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Colombia may have to grant Most-Favoured-Nation Treatment to some foreign “royalties” as Double Tax Treaty (DTT) with France comes into force

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Probably without noticing it, Colombia did not take into account that signing the recent DTT with France would allow some treaty-covered taxpayers to claim Most-Favoured-Nation (MFN) protection.

Some of Colombia’s DTTs, as the ones signed with Spain, Chile, Switzerland, Portugal and Mexico, include Most-Favoured-Nation clauses with respect to royalties. In this sense, it is important to stress that one of the features of the treaty policy implemented by Colombia in most of its conventions has been to characterize technical services, technical assistance services and consultancy services as royalties, thus subject to Article 12 of DTTs. Moreover, as a general rule, this article attributes the power to tax to both residence and source states, with the limited possibility of applying a maximum tax rate of 10% for the latter.

Nevertheless, the recently signed and soon-to-be enforced DTT with France takes an approach closer to the OECD, excluding the above-mentioned services from the royalties clause and then leaving the income derived from those services covered by either “business profits” or “other income” clauses, depending on the case. This means that the said income, in most cases, will only be taxed in the residence state. In other words, in such a treaty, neither “technical assistance services” nor “technical services” or “consulting services” are considered royalties. It is important to clarify, however, that the Franco-Colombian treaty leaves open, in the source state, the possibility of taxing royalties at a maximum rate of 10%.

Evidently, this Treaty raises the question of what the effect of its content would be on treaties that include Most-Favoured-Nation clauses.

If we go through the treaties that have included MFN clauses applicable to royalties, it is clear that, in general terms, such clauses address the MFN treatment with two different approaches in wording. On the one hand, some treaties refer to the obligation of granting MFN treatment “in the case in which Colombia, after signing the treaties, agreed with a third State an [exemption] or a lower tax rate on royalties”, this being the case for treaties such as with Spain, Chile and Switzerland. Conversely, other treaties such as the one signed between Colombia and Mexico refer to the obligation of granting MFN treatment “in the event that Colombia agreed with a third State a tax rate on royalties applicable to payments for technical assistance and technical services that is less than that stipulated in Article 12 of this Agreement, or considers such payments with a

different nature to that of royalties". The case of the DTT with Portugal is similar to the DTT with Mexico, in that it states that any clause that grants, in a future DTT, a better treatment for technical services, technical assistance services and consultancy services, shall be applicable to the relationships covered by the treaty signed between the two countries.

To resolve the question posed, i.e. whether the Franco-Colombian Tax Treaty has changed the status of technical services, technical assistance services and consulting services in treaties including the MFN clause, we can present two different approaches. Some practitioners or scholars might argue that for the purposes of the debate, we should split the problem between two blocks: The first one covers the cases in which the respective MFN clause refers to the possibility of reducing "the tax rate" of royalties in a future DTT. The second one includes those cases in which the MFN clause refers to the possibility of applying the favourable treaty to both the tax rate and the nature of the income for treaty purposes, or cases that in any way said clause is sufficiently open to cover the different possibilities that may arise in practice.

In this sense, it could be argued that, for example, whenever the treaty containing the MFN clause only refers to reductions in the tax rate, this clause does not have the power to cover situations in which the most favourable treatment derives from a treaty that changes the nature of the payments under analysis. This would be the case with the Franco-Colombian DTT, as it has not lowered the rate for technical services, technical assistance services and consultancy services but has only changed the nature of these payments if compared to other treaties, leaving them with a more favourable treatment from the source-state point of view. According to this position, countries like Spain and Switzerland would not be entitled to claim for MFN treatment, as the corresponding treaties only mention the MFN treatment in cases of a reduction in the tax rate. On the other hand, other treaties would clearly grant MFN protection as long as they are sufficiently broad in spectrum or otherwise expressly state that said protection derives from a change in the tax rate or in the nature of the income by the new and more favourable treaty.

However, we consider this latter approach misleading. Putting aside the statements contained in the treaties, the arguments in favour of applying the MFN clause contained in treaties like the Swiss-Colombian and the Spanish-Colombian ones are without a doubt stronger. When the MFN clauses of said treaties are read, it is clear that the most-favoured-treatment clause has to be understood holistically and should not be fragmented. In this sense, it could be argued that the clauses included in said treaties did indeed refer to a "tax rate" but under the broad definition of royalties that was established in the basic treaties. When reading the MFN clause as a whole and following the principle according to which treaties shall be interpreted in good faith and in the light of the treaty's objectives and purposes as well as the intentions of the contracting parties, it is clear that when the most favourable treatment derives, not from a change in the tax rate but in a change in the nature of the income, the MFN is still applicable. Needless to say, changes in the tax rate are not only derived from a reduced tax rate itself but also from a change in the nature of the income; if such change in nature has the effect of not taxing the services in the new treaty, such treatment has to be extended to treaties that have included the MFN clause.

Furthermore, the MFN clause of the treaties signed by Colombia have been written to address directly a most favoured treatment granted at the source state, which means that the emphasis is left in Colombia when acting as a source country. Although some can argue that this approach is irrelevant, we cannot forget that, in the strictest sense, technical services, technical assistance services and consulting services are not royalties, and their inclusion in Article 12 derives more from the pressure that some countries –and, in this case, Colombia– have put on negotiations in

order to have room to tax these services at source. Without a doubt, this is the reason why other contracting states have accepted the Colombian treaty policy, on condition that if said policy is changed in future DTTs with third parties, they can claim MFN treatment.

We look forward to seeing the approach that the Colombian Tax Administration will take, with respect to the treaties that include MFN clauses for royalty payments.

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