

## **Some Examples of Entry into Force and Effective Date Provisions**

### **Introduction**

Article 31 of the OECD Model Tax Convention on Income and on Capital (the OECD Model) and Article 30 of the UN Model Double Taxation Convention between Developed and Developing Countries (the UN Model) set out the rules for bringing a bilateral tax treaty into force. Both models provide that the treaty will enter into force upon the exchange of instruments of ratification. Neither specifies when the provisions of the treaty will have effect; paragraph 4 of the Commentary on Articles 31 and 32 of the OECD Model (adopted in the Commentary on Articles 30 and 31 of the UN Model) notes that the dates on which a treaty will have effect will “largely depend on the domestic laws of the Contracting States concerned.” This short note therefore sets out some examples of provisions that have been used in actual tax treaties and discusses some of the issues presented.

### **Example 1: Entry into Force by Notification and Delayed Entry into Force**

The following example adopts two variations that are described in paragraph 3 of the Commentary on Articles 31 and 32 of the OECD Model (adopted in the Commentary on Articles 30 and 31 of the UN Model):

1. This Convention shall be approved by each of the Contracting States in accordance with the constitutional provisions thereof, and shall enter into force on the thirtieth day after the date of exchange of notifications stating such approval.

2. The Convention shall apply:

a) in [State A]:

i) for taxes collected by withholding at the source, to taxable sums starting on January 1 of the calendar year following the one during which the Convention entered into force;

ii) for taxes on income that are not collected by means of withholding at the source, and to related income, as the case may be, to any calendar year or fiscal year starting on January 1 of the calendar year following the one during which the Convention entered into force;

iii) for other taxes, to tax assessment generated starting on January 1 of the calendar year following the one during which the Convention entered into force;

b) in [State B]:

i) for taxes collected by withholding at the source, to taxable sums starting on or after January 1 of the calendar year following the one during which the Convention entered into force;

ii) for taxes on income that are not collected by means of withholding at the source, and to related income, to any tax year starting on or after January 1 of the calendar year following the one during which the Convention entered into force.

iii) for other taxes, to taxation pertaining to any tax year starting on or after January 1 of the calendar year following the one during which the Convention entered into force.

First, it provides for entry into force not by exchange of instruments of ratification but through reciprocal notification that the constitutional requirements of each country have been met. Second, it provides for a delay of 30 days in the entry into force of the treaty. The effective date of the various provisions is generally January 1 of the year following entry into force. Before adopting this formulation, negotiators should consider the process by which treaties are approved in their countries and how long that process generally takes. Under this formulation, the later of the two notifications must be provided by 1<sup>st</sup> December or the effective date of the treaty's provisions will be delayed until 1<sup>st</sup> January of the year that begins thirteen months later.

### **Example 2: Entry into Force by Notification and Split Effective Dates**

The following example includes a different effective date with respect to taxes withheld at source, an option noted in paragraph 4 of the Commentary on Articles 31 and 32 of the OECD Model (and adopted in the Commentary on Articles 30 and 31 of the UN Model):

1. This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State. The Contracting States shall notify each other in writing, through diplomatic channels, that their respective applicable procedures have been satisfied.

2. This Convention shall enter into force on the date of the later of the notifications referred to in paragraph 1, and its provisions shall have effect:

a) in respect of taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date on which the Convention enters into force; and

b) in respect of other taxes, for taxable periods beginning on or after the first day of January next following the date on which the Convention enters into force.

As in the first example, this example allows for entry into force through notification, although this provision specifies that such notification must be made through diplomatic channels. This practice

seems advisable as it clarifies that casual notifications are not sufficient to bring the treaty into force, thus reducing the chance of disagreements regarding when the treaty entered into force. In this case, paragraph 2 provides for different effective dates for different types of taxes. This will allow any reductions in withholding rates to take effect quite quickly, while taxes that are imposed on the basis of a taxable year (or taxable period) will not be affected until the next taxable year or period begins. Under this provision, the later of the two notifications can be provided as late as 31<sup>st</sup> December and the provisions of the treaty will apply to taxable years beginning 1<sup>st</sup> January directly following. In that case, any reductions in withholding taxes would be effective as of 1<sup>st</sup> February.

### **Example 3: Effective Dates Tailored to Domestic Law**

As noted above, the Commentaries on both Models note that the effective date provisions may be tailored to the domestic law of a Contracting State. The following is such a provision:

(1) Each of the Contracting States shall notify the other, through diplomatic channels, of the completion of the procedures required by its law for the bringing into force of this Convention. This Convention shall enter into force on the date of the later of these notifications and shall thereupon have effect:

a) in [State A], in respect of [State A] taxes, for any fiscal year beginning on or after 1<sup>st</sup> January next following the date on which this Convention enters into force;

b) in the United Kingdom:

(i) in respect of income tax and capital gains tax, for any year of assessment beginning on or after 6<sup>th</sup> April next following the date on which this Convention enters into force;

(ii) in respect of corporation tax, for any financial year beginning on or after 1<sup>st</sup> April next following the date on which this Convention enters into force:

c) in both Contracting States, in respect of cases falling within paragraph 5 of Article 23 two years after the date upon which this Convention enters into force.

This is the common form of effective date provision for the United Kingdom, which takes into account the different years of assessment and financial years specified in its domestic law. Under these provisions, the treaty could have quite different effective dates in the two signatory countries. For example, if the second of the notifications is given on any date up to 1<sup>st</sup> December, the effective dates for the provisions would be 1<sup>st</sup> January in State A and 1<sup>st</sup> and 6<sup>th</sup> April of the same year. If, however, the second notification is given as early as 1<sup>st</sup> January, its effective date would be the next 1<sup>st</sup> January with respect to State A, but the same 1<sup>st</sup> and 6<sup>th</sup> April with respect to the United

Kingdom. If one of the Contracting States has a generally-applicable taxable year that is not a calendar year, then the Contracting States may want to coordinate the timing of the notifications so as to minimize the differences in entry into force as between the two parties.

#### **Example 4: Administrative Provisions**

Examples that focus on the year in which income is paid or taken into account may not provide a clear rule with respect to certain administrative provisions. Note, for example, that subparagraph (c) in Example 3 provides a delayed effective date with respect to the treaty's arbitration provision.

On the other hand, particularly in the case of a new treaty, the Contracting States may want to clarify that information may be exchanged immediately, even with respect to taxable years or periods that are not affected by the treaty. The following example so provides:

Notwithstanding the provisions of paragraph 2, the provisions of Article 24 (Mutual agreement procedure), Article 25 (Exchange of information) and Article 26 (Assistance in the collection of taxes) shall have effect from the date of entry into force of this Convention, without regard to the taxable period to which the matter relates.

#### **Example 5: Replacement Treaties**

If a new tax treaty is replacing an existing treaty, it is common in the entry into force provision to include a paragraph that effectively terminates the prior treaty. The following is an example of such a provision:

The Convention between [State A] and [State B], signed at [ ] on [ ], (hereinafter referred to as "the prior convention") shall cease to have effect in relation to any tax from the date upon which this Convention has effect in respect of such tax in accordance with the provisions of paragraph 2 of this Article. The prior Convention shall terminate on the last date on which it has effect in relation to any tax in accordance with the foregoing provisions of this paragraph.

If the replacement treaty is less favorable to taxpayers in certain ways, the negotiators may agree to allow the more favorable provisions of the prior treaty to continue to apply (but only of course for those taxpayers that were benefiting from them). Where the taxpayer is an individual, it may be appropriate to allow that individual to continue to claim the benefits of the old treaty indefinitely, in order not to cause hardship. For example:

Notwithstanding the entry into force of this Convention, an individual who was entitled to benefits of Article 17 (Teachers), Article 18 (Students and Trainees) or Article 19 (Government Functions) of the [prior treaty] at the time of the entry into force of this Convention shall continue to be entitled to such benefits until such time as the individual would cease to be entitled to such benefits if the [prior treaty] remained in force.

In other cases, the language of the relieving provisions themselves may not change, but the replacement treaty might include a limitation on benefits provision or other anti-treaty-shopping provision, which would cause the taxpayer (more likely to be a company) to lose benefits that it enjoyed under the previous treaty. In this case, it may be fair to give the taxpayer some time to restructure itself or its transactions. For example:

Notwithstanding [the termination paragraph], where any person entitled to benefits under the prior Convention would have been entitled to greater benefits thereunder than under this Convention, the prior Convention shall, at the election of such person, continue to have effect in its entirety with respect to that person for a twelve-month period from the date on which the provisions of this Convention otherwise would have effect under [the general effective date provision] of this Article. The prior Convention shall terminate on the last date on which it has effect in relation to any tax in accordance with the foregoing provisions of this sub-paragraph.

These two approaches are not necessarily mutually exclusive; they could be combined.