L&P

Newsletter Nr. 185 (EN)

The OECD Model Tax Convention and Commentary and BEPS

June 2017

All rights reserved © Lorenz & Partners 2017

Although Lorenz & Partners always pays great attention on updating information provided in newsletters and brochures we cannot take responsibility for the completeness, correctness or quality of the information provided. None of the information contained in this newsletter is meant to replace a consultation with a qualified lawyer. Liability claims regarding damage caused by the use or disuse of any information provided, including any kind of information which is incomplete or incorrect, will therefore be rejected, if not generated deliberately or grossly negligent.

I. Introduction

The Organization for Economic Co-operation and Development ("**OECD**") published a new edition of its *condensed Income and Capital Model Convention and Commentary* (the ninth edition) in 2014 which can be found here.

More than 3,000 double tax agreements exist worldwide, and at least 70-80 % of them follow the OECD Model. The Convention and its Commentary is generally used to interpret the provision of any Double Tax Agreement ("**DTA**").

The 2014 update notably includes the following:

- Clarification concerning the meaning of **"Beneficial Owner"**;
- Changes in Article 26 **(Exchange of Information)**;
- Revised discussion draft on tax treaty issues related to Emissions Permits and Credits;
- Clarification on the application of Article 17 **(Entertainers and Sportspersons)**;
- Treatment of **Termination Payments** (income from employment).

The update reflects the work carried out between 2010 and the end of 2013. It does not yet include work concerning the Base Erosion and Profit Shifting ("**BEPS**").

II. The 2014 update

1. Beneficial Owner

The concept of "beneficial owner" was introduced to clarify what is meant by the term "paid to a resident" found in Articles 10, 11, and 12 of the OECD Model (dividends, interest, and royalties, respectively) to determine whether the recipient of such incomes is entitled to treaty benefits (against the interposing of artificial intermediary in a treaty partner state to receive income on its behalf).

The notion of beneficial owner has received various interpretations by courts and tax administrations which raised risk of double taxation or non-taxation.

To prevent such situations and harmonize the beneficial owner interpretation, the updated 2014 Commentary states that the term "beneficial owner" has an international tax treaty meaning (autonomous meaning) and should not be interpreted in the light of any domestic law of a specific country (such as the meaning that it has under the trust law of many common law countries). It should therefore be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

The "beneficial owner" is the one who has the [final] right to use and enjoy the dividend, interest, or royalty without any contractual or legal restrictions to pass on its dividend or interest.

2. Exchange of Information

The OECD Model Tax Convention and its Commentary establish an international standard for the exchange of tax information between the tax authorities in the countries of the DTA.

The Commentary explicitly allows the "group requests" (possibility for the tax administrations to ask for information on a group of taxpayers without naming them individually) as long as the request is not a "fishing expedition". The 2014 update aims to strengthen the capacity for the tax administrations to fight tax avoidance.

It also contains new interpretations of the standard of "likely relevance" and proposes to the parties of a DTA to optionally set a time limit within which the information shall be provided.

Following the US Foreign Account Tax Compliance (FATCA) regime and the G5 (the largest West European countries: France, Germany, Italy, Spain and UK) statement issued on 19 March 2014 for the implementation on a global standard for automatic exchange of information involving 44 states and starting 2017, a large number of states as well as the European Union will have to change their laws to implement and allow information exchange with greater levels of disclosure.

3. Emission Permits and Credits

Following a Discussion Draft related to emissions permits and credits, the 2014 update has clarified the classification of such income.

The tax treatment of the income from the emission permits and credits disposal by a resident of a contracting state can be covered by the following articles of the OECD Model Tax Convention:

- Article 7 (business profit);
- Article 8 (Shipping, Inland Waterways Transport and Air Transport);
- Article 13 (Capital Gains); or
- Article 21 (Other Income).

