

OECD UPDATE

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1

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1. Article 17 (Artistes and Sportsmen)
2. Beneficial Owner
3. Article 5 (Permanent Establishment)
4. Hybrid Mismatches
5. Various Issues

2

1. Artistes and Sportsmen (1)

- n The State in which a non-resident entertainer or sportsman performs activities as such is allowed to tax the income derived from these activities.
- n Necessity to determine:
 - ∅ what is an entertainer or sportsman?
 - ∅ what are the personal activities of an entertainer or sportsman as such?
 - ∅ what are the source and allocation rules for activities performed in various countries? etc.
- n Changes to the Commentary on Art. 17 were released in April 2010.
- n Public comments received are under consideration.

3

1. Artistes and Sportsmen (2)

- n Art. 17 should be deleted and artistes and sportsmen should be treated like other taxpayers:
 - ∅ countries of performance levy tax from the gross performance fee, including expenses
 - ∅ administrative work and expenses
- n Most delegates have decided to keep Art. 17:
 - ∅ top artistes and sportsmen are very mobile and can easily move their residency to a tax haven
 - ∅ difficulties for the residence State of obtaining the relevant information
 - ∅ source taxation is easier to administer
 - ∅ public opinion would not support exempting high-income earners

4

1. Artistes and Sportsmen (3)

- n Most delegates have supported the inclusion of a “de minimis” rule as an alternative in the Commentary:

“Notwithstanding the provisions of Articles 7 and 15, income derived by a resident of a Contracting State as an entertainer ... or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State, except to the extent that the gross amount of such income derived by that resident from these activities exercised during a taxation year of the other Contracting State does not exceed an amount equivalent to 15 000 IMF Special Drawing Rights expressed in the currency of that other State at the beginning of that taxation year or any other amount agreed to by the competent authorities before, and with respect to, that taxation year.”

5

1. Artistes and Sportsmen (4)

- n Artistes who are employed should be covered by Art. 15 and not Art. 17.
- n The majority of the delegates have rejected such suggestion:
 - ∅ excluding all employees would allow an artiste to set up a star-company acting as his employer to avoid the application of Art. 17
 - ∅ the inclusion of a “de minimis rule” would reduce the problems relating to the taxation of employees

6

1. Artistes and Sportsmen (5)

- n Many entertainers earn small amounts of income and not recognising expenses results in excessive taxation.
- n The majority of the delegates have rejected an addition to the Commentary mentioning the necessity to eliminate such excessive taxation:
 - ∅ this issue is indirectly dealt with through a “de minimis” rule
 - ∅ taxation on a gross basis but at a low rate might be more beneficial than net taxation
 - ∅ par. 10 of the Commentary already mentions the issue

7

1. Artistes and Sportsmen (6)

- n Art. 17(2), as interpreted in the Commentary, goes too far in allowing the taxation of the producer's own profits and not only the part of the income relating to the performance of the artiste.
- n The majority of the delegates have rejected adding to the Commentary an alternative provision allowing States to restrict the application of Art. 17(2) to star-companies (entities in which the entertainer or sportsman participates directly or indirectly in the profits, management, control or capital):
 - ∅ perceived complexity
 - ∅ potential for abuse
 - ∅ opposition to any restriction on the source taxing rights granted by Art. 17

8

1. Artistes and Sportsmen (7)

- n What is an entertainer or sportsman? Anyone who acts as an entertainer or sportsman, even for a single event (e.g. an amateur who gets a prize or a fee for a once-in-a-lifetime appearance).
- n What are his personal activities as such?
- ∅ The appearance in an entertainment or sports event in a State and activities, such as advertising or interviews in that State, “closely connected” with such appearance.
- ∅ Merely reporting or commenting on an entertainment or sports event in which an entertainer or sportsman does not participate is not an activity as entertainer or sportsman.
- ∅ A model presenting clothes during a fashion show or photo session is not performing as an entertainer. Still under consideration.

9

1. Artistes and Sportsmen (8)

- ∅ Preparation and training are parts of the normal activities of an entertainer or sportsman. Remuneration for time spent on preparation and training in a State and remuneration for time spent travelling in that State for the purposes of performances, preparation or training, are covered.
- ∅ Regardless of whether or not such preparation or training is related to specific public performances taking place in that State (e.g. remuneration paid with respect to the participation in a pre-season training camp). Still under consideration.

