

# PRELIMINARY BRIEFINGS: PROTOCOLS AMENDING TAX TREATIES WITH GERMANY, ESWATINI AND SWITZERLAND

*Presentation to the Standing Committee on Finance*

Presenters: National Treasury and SARS | 1 September 2021



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Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# Officials Present

- Ismail Momoniat, NT, DDG: Tax and Financial Sector Policy
- Yanga Mputa, NT, CD: Legal Tax Design
- Nhlanhla Radebe, NT, Director: Legal Tax Design
- Franz Tomasek, SARS, Head: Legislative Policy
- Morne Van Niekerk, SARS
- Celeste van der Lith, SARS

# Contents

- Purpose of tax treaties
- Overview of the tax treaty process
- Protocol amending tax treaty between South Africa and Germany
- Protocol amending tax treaty between South Africa and Eswatini
- Protocol amending tax treaty between South Africa and Switzerland

# Purpose of tax treaties

- Elimination of double taxation.
- Provide certainty as to when and how tax is to be imposed in a country.
- Mitigate instances of non-taxation, or reduced taxation through tax evasion or avoidance.
- Exchange of information on tax matters between the tax authorities of the two countries.
- Assistance in tax collection between the tax authorities of the two countries.
- Resolution of tax disputes/interpretation between the tax authorities of the two countries.
- Increase economic ties, (for example investment flows) and development between the two countries.

# Overview of the tax treaty process

- The legal framework for the conclusion of a tax treaty in South Africa is governed by section 231 of the Constitution of the Republic of South Africa.
- Negotiations of a tax treaty are done by both National Treasury and SARS.
- After the negotiations are finalised, National Treasury and SARS will provide informal briefings to the SCoF before the signing of a tax treaty.
- Signing of a tax treaty is done by the Minister, after the President has issued a Presidential Minute designating the name of the Minister responsible for signing such a tax treaty.
  - Once a tax treaty is signed, National and Treasury will provide briefings to the SCoF and SECoF for ratification of a tax treaty.
- A tax treaty will only bind South Africa after it has been (ratified) approved by resolution in both the National Assembly and the National Council of Provinces.

# Overview of the tax treaty process

- After ratification, Minutes of Proceedings are obtained from the two houses of Parliament. The Minutes of Proceedings and a Note Verbale are sent through the diplomatic channel advising our counterparts in the other country that the legal and constitutional process required to bring a tax treaty into force in South Africa have been completed.
- The other country will notify South Africa through the diplomatic channels once they have completed their legal and constitutional requirements to bring the Agreement into force.
- On receipt of the notification from the other country through the diplomatic channels, the tax treaty will enter into force between the two countries.
- After that, the tax treaty is published in the Government Gazette and the tax treaty becomes part of the Income Tax Act in terms of section 108 of the Income Tax Act.

# Protocol amending tax treaty between South Africa and Germany



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# Investment flows between South Africa and Germany

- The table below indicates the investments flows between South Africa and Germany in a particular year

R millions	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>South Africa (outward investment)</b>	90 634	63 616	63 029	73 134	466 036	371 282	102 952	169 488	111 664
<b>Germany (inwards investment)</b>	235 930	236 252	243 668	275 056	281 720	291 134	405 098	310 866	306 280

- Outward investment showing amounts South Africa invested in Germany.
- Inward investment showing amounts Germany invested in South Africa.
- Table shows an increase in investments between the two countries signaling a positive economic relationship.



# Background to South Africa/Germany Tax Treaty

- The first tax treaty between South Africa and Germany came into force on 28 February 1975.
- At that time, South Africa was still on source-based system of taxation and did not have capital gains tax system.
- In 2001, South Africa introduced residence-based system of taxation and capital gains tax.
- As a result, the 1975 tax treaty was revised to address the above-mentioned aspects that were not present in that tax treaty.
- The revised tax treaty was signed in Berlin on 9 September 2008.
- South Africa ratified the revised 2008 tax treaty.
- However, the revised 2008 tax treaty is still not yet in force as it has not yet been ratified by Germany.