Nevertheless, in case of agriculture and forestry enterprises, such income may also fall within the scope of Article 6 (Income from Immovable Property). The 2014 update includes in its Commentary to Article 6 a reference to the income derived from the trading of emissions permits and credits.

4. Entertainers and Sportspersons

Article 17 of the OECD Model Tax Convention "Artistes and Sportsmen" is now titled "Entertainers and Sportspersons". Following the provisions of this Article, a source state in which such activities are performed by a non-resident is allowed to tax the corresponding income.

Besides the change of terminology in Article 17, the 2014 update eliminates the reference to Article 7 (Business Profit) and clarifies in the Commentary the questions what an entertainer and or a sportsperson is, distinguishes between activities of an individual as an entertainer and sportsperson and personal activities of such individual, provides allocation rules for activities performed in various countries and describes special categories of payments.

5. Treatment of Termination Payments

Payments upon the termination of an employment include numerous types of payments (bonuses accrued, judicial awards, non-competition payments, severance payments, unused vacation etc.). Such payments are generally covered by Article 15 (Income from Employment).

The 2014 update amends the commentary to Article 15 in order to clarify the characterization of termination payments, especially by giving examples of common situations where termination payments raise treaty issues.

It also adds that the term "fiscal year concerned" contained in Article 15(2) shall be interpreted as the fiscal year of the country in which the services have been rendered.

III. Base Erosion and Profit Shifting

Base erosion and profit shifting refers to aggressive tax planning and tax avoidance schemes by multinational companies. The main idea is shifting profits to low (corporate) tax countries and thereby minimizing the effective tax burden. In 2012, the OECD initiated a multipronged investigation to create new international regulations to counter aggressive (corporate) tax avoidance.

Eventually, the OECD developed 15 action points that are to be implemented in the laws and regulations of the OECD member states (BEPS Package):

- Action 1: Addressing the tax challenges of the digital economy
- Action 2: Neutralising the effects of hybrid mismatch arrangements
- Action 3: Designing effective controlled foreign company rules
- Action 4: Limiting base erosion involving interest deductions and other financial payments
- Action 5: Countering harmful tax practices more effectively, taking into account transparency and substance
- Action 6: Preventing the granting of treaty benefits in appropriate circumstances
- Action 7: Preventing the artificial avoidance of permanent establishment status
- Action 8 to 10: Aligning transfer pricing outcomes with value creation
- Action 11: Measuring and monitoring BEPS
- Action 12: Mandatory disclosure rules
- Action 13: Transfer pricing documentation and country-by-country reporting
- Action 14: Making dispute resolution mechanism more effective
- Action 15: Developing a multilateral instrument to modify bilateral tax treaties

Our experience shows that especially the provision regarding the **artificial avoidance of permanent establishments** are relevant to international companies.

The OECD report recommends changing Article 5 of the OECD Model Tax Convention. **Action 7** aims predominantly at preventing the artificial avoidance of permanent establishments.

A relevant change will be the widening of Article 5 para 5 of the OECD Model Tax Convention to include **commissionaire arrangements**. According to the proposed change, commissionaires will be deemed a permanent establishment of a company if the commissionaire habitually concludes contracts (or exercises a major influence on the conclusion of the contract) without substantial alterations implemented by the company the commissionaire is acting for.

On 7 June 2017, several countries (including Germany, China, Hong Kong, Singapore and Austria) signed a multilateral agreement which will allow easy implementation of some major BEPS measures. Germany estimates that it will start using the new rules by 2019.

Companies should, therefore, carefully examine existing commissionaire agreements to avoid the creation of permanent establishments.

We hope that the information provided in this brochure was helpful for you. If you have any further questions, please do not hesitate to contact us.

LORENZ & PARTNERS Co., Ltd.
27th Floor Bangkok City Tower
179 South Sathorn Road, Bangkok 10120, Thailand
Tel.: +66 2 287 1882
E-Mail: info@lorenz-partners.com
www.lorenz-partners.com