10

1. Artistes and Sportsmen (9)

- n **Special categories of payments:**
- ∅ **Royalties for intellectual property rights are covered by Art. 12.**
- ∅ **Art. 17 applies whenever there is a “close connection” between the income and the performance of activities as entertainer or sportsman in a State.**
- ∅ **A close connection exists where it can reasonably be considered that the income would not have been derived in the absence of the performance of these activities.**

11

1. Artistes and Sportsmen (10)

- n **Examples of closely connected income:**
- ∅ **a payment received by a professional golfer for an interview given during a tournament in which he participates**
- ∅ **a payment made to a tennis player for the use of his picture on posters advertising a tournament in which he will participate**
- ∅ **payments made to a tennis player for wearing a sponsor’s logo, trade mark or trade name on his equipment during a match**
- ∅ **merchandising payments relating to a public performance in a State (not merchandising payments derived from sales in a State that are related to performances in another State)**
- n **In the absence of a “close connection”, payments fall under the standard rules of Art. 7 or Art. 15**
- n **Payments received in the event of the cancellation of a performance are outside the scope of Art. 17, and fall under Art. 7 or Art. 15.**

12

2. BENEFICIAL OWNER (1)

§ CONTEXT (1)

- Ø Article 10 § 2, 11 § 2 and 12 § 1 OECD Model (introduced in 1977)
- Ø Source state taxation for dividends/interest paid to a resident of other C.S. but limited if requirement of beneficial ownership is met (BO : clarification of term “paid...to resident”)
- Ø Residence state taxation for royalties if requirement of beneficial ownership is met

13

2. BENEFICIAL OWNER (2)

§ CONTEXT (2)

- Ø OECD Commentary on BO
 - Ø Context and objective of the DTT (10.12)
 - Ø Agent / Nominee : no BO (10.12.1)
 - Ø Conduit company : no BO (10.12.1) if very narrow powers
- Ø Legal vs. economic ownership / common-law vs. civil law
- Ø Jurisprudence :
 - Ø Prévost (Canada-2008)
 - Ø Indofood (UK-2005)

14

2. BENEFICIAL OWNER (3)

§ Short History (1)

- Ø 2008 – 2009 : Need for more guidance and clarification of concept Beneficial Owner - diversity in jurisprudence
- Ø + OECD Commentary amendments (article 10, 11 and 12) proposed

15

2. BENEFICIAL OWNER (4)

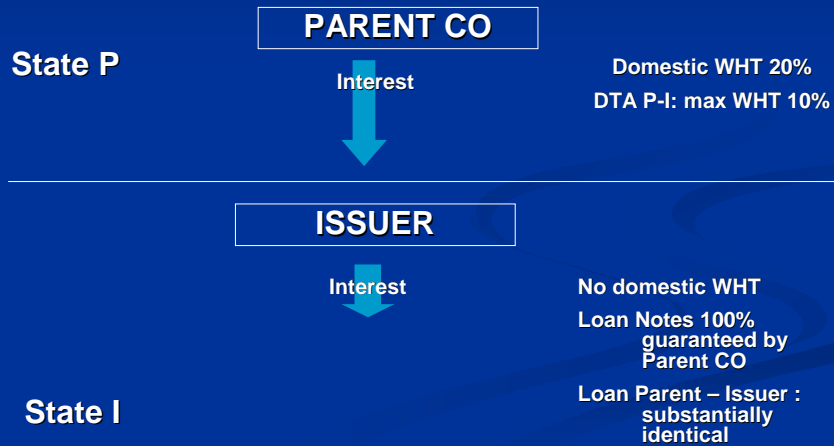
§ Short History (2)

- Ø 2010 : Work method changed
- Ø Basis for discussion: 8 borderline examples
- Ø identify majority view / key issues / possible conclusions
- Ø Draft commentary changes
- Ø 2011/4 : draft commentary changes released for public comments
- Ø 2011/9 : first discussion

