewise with the OECD model (and also the UN model), are typically organised within seven chapters.[16] The previous DTAs of Georgia include Article 14 of the OECD MC (Independent Personal Services) whilst some of new ones do not.[17] Some of the latest ones, however,[18] still include the separate article for independent personal services but exclude the definition of “business” instead.[19] Almost all the agreements include the article concerning the taxation of professors, teachers and researchers.[20] Some of the agreements include innovations such as, for instance Article 27 which refers to taxation at the source that relates to withholding taxes[21] and also the aid in recovery of taxes.[22] There is some other novelty as well which has still not been reflected in the OECD MC although the agreement with the Netherlands includes the provision regarding arbitration. Each of the particular features will be discussed below.

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15 See Article 10.6, 11.6, 12.6 and 24.2 of the Georgia-UK Agreement and paragraph 3 of the Minutes to the Georgia-Luxembourg Agreement.

16 Those that are not drafted by the chapters are still designed in the consequence of the OECD MC.

17 For instance, the Georgia-UK Agreement of 2005.

18 Concluded with Germany in 2006 and France in 2007.

19 The term “business” was added to the OECD Model in 2000 at the same time as Article 14 (Independent Personal Services) was deleted from the Convention. It was considered that “business” includes the performance of the activities defined previously by Article 14. See Commentaries, Article 4, paragraph 10.2.

20 There is no special article devoted to this in the OECD Model.

21 The Agreement with Germany; these provisions have no analogues either in the OECD Model or in other agreements of Georgia.

22 Article 27 of the agreement with the Netherlands; these provisions do not exist in other agreements of Georgia.

3. The Relationship between Tax Agreements and the National Law of Georgia

Like all of the other double taxation treaties of different countries, the Double Taxation Agreements (DTA) of Georgia are internationally binding obligations for Georgia (not the taxpayers) under public international law. All the DTAs of Georgia are subject to ratification and become binding according to the principles of international public law once the instruments of ratification have been exchanged. As soon as they become binding under international law, they gain internal domestic validity as well. Internal validity, however, has to be distinguished from the internal applicability of the treaties.[23] States vary in the procedure required for introducing tax treaties into domestic law wherein they can be either directly or indirectly applicable. It is essential, therefore, to know how the rules are involved and how they are applied internally in the Georgian law system. The issue of the problem of treaty override has become the subject of a short paper produced by the OECD Fiscal Committee.[24] The possibilities of treaty override are discussed herein from a different standpoint of whether or not Georgian legislation allows the treaty override *de iure* or *de facto*. Both situations are of major significance as, apart from legal status of tax treaties, it could undermine the actual efficiency of mechanisms provided by them.

Treaty override from the legal viewpoint is mostly relevant for common law countries.[25] It is worth reviewing the issue from the Georgian law perspective as well. According to the Constitution of Georgia, its international agreements prevail over the internal laws of the country if it does not contradict the Constitution itself.[26] According to the Law on International Agreements of Georgia, international agreements are an inseparable part of Georgian legislation.[27] Once it is incorporated automatically or through specific legislation, however, it still remains as an international agreement and which keeps primacy over other legislation. Becoming part of the internal legislation does not transform the international agreement into general domestic law but, rather, it works as domestic law but still with a high

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[23] See *Knechtle*, Basic Problems in International Fiscal Law, HFL Ltd., Weisflog (Transl.), 1973, 171.

[24] See the OECD report on treaty override adopted by the Council on 2 October 1989. The term “treaty override” refers generally to the possibility of enactment of subsequent domestic legislation which conflicts with obligations undertaken by a prior and binding treaty. The OECD distinguishes two situations here a) “intentional” treaty override where the state enacts legislation knowing and intending that it will conflict with treaty obligations and b) “unintentional” treaty override where no such intention exists.

[25] Generally, the treaties of most Continental European countries have a superior status than the internal legislation.

[26] Article 6 of the Constitution of Georgia.

[27] Paragraph 1-2 of Article 6 of the law on International Agreements of Georgia of 1997.

degree of supremacy whilst preserving the status of an international agreement. In the hierarchy of Georgian Legislative Acts, the international agreement (treaty) holds the position after the Constitution of Georgia although it prevails upon other statutes including tax legislation. The Tax Agreement of Georgia has precedence over national laws even when a subject matter is regulated by a subsequent national rule of law in a way which deviates from the obligation undertaken by the agreement. If a provision of Georgian fiscal law contradicts a specific DTA of Georgia, the relevant provision of fiscal law is not simply invalidated. It remains in force but must not be applied to persons or facts which fall within the scope of a specific treaty. The rules of the DTAs, therefore, do not replace the provisions of national tax law but are only valid in so far as the application of the treaty is concerned.

The *de facto* application of the agreements, however, is another story. Georgian legislation took a two-fold view concerning the introduction of the international agreements into domestic legislation. The direct effect of the agreements depend upon whether or not they need approval of some precise internal regulations. In other words, in the case when they are self-executive, they have direct force once they are ratified. In reality, the mechanism of international agreements and, notably, double taxation agreements, could hardly be self-executive due to the lack of precise procedural rules and dramatic differences between the tax regulations of contracting states. The majority of double taxation agreements have to be read in conjunction with the internal regulations of contracting states and this type of agreement, therefore, needs a high degree of involvement into the domestic legislation with close consistency to the provisions of the treaties. The problem of the necessity of prescribing and elaborating norms has arisen in the Georgian case of the *Tax authority v. Aragvi Business Bank* wherein the Supreme Court of Georgia held that Free Trade International Agreement between Georgia and Turkey requires the adoption of prescribing legislative norms and, thus, it has to be subject to ratification.[28] The Court interpreted that, in reality, the fact that no implementation norms were adopted does not mean that the agreement can have direct force without this. Finally, the Court held that the agreement is not a legally binding international obligation of Georgia unless it is ratified by the Parliament of Georgia given the fact that implementation legislation is needed for the application of the Agreement. The idea of the judgment is that the fact of ratification itself does not mean that the agreement is directly applicable, in principle.[29] Whether or not there are detailed rules of how the agreements should be executed, it has no direct effect in reality or

[28] The agreement was given force without ratification solely upon the basis of presidential approval which was confirmed by the notification of the Ministry of Foreign Affairs of Georgia, Decision of the Supreme Court of Georgia of 18 October 1999, *Aragvi Business Bank v. Regional Customs Service*, No 3g-ad-9-k.
[29] There is quite an opposite approach in Dutch constitutional law according to which courts are not allowed to disregard treaties even if they have not been properly ratified, discussed or presented in Parliament. See *Maarten*, The Judiciary and the OECD Model Tax Convention and its Commentaries, response to *van Brunschot*, IBFD, January 2005, 11-13.

de facto. To my point of view, these types of situations could also be regarded as treaty override. It is understood that the override is not done by the courts in this case but, in fact, comes as a result of the gaps in the legislation. The only exception where Georgian Tax Code relies upon the international agreement is Article 122 concerning the exchange of information. This article, however, gives very little to the relevant application of information exchange provisions. This inapplicability is also well illustrated in the examples of terminological inconsistencies that are discovered in great numbers in the different language versions of the agreements. This is not the result of inadequate legal translation alone but, rather, the relatively undeveloped legal concepts in Georgian tax law.