# Rationale for the protocol amending South Africa/Germany Tax Treaty

- In 2010 South Africa received a request from Germany to renegotiate the 2008 revised tax treaty as follows:
  - change Article dealing with exchange of information
  - add an Article dealing with assistance in tax collection
  - changes to Articles dealing with taxation of pensions, annuities and similar payments as well as taxation of government services.
- In turn, South Africa proposed the following changes to the 2008 revised tax treaty:
  - Article dealing with withholding tax on interest to take into account the announcement by the Minister of Finance in 2010 of the introduction of withholding tax on interest in the South African Income Tax Act. As a result, all tax treaties with zero rate on interest required to be renegotiated.
  - Article dealing with withholding tax rates on interest, dividends and royalties to take into account the announcement by the Minister of Finance in 2012 of the rationalisation of the South African withholding tax regime, thereby increasing all the withholding tax rates for dividends, royalties and interest to 15%.
- Negotiations of the Protocol amending the 2008 DTA between South Africa and Germany took place and the final draft English text of the Protocol was considered finalised by the officials of both South Africa and Germany on 16 October 2019.

# Preamble

- Preamble of the SA-Germany tax treaty explains the objective of elimination of double taxation between the two States.
- The current preamble, which focuses on the elimination of double taxation, is deleted and replaced by a new preamble, taking into account BEPS minimum standard that seeks to stop treaty abuse. This stems from the fact that although tax treaties have played an important role in eliminating double taxation and facilitating globalisation of liberal investment and trade in past decades, the loopholes and mismatches in existing treaties are one of the root causes of widespread unregulated BEPS opportunism.
- The proposed preamble provides for the elimination of double taxation with respect to the taxes covered by this Agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Agreement for the indirect benefit of residents of third States).

# Article 2: Taxes Covered

- Article 2 of the SA-Germany tax treaty deals with taxes covered by the tax treaty.
- Currently subparagraph (b) of paragraph 3 of Article 2 lists normal tax, secondary tax on companies and withholding tax on royalties.
- The proposed changes are based on South Africa's aim to coordinate and streamline all the withholding tax rates applicable to royalties, dividends and interest.
- Subparagraph (b) of paragraph 3 of Article 2 of the Agreement is deleted and replaced by a new subparagraph (b).
- The new subparagraph (b) provides that the Agreement from a South African perspective will apply to the normal tax, the withholding tax on royalties, the dividends tax, the withholding tax on interest and the tax on foreign entertainers and sportspersons.

# Article 5: Permanent Establishment

- Article 5 of the SA-Germany tax treaty contains a general rule regarding the definition of permanent establishment (PE).
- Paragraph 4, (a)-(f) of Article 5 sets out certain exclusions to the PE definition.
- These exclusions should, however, only apply to activities of a purely preparatory or auxiliary character. This deals with the artificial avoidance of permanent establishment status through the specific activity exemptions, which was agreed in the OECD/G20 BEPS Action 7 Report.
- The current paragraph 4 is deleted and replaced by a new paragraph 4.
- The new paragraph 4 provides the following:
  - Updated exclusions to the PE definition.
  - An overall requirement that the exclusions only apply to activities that are of a preparatory or auxiliary nature. (The key criterion in distinguishing between activities that are of a preparatory or auxiliary nature and those that are not, is whether or not the activity of a fixed place of business in itself forms a significant part of the activity of the enterprise as a whole.)

# Article 11: Interest

- Article 11 of the SA-Germany tax treaty deals with taxation of interest.
- The current Article 11 does not provide for a withholding tax rate and does not specify certain exemptions from withholding tax.
- The replacement of Article 11 became necessary due to the introduction by South Africa of withholding tax on interest.
- The current Article 11 is deleted and replaced by a new Article 11 dealing with taxation of interest.
- The new Article 11 provides the following:
  - A right of taxation of interest in the source State, but limits the rate of tax to 5% of the gross amount of the interest, provided that the beneficial owner of the interest is a resident of the other State.
  - Exemptions from withholding tax on interest in respect of the State, Central Banks and for debt instruments listed on recognised stock exchanges. This exemption is in line with domestic law. Paragraph 4 notes the recognised stock exchanges as the JSE and Frankfurt Stock Exchange.

# Article 12: Royalties

- Article 12 of the SA-Germany tax treaty deals with taxation of royalties.
- The current Article 12 does not provide for a withholding tax rate.
- The replacement of Article 12 became necessary due to South Africa's rationalisation of its withholding tax regime, including withholding tax on royalties.
- The current Article 12 is deleted and replaced by a new Article 12 dealing with taxation of royalties.
- The new Article 12 provides the following:
  - A right of taxation of royalties in the source State, but limits the rate of tax to 5% of the gross amount of the royalties, provided that the beneficial owner of the royalties is a resident of the other State.

# Article 13: Capital gains

- Article 13 of the SA-Germany tax treaty deals with the taxation of capital gains.
- The current Article does not address capital gains derived from alienation of shares or interests of entities deriving their value principally from immovable property.
- The current paragraph 2 of Article 13 of the tax treaty is deleted and replaced by a new paragraph 2.
- The new paragraph 2 provides the following:
  - Gains arising from the alienation of shares in a company or comparable interests (such as interests in a partnership or trust), deriving more than 50% of their value directly or indirectly from immovable property located in a State, may be taxed in that State.
  - The measurement of the 50% over the 365 days preceding alienation to address a situation in which assets are contributed to an entity shortly before the alienation in order to dilute the proportion of the value that is derived from immovable property.



# Article 17: Pensions, Annuities and Similar Payments

- Article 17 of the SA-Germany tax treaty deals with the taxation of pensions, annuities and similar payments.
- The current paragraph 1 of Article 17 of the German text of the tax treaty is deleted and replaced with the new wording.
- The new paragraph 1 clarifies the German text of the main tax treaty. The English text remains unchanged.

# Article 18: Government Service

- Article 18 of the SA-Germany tax treaty deals with the taxation of government service.
- Paragraph 6 is added to Article 18.
- Paragraph 6 provides that salaries, wages and other similar remuneration as well as pensions paid by the Association of Chambers of Industry and Commerce for services by individuals to the SA-German Chamber of Commerce and Industry from government funds shall be taxable only in the State which pays the salary, wages and other similar remuneration as well as pensions.

# Article 22: Elimination of Double Taxation

- Article 22 of the SA-Germany tax treaty deals with elimination of double taxation.
- The current paragraph 1 of Article 22 is deleted and replaced by a new paragraph 1.
- The current paragraph 2 of Article 22, which provides for the manner in which South Africa will provide relief in cases of double taxation to its residents, remains unchanged.
- The new paragraph 1, which relates to the position of Germany on the elimination of double taxation with regards to its residents, has been updated in line with their domestic law or treaty policy.
- Paragraph 3 of Article 22 is deleted, as it refers to paragraphs in Article 10 that have now been replaced by a new Article 10.

# Article 23: Non-discrimination

- Article 23 of the SA-Germany tax treaty deals with non-discrimination.
- Paragraph 5 of Article 23 permits a branch profits tax that may be 5% higher than the normal tax rate.
- Following the repeal of the secondary tax on companies and its replacement by a withholding tax on dividends tax, South Africa no longer imposes a higher branch profits tax.
- The current paragraph 5 is deleted and the current paragraph 6 is renumbered as paragraph 5.

# Article 25: Exchange of Information

- Article 25 of the SA-Germany tax treaty deals with exchange of information.
- The current Article 25 does not provide for the exchange of information for taxes of any kind or description, automatic exchange of information and the exchange of banking information.
- The current Article 25 is deleted and replaced by a new Article 25 dealing with exchange of information.
- In accordance with current international standards, the new Article authorises full exchange of information including automatic exchanges.
- The new Article provides as follows:
  - Exchange of information is not restricted by Articles 1 and 2 of the tax treaty. Thus, should South Africa obtain tax information relating to a resident of a third State who is liable for tax in Germany, it may make that information available to Germany and vice versa.

# Article 25: Exchange of Information

- A State is obliged to exchange information even in cases where the requested information is not needed by that State for domestic tax purposes. In addition, a State cannot decline to supply information solely because it has no domestic interest in such information.
- The requested State shall not decline to supply information to the requesting State solely because the requested information is held by a bank or other financial institution. In addition, the requested State shall not refuse to supply the requested information on grounds that the information is held by persons acting in an agency or fiduciary capacity or because the information relates to an ownership interest in a person.

# Article 25a: Assistance in the Collection of Taxes

- Article 25a of the SA-Germany tax treaty deals with assistance in the collection of taxes. Under this new Article the two States are empowered to collect taxes on behalf of each other.
- This is a new Article and provides as follows:
  - States will lend each other assistance in the collection of revenue claims and will not be restricted by Articles 1 and 2. The mode of application may be settled by the competent authorities of the States.
  - Defines the term “revenue claim”.
  - The competent authority of a State may arrange for a revenue claim, proved to be payable in that State, to be collected by that other State in terms of its domestic law.
  - A State shall take measures to protect the collection of revenue claims (measures of conservancy) if approached to do so by the competent authority of the other State even if, at the time such measures are applied, the revenue claim is not enforceable in the other State or the person by whom it is owed has a right to prevent its collection.

# Article 25a: Assistance in the Collection of Taxes

- A revenue claim, accepted in terms of paragraphs 3 and 4 shall not be subjected to time limits or given any priority due to its nature as such. If the other State has domestic law giving such priority, this will not be taken into account.
- No legal or court action concerning the existence, validity or amount of a revenue claim shall be instigated in the State of collection.
- When request in respect of a revenue claim has been made by a State to the other State in terms of paragraph 3 or 4, and such claim is rescinded in the requesting State, the competent authority of the requesting State shall promptly notify the competent authority of the other State of this fact.
- This Article must not be construed as imposing an obligation:
  - to carry out administrative measures at variance with the laws or administrative practice of either State;
  - contrary to public policy;
  - to provide assistance if the requesting State has not pursued all reasonable measures under its own domestic law for collection;
  - if the administrative burden is clearly disproportionate to the benefit derived by the requesting State.



# Article 26: Limitation of Benefits

- Article 26 of the SA-Germany tax treaty deals with limitation of benefits.
- The OECD/G20 BEPS Action 6 Report includes three alternative rules to address treaty abuse. The second is a general anti-abuse rule based on the principal purpose of transactions or arrangements.
- A new paragraph 1 is inserted before the existing paragraph 1 of Article 26.
- The new paragraph introduces a general anti-abuse rule based on the principal purpose of transactions or arrangements.
- The previous paragraphs 1 and 2 of Article 26 are renumbered as paragraphs 2 and 3.

# Article 29: Entry into Force

- Article 29 of the SA-Germany tax treaty deals with entry into force.
- The current paragraph 3 of Article 29 of the German text of the tax treaty is deleted and replaced by a new paragraph 3, as paragraph 3 refers to the 1973 DTA which will be replaced by the DTA signed in 2008.

# Amendment of the Current Protocol to the South Africa/ Germany tax treaty

- The proposed amendment deals with amendments made to the provisions in the current Protocol, insertion of new paragraphs and renumbering of the existing paragraphs.
- Clarification on Article 7 dealing with taxation of business profits, that payments received as a consideration for technical services, including studies or survey of a scientific, geological or technical nature, or for engineering contracts including blueprints related thereto, or for consultancy or supervisory services shall be deemed to be payments to which the provisions of Article 7 (dealing with taxation of business profits) apply.
- Clarification on paragraph 3 of Article 11 dealing with interest arising in South Africa and paid in consideration of a loan guaranteed by the German Government in respect of export or foreign direct investment or paid to the Kreditanstalt für Wiederaufbau or the DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH shall be exempt from South Africa tax.

# Effective date

- This Amending Protocol shall be ratified and the instruments of ratification shall be exchanged at Pretoria as soon as possible.
- This Amending Protocol shall enter into force together with the tax treaty.

# Protocol amending tax treaty between South Africa and Eswatini



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# Investment flows between South Africa and Eswatini

- The table below indicates the investments flows between South Africa and Eswatini in a particular year.

R millions	2015	2016	2017	2018	2019
<b>South Africa (Outward investment)</b>	16 870	14 564	16 152	14 910	16 342
<b>Eswatini (Inward investment)</b>	23 441	25 122	45 986	33 994	40 088

- Outward investment showing amounts South Africa invested Eswatini.
- Inward investment showing amounts Eswatini invested in South Africa.

# Rationale for the protocol amending South Africa/Eswatini Tax Treaty

- South Africa and Eswatini (Swaziland) tax treaty came into force on 8 February 2005.
- The rationale for the protocol amending South Africa and Eswatini tax treaty is the following:
  - Name change from Swaziland to Eswatini.
  - Replacement of Article 25, dealing with exchange of information, to take into account recent changes in international standards.

# Article 3: General Definitions

- Article 3 of the SA-Eswatini tax treaty deals with the general definitions.
- The current subparagraph (f)(i) of paragraph 1 of Article 3 defines the term “**competent authority**” to mean: “in the case of Swaziland, the Commissioner of Taxes or an authorised representative”
- The updated subparagraph (f)(i) defines the term “**competent authority**” to mean: “in the case of Eswatini, the Commissioner-General, Eswatini Revenue Authority or an authorised representative of the Commissioner-General”.
- In addition, the updated subparagraph (f)(ii) clarifies in the case of South Africa, that an authorised representative means an authorised representative of the Commissioner.



# Article 25: Exchange of Information

- Article 25 of the SA-Eswatini tax treaty deals with exchange of information.
- Article 25 of the Agreement is deleted and replaced by the new Article on Exchange of Information.
- This new Article is in line with the updated OECD Model and extends to taxes of every kind and description.
- The new Article ensures that bank secrecy or the absence of a domestic tax interest can no longer be used to deny a request for exchange of information.
- The new Article also allows information received by a State to be used for other purposes when the competent authority of the supplying State authorises such use and such use is allowed under the laws of both States.

# Effective date

- Each of the States shall notify to the other in writing, through the diplomatic channel, of the completion of the procedures required by its law for the bringing into force of this Protocol.

# Protocol amending tax treaty between South Africa and Switzerland



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# Investment flows between South Africa and Switzerland

- The table below indicates the investments flows between South Africa and Switzerland in a particular year

R millions	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>South Africa (outward investment)</b>	55 454	56 024	78 590	63 174	58 922	46 040	56 938	314 678	325 848
<b>Switzerland (inward investments)</b>	152 236	233 370	151 654	176 878	203 514	165 672	191 546	175 036	156 270

- Outward investment showing amounts South Africa invested in Switzerland
- Inward investment showing amounts Switzerland invested in South Africa
- Table also shows an increase in investments between the two countries signaling a positive economic relationship.
- South Africa as an emerging market invested in Switzerland more than Switzerland invested in South Africa in 2018 and 2019. Further strengthening the investment relationship between the two countries.

# Background to South Africa/Switzerland Tax Treaty

- The first tax treaty between South Africa and Switzerland came into force on 11 July 1968.
- At that time, South Africa was still on source-based system of taxation and did not have capital gains tax system.
- In 2001, South Africa introduced residence-based system of taxation and capital gains tax.
- As a result, the 1968 tax treaty was revised to address the above-mentioned aspects that were not present in that tax treaty.
- The revised tax treaty came into force on 27 January 2009.

# Rationale for the protocol amending South Africa/Switzerland Tax Treaty

- The rationale for the protocol amending South Africa and Switzerland tax treaty is the following:
  - Changes to Article 10, dealing with taxation of dividends and replacement of Article 12, dealing with taxation of royalties to take into account the announcement by the Minister of Finance in 2012 of the rationalisation of the South African withholding tax regime, thereby increasing all the withholding tax rates for dividends, royalties and interest to 15%.
  - Replacement of Article 18, dealing with taxation of pensions, to allow for equal and reciprocal treatment of contributions.
  - Replacement of Article 22, dealing with elimination of double taxation, to take account of changes in Swiss domestic and treaty policy on Swiss residents.
  - Replacement of Article 25, dealing with exchange of information, to take into account changes in international standards.

# Article 3: General Definitions

- Article 3 of the SA-Switzerland tax treaty deals with the general definitions.
- Subparagraph (e)(ii) of paragraph 1 of Article 3 defines the term “competent authority” to mean: “ in the case of Switzerland, the Director of the Federal Tax Administration or an authorised representative of the Director”
- The current subparagraph (e)(ii) is deleted and replaced by a new subparagraph (e)(ii).
- The new subparagraph (e)(ii) defines the term “competent authority to mean: “in the case of Switzerland, the Head of the Federal Department of Finance or his authorised representative;”

# Article 10: Dividends

- Article 10 of the SA-Switzerland tax treaty deals with taxation of dividends.
- The current subparagraphs (a) and (b) of paragraph 2 of Article 10 of the current tax treaty are deleted and replaced by new subparagraphs (a) and (b).
- These subparagraphs set out the withholding tax rates on dividends.
- The rates for withholding tax vary widely internationally.
- The new subparagraphs (a) and (b) specify the following rates:
  - 5% of the gross amount of the dividends, if the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividends (currently 5%, with a 20% shareholding), or
  - Limited to a rate of 10% in all other cases (currently 15%).



# Article 12: Royalties

- Article 12 of the SA-Switzerland tax treaty deals with taxation of royalties.
- The current version of Article 12 does not permit source State taxation of royalties.
- The current Article 12 is deleted and replaced by a new Article 12.
- The new Article 12 introduces a right of taxation of royalties in the source State, but limits the rate of tax in the Source State to 5% of the gross amount of the royalties, provided that the beneficial owner of the royalties is a resident of the other State.

# Article 18: Pension

- Article 18 of the SA-Switzerland tax treaty deals with the treatment of pensions and pension contributions.
- Both the current and new versions of Article 18 allow for a shared right to tax pensions and other similar remuneration.
- The current Article 18 is deleted and replaced by a new Article 18.
- The new Article 18 introduces an additional paragraph which ensures that contributions to a pension fund or similar institution are treated in the other State in the same way and subject to the same conditions and limitations as contributions made to a pension scheme that is recognised for tax purposes in that other State. This allows for equal and reciprocal treatment of contributions.

# Article 22: Elimination of Double Taxation

- Article 22 of the SA-Switzerland tax treaty deals with the actual mechanisms for the elimination of double taxation.
- The current Article 22 is deleted and replaced by a new Article 22 on elimination of double taxation.
- The current paragraph 1 of Article 22, which provides for the manner in which South Africa will provide relief in cases of double taxation to its residents, remains unchanged.
- The new paragraph 2, which relates to the position of Switzerland on the elimination of double taxation with regards to its residents, has been updated in line with their domestic law or treaty policy.

# Article 25: Exchange of Information

- Article 25 of the SA-Switzerland tax treaty deals with exchange of information.
- The current Article 25 only allows for the exchange of information concerning tax fraud in relation to taxes which are the subject of the Convention.
- The current Article 25 is deleted and replaced by a new Article 25.
- The new Article is in line with the updated OECD Model and provides as follows:
  - It extends to taxes of every kind and description.
  - Bank secrecy or the absence of a domestic tax interest can no longer be used to deny a request for exchange of information.
  - Information received by a State to be used for other purposes when the competent authority of the supplying State authorises such use and such use is allowed under the laws of both States.

# Article 4 (Article VII): Protocol

- The existing Protocol under the current tax treaty has also been updated to provided clarity in relation to certain Articles. The current paragraphs are replaced as the Articles to which they provide clarity on have also been updated or replaced.
- The current paragraph 1 under the existing Protocol to the tax treaty is deleted and replaced by a new paragraph 1 which provides clarity regarding the term “resident of a Contracting State” under Article 4.
- It is clarified that this term includes,
  - a recognised pension fund or pension scheme in that Contracting State and
  - an organisation that is established and operated exclusively for public benefit and that is a resident of a Contracting State.

# Article 18 (Article VIII)

- The current paragraph 2 of the existing Protocol to the tax treaty is deleted and replaced with a new paragraph 2.
- The updated paragraph 2 provides that the term “other retirement benefits” in Article 18 includes; in South Africa, payments made by retirement annuity funds and, in Switzerland, payments from tied individual savings accounts.
- It is further clarified that income as referred to in Article 18 also includes lump sum payments .

# Article 25 (Article IX): Protocol

- The current paragraph 3 of the existing Protocol to the tax treaty is deleted and replaced by a new paragraph 3.
- The Article clarifies the operational aspects of Article 25 and provides for the following:
  - That exchange of information will only be requested once a State has exhausted all its normal sources of information under its internal taxation procedure.
  - A list of the information that must be provided by the competent authorities of a State when making a request for information under Article 25.
  - Clarifies that the purpose of referring to information that may be foreseeably relevant is intended to provide for exchange of information in tax matters to the widest possible extent without allowing for “fishing expeditions” by States.
  - Clarifies that the States are not required to exchange information under Article 25 on an automatic or spontaneous basis.
  - Clarifies that the administrative procedural rules regarding taxpayers’ rights as provided for in the requested State remains applicable.

# Effective date

- Each of the States shall notify to the other in writing, through the diplomatic channel, of the completion of the procedures required by its law for the bringing into force of this Protocol.



# THANK YOU