16

2. BENEFICIAL OWNER (5)

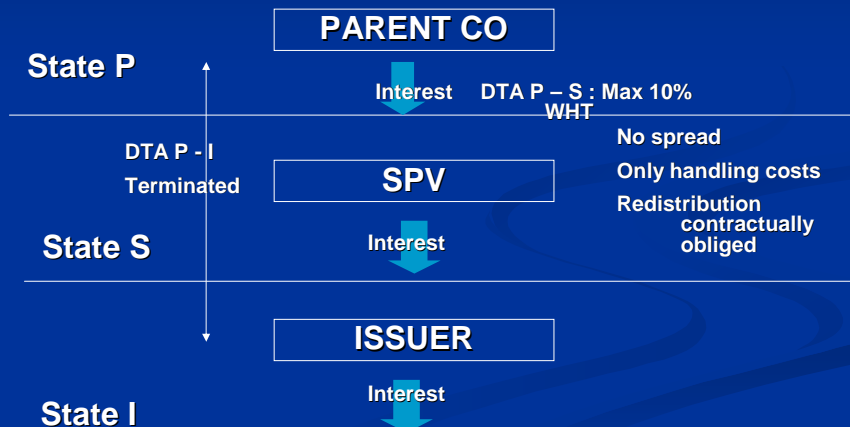
§ EXAMPLE 1 : SPV Financing structure



17

2. BENEFICIAL OWNER (6)

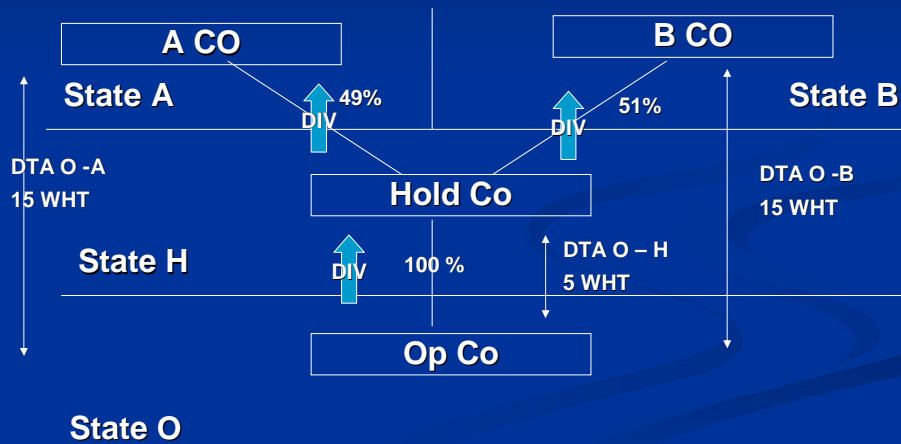
§ EXAMPLE 1 : SPV Financing structure



18

2. BENEFICIAL OWNER (7)

§ EXAMPLE 2 : Joint Venture Arrangement



19

2. BENEFICIAL OWNER (8)

§ Example 2 Specifics

- Ø Holdco : no employees or offices, shares only investment , board members identical as Op Co board
- Ø Registered office Holdco => office Trust Co administering payment Holdco
- Ø Bi-annual dividend payments by Holdco following prior resolutions of the Board of Holdco.
- Ø Some years: dividend payment to Holdco at request of Holdco Shareholders (afterwards declared by Opco directors)
- Ø Holdco : ordinary expenses => authorization required from shareholders
- Ø Inconsistencies with Holdco ownership of Opco shares (shareholders meeting)

20

2. BENEFICIAL OWNER (9)

§ KEY ISSUES (1)

- Ø Need for clarification of BO : general support
 - Ø Divergent jurisprudence
 - Ø Lack of definition in domestic legislation
 - Ø Need of internationally-agreed meaning

21

2. BENEFICIAL OWNER (10)

§ KEY ISSUES (2)

- Ø Domestic vs. Autonomous meaning ?
 - Ø Majority: autonomous meaning
 - Ø Domestic meaning applicable if not contrary to context Treaty ?!
- Ø Possible new “concepts” for clarifying the meaning of BO
 - Ø “use and enjoyment of the income-producing property” (power to generate the income) ?
 - Ø “use and enjoyment of the income” (power to enjoy the income) ?