4. Interpretation of Tax Agreements

The purpose of tax treaties is to allocate tax claims between the contracting states. This goal can only be achieved if the treaty is applied consistently by the authorities and courts in both countries.[30] This article deals with questions of interpretation with regards to the application of the treaty which can arise before Georgian administrative authorities and the courts. What must be taken into consideration in this process is that the domestic principles for the interpretation can differ from the interpretation of tax treaties.[31] In Georgia, courts are authorised to interpret the treaties although judges are strictly bound by the wording of the statute whilst at the same time the judiciary should have the task of protecting taxpayers against the ambiguities found in the treaties. Regretfully, the judiciary practice is very pure in Georgia in this regard and is of little help in giving an analysis of its approaches.

A partial solution to the qualification problem is provided by Article 3.2 of the Model that is included without any changes in all tax agreements in Georgia. This article outlines the order of reference for interpreting terms used in DTCs. In the interpretation of treaty terms, one has to consider: a) the face value of the term, b) the definition (if any) of the term in the treaty itself, c) the requirements of the context and d) the meaning of the term in the tax law of the applying state.[32] According to *Vogel*, interpretation by recourse to domestic law in cases not covered by Article 3.2 is permissible only if the context does not provide any basis for interpretation at all.[33] A reference back to domestic law, however, will cause an unavoidable divergent interpretation of Georgian tax agreements due to the inconsistent usage of terms

[30] *Op. cit.* note 5, 39.
[31] For more details of the interpretation problem arising out of the basis of the Vienna Convention and Article 3.2. of the OECD Model, see *Qureshi*, The Public International Law on Taxation, Texts, Cases and Materials, 1994, 135-153.
[32] See *Brunschot*, The Judiciary and the OECD Model Tax Convention and its Commentaries, IBFD, January 2005, 5-10.
[33] For more details, see *op. cit.* note 5, 207-217.

which will be discussed further herein in greater detail. On the other hand, it is apparent that tax officials and judges in possession of some experience in international tax law will tend to give priority to the context of the agreement whereas those without such experience will be more influenced by the meaning of domestic law with which they are more familiar.

The place of the Commentary in treaty interpretation when parties to the agreement are not OECD members is still an issue. Member states, as mentioned above, have reached a consensus in relying upon the Commentaries whilst interpreting the points of the treaties. The question remains whether or not non member countries have to share the same practice in case they do apply the OECD MC in their treaty practice. There is well-founded idea that if the OECD Model is used by everyone, then it has to be interpreted in the same way by everyone involved regardless of whether or not they are OECD member countries.[34] It seems to be that non-member countries have adopted the practice of making reservations and observations to the OECD MC that in fact demonstrate their acceptance of the Model and its Commentary,[35] whilst OECD members are legally obliged to follow the Model and the Commentary in principle, these are documents which *Vogel* regards as less important for non-member states.[36] According to him, an intention by the contracting parties to adopt a provision within the meaning of the OECD MC can be presumed only where a) the text of the provision coincides with the OECD MC and b) its context suggests no other interpretation. The weight to be given to the Commentary in such cases cannot be stated generally but must be determined according to the circumstances of the individual cases. He does not cases wherein a contract is made between a member and a non-member state. Should member states apply the dual practice? To my mind, in the case when a non-member state negotiates with a member upon the basis of the OECD MC, the former has to take into account that the member state will operate mostly upon the basis of the Commentary's explanations within the scopes of its own reservations (if they exist).

If the text of the OECD MC has been adopted by non-member states or between the non-member and member states and if it is unchanged or only with a slight variation that permits an interpretation consistent with the OECD Model, then there is the presumption that the contracting states intended to conform to the OECD Model and its Commentary. In the case when the text of the OECD Model is not adopted literally and the context suggests an interpretation diverging from the model, then the OECD MC and Commentary is presumed to have been disregarded. The justification to this approach is the goal of a common interpretation of the agreement. If Georgia intends to imply an interpretation which is different from those of the OECD Model, then it has

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[34] *Op.cit.* note 3.
[35] Georgia, however, has not undertaken any reservation or observation of the Commentary.
[36] *Op. cit.* note 5, 44-46.

to prescribe this in the agreement in advance otherwise it must be assumed that the OECD's Commentary will be applicable.[37]

Agreements with Estonia, Latvia and Lithuania are illustrations to this idea. The protocols to the agreements include the reservation that specific articles[38] are not applicable until these states have introduced the term of "the place of effective management" in their domestic legislation as a criterion for the determination of residence.[39] These agreements instead envisage the solution of double residence by mutual agreement procedure.

An interesting solution to the interpretation problem has been discovered in the agreement with Austria.[40] According to the Introduction to the Commentary, it is not designed to be annexed to the Convention in any manner or to be signed by member states.[41] The Georgian-Austrian and Georgian-Danish Agreements are supplemented by the Protocol regarding the application of the Commentary for interpretation purposes. The protocols are integral parts of these Agreements and, thus, represent binding instruments under international public law. The interpretation rule is designed in the following way in the protocols: "It is understood that the provisions of the Agreement ... shall generally be expected to have the same meaning as expressed in the OECD Commentary thereon." The derogation from the rule, however, is allowed if contracting states will agree upon any contrary interpretation. One point is unclear. There is also a reference to commentaries which may be adopted in the future: "The Commentary, as may be revised from time to time,[42] constitutes a means to interpretation..." This citation points out the increase of status of the Commentary in this case. Although perhaps reasonable, however, it is doubtful whether or not any legal weight should be given to the commentaries retrospectively.[43] How will the Georgian court look at the issue that existing treaties be interpreted in the light of the new commentaries? It is worth mentioning here that the Austrian court[44] held that existing but not later commentaries have to be applied for interpretation.[45] The issue should have created a constitutional problem in Georgia as well although, and somewhat

[37] Especially in those cases when the agreement is concluded with a member state.
[38] Articles 8(1), 13(3), 15(3), 23(3) use the term "place of effective management".
[39] The reservations are done from the side of Estonia, Latvia and Lithuania. This term is not the subject for national law and has to be defined autonomously by the parties. This solution is better than an unpredictable interpretation of the terms.
[40] Protocol to Austria-Georgia Agreement of 2005. This is not the only exception with Georgian agreements. Austria has engaged in similar types of protocols with some other states as well. For more details see *op. cit.* note 3.
[41] See Introduction to the Commentary, paragraph 29.
[42] This is also the wording of the OECD Council recommendation.
[43] For more details see *op. cit.* note 3.
[44] After Austria concluded the agreement with the US which included the same provision as the Protocol with Georgia.
[45] Decision 92/13/0172 by the Austrian Administrative Court on 31 July 1996 discussed in *Lang*, Later Commentaries of the OECD Committee on Fiscal Affairs, Not to Affect the Interpretation of Previously Concluded Tax Treaties, 25 Intertax, 7-9, 1997.

surprisingly, the Georgian Parliament still ratified the Agreements.[46] The other problem that may rise in conjunction with this issue, however, is that if a country concludes a tax agreement with another country which is exactly the same as the previous one, should these agreements be interpreted differently because of the problem of the legal weight of the later commentaries? *Jones* suggests drawing the boundary between "interpretation" and "change" but this will not be of great help in practice. The debates will never come to a conclusion of producing a new interpretation or changing the previous meaning but will remain, in the end, one-way path.

The idea of enclosing the protocol with interpretation rules seems to be the right path to follow. At any rate, the solution of this problem is mainly in the hands of the courts in Georgia as regards later commentaries. The courts will have to decide whether or not these commentaries are applicable, if they change or if they only provide an interpretation.

