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NATIONALITY NON-DISCRIMINATION IN SERBIAN TAX TREATY LAW

This paper deals with the nationality non-discrimination provision in Serbian double taxation treaties. First the author analyses the historical development of the nationality non-discrimination clause found in the OECD Model Tax Convention and illustrates the dilemmas related to its interpretation, particularly the relevance of residence of taxpayers for comparability purposes and the application of Art. 24.1 of the OECD Model Tax Convention. Subsequently, the author turns his attention to the solutions found in Serbian double taxation treaties which are methodologically divided into three groups. One of them stands out as the most notable, being unique in global terms: double taxation treaties which provide for a prohibition of discriminatory treatment based on residence. The author critically addresses the fundamental flaws of the Serbian double taxation treaty policy which are recognized through a detailed scrutiny of the relevant norms of these international agreements.

Key words: *Non-discrimination. – Residents. – Non-residents. – Double taxation treaties. – OECD Model Tax Convention.*

Non-discrimination is one of the fundamental principles of international tax treaty law, embedded in the vast majority of more than 2,500 bilateral double taxation treaties which are being applied at this moment in the world.¹ Furthermore, the prohibition of discrimination is at the core of most legal systems of supranational organizations, such as the European Union and the World Trade Organization.² On the other hand, differ-

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¹ See: R. S. Avi-Yonah, *International Tax as International Law – An Analysis of the International Tax Regime*, Cambridge University Press, New York 2007, 6.

² See: S. van Thiel, “General Report”, *WTO and Direct Taxation* (eds. M. Lang, et. al.), Linde Verlag Wien, Vienna 2005, 19–21; C. Staringer, H. Schneeweiss, “Tax Trea-

ent treatment of taxpayers, as well as of particular situations, is present in the tax systems of virtually all countries. In international tax law, which is primarily contained in the rules of domestic legislation which govern cross-border taxation,³ we unavoidably come across provisions which differently treat those who are subject to unlimited tax liability (tax residents) and those who are taxed only based on the source of their income and property (non-residents).⁴ In addition, tax laws will often apply diverging approaches to the treatment of expenses, and in some cases income, depending on whether these have been incurred (or generated) from domestic or foreign sources. Double taxation treaties, as a further source of international tax law, do not stipulate how contracting states will tax their residents and non-residents, but only delineate which contracting state will be allowed to tax particular income and property. Apart from the non-discrimination principle, there is nothing in double taxation treaties which would impact the described state of affairs in international tax law, as found in domestic tax legislation, while we may also note that these treaties are founded on the premise of different treatment of resident and non-resident taxpayers.

The task before us is to determine the relevance of the primary rule found in the non-discrimination provision of double taxation treaties: the nationality non-discrimination clause. Avi Yona noted a striking similarity in the wording of double taxation treaties,⁵ which is caused by the widespread reliance of countries on the OECD Model Tax Convention⁶ in drafting their bilateral double taxation treaties. In other words, an analysis of the provision of Art. 24.1 of the OECD Model Tax Convention, which contains the prohibition of discrimination based on the nationality of the taxpayer, should provide us with an understanding of the global consensus, if such a consensus exists, on this particular issue. However, researching the 54 bilateral double taxation treaties applied by Serbia in 2014⁷

ty Non-discrimination and EC Freedoms”, *Tax Treaty Law and EC Law* (eds. M. Lang, J. Schuch, C. Staringer), Lind Verlag Wien, Vienna 2007, 230.

³ See: K. Vogel, *Klaus Vogel on Double Taxation Conventions – Third Edition*, Kluwer Law International, London 1997, 10.

⁴ See: D. Pinto, “Exclusive Source or Residence-Based Taxation – Is a New and Simpler World Tax Order Possible?”, *Bulletin for International Taxation*, Vol. 61, 7/2007, 277.

⁵ See: R. S. Avi-Yonah, “Double Tax Treaties: an Introduction”, December 3, 2007, <http://ssrn.com/abstract=1048441> or <http://dx.doi.org/10.2139/ssrn.1048441>, last visited 30 September 2014.

⁶ See: *OECD Model Tax Convention on Income and on Capital – Full Version* (as it read on 22 July 2010), OECD Publishing, Paris 2012, I-4.

⁷ In 2014 Serbia applies double taxation conventions with the following countries: Albania, Austria, Azerbaijan, Belgium, Belorussia, Bosnia and Herzegovina, Bulgaria, Canada, (PR) China, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, India, Iran, Ireland, Italy, (DPR)

may lead us to surprising findings, which stand apart in comparative international tax treaty law.

1. NATIONALITY NON-DISCRIMINATION IN THE OECD MODEL TAX CONVENTION UP TO 1992

The OECD Model Tax Convention resembles an outline of a theatrical play. Two contracting states are given their respective roles, one as the state of residence of the taxpayer and the other as the state of source.⁸ Double taxation is solved by either preventing the state of source from taxing particular income or property, while in the case it is allowed to do so, the state of residence is obliged to alleviate double taxation.⁹ The non-discrimination article (Art. 24) can be described as a dissonant element of the OECD Model Tax Convention, as it, contrary to its other provisions, does not stipulate a technical rule relevant for the taxation of a particular form of income and property, but an overreaching principle to which any such taxation must adhere. Furthermore, Art. 24 of the OECD Model Tax Convention is not a coherent legal norm, but a heterogeneous compilation of prohibitions of various forms of discrimination, which are not always interrelated. Namely, in it we find a general prohibition of discrimination of taxpayers based on nationality, followed by non-discrimination provisions addressing quite specific situations (non-discrimination of stateless persons,¹⁰ permanent establishment non-discrimination,¹¹ non-discrimination in deductibility of expenses,¹² capital ownership non-discrimination¹³). Thus, the described structure of the non-discrimination provision of the OECD Model Tax Convention enables us to separately analyze specific forms of prohibited discrimination.

The initial nationality non-discrimination provision found in Art. 24 of the 1963 OECD Draft Double Taxation Convention on Income and Capital stated:

Korea, Kuwait, Latvia, Libya, Lithuania, Macedonia, Malaysia, Malta, Moldova, Montenegro, Netherlands, Norway, Pakistan, Poland, Qatar, Romania, Russia, Sri Lanka, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tunisia, Turkey, Ukraine, United Arab Emirates, United Kingdom and Vietnam.

⁸ See: *OECD Model Tax Convention on Income and on Capital – Full Version*, I-5 – I-7.

⁹ See: *Ibid.*, I-7 – I-8.

¹⁰ Art. 24.2 of the OECD Model Tax Convention.

¹¹ Art. 24.3 of the OECD Model Tax Convention.

¹² Art. 24.4 of the OECD Model Tax Convention.

¹³ Art. 24.5 of the OECD Model Tax Convention.

“The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirements connected therewith which is other of more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

The term “national” 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.”

At first glance the cited provision may be deemed as irrelevant in the international tax environment. Most countries in the world (with the notable exception of the United States of America) do not use nationality of the taxpayer as a factor relevant for determining tax obligations.¹⁴ Therefore, we will almost never find a case wherein two taxpayers are subjected to a different tax treatment explicitly due to their respective nationality. The tax residence of individuals, which determines whether they are subject to unlimited tax liability in a particular country, or to source based taxation only, will be decided based on criteria which do not include nationality.¹⁵ In the case of legal persons, partnerships and associations the conclusion is somewhat more complicated due to the fact that the same criteria may be used for tax residence as they are for deriving their legal status as such under respective national legislations.¹⁶ Two main issues may be drawn from the nationality non-discrimination provision of the 1963 OECD Draft Double Taxation Convention on Income and Capital:

- a) While overt nationality discrimination of individuals is only a theoretical possibility, does this rule encompass covert nationality discrimination? Namely, in the case of individuals’ tax residence, criteria usually include domicile and habitual abode and quite often it may be that tax residents are in fact also nationals of a particular state. Thus, despite the fact that domestic tax legislation does not differentiate on the basis of nationality, the outcome of its norms may lead to nationality discrimination.
- b) Is tax residence a factor which must be taken into account independently, regardless of the fact that the criterion used for its

¹⁴ See: D. Popović, *Poresko pravo*, Pravni fakultet Univerziteta u Beogradu, Beograd 2013, 225–226.

¹⁵ See: L. Cerioni, “Tax Residence Conflicts and Double Taxation: Possible Solutions?”, *Bulletin for International Taxation*, Vol. 66, 12/2012, 647.

¹⁶ See: D. Popović, 230.

ascertainment is identical to the one used for nationality purposes? E.g. what if a legal entity derives its status from the laws of the state in which it has been incorporated, while that same state uses the place of incorporation criteria for determining tax residence?

The two posed dilemmas essentially come down to determining when two taxpayers are in the same circumstances, and which elements must be taken into account when deciding on the comparability of those circumstances. In order to clarify our conclusion we may use a simple example. Assume that national legislation of a particular country deems as tax residents individuals who have their domicile in its territory. Dividend income of resident taxpayers is taxed at a rate of 10%, while non-residents are subjected to a rate of 20% on the same type of income. Resident taxpayers are obliged to pay tax on their worldwide dividends, while non-residents have that duty only with respect to the dividends distributed by companies established in that country. Resident individual A and non-resident individual B receive dividends from a company established in that particular country.

First we must wonder are there any objective differences, apart from residence, which justify the variation in the tax treatment of individuals A and B regarding the dividends received from the same company? The described cedular system of taxation leaves little room to argue the existence of any objective differences between resident and non-resident taxpayers.¹⁷ Accordingly, if residence is not a factor which can be included in the same circumstances analysis, then we are faced with the question of whether this is a case of covert discrimination, provided that we conclude that the overall majority of tax residents of the country in question are at the same time its nationals. If we apply our example to persons other than individuals, where the legislation of this particular country uses the same criteria for deriving their legal status, as it does for tax residence, then the crucial issue for determining the presence of discriminatory treatment is whether tax residence is a particular circumstance which must be taken into account for the purposes of comparability. Notably, with respect to persons other than individuals we would not even have to consider the applicability of Art. 24 1963 OECD Draft Double Taxation Convention on Income and Capital to covert discrimination, as

¹⁷ In a cedular income tax system particular types of income are taxed by virtue of designated tax forms which usually prescribe proportional tax rates. E.g. employment income is subject to a Salary Tax, while dividends are subject to Capital Income Tax. As the taxpayer's overall ability to pay is irrelevant for tax purposes, no general expenses (expenses which are not related to the generation of any specific type of income, but to his personal circumstances – children's school fees, medical expenses, mortgage payments, etc.) can be claimed in a cedular income tax system. Thus, effective tax rates remain unchanged regardless of the amount of taxable income.

our example would represent a clear case of overt nationality discrimination.

Depending on the interpretation we apply, the nationality non-discrimination provision of Art. 24 of the 1963 OECD Draft Double Taxation Convention on Income and Capital has the potential to undermine the fundamentals of international tax law. E.g. most countries in the world will not tax dividends received by resident companies from other resident distributors, but will levy a withholding tax in case a resident company distributes dividends to a non-resident one.¹⁸ If tax residence is not a “circumstance” of a taxpayer, while identical criteria are used for deriving legal status (i.e. nationality) and for tax residence of companies, than the described taxation of dividends represents prohibited nationality discrimination under Art. 24.1 of the 1963 OECD Draft Double Taxation Convention on Income and Capital. In case of individuals we may be dealing with prohibited forms of nationality discrimination, only if we extend the application of the respective rule to cover covert discrimination.

The general and somewhat esoteric nature of the nationality non-discrimination provision of Art. 24.1 of the 1963 OECD Draft Double Taxation Convention on Income and Capital was most likely the reason why taxpayers were slow to realize its full potential. It was the development of non-discrimination based case law of the ECJ in the area of direct taxation, which started in the 1980’s,¹⁹ which brought to light the possibilities which may arise from the application of non-discrimination norms in double taxation treaties. However, the OECD member states promptly reacted to this threat.

2. NATIONALITY NON-DISCRIMINATION IN THE OECD MODEL TAX CONVENTION AFTER 1992

In 1992 the wording of Art. 24.1 of the OECD Model Tax Convention was amended in a attempt to give tax residence the crucial relevance in determining if two taxpayers are in the same circumstances:

“Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirements connected therewith, which is other or more burdensome than the taxation and connected

¹⁸ E.g. Art. 25, para. 1 and Art. 40, para 1 of the Serbian Corporate Income Tax Law, *Official Gazette of the Republic of Serbia*, No. 25/01, 80/02, 80/02, 43/03, 84/04, 18/10, 101/11, 119/12, 47/13, 108/13 and 68/14.

¹⁹ See: M. C. Bennett, “The David R. Tillinghast Lecture Nondiscrimination in International Tax Law: A Concept in Search of a Principle”, *The Tillinghast Lecture 1996 – 2005*, NYU School of Law, New York 2007, 411–412.

requirements to which nationals of that other State in the same circumstances, *in particular with respect to residence*, are or may be subjected.”

In principle, by adding that residence must be given particular importance when deciding if two taxpayers are in the same circumstances, the authors of the OECD Model Tax Convention closed the doors to some of the dilemmas which existed in the past. A resident and a non-resident are not in comparable circumstances and thus Art. 24.1 of the OECD Model Tax Convention is limited to prohibiting only overt nationality based discrimination, which, as we have already stated, is at least in the case of individuals, only a theoretical possibility. However, the ultimate relevance given to tax residence in determining the comparability of taxpayer’s circumstances may be accepted in rare circumstances. Only in completely synthetic global income tax systems, which prescribe progressive tax rates and alleviate double taxation by applying a tax credit mechanism, can we recognize the objective divide between resident and non-resident taxpayers. Namely, in such a tax system the economic strength (ability to pay) relevant for taxation of resident and non-resident taxpayers is incomparable, warranting the differences in their treatment as justified. In the case of tax residents it is their overall ability to pay which will govern the extent of their tax obligations, while in the case of non-residents this factor will not be of relevance. On the other hand, in cedular or dual income tax systems, equation between these two categories of taxpayers may be reached more easily, as in them the importance of the taxpayer’s ability to pay for the purpose of taxation significantly diminishes even in the case of residents. Our conclusion becomes more relevant when we note that completely synthetic global and progressive income tax systems relying on the credit method for avoiding double taxation are virtually extinct in the world today. Therefore it would be more precise to state that residence should be given a considerable role in determining the comparability of taxpayer’s circumstances, but that it cannot be an unconditional divide, as much depends on the overall tax environment within which we observe the respective taxpayers. However, the Commentary of the OECD Model Tax Convention chooses to give tax residence the role of an insurmountable obstacle, and adopts a position under which resident and non-resident taxpayers are never in comparable circumstances.²⁰

One would have to ask what to do in the case of the multitude of double taxation treaties which are still in force and were drafted based on the versions of the OECD Model Tax Convention prior to 1992, thus lacking the explicit reference to residence as the deciding element in de-

²⁰ See: Para. 7 of the Commentary on Art. 24 of the OECD Model Tax Convention.

termining the comparability of taxpayer's circumstances. The Commentary of the OECD Model Tax Convention attempts to solve this issue by stating that the 1992 addition – *in particular with respect to residence* – is no more than a clarification, and that the same reverence should be paid to the issue of tax residence regardless of the version of the OECD Model Tax Convention after which a particular double taxation treaty has been tailored (the 1963 OECD Draft Double Taxation Convention on Income and Capital or the 1977 OECD Model Double Taxation Convention on Income and on Capital).²¹

Faced with a growing volume of non-discrimination case law, the OECD member states (a) used the Commentary in order to close the venues for allowing Art. 24.1 of the OECD Model Tax Convention to be anything more than a very narrow overt nationality based discrimination prohibition. In 2008 several additions were made to the Commentary in order to prevent the further development of broad interpretations of Art. 24.1 of the OECD Model Tax Convention:

- Covert discrimination is not prohibited by Art. 24.1 of the OECD Model Tax Convention. In other words, if the criterion used for determining tax residence allows for even a theoretical possibility that a non-national can be a tax resident, nationality discrimination cannot be invoked.²²
- In the case of persons other than individuals, even if the criterion for tax residence is identical to the one for nationality, it is tax residence which determines the comparability of their circumstances.²³
- Finally, if all else fails, the Commentary undermines the relevance of Art. 24 by making its interpretation subject to all other provisions of the OECD Model Tax Convention.²⁴ Thus the non-discrimination principle is not a general rule which governs the application of other technical rules of taxation found in the OECD Model Tax Convention, but should be applied only in situations which are not covered by them. E.g. if Art. 10 of the OECD Model Convention allows the state of source to tax dividends distributed to non-resident taxpayers, such a right cannot be disputed by virtue of the non-discrimination provision.

²¹ See: *Ibid.*

²² See: Para. 1 of the Commentary on Art. 24 of the OECD Model Tax Convention.

²³ See: Paras. 9 and 17 of the Commentary on Art. 24 of the OECD Model Tax Convention.

²⁴ See: Para. 4 of the Commentary on Art. 24 of the OECD Model Tax Convention.

It would be safe to say that the fear from the potential consequences of Art. 24.1 of the OECD Model Tax Convention lead the OECD member states to introduce into the Commentary interpretations which are highly questionable. Relying on the overwhelming authority of the Commentary, its authors promote a legal approach which can hardly be based on the very nature of Art. 24.1 of the OECD Model Tax Convention, or in sound legal reasoning.²⁵ On the other hand, the threat from denying many of the taxation prerogatives countries have so far taken for granted and in turn tearing down the structure of the global double taxation treaty network, was too great to shy from this temptation.²⁶ Only time will tell if the current state of the Commentary of the OECD Model Tax Convention will “survive” the onslaught of taxpayers and if the courts will be ready to overlook its evident faults. However, at this point in time, the *authorized* approach is that there can be no discussion on the comparability, and therefore discrimination, between a resident and a non-resident taxpayer. On the other hand, it would be important to note, that even if this view were to be changed, it could never reach the opposite extreme of unquestionable comparability of residents and nonresidents.²⁷

3. THE NATIONALITY NON-DISCRIMINATION PROVISION IN SERBIAN DOUBLE TAXATION TREATIES

Serbian double taxation treaties are a notable source of challenges for both scholars and practitioners. Firstly, this area of law is still a *terra incognita* in many ways, due to the fact that we are yet to see any court decisions in the interpretation of double taxation treaties in Serbia. Secondly, as we will show later in some detail, it is often impossible to determine the policy reasons which underline some of the solutions adopted by Serbia in its double taxation treaties.

If we use the nationality non-discrimination provision as a *criterium divisionis*, Serbian double taxation treaties can be separated into three groups.

²⁵ Prior to the 2008 additions to the Commentary the courts in several jurisdictions (logically) interpreted Art. 24.1 of the OECD Model Tax Convention to contain a principle to which all other provision of the OECD Model Tax Convention must adhere. See: *Undisclosed v. Commissioner for Inland Revenue* of 10 March 1992, 54 SATC 456 (T); BFH, Beschluss vom 14.09.1994 – I B 40/94; BFH, Urteil vom 22.4.1998 – I R 54/96.

²⁶ If Art. 24.1 of the OECD Model Tax Convention was given the power to deny countries the prerogative to freely discriminate between residents and non-residents, this would inevitably lead to the renegotiation of most double taxation treaties being applied today and in some cases their termination.

²⁷ In other words, residents and non-residents may be in comparable circumstances, but this has to be confirmed on a case by case basis.

The first group includes the double taxation treaties Serbia applies with Belgium,²⁸ Kuwait,²⁹ Malaysia,³⁰ United Arab Emirates,³¹ and Vietnam,³² which do not contain a provision dedicated to the prohibition of discrimination at all. To these double taxation treaties we can add the one with Germany³³ due to the fact that it prescribes a specific non-discrimination article, which however does not contain a nationality non-discrimination clause.³⁴ In the case of the aforementioned double taxation treaties there can be no discussion on the prohibition of discrimination of taxpayers based on their nationality, but they indicate that neither Serbian policies, nor those of any of its predecessor states, were adamant in respect to the issue of non-discrimination. In other words, Serbia (SFRY and FRY in the past) is ready to accept the exclusion of the non-discrimination article from its double taxation treaties on the insistence of the other treaty partner.

The second, numerically most significant group is made up of those double taxation treaties which do contain a nationality non-discrimination provision, similar to both the OECD Model Tax Convention solution prior to³⁵ and after the 1992 amendments.³⁶ However, within them stand out double taxation treaties with China³⁷ and Sweden³⁸ in whom nationality non-discrimination clauses encompass only individuals and do not relate to the tax treatment of legal persons.

For the purposes of interpreting those Serbian double taxation treaties which follow the OECD Model Tax Convention we should be able to rely on its Commentary, despite the fact that Serbia is not a member of the OECD.³⁹ However, a comparison between the Serbian and English versions of a number of the double taxation treaties falling into this group

²⁸ *Official Gazette of the SFRY – International Agreements*, No. 11/81.

²⁹ *Official Gazette of the FRY – International Agreements*, No. 4/03.

³⁰ *Official Gazette of the SFRY – International Agreements*, No. 15/90.

³¹ *Official Gazette of the Republic of Serbia – International Agreements*, No. 3/13.

³² *Official Gazette of the Republic of Serbia – International Agreements*, No. 7/13.

³³ *Official Gazette of the SFRY – International Agreements*, No. 12/88.

³⁴ See: Art. 25 of the double taxation treaty with Germany.

³⁵ E. g. see: Art. 24.1 of the double taxation treaty with the Netherlands, *Official Gazette of the SFRY – International Agreements*, No. 12/82.

³⁶ E. g. see: Art. 25.1 of the double taxation treaty with Austria, *Official Gazette of the Republic of Serbia*, No. 8/10.

³⁷ *Official Gazette of the FRY – International Agreements*, No. 2/92.

³⁸ *Official Gazette of the SFRY – International Agreements*, No. 7/81.

³⁹ See: D. Popović, S. Kostić, *Ugovori Srbije o izbegavanju dvostrukog oporezivanja – pravni okvir i tumačenje*, Cekos IN, Belgrade 2009, 33.

indicates a much deeper problem. Namely, if we take e.g. double taxation conventions with Hungary,⁴⁰ Greece,⁴¹ Malta,⁴² Spain⁴³ and Switzerland⁴⁴ we see that the English versions of their nationality non-discrimination provisions are identical to the one found in the OECD Model Tax Convention after 1992. On the other hand, the Serbian text of those norms is significantly different, as under it the residence of taxpayers cannot be understood as a crucial circumstance which determines their comparability, but as one of the aspects of taxation in which uniform treatment is required, provided nationals of two contracting states are in similar circumstances.⁴⁵ As the role of residence in interpreting the nationality non-discrimination clause of Art. 24 of the OECD Model Tax Convention is of the utmost importance, the Serbian versions of the aforementioned double taxation treaties show a worrying lack of comprehension of issues on the Serbian side. Namely, we can with some surety confirm that the described difference in the Serbian and English versions of the nationality non-discrimination clauses in the double taxation treaties with Hungary, Greece, Malta, Spain and Switzerland are due to a translation error. The nationality non-discrimination provision of the Serbian Model Tax Convention, a model used by Serbian representatives in negotiating double taxation treaties, is identical to one found in the 1992 OECD Model Tax Convention, while Serbian tax authorities rely on the interpretations of the Commentary for the purposes of applying the aforementioned treaties, regardless of the differences in their Serbian and English versions.⁴⁶ Alas, “blaming the translators” is not of much consolation, as we must note that the Serbian versions of these five double taxation treaties had to be scrutinized by the representatives of the Serbian Ministry of Finance (in case of the double taxation treaty with Hungary – the FRY Ministry for International Economic Relations), the Serbian Government and its

⁴⁰ *Official Gazette of the FRY – International Agreements*, No. 10/01.

⁴¹ *Official Gazette of the Republic of Serbia – International Agreements*, No. 2/98 and 42/09.

⁴² *Official Gazette of the Republic of Serbia – International Agreements*, No. 1/10.

⁴³ *Official Gazette of the Republic of Serbia – International Agreements*, No. 105/09.

⁴⁴ *Official Gazette of the S&M – International Agreements*, No. 11/05.

⁴⁵ Translated into English these norms would state: Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, particularly with respect to residence, 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.

⁴⁶ See: D. Dabetić, *Republika Srbija i izbegavanje dvostrukog oporezivanja – Priručnik za primenu međunarodnih ugovora o izbegavanju dvostrukog oporezivanja*, Računovodstvo d.o.o., Beograd 2008, 191.

support services and finally by the members of the Serbian Parliament and presumably experts who assist them in their work. Thus, wrong translations of financially very relevant international agreements managed to pass three tiers of control without anyone seeing, or being able to see the evident errors. Such a state of affairs duly calls for a serious analysis of the capacities of Serbian administrative and legislative bodies to facilitate its international fiscal policy and even beg the question of whether such a policy exists.

Finally, we come to the third group of double taxation treaties applied by Serbia today, whose non-discrimination provisions are so unique that they require a separate analysis.

4. PROHIBITION OF DISCRIMINATION ON THE BASIS OF RESIDENCE IN SERBIAN DOUBLE TAXATION TREATIES

In the double taxation treaties Serbia applies with Belorussia,⁴⁷ Bulgaria,⁴⁸ Cyprus,⁴⁹ Macedonia,⁵⁰ Norway,⁵¹ Poland,⁵² Romania,⁵³ Russia,⁵⁴ and Sri Lanka,⁵⁵ instead of a nationality based non-discrimination provision, we find the prohibition of unequal treatment on the basis of residence:

*“Residents 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 residents of that other State in the same circumstances are or may be subjected.”*⁵⁶

The cited provision found in 9 Serbian double taxation treaties leads to two important questions:

⁴⁷ *Official Gazette of the FRY – International Agreements*, No. 5/98.

⁴⁸ *Official Gazette of the FRY – International Agreements*, No. 1/99.

⁴⁹ *Official Gazette of the SFRY – International Agreements*, No. 2/86.

⁵⁰ *Official Gazette of the FRY – International Agreements*, No. 5/96.

⁵¹ *Official Gazette of the SFRY – International Agreements*, No. 9/85.

⁵² *Official Gazette of the FRY – International Agreements*, No. 2/98.

⁵³ *Official Gazette of the FRY – International Agreements*, No. 4/96.

⁵⁴ *Official Gazette of the FRY – International Agreements*, No. 3/95.

⁵⁵ *Official Gazette of the SFRY – International Agreements*, No. 4/86.

⁵⁶ See: Art. 25.1 of the double taxation treaty with Belorussia; Art. 25.1 of the double taxation treaty with Bulgaria; Art. 23.1 of the double taxation treaty with Cyprus; Art. 25.1 of the double taxation treaty with Macedonia; Art. 24.1 of the double taxation treaty with Norway; Art. 25.1 of the double taxation treaty with Poland; Art. 26.1 of the double taxation treaty with Romania; Art. 25.1 of the double taxation treaty with Russia; Art. 24.1 of the double taxation treaty with Sri Lanka.

- What are the implications of this diversion from the nationality based discrimination prohibition?
- What are the reasons behind such an approach?

The relevance of a residence based non-discrimination provision cannot be overestimated, particularly when the double taxation treaties which contain it include countries such as Cyprus and Russia, i.e. some of the most relevant inbound foreign investment jurisdictions. It is sufficient to remember that under Art. 10 of the double taxation treaty with e.g. Cyprus, Serbia can subject dividends distributed by its residents to Cypriot resident shareholders to a 10% withholding tax. However, when those same companies distribute dividends to Serbian shareholders – legal entities, no tax is levied. Thus, evidently, Cypriot residents are subjected to more burdensome taxation as compared to Serbian residents in the same circumstances, and such treatment may represent prohibited discrimination. Essentially, the residence based non-discrimination prohibitions threaten all Serbian norms which provide for higher nominal or effective tax rates in case income is generated by non-residents (residents of one of the mentioned 9 treaty partners) as compared to those provided for residents. This implies that they undermine the very foundations of the Serbian international tax system for legal entities which is based on the provisions of Art. 40 of the Serbian Corporate Income Tax Law. In other words, the withholding taxation which is prescribed for non-resident legal entities in Serbia is discriminatory and cannot be applied in its present form in the case of income generated by residents of Belorussia, Bulgaria, Cyprus, Macedonia, Norway, Poland, Romania, Russia, and Sri Lanka.

When one realizes the full potential of the residence non-discrimination provisions found in Serbian double taxation treaties, it is highly surprising that no taxpayer has tried to exploit it so far in Serbia. Such impressions may only be enhanced if we realize that the only defense which may be used to counter this threat effectively, lies in the questionable interpretation derived from Para. 4 of the Commentary on Art. 24.1 of the OECD Model Tax Convention, under which treatment explicitly allowed by a double taxation convention cannot be viewed as discriminatory. The lack of legal actions by taxpayers can only be explained by the quite low level of expertise in international taxation which exists in Serbia and perhaps by the fear that confronting Serbian authorities with the consequences of the residence based non-discrimination norms may lead them to terminate some or all double taxation treaties which contain them.

With respect to the policy reasons which lie behind using residence instead of nationality as the basis for the prohibition of unequal treatment we are to a notable extent in the dark. Comparative academic sources

usually only mention this peculiarity of double taxation treaties concluded by the SFRY and FRY and reference it to a similar approach used by the USSR.⁵⁷ However, in double taxation treaties concluded by the USSR we find the requirement for equal treatment of residents of one contracting state and citizens of the other contracting state or of residents of one contracting state with the residents of third states, but not the one for equal treatment of residents of the two contracting states.⁵⁸

Demirović and T. Popović, citing Arsić, state that due to the fact that the notion of a “national” in Serbian domestic legislation includes only individuals, in older (SFRY and FRY) double taxation treaties residence based non-discrimination provisions were provided in order to encompass legal entities under their protection.⁵⁹ Similar explanations related to the inability to cover persons other than individuals under the term “nationals” have been put forward to explain USSR examples of straying from the nationality non-discrimination norms.⁶⁰ However, in the case of the USSR, alternative non-discrimination provisions were tailored in ways which raise much less controversy and do not open the *Pandora’s box* of equal treatment of residents of two contracting states. Furthermore, we are also faced with examples where the SFRY and FRY, virtually simultaneously with the conclusion of some of the enumerated 9 double taxation treaties, concluded double taxation treaties which dealt with the problem of including legal entities under the scope of nationality non-discrimination provisions in a rather simple manner. E.g., Art. 24.1 of the double taxation treaty with Italy⁶¹ states:

“The nationals of a Contracting State, whether or not they are residents of one of the Contracting States, 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 paragraph shall also apply:

- (a) to legal persons deriving their status as such from the laws in force in Yugoslavia;
- (b) to legal persons, partnerships and association deriving their status as such from the laws in force in Italy.”

⁵⁷ See: J. F. Avery Jones, *et al.*, “The Non-discrimination Article in Tax Treaties”, *European Taxation*, Vol. 31, 10/1991, 311.

⁵⁸ See: *Ibid.*, fn. 6.

⁵⁹ See: D. Demirović, T. Popović, “Serbia”, *Non-discrimination at the Crossroads of International Taxation*, IFA Cahiers de Droit Fiscal International, Vol. 93a, Sdu Fiscale & Financiele Uitgevers, Amersfoort 2008, 525–526.

⁶⁰ See: K. Vogel, 1285–1286.

⁶¹ *Official Gazette of the SFRY – International Agreements*, No. 2/83.

Similarly, in the case of the FRY, we may mention the double taxation treaty with the Ukraine⁶² whose Art. 25.1 provides the following solution:

“Nationals 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 apply also with regard to legal entities possessing their status as such according to the Yugoslav law in force.”

Residence based non-discrimination provisions found in Serbian double taxation treaties can only be explained as a rather ill-conceived attempt to solve a non-existent problem. Namely, the term “national” is rarely attributed to persons other than individuals in numerous comparative jurisdictions, but most of them did not have an issue with accepting the wording of Art. 24.1 of the OECD Model Tax Convention. Including a corresponding provision in a country’s double taxation conventions does not imply giving legal entities the status of nationals under domestic legislation, but merely tailors terminology for the purposes of the proper functioning of an international agreement. Furthermore, the readiness to implement novel and untested solutions in drafting norms whose basic principles were not fully understood (as evidenced in our discussion on the problem of inadequate Serbian translations) testifies to the need to put Serbian double taxation treaty policy under scrutiny and provide its administration with the resources needed to address this fiscally highly relevant area with more care. Academic literature from countries with whom Serbia has concluded double taxation treaties which provide residence based non-discrimination provisions is silent with respect to this anomaly, and we may be bold enough to imply the same criticism to their negotiators and policy makers as we have made in the case of Serbian ones.

5. CONCLUSION

Our venture into the topic of nationality non-discrimination provisions in double taxation treaties showed that this is a legal area which hides a growing potential to undermine state’s power to be unhindered in drafting their international tax legislation. However, controversies which are found in comparative discussions become of secondary importance in the Serbian environment where we witness striking examples of negligence by virtually all responsible parties when it comes to approaching double taxation treaties. Such callousness and lack of awareness of one’s

⁶² *Official Gazette of the FRY – International Agreements*, No. 4/01.

inadequacies, particularly those related to legal expertise, caused Serbian double taxation treaties to provide for residence based non-discrimination, while the majority of the world's tax administrations fought bitterly to prevent even the notion of the possibility of comparing a resident and a non-resident taxpayer. If the true nature of the use of the term "national" (a *terminus technicus* whose implications were limited to the application of a particular double taxation treaty) in double taxation treaties was better understood, perhaps we would not be facing the *Damocles sword* of residence based non-discrimination that we are today. The only thing shielding the Serbian *fiscus* from the grave consequences (i.e. loss of much needed revenue) of the described residence based non-discrimination provisions is the novelty of many international tax issues to Serbian taxpayers as well as tax practitioners and the lack of trust in Serbian courts which drives taxpayers away from litigation. However, Serbia cannot afford to allow norms which may lead enormous amounts of tax revenues away from the coffers of its government to continue to be introduced without any qualified public debate and critical analysis. It is with the call for more public insight into the development and application of the Serbian double taxation treaty policy that we must end our journey, as without it there is little hope that similar issues will not arise in the future as well.