22

2. BENEFICIAL OWNER (11)

§ KEY ISSUES (3)

- Ø BO => Full right to “use and enjoy the income”
 - Ø not constrained by a contractual or legal obligation to pass the payment received to another person
 - Ø Legal documents and/or fact and circumstances
 - Ø Use and enjoyment of dividend/interest <> legal ownership / right to use and enjoy the shares / debt-claim

23

2. BENEFICIAL OWNER (12)

§ KEY ISSUES (4)

- Ø Relationship between BO and Anti-abuse rules
 - Ø BO concept: deals with some forms of abuse
 - Ø No automatic granting of limited source tax if recipient is BO (resident of other CS)
 - Ø Application of general / specific anti-abuse provisions, substance over form / economic substance approaches still possible
- Ø BO in context of 10 ,11 and 12 vs other instruments (anti-money laundering, etc.)
 - Ø No interference

24

2. BENEFICIAL OWNER (13)

§ Current Status of discussions

- Ø autonomous interpretation most supported
- Ø Domestic law interpretation if not contrary to general principles : not clear (examples !)
- Ø “full right to use and enjoy the income” / “unconstrained by legal or contractual obligation” => quid impact on trusts, hybrid entities, CIV, holdings ?
- Ø Judgment on facts and circumstances => divergent opinions

§ New draft commentary expected in Sept 2012

25

3. Permanent Establishment (1)

- n **A Working Group on the Definition of PE was set up in February 2009.**
- n **Mandate:**
 - Ø **solving interpretation issues arising from the current Art. 5**
 - Ø **identifying policy issues but not developing proposals to address them.**
- n **In September 2011, the Working Party 1 agreed to release the discussion draft on the Definition of PE prepared by the WG (25 issues were discussed).**
- n **Comments are requested before 10 February 2012.**

26

3. Permanent Establishment (2)

- n Meaning of “at the disposal of”.
- n A place of business may constitute a PE of an enterprise if that place is “at the disposal” of the enterprise
- ∅ not found in the definition of PE but in par. 4 of the Commentary in order to explain the concept of “place of business”
- ∅ diverging views
- ∅ uncertainty.

27

3. Permanent Establishment (3)

- n Where an enterprise has an exclusive legal right to use a particular location and uses such location only for carrying on its own business activities.
- n Where an enterprise performs activities on a “continuous and regular basis” during an extended period of time at a location that belongs to another enterprise or that is used by a number of enterprises.
- n Not, where the enterprise’s presence at a location is intermittent or incidental.
- n Antwerpen, 13 May 2008: wrong interpretation of the PE concept by requiring an exclusive right to use the premises for carrying on the activities.

28

3. Permanent Establishment (4)

- n Home office as a PE
- n Could the home office of a resident employee of a foreign company be considered to be a PE of the foreign company?
- n The home office is not automatically at the disposal of the enterprise because it is at the disposal of the employee.
- n Where a home office is used on a “regular and continuous basis” for carrying on business activities for the enterprise and the enterprise has required the individual to work from home, the home office may be considered to be at the disposal of the enterprise.
- n The activities carried on at a home office will often be merely auxiliary (par. 4 of Art. 5).

29

3. Permanent Establishment (5)

- n Time requirement for the existence of a PE
- n As the place of business must be fixed, it must have a certain degree of permanency.
- n General practice: at least six months.
- n Two exceptions to that general practice.
- n The inclusion in the Commentary of an objective standard was required and, if not, clarification of the more subjective standard was required.

30

3. Permanent Establishment (6)

∅ **An example of activities of a recurrent nature :**

A resident of State R rents a stand at a commercial fair in State S for 15 consecutive years where he sells sculptures during a period of five weeks each year. The time requirement for a PE is met due to the recurring nature of the activity regardless of the fact that any consecutive presence lasts less than 6 months.

∅ **An example of activities exclusively carried on in a State:**

A film is shot in a village in State S where the parents of a resident of State R own a house. Since the film requires the presence of people during four months, she decides to transform the house into a restaurant which she operates during that period. These are the only business activities that she has carried on and she does not intend to carry on such activities in the future; the restaurant will therefore be the location where the business of that enterprise will be wholly carried on. The time requirement for a PE is met since the restaurant is operated during the whole existence of that particular business.

This would not be the case where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four week sports event. The company's business, which is permanently carried on in State R, is only temporarily carried on in State S.

31

3. Permanent Establishment (7)

n **Main contractor who subcontracts all aspects of a contract.**

n **Business of an enterprise is carried on by the entrepreneur or by persons who are in a paid-employment relationship with the enterprise (personnel).**

n **Business of an enterprise is also carried on through subcontractors.**

A PE exists for the enterprise if the other conditions of Art. 5 are met. In the context of par. 1, that requires that the subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise for reasons other than the mere fact that the subcontractors perform such work at that location.