To sum up the issue, two topics have to be distinguished herein. Who is the subject of the application of the Commentary, the tax authorities (the government) or the judiciary? The Commentary, as well as the MAP decisions, can only bind the government and not the judiciary. *Vogel* points out that: "The courts have to observe the law exclusively which includes the international treaties ..., but does not include resolutions of international bodies."[47] In making this conclusion, however, he does not imply the cases where the interpretation rule is stated in the protocol which is an inseparable part of the agreement. To my point of view, this situation will differ from those where there are no such protocols annexed stating the obligation of interpretation according to the Commentary such as in the Austria-Georgia and Luxembourg-Georgia examples. In all other cases, the issue is clear-cut. The Commentary should only be regarded as the government's position or expert's opinion in the judiciary.

5. Definition of Terms

Like the OECD Model, the Double Taxation Agreements of Georgia group together the general provisions in Article 3 and explain some other provisions in other articles of the Agreements. According to the OECD approach, some terms are subject to treaty interpretation whilst some have to be defined autonomously by the contracting states and others are interpretable according to national law concepts. Interpretation should be done in consequence as specified by Article 3.2 as was discussed above. In addition, contracting states may be free to bilaterally include some additional explanations of the terms that are not defined in the OECD Model such as, for instance, the Georgia-UK DTA which includes an additional explanation of term "the capital" and also adds some

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[46] The Georgia-Austria Agreement was ratified on 01.03.06 and the Georgia-Danish Agreement was ratified on 28.12.07.
[47] *Vogel*, The Influence of the OECD Commentaries on Treaty Interpretation, IBFD, 12, 2002, 614.

clarifications to the existing term of “business”.[48] The Agreement with Russia additionally defines the term as the “actual place of management”.[49]

a) Relationship Between the Terms “Business” and “Enterprise”

The terms “business” and “enterprise” are discussed here in conjunction with each other as they have been recently replaced in the OECD Model.[50] Previously, the Commentary adhered to the view that the terms were subject to entire domestic interpretation. Regardless of giving definition of the “enterprise” in its existing text, the Commentary still clarifies that domestic law provisions are also applicable for interpreting the term.[51] The same applies to “business” as its definition is also not exhaustive. “Enterprise” is defined by making reference to the term “business”[52] in which their meanings are not isolated but, rather, interconnected with one including the other and vice versa. Neither Georgia’s earlier agreements nor recent ones reflect this definition with the exception of the Agreements with the UK, Austria and Luxembourg[53] even though the concept of “enterprise” is unfamiliar for common law and, on the contrary, the term “business” is unknown in Georgian law. It is not only the common law countries that will face the difficulty of interpreting “enterprise” in tax treaties. The term “business” will also pose the same problem for Georgian tax authorities.

I am not alone in wondering whether or not “enterprise” means “business” in the Model. There are a great deal of debates in literature about the overlapping of the meaning of “enterprise” and “business”.[54] Some authors argue that there is a partial definition of “enterprise” in the OECD Model.[55] Georgian law defines “enterprise” as an entity that performs economic activity or is established to perform such an activity; namely, it refers to the creation or the organisational form of the activity and not to the function or process as is done in the OECD Model. Besides, it is not a tax law definition. Georgian tax law has to apply to company law. In the case of interpreting the term according to Article 3.2, the applying state has to refer to the domestic tax

[48] The term “business” is equalised with “economic activity”.
[49] Articlre 3.1 (h) of the Georgia-Russia Tax Agreement of 1999.
[50] Sub-paragraphs c) “enterprise” and h) “business” of Article 3 were replaced in the Model by the report entitled “The 2000 Update to the Model Tax Convention”.
[51] See Commentary, Article 3, paragraph 4.
[52] See Article 3.1.c. “the term ‘enterprise’ applies to the carrying on of any business”.
[53] See Article 3.1.f. and 3.1.k. of the Austria-Georgia Tax Agreement and Article 3.1.f. and 3.1.k. of the Georgia-UK Tax Agreement and Article 3.1.f. of the Luxembourg-Georgia Agreement.
[54] It is apparent that there is no agreement on the meaning of the concepts of “enterprise” and “business” even in the OECD Model. See *Jones,* Does “Enterprise” in the OECD Model Mean “Business”*?* IBFD, December 2006, 476-480.
[55] *Jones/De Broe/Ellis/Van Raad/Le Gall/Goldberg/Killius/Maisto/Miyatake/Torrione/Vann/Ward/Wiman*, The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States, IBFD, June 2006, 220-254.

law that has no concept of "enterprise".[56] The OECD definition of "enterprise" is somewhat blurred for Georgian legal thinking. In reality, the Model's term, "company," equals the concept of "enterprise" according to the understandings of Georgian law. Consequently, the contingency of applying this term in Georgian tax practice is completely clear. The practice will ignore the OECD meaning of the term.

Georgian negotiators on the Agreement with the UK apparently understood this conceptual inconsistency and included the term "economic activity" withi as an equal term for "business". Treaty equalisation alone, however, does not mean that they would have the same or similar meanings for both legal systems. The concept of "economic activity" does not equal the term "business". The Tax Code of Georgia defines economic activity as any activity undertaken with the intent to gain profit, income or compensation regardless of the results of such activity.[57] In other words, all the activities, the entrepreneur and the non-entrepreneur are regarded as economic activity. In common law, the company may or may not carry on business; in other words, it can merely receive an income but not carry on a business[58] whereas economic activity encompasses the activity of the entrepreneur and the non-entrepreneur according to Georgian tax law. Consequently, UK tax law makes the determination of business profit upon the type of income[59] and not upon the type of person as is regarded in Georgian tax law. This difference will play a major role whilst applying the agreement in practice and, particularly, with regards to the taxation of permanent establishments.

Taking into consideration the abovementioned divergences of legal thinking, the terms "enterprise" and "business" should be omitted from Georgian tax agreements since they add nothing for the common understanding of the agreements but, rather, blur the distinction between treaty concepts and national law understandings.

b) "Enterprise of a Contracting State"

Article 3.1.d. of the OECD Convention and the relevant articles of the Georgian agreements apply the term of the "enterprise of a contracting state" and give its definition as an enterprise carried on by a resident of a contracting state.[60] The definition given by the internal tax law of Georgia differs from it dramatically and

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[56] The concept of enterprise is unknown in both general and tax law in common law countries. See *Jones*, "Does "enterprise" is the OECD Model Mean "Business"? IBFD December 2006, 477-479.
[57] Article 13 of the Georgian Tax Code.
[58] *Op. cit.* note 56.
[59] *Jones/De Broe/Ellis/Van Raad/Le Gall/Torrione/Miyatake/Roberts/Goldberg/Killius/Maisto/Giulian/Vann/Ward/Wiman*, Treaty Conflict in Understanding Income as Business Profits Caused by Differences in Approach Between Common Law and Civil Law, B.T.R , 2003, 224-246.
[60] See Article 3.1.d of the OECD MC.

attaches the enterprise to the country according to the place of business and or management. The place of business is defined as the place of registration of the company[61] and the place of management refers to the actual place of management which refers to the place where the management (other similar managerial agency) of the enterprise fulfils its managerial function in accordance with the company's statute (or other founding documents) irrespective of the place of activity of the company's supreme controlling body and the income generated from the activity thereof.[62] The most blurred definition is given in Section 3 of Article 28 of the Tax Code of Georgia according to which it states that if the company is run by a manager (the company or a physical person), the place of the management of the company, or the residence of the physical person, will be considered as the place of the activity of the managing enterprise. This last phrase seems to be included in the Code as a result of giving regards to the provisions of the OECD Model. This definition, however, is in full incompliance with other sections of the same Article and the Companies Act.[63] According to the "Law on Entrepreneurs," the company is run by a one or two-tiered board (a board of directors and a supervisory board) and there are no other managers, governors or other companies who could be eligible by law to manage the company. This definition of Article 28.3 of the Tax Code of Georgia seems to be an incorrect transplant from the OECD proposals. Be that as it may, the term "enterprise of the contracting state" is linked to the place of registration or to the place where managerial functions are fulfilled in Georgian law whereas the OECD MC links the term to the residence of a person who run a business of a company. According to the OECD Model, the treaty protection of an enterprise depends upon the residence of the person that run the enterprise rather than on the place where the enterprise is carried on.[64] Georgian tax agreements do not include any other clarifications or reservations concerning the definitions of the agreements as concerns this term. Accordingly, the OECD term of "enterprise of a contracting state" will be applicable. A twofold practice, however, will be inevitable given that the enterprises will in some cases have treaty protection if they are attached to the state according to the treaty definition and, in other cases, the enterprises may not have the treaty protection[65] where their attachment is resolved according to Georgian tax law provisions.

c) "Residence" of a Physical Person

Neither the OECD Model nor the tax agreements of Georgia lay down the standards according to which a person is to be treated fiscally as "resident."[66] This is left entirely to domestic law. The resident of a contracting state within the meaning of

[61] Article 27 of the Tax Code of Georgia.
[62] Article 28 of the Tax Code of Georgia.
[63] The Law on Entrepreneurs of Georgia of 1994.
[64] See Commentary to Article 3.1.d.
[65] Interpreting the attachment according to treaty term, however, they could have been fallen under the agreements provisions.
[66] Article 34.1 of the Tax Code of Georgia.

the OECD MC is a person who meets the locality related criteria that must be interpreted by the domestic law. These criteria for individuals are: domicile, residence and other criterion of a similar nature which could be regarded to both individuals and companies. The term of “other criterion of similar nature,” however, makes clear that the enumerated criteria could be expanded only by locality-related attachments. The law related attachments do not fit within these criteria according to the OECD view.

“Domicile” as a concept is unfamiliar both to Georgian tax and civil law.[67] The Tax Code of Georgia stipulates the rule for determining the “residence” that is linked to factual stay within the territory for more than 183 days during the entire year.[68] Consequently, for the purposes of Article 4.1, the concept of “residence” or duration of stay for 183 days is applicable since there is no other criterion in Georgian tax law. Some misunderstandings in applying the agreement could have arisen, however, such as the case with Poland. Article 4.2.b, instead of “habitual abode,” involves a duration of stay of more than 182 days within a 12-month period as a tie-breaker[69]; As a duration of stay is the main idea of the concept of “residence” according to Georgian law, it could not be applicable as a tie-breaker in the case of double residence. These two concepts coincide in this case. The Agreement with Belgium involves the “duration of stay” as a main criterion and not a tie-breaker but still coincides with the Georgian tax law concept of “residence” that is linked only with the duration of stay.

If an individual is a resident of both states, then the tie-breaker attachments of Article 4.2 become applicable. These locality-related attachments must be determined independently of domestic law and autonomously, except for that of “nationality.”[70] Article 4.2 supplements the residence criteria of domestic law by adding autonomous terms. A person is deemed to be a resident of that state which is determined in order of precedence given in Article 4.2 from a) until b). The criteria of permanent home, habitual abode and nationality can be met in one or both states or in neither of them. A centre of vital interests can exist only in one of the contracting states or in a third state.[71]

[67] In British law, “domicile” has a particular significance which has no exact parallel in other legislations. It is initially acquired by the birth place or “domicile of origin” and is capable of being altered into a “domicile of choice” in very exceptional cases. See *Clarkson/Hill,* The Conflict of Laws, 3 ed., Oxford University Press, 2006, 18-52.
[68] Article 34.1 of the Tax Code of Georgia.
[69] The Commentary does not support the use of a fixed period as a tie-breaker. It has to be a sufficient length of time for determining whether or not the residence in each state is habitual and also to determine the intervals at which the stays take place. See Commentary, Article 4, paragraph 19.
[70] “Nationality” is a national law concept and could not be interpreted otherwise.
[71] *Op. cit.* note 5, 246.

The Georgian language version of earlier Double Taxation Agreements with the former Soviet states include the term of "place of permanent residence" as a tie-breaker instead of "permanent home" whilst other Agreements with developed countries reflect the term of "permanent home." Their Georgian translations, however, still apply the term of "place of permanent residence." These variations of the same term will be disruptive in achieving an autonomous interpretation. The OECD tie-breaker of "permanent home available to him" contains a subjective element[72] whilst "residence" is an objectively determinable concept. "Home" in the Georgian language means a house or an apartment belonging to or rented by an individual; in other words, it lacks some sort of attachment to the subject and focuses only upon belonging as such. In its conventional meaning, however, "permanent home" has to be understood as a concept containing the personal link with the accommodation. Being the "seat of domestic life and interests," the "home" concept is somewhat similar to the "centre of vital interests" used in article 4.2.a. [73] From the second sentence of the Article 4.2.a, it is apparent that the "centre of vital interests" is one of the attributive factors for the qualification of a "permanent home." According to Georgian tax law, the "permanent home" or "place of residence"[74] is equal to the "habitual abode" wherein the former includes the latter as one of the situations of a "permanent home." Georgian law envisages the possibility of having more than one "permanent home" or "habitual abode." In case of a dual "place of residence," the matter is solved through the agreement between the tax authority and the taxpayer.[75] Finally, according to Georgian tax law, the precedence is given to the 183 days rule, then comes into play "the permanent residence rule" which overlaps the "permanent home" and the "habitual abode" concepts; a sort of last resort is an agreement between the taxpayer and the tax authority. No criteria are laid down for this agreement which means that tax authorities could claim the "residence" of a person in a wide range of situations.

d) "Residence" of a Person Other than an Individual

The "residence" principle for a person other than an individual is linked to the place of management according to the OECD Model. Article 4.3 becomes applicable only if the same non-individual by virtue of Art. 4.1 is a resident of both contracting states. The decisive criterion in this case is a "place of effective management". Tax agreements of Georgia, in addition to the OECD criterion, apply the following criteria: the place of registration,[76] the place of location of the actual management,[77] the place of incorporation,[78]

[72] *Op. cit*. note 5, 247.
[73] *Jones*, Dual Residence of Individuals: The Meaning of the Excretions in the OECD Model Convention, BTR 15, 104, 1981.
[74] The term of "place of residence" is used in the Tax Code of Georgia in Article 35 which is conceptually closer to the term "permanent home".
[75] Article 35.5 of the Tax Code of Georgia.
[76] Agreements with Ukraine, Azerbaijan and Armenia.
[77] Agreements with Armenia, Kazakhstan, Ukraine and Poland.
[78] Agreements with Latvia, Estonia, Lithuania and the UK.

the place of economic activity[79] and the place of actual management.[80] It must be mentioned that giving importance to many attachments will just increase the possibility of double taxation situations for the companies. If one state attaches importance to the registration and another to the place of management, for example, the risk of arising double taxation situation is higher.

According to the OECD Commentary, residence criteria are also subject to entire domestic law interpretation in the case of companies.[81] The specification of Georgian tax law is that it is not familiar with the term of "residence of legal persons."[82] The Code stipulates the term of "enterprise of Georgia" instead.[83] The latter is determined according to the place of activity which is equal to the place of incorporation[84] and the place of management.[85] The Code applies the "residence of enterprise" in other articles, however, such as when determining the provisions of source-based taxation. According to the whole structure of the Code, it seems that it implies the nationality of the company under the "residence" concept. The latter is determined according to the law related and locality related criteria together as has been previously mentioned. Locality related criterion, however, differs from the OECD understanding of the management principle. To sum up, Georgian tax law refers to the incorporation and management principle whilst all other criteria as stipulated above are of no relevance for the application of the agreements in Georgia.

The majority of the Georgian Tax Agreements relies upon the term of "place of effective management" as tie-breaker for double residence situations. The term is defined neither in the OECD MC nor in Georgian Tax Agreements. As previously stated, the tie-breaker concept has to be defined autonomously or it will not be helpful for a co-ordinated approach for avoiding double residence situations.[86] Here, the problem is not just in the interpretation. Uncertainties will cause also differences in the corporate laws of contracting states, notably between the common law and civil law countries.[87] Due to these structural and conceptual differences, it will be difficult to describe the appropriate level of management that is sufficient for qualifying it as effective.[88]

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[79] Agreements with Bulgaria and Russia.
[80] Agreement with Germany.
[81] See Commentary, Article 4.1, paragraph 4.
[82] Georgian company law is built upon the notion of a legal person which is equal to a company or enterprise.
[83] Article 26 of the Tax Code of Georgia.
[84] Article 27 of the Tax Code of Georgia.
[85] Article 28 of the Tax Code of Georgia.
[86] See Commentary, Article 4.3. See also *Jones*, Place of Effective Management as a Residence Tie-breaker, IBFD January 2005, 20-24 and *Hinnekens*, Revised OECD-TAG Definition of Place of Effective Management in Treaty Tie-Breaker Rule, Intertax, Volume 31, Issue 10, 314-319.
[87] Georgia, as with other civil law countries, has taken the two-tiered approach whilst civil law countries historically adhere to the single board principle.
[88] *Op. cit.* note 56.

Other decisive criteria for resolving double residence situations in Georgian Tax Agreements have been discovered as well. The Georgia-Russia Double Taxation Agreement attaches importance to the "factual place of management" as a tie-breaker instead of "effective place of management" and gives the definition in Article 3 of the Agreement. According to the definition, the "factual place of management" is linked to the physical location of the enterprise whereas the Commentary attaches importance to the place where the company is actually managed.[89] According to the OECD approach, it is not the place where the management directives take effect but, rather, the place where they are made in substance. The Georgia-Germany Agreement also includes the same term of "actual place of management" as the tie-breaker choice in Article 4.3 although this Agreement does not give any definition of the term. According to *Vogel*, German case law regards the "place of management" as the centre of the top level management of the company[90] which is very similar to the treaty term of "effective place of management". Thus, the wording of the Agreements with Russia and Germany coincide although they differ in concepts and, consequently, the interpretation of literally the same terms will cause different results. There is some other criterion for resolving the double residence situations. The Agreement with Bulgaria includes "the place of head office". In fact, there is no set definition of the term since it is easily determinable in practise without the necessity of a statutory definition.

The most desirable solution for achieving a common understanding of the term of "effective place of management"[91] is giving it an autonomous definition in the Agreements. The definition stipulated in the Agreement with Russia, however, is different from the OECD understanding. It is nonetheless still helpful for the solution of double residence cases rather than other more unpredictable and unknown interpretations which will not serve as a solution in double residence cases.

e) "Permanent Establishment"

The OECD concept of permanent establishment appears to have the most influence upon the internal laws of countries. It has been adopted by the majority of countries in their internal laws.[92] The Georgian Tax Code also includes a special article devoted to the "permanent establishment"[93] although domestic tax law interpretation is not relevant for the purposes of double taxation agreements even if the wording of the national law concept is literally the same.[94] National tax law interpretation has to be applied in unilateral occasions with regards to those enterprises that are not the subject to treaty protection; that is, for a third party's permanent establishments.

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[89] See Commentary, Article 4.3, paragraphs 22 and 24.
[90] *Op. cit.* note 5, 262, paragraph 104.
[91] Taking into account that the status of the Commentary for countries like Georgia is still an issue.
[92] With the exception of the US, see *op. cit.* note 56.
[93] Article 29 of the Tax Code of Georgia.
[94] *Op. cit.* note 5, 282, paragraph 9.

Article 5.1 of the OECD Model defines the "permanent establishment" as a fixed place of business. The place of business must be a "fixed" one which means that the permanent establishment must be established at a distinct place with a link between the place of business and a specific geographical point.[95] The term of "permanent establishment" is transferred into English language versions of Georgian DTAs unchanged. Some confusion within has resulted in the Georgian language versions of various agreements and also those which are written in Russian and in the languages of other former USSR states. These Agreements define permanent establishment as a "permanent place of business" instead of a "fixed" place. The only exception is the Agreement with France where the Georgian language text refers to the exact translation of the "fixed" place. All these divergences are not the issue in cases where the English text prevails although not all the agreements, however, state this rule. The Russian text prevails in some cases[96] or both texts are equally authoritative.[97]

The concept of "permanent place of business" differs from the "fixed place" as the former is associated with continuity of activities rather than with specific geographical point or some distinct area. Apparently, those cases of the Agreements with different wording will be the issue whilst interpreting the relevant articles of the agreements. In the cases where Georgian competent authorities are guided by the Georgian text, the views will be divergent from those that are proposed by the OECD. The crucial requirement for tax treaties is that their provisions have to be interpreted consistently. As regards permanent establishment, if they are interpreted inconsistently between jurisdictions, international enterprises (companies) will always use planning techniques to exploit the different interpretations.[98]

6. Tax Sharing Rules

There is well-supported doctrine in tax law that the source state has the primary right to tax. Advocates of this idea argue that source principle is one of the basic principles upon which the taxation on the production of income and the possession of the wealth should be allocated to states.[99] The residence states, however, have traditionally claimed that they have the better rights. This is the position supported by the OECD Model and the majority of double tax treaties as well. "The primary

[95] See Commentary, Article 5, paragraphs 2 and 5.
[96] For instance, the Agreement with Germany.
[97] The Agreement with the UK.
[98] See *Kobetsky*, Article 7 of the OECD Model: Defining the Personality of Permanent Establishments, IBFD October 2006, 411-425.
[99] See *Kemmeren*, Source of Income in Globalising Economies: Overview of the Issues and a Plea for an Origin-Based Approach, IBFD November 2006, 430-453. See also *Pinto*, Exclusive Source or Residence-Based Taxation: Is a New and Simpler World Tax Order Possible? IBFD, July 2007, 277-293.

aim of the DTA is to demarcate the national tax systems from each other."[100] I would say that the final objective of the DTA is the prevention of double taxation that could be achieved through several methods wherein the main device is the allocation of a tax base. Some of the commentators consider that the main obstacle to the economic growth and the reason for double taxation is worldwide taxation which results in endless conflicting tax claims between the states."[101] On the contrary, others argue that worldwide taxation is justifiable by capital-export neutrality (CEN) which would promote worldwide efficiency and not capital-import neutrality (CIN) because it provides taxation wherein there is no difference in taxation if capital is invested abroad or in the residence country."[102] It is doubtful, however, that this system could provide any efficiency for developing countries since it does not favour investment promoting activities but adheres to a neutral approach for making investments abroad and clearly favours the tax interests of industrial countries.

Tax treaties operate by means of a system of conflict rules[103] as the allocation of fiscal jurisdiction is the main way for avoiding double taxation. That said, however, it does not mean that tax treaties contain conflicts of law rules in its original sense. They do not provide whether or not a state must apply domestic or foreign law but, rather, impose their own distributive rules which are fundamentally different from the conflicts rules of private international law.[104] Tax authorities do not apply the foreign law as it is in conflicts of law situations but rely upon allocated taxing power and tax upon the basis of national laws using the concepts of national law or treaty definitions according to Article 3.2.

According to *Knechtle's* formulation, the allocating rules could figuratively be regarded as demarcating rules.[105] *Rohatgi* refers to allocating rules as distributive rules that initially classify and then assign the taxing rights to one or both contracting states."[106] I would add that in short, assignment rules could be regarded as tax sharing rules between the states involved. The main parts of the Agreements consist of these types of rules and for their correct interpretation, the wording of the specific provisions are precisely important. "Assignment rules" in the OECD Model operate by using the following phrases: "shall be taxable only", "shall be taxable only in the contracting state... unless", "may be taxed in that other state", "...but may be also taxed in the first state", and "shall not be taxed". The phrases "shall be taxable" or

[100] *Op. cit.* note 24, 162.
[101] *Andersson,* An Economists View on Source versus Residence Taxation – The Lisbon Objectives and Taxation in the European Union, IBFD, October 2006, 395-401.
[102] *Mossner*, Source versus Residence: A EU Perspective, IBFD, December 2006, 501-503. The author of this article is not himself of the above mentioned idea but cites other commentators.
[103] *Op. cit.* note 24, 167-168.
[104] See *op. cit.* note 5, 52.
[105] See *op. cit.* note 24.
[106] *Rohatgi*, Basic International Taxation, Kluwer Law International 2002, 56.

"may be taxed" should be interpreted by the ordinary meaning of the words as "exclusive" or "non-exclusive" taxing rights, respectively.[107] Since the right of the other state is not denied by the construction of the non-exclusive assignment articles, it would invariably lead to tax relief in accordance with the Agreement. Regretfully, some Georgian language versions of tax agreements do not strictly adhere to this construction of "assignment rules" but in a way represent a literary translation of legal constructions that mislead whilst applying Georgian language versions of the agreements. In the Georgian language version of the Agreement with Ukraine, for example, the wording of Article 11 I is "...shall be taxable" instead of "may be taxed" and which changes the whole idea of the rule.

Georgian double taxation agreements include some divergences from assignment rules of the OECD Model. It is not surprising as the OECD Model represents the present state of opinion of most industrial countries. Some of Georgia's agreements slightly extend the source state's taxing right rather than the OECD Model whilst others make it narrower. Agreements with the former Soviet states, including the Baltic states, for example, involve the provision of allocating a taxing right upon royalties to the source state as well.[108] The Agreement with Belgium shares the same provision. All other items of income[109] that are not dealt with in specific articles (Article 21) of the agreement and are generated from the sources of that state may be taxable in the source state according to the Agreement with Azerbaijan, Bulgaria and Russia.[110] According to the Agreement with Belgium, other items of income are capable of being taxed in the source state whether they are not taxed in the residence state.[111] In this regard, Professor Ellis points out that Article 21 is the basic rule of the OECD Model as the other articles are exceptions to this fundamental rule. Only the residence state should be allowed to tax this type of income.[112] This is, however, dealt with differently in the above mentioned Agreements.

Almost all the Agreements with developed countries make the taxing capabilities of the source state narrower exempting the taxation of interest from the source state allowance. Agreements with the UK, France, the Netherlands, Austria and Germany, for example, exempt Article 11.2 of the OECD Model from the agreements and, thus, do not permit the taxation of interest in a source state. The wording of this Article has been changed as follows: "…shall be taxable only" which means that the exclusive right to tax is on the residence state with regards to these agreements.

[107] See *op. cit.* note 5, Preface to Articles 6-22, 3-5. See also Commentary, Article 23, paragraphs 6 and 7 and *op. cit.* note 108.
[108] The OECD Model does not share the same approach although the same provision is included in the UN Model.
[109] Article 21 of the OECD Model.
[110] Article 21 of the Agreements with Azerbaijan and Russia and Article 22.1 of the Agreement with Bulgaria.
[111] Article 22.2 of the Agreement with Belgium.
[112] *Op. cit.* note 30.

Dividend allocating articles are of special importance in tax agreements of Georgia. According to the OECD Model, this rule is regarded as allocating the limited taxing right to the source state. Georgia's DTAs differ from the OECD MC and, accordingly, they could be distinguished as a) dividend allocating rules with provisions for tax incentives for investments and b) mere dividend allocating rules that are done mostly upon the pattern of the OECD Model. Agreements with the countries of the former USSR (excluding the Baltic states) and some other non-industrial states do not include the investment promoting provisions although the amount of tax upon dividend in the source state is determined at a lesser rate than is proposed by the OECD Model. Agreements with developed states together with dividend distributive rules apply the investment promoting provisions. Dividends are exempted from tax in the residence state of the company paying the dividends, for example, if the investment allocated in that company reaches a specifically determined amount. The special amount of investment is a condition for incentives and differs from agreement to agreement. These types of provisions have to be grounded upon economic rationalism and so it is desirable to have different practices with different countries. The construction of dividend allocating rules somewhat changes the purpose of double taxation agreements, aiming at additional results through investment promotion. These provisions, however, fit nicely within tax agreements.

7. Double Taxation Relief Methods

Article 23 of the OECD and Georgian DTAs deal with the so-called judicial double taxation. This case has to be distinguished from economic double taxation which is not discussed in this article.[113] International judicial double taxation is not defined in the OECD Model or in Georgian tax law. The Commentary, however, does shed some light upon this issue[114] and clarifies that judicial double taxation occurs where the same income or capital is taxable in the hands of the same persons by more than one state. Georgian tax law does not give any definition of judicial double taxation although the judiciary interpretation has to be regarded as guidance in this case. The Supreme Court of Georgia held that it is against the law "to tax the same person with regards to the same taxable basis more than once".[115] In fact, the interpretation is similar to the one given by the Commentary.

[113] If states wish to solve the problem of economic double taxation, they can do so by bilateral negotiations.
[114] See Commentary, Article 23a and 23b, Preliminary Remarks, paragraph 2.
[115] *"Didubis Rdze" LTD v. Customs Department of Georgia* of 20 July 2000.

Three methods are in common use today for giving relief in the case of double taxation: deduction, exemption and credit methods.[116] The OECD has sanctioned only the exemption and credit methods[117] both of which are permissible for Agreements based upon the Model with each state being left free to make its own choice.[118] The exemption and credit methods are distinguished further: full exemption and exemption with progression and full credit and ordinary credit methods. The OECD Model limits the choice between the exemption method with progression (Article 23a) and the ordinary credit method (Article 23b). Most of the Georgian tax agreements use the exemption method for eliminating double taxation from the Georgian side.[119] In several of them, a combination of the two methods or a mixed version of Articles 23a and 23b are applicable.[120] As a rule, developed countries use a combination of the two methods with Georgia wherein they apply exemption plus credit or exemption plus deduction method (for dividends).

The reason for OECD Member States being unable to agree upon one universal method of revealing double taxation is that the philosophies underlying these two methods are far different. The exemption method favours capital import neutrality and puts the investors in equally competitive conditions in the source state whereas the credit method favours capital export neutrality and treats the capital investments equally in a residence state. *Vogel* advocates the exemption method as it avoids not only actual double taxation but also potential double taxation.[121] This idea is supported by other scholars as well.[122] On the other hand, some commentators believe that the credit method is recognised to be the best method for eliminating international double taxation.[123] By taxing income upon a worldwide basis and relieving double taxation by means of credit, however, European countries are effectively exporting their high tax levels to foreign markets.[124] The truth is that very few counties have either a pure exemption or a pure credit method. In most cases, countries apply both approaches for different income and activities such as in the Georgian case. In case both methods are designed properly, they can be reasonably comparable.[125]

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[116] See *Arnold/McIntyre*, International Tax Primer, Kluwer Law International, 2 ed. 2002, 30-47.
[117] See *op. cit.* note 107, 32. The credit and exemption methods are also sanctioned by the UN and US models. The deduction method is also used by some states as an optional form of relief in case foreign taxes are not creditable.
[118] Theoretically, a single principle could be held to be more desirable. See Commentary, Article 23, paragraph 28.
[119] Agreements with Armenia, Azerbaijan, Kazakhstan and France, etc.
[120] Austria-Georgia Agreement.
[121] *Vogel,* Tax Treaty News, IBFD, December 2006, 474-475.
[122] *Rohatgi* argues that the exemption method avoids or totally eliminates double taxation whilst the credit method prevents or partly eliminates it. See *op. cit.* note 107, chapter 2, paragraph 5.5.
[123] *Op. cit.* note 117, 37.
[124] *Op. cit.* note 102.
[125] *Op. cit.* note 117.

Both methods in the OECD Model are drafted in a general way and do not give detailed rules on the computation of the methods and operation of the credit. This is left to domestic tax laws. Domestic law provisions are not just additional norms to the DTAs, the double taxation relieving provisions can also be given the effect unilaterally without tax agreements. However, Treaty relief is still important as it may be more generous than the unilateral relief. The Georgian Tax Code (the recent updates to the Code) provides for a tax relieving rule which is very close to the ordinary credit method. Generally, the countries using the deduction methods tax their residents on their worldwide income.[126] In effect, foreign taxes are treated as current expenses of doing business or earning income in the foreign jurisdiction. Georgian law, however, is far from being perfect in this respect. As already mentioned, the method chosen by the Code is not favoured by the OECD. The corresponding article of the Georgian Tax Code specified that the deduction is allowed just with respect to foreign source based profit taxes. It is apparent, that the problem will rise with regards to the application of the exemption and credit methods[127] as these rules are not stipulated in Georgian tax law at all. Finally, the provisions of the national tax law concerning the relief of double taxation are very poor and seem to be of no real help in completing the whole picture of any chosen (treaty or unilateral) methods.

The Agreements with Ukraine and the UK include some different approaches in this regard. Relief will be granted if taxation is done upon the basis of source rule in another state. The OECD MC wording is rather simple for application because it only requires that taxation is done in another contracting state as a condition for relief. Additional involvement of the source rule here could through the contracting states into excess trouble to determine whether or not the source of income is in another state. These situations can cause a conflict between the understandings of source rule in that it has no universal definition. The potential consequences of this conflict will be frightening because no relief would be granted to the taxpayer. Luckily, the Agreement with the UK copes better with this situation. Article 23.2.a. points out the Agreement as a basis for determining the source state. Accordingly, no internal definitions of the source will be needed for applying the Agreement. The Agreement with Ukraine lacks this clarification, however, which means that the national law concept of the source will be applicable. In this case, there will be inevitable conflicts in determining whether or not the taxation had been done in another state according to the source principle. It is apparent that this practice has to be changed by the OECD construction of the relevant article.

[126] *Op. cit.* note 116, 32.
[127] Agreement with Belgium.

8. Mutual Agreement Procedure (MAP) and Arbitration

The existing version of Article 25 of the OECD Model is placed unchanged in almost every tax agreement of Georgia. This research is not intended to explore this Article (its existing version) in all details but is more focused upon the novelty that has been decided for inclusion in this article. Several comments thereto, however, are necessary since some questions will arise with regards to Article 25 such as: What is the place that should be regarded to the agreements reached by MAP process within the legal system of the contracting state which, in this instance, is Georgia? What is the binding effect of these agreements or is the MAP initiated merely for communication between the authorities? The wording of Article 25 also seems quite ambitious to some extent. It indicates that "any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the contracting states." What if the court has held the ruling before or afterwards? How could the MAP agreement override the court decision? Will the court have to take into consideration this agreement in reaching its judgment when the MAP has already reached an agreement? This seems to be the case not just for Georgian law but for other jurisdictions as well. In 1999, the Supreme Court of Georgia held that "it is not acceptable for courts to base their judgments upon the interpretations given by the executing bodies on the matters of law."[128] The judiciary of the UK also holds that the Map decisions are not binding in internal law. In *IRC v. Commerzbank*, it was held that competent authorities may communicate with each other for reaching the common interpretation of the treaty, however "... this joint statement has no authority in English courts. It expresses the official view of revenue authorities of the two countries. That view may be right or wrong..."[129] In substance, the judiciary decisions of both countries reflect the same position. It is clear that the courts will be reluctant to adhere to the MAP's interpretation of the case. This, however, will be the issue until the solution is found. The MAP procedure and its decisions need some allocation within the legal framework of contracting states.

Recently the amendment was made to Article 25 of the OECD Model which refer to the arbitration procedure.[130] It is worth mentioning here that the OECD has not always favoured this innovation and the Committee on Fiscal Affairs did not recommend the adoption of arbitration for some time. The Committee later reported that the adoption of the latter "would represent an unacceptable surrender of fiscal sovereignty."[131] Since then, the realities have been changed and the views also. The novelty has been discussed for a

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[128] Decision of the Supreme Court of Georgia on 18 October 1999, *Aragvi Business Bank v. Regional Customs Service*.
[129] *IRC v. Commerzbank* [1990] STC 285 at 302b.
[130] The amendments were made according to the Report, adopted by the Fiscal Committee on 30 January 2007.
[131] See the 1984 Report of the OECD Committee on Fiscal Affairs, Transfer Pricing and Multinational Enterprises, Taxation Issue, 39.

long period and a decision was recently made for inclusion of arbitration procedure in the MC.

In its latest report, the Fiscal Committee[132] confessed that the MAP procedure is not as effective as it appears to be. There is no direct confession but the facts speak for themselves. After the draft was submitted for public discussion, private sector representatives and tax officials also pointed out that the MAP does not always facilitate the solution of a case.[133] In reality, the MAP procedure is not created to arrive at a common understanding of the debatable issues. The procedure is supposed to provide adequate efforts for the parties to come to a common understanding of the issues arising out of treaties. The concept of the MAP itself implies that it is not the final dispute resolving procedure which means that the case could still be open after years of consultations between the competent authorities. The OECD draft looks at the arbitration as an additional tool together with the MAP procedure and does not attempt to supersede the latter. The innovation has merits and demerits as well.[134] The OECD MC understands that constitutional difficulties will not allow states to adopt the procedure in some cases and so the article is with a reference footnote that indicates that it is a selective provision for those countries whose legislation allows such a legal luxury. It is clear that arbitration will force competent authorities to come to the agreement in a reasonable time and they endeavour to work harder at finding a solution if they are not willing to enter into arbitration. It seems that the result of the inclusion of arbitration will be profitable for both parties. The taxpayer will benefit as he gets an additional step towards claiming his rights and the tax authorities will get benefits as they will save time and use resources effectively.

The Tax Agreement of Georgia with the Netherlands includes similar provisions. This Agreement was signed in 2002 far before the OECD published its first draft for public discussion.[135] No other tax agreements of Georgia include such a provision. Article 26.5 of this Agreement states that in case the issue is not resolved after two years, the parties to the agreement are allowed to submit the case to arbitration. The advance permission of taxpayers is required for rendering the decision binding. Despite how innovative and advantageous this provision can be, it is still wholly confusing. The wording of the Agreement alone means that the procedure will not fit within the legal structure of Georgia. At the same time, the agreement does not give any indication of the type of arbitration

[132] February 2007, Improving The Resolution of Tax Treaty Disputes.
[133] See OECD Report of February 2007, Improving the Resolution of Tax Treaty Disputes, Introduction, paragraph 11.
[134] For more details about the advantages and disadvantages of arbitration, see *Fogarasi/Gordon/Venuti/Andersen*, Use of International Arbitration to Resolve Double Taxation Cases, Tax Management International Journal, 11 August 1989, 319-327.
[135] The Government of the Netherlands published a paper in 1987 on tax treaty policy together with the Netherlands Standard Convention. See *Brunschot*, The Judiciary and the OECD Model Tax Convention and its Commentaries, IBFD, January 2005, 5-10.

that is implied, who has to take the case to arbitration (the tax authorities or the taxpayer), how arbitration will deal with the case, what the procedures will be, how the decisions will be enforceable and, finally, what place should be regarded to the decision of this arbitration within the national legal system. These are the issues that have to be elaborated consistently in the agreement and in national law. Since this has not yet been done, there is only little hope that these provisions of the Georgia-Netherlands Tax Agreement concerning the arbitration will ever work.

After amending the OECD Model, however, the question will still be posed of whether or not the arbitration procedure will be desirable for Georgian tax practice. The OECD contemporary concept of arbitration clearly does not represent a threat to fiscal sovereignty or its unacceptable surrender although it all must be analysed in detail, particularly the composition of the arbitration and decision-making procedure of arbitration within an "independent opinion" approach or the "last best offer".

9. Assistance in the Collection of Taxes

In addition to the component of arbitration, some other provisions of the Agreement with the Netherlands look like a white elephant for the Georgian tax system; namely, the provisions of giving assistance in tax recovery matters which is not followed in other agreements. Georgian negotiators, however, will be facing this challenge in making further agreements as the Georgian authorities do not adhere to a consistent stand with regards to some practices. Unfortunately, the variety of approaches in different agreements leads to the idea that there is no established practice of making tax agreements even whilst negotiating special provisions. Consequently, the question will arise every time: If this practice is suitable with one state, then why is it not with the same in another? Sometimes the views of the negotiators involved change with the treaty practice being changed as well. This is a better situation than blind adherence to the proposed drafts.

Article 28 of the Agreement with the Netherlands states the obligation of giving assistance in the recovery of taxes. My personal opinion is quite the opposite of that approach because Georgian tax law and the tax system in whole remains completely unprepared for these types of advances in its tax practices. The provisions were included without caring for the inclusion of further specific norms into Georgian tax law. The concept of the idea is the same as it is drawn in the OECD Model although this Model raises this mechanism to the international level which requires setting down the mode of application of the relevant article between the contracting states. On the contrary, the discussed Agreement pulled down the procedure to the level of national laws. Article 28.1 of the Agreement states that assistance and support in recovery of taxes will be granted in accordance of the relative norms and administrative practices of the contracting states. This type of tactic in designing a treaty is sometimes needed for creating safeguards upon the basis of national law. Again on the contrary, this wording of relying upon the national law and practice in this case turned the provisions of the Agreement into complete fiction. The Tax Code of Georgia is the only basis for the enforcement of tax claims. In that there is no support of these provisions in this Code, the prospects of recovery of tax claims of foreign countries seems to be very vague, not to say unlawful, according to the Georgian Tax Code.

Georgian courts do not yet recognise and enforce the foreign judgments on tax cases as, for example, is done in English courts.[136] It goes without saying that the judgments are of more legal weight than the decisions of tax authorities. Tax recovery aid provisions, whether direct or indirect, contradict the main principles of Georgian law at this stage. Whether or not the legislative views and judiciary practice change, the recovery provisions of tax claims could be discussable but there is still a great deal to be done in this regard. Yet it is to go too far and too quickly."[137]

I do not mean to imply that there is anything wrong in the assistance in the collection of taxes. It is fine to do so when there is some degree of similarity between the tax systems of contracting states. When there has been no real harmonisation, however, this emerges as quite a large step.

10. Conclusion

I would sum up with the same idea with which I started. Georgian Tax Agreements are made upon the pattern of the OECD Model. Nevertheless, the whole analysis takes me to the idea that the Model has had less influence upon the internal tax law of Georgia than might have been expected. Is there any hope for improvement? To my mind, several suggestions could be made in conclusion. First, the Government has to adopt some general guidelines or strategies for tax treaty negotiating policies. It has to define the main purposes of negotiations: to secure the most beneficial attribution of taxing rights to Georgia or to protect taxpayers against double taxation? Second, it is necessary to draft some standard implementing norms for giving real effect to tax agreements. Third, MAP decisions need to be allocated within the internal legal system. Fourth, arbitration procedures need to be elaborated whether is has to be persuaded. Fifth, the legal status of the Commentary should be clarified by referring to it in treaties as in effect we do not know to what extent the Commentary has relevance for the interpretation in the eyes of the Government. Sixth, steps need to be taken towards consolidating the

[136] It is well established principle that English court will not enforce a foreign revenue laws. The reason why the English courts do so is simply that they don't sit to collect taxes for another country; nor will be a foreign revenue law enforced by allowing the Foreign Government to recover property in England; see *Government of India v Taylor* [1955} 2 QB 490 at 515; *Regazzoni v. K C Sethia* (1994) LTD [1956} 2QB 490, 515.

[137] This hypothetical assessment was given by *Jones* to the attempt of involving same rules in the agreements between EU countries; see *op. cit.* note 3.

wording of treaties and especially giving the terms the same definitions in each treaty. Seventh, it is needed to correct Georgian language versions of existing treaties in terms of relevant translations of the terms and definitions. Eighth, the double taxation relief article in relevance with the OECD Model needs elaboration in clear terms. All of these suggestions and others that are pointed out above are easily to achieve but the main thing is to hold the balance between Georgian resident taxpayers, on the one hand, and the interests of Treasury, on the other. It is understood that given interests as a rule are not exactly identical although the clarity of the tax agreements is a far more desirable issue for both parties involved. The great regret left after reviewing the topic is that tax agreements of Georgia have not yet become the subject of extensive judiciary control and review. Hopefully, they will have a long way forward.