32

3. Permanent Establishment (8)

- n Examples:
- n An enterprise that owns a small hotel and rents out the hotel's rooms through the internet has subcontracted the on-site operation of the hotel to a company that is remunerated on a cost-plus basis. The hotel is at the disposal of the owner.
- n If a general contractor which has undertaken a construction project subcontracts all of the project, the period spent by the subcontractors working on the building site is considered as being time spent by the general contractor on the building project. The site should be considered to be at the disposal of the general contractor during the time spent on the site by any subcontractor where the general contractor has overall responsibility for the site and the site is made available to him for the purposes of carrying on its construction business.

33

3. Permanent Establishment (9)

- n Meaning of the terms "to conclude contracts in the name of the enterprise"
- n Only cases where the foreign principal is legally bound vis-à-vis the third party, under agency law, by reason of the contract concluded by the agent?
- n Is it sufficient that the foreign principal is economically bound by the contracts concluded by the person acting for it?
- n Extensive discussions based on diverging court decisions on "commissionnaire" arrangements in France (Zimmer Ltd) and Norway (Dell DUF).
- n Not possible to reach a common view.
- n An example was simply added of a situation where a foreign principal would be bound by a contract not literally concluded in his name.

34

4. HYBRID MISMATCHES (1)

§ HISTORY

- ∅ **1993** : start of subgroup WP 1 => application of OECD Model to Partnerships, Trusts and other non-corporate entities
- ∅ **1999** : publication of Partnership-Report + New OECD Commentary 2000 (art. 1, 4 and 23)
- ∅ **After 1999** : subgroup continues work
 - ∅ CIVs => result : new OECD Commentary 2010 (art. 1)
 - ∅ Trusts and "other entities" : work ended in 2005 without results
- ∅ **2010-2011 (WP 1)** : Hybrid Mismatches

35

4. HYBRID MISMATCHES (2)

§ **DEFINITION AND SCOPE** : mismatches due to domestic law differences => conflicts of qualification => double taxation or double non-taxation (double exemption or double credit)

- ∅ Double deduction schemes
- ∅ Deduction/no inclusion schemes
- ∅ Foreign tax credit generators

36

4. HYBRID MISMATCHES (3)

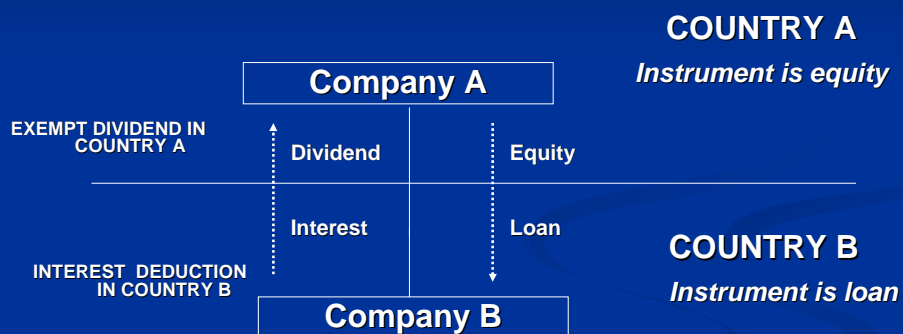
§ POSSIBLE FORMS/CAUSES

- ∅ **Hybrid instruments** : instrument => debt vs. equity (PPL, ...)
- ∅ **Hybrid entities** : transparent vs. opaque entity
- ∅ **Hybrid transfers** : transfer of ownership vs. no transfer of ownership (collateralized loan or “repo”)

37

4. HYBRID MISMATCHES (4)

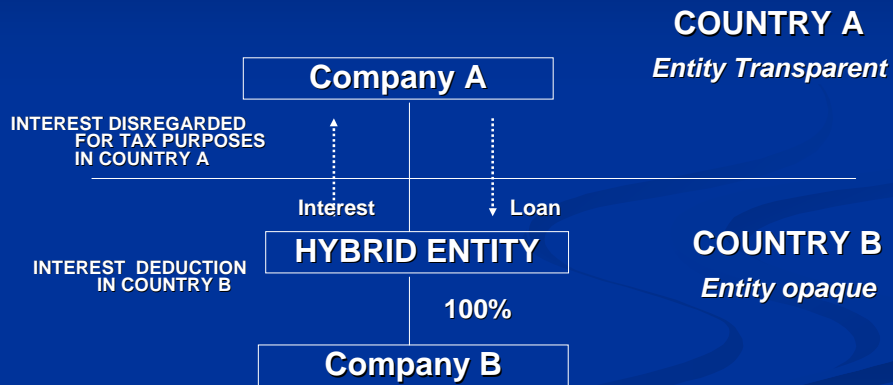
§ CASE 1 : HYBRID INSTRUMENT (PPL)



38

4. HYBRID MISMATCHES (5)

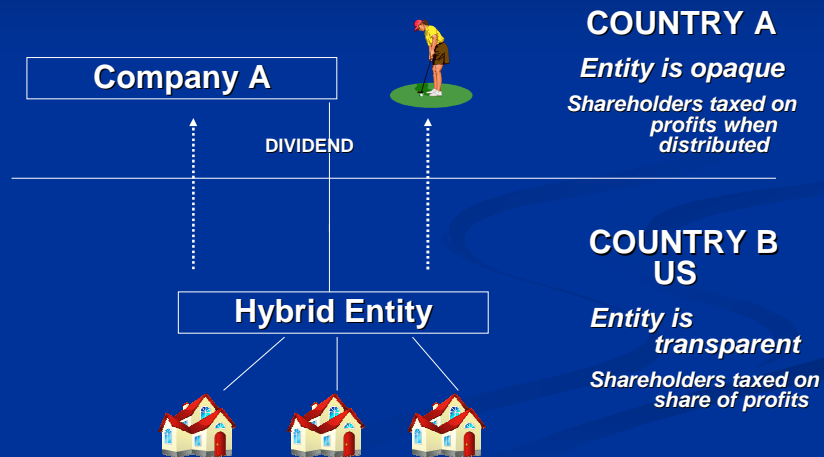
§ CASE 2 : HYBRID ENTITY



39

4. HYBRID MISMATCHES (6)

§ CASE 3 : HYBRID ENTITY (US LLC)



40

4. HYBRID MISMATCHES (7)

§ Main questions

- Ø Does the treaty allow the source state to tax the income ? If so, is the residence state obliged to credit the source tax ?
- Ø Is the residence state (of the partners or hybrid entity) obliged to eliminate double taxation ?
- Ø How can the residence state deal with cases of double non-taxation ?
- Ø How to deal with foreign tax credit generators ?

41

4. HYBRID MISMATCHES (8)

§ POSSIBLE SOLUTIONS (1)

- Ø **Common definitions ?** Practically impossible
- Ø **Domestic law ?**
 - Ø general anti-abuse provisions (difficult)
 - Ø Specific provisions : domestic treatment linked to treatment in other state (UK, DK) => can work for PPL

42

4. HYBRID MISMATCHES (9)

§ POSSIBLE SOLUTIONS (2)

Ø Treaty solutions ?

- Ø OECD Model and Commentary : relief of double taxation provisions and double non-taxation (basis => Partnership report 1999)
 - § Par. 32.1...32.7 commentary art. 23 dealing with conflicts of qualification
 - § Double taxation (par. 32.2 – 32.5) / Non-taxation (par. 32.6 - 32.7)
 - § Art. 23 A par. 4 (par. 56.2 – 56.3 commentary) : scope of provision ? Interpretation conflicts (conflicts of qualification)
 - § BELGIUM : “subject to tax”

43

4. HYBRID MISMATCHES (10)

§ POSSIBLE SOLUTIONS (2)

Ø Treaty solutions ?

- § Art. 23 A par. 4 (par. 56.2 – 56.3 commentary)

“The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a CS where the other CS applies the provisions of this convention to exempt such income or capital from tax or applies the provision of paragraph 2 of article 10 or 11 to such income”.

44

4. HYBRID MISMATCHES (11)

§ POSSIBLE SOLUTIONS (3)

∅ Treaty solutions ?

- ∅ Extension of PS report principles to other transparent entities (Hybrid Entities) !!

- § Entitlement of entity to treaty benefits

- § When is income “paid to”, “derived by”, “beneficially owned by” or otherwise attributed to a resident for purposes of article 6 to 21 ?

(No unanimity on PS report principles and on extension)

- ∅ Alternative solution : inclusion of specific treaty provisions

- § Example: article 1 § 6 Belgium-USA Treaty 2006 – dealing with income derived through a transparent entity

45

4. HYBRID MISMATCHES (12)

§ Partnerships vs. Hybrid Entities

Definition Partnership (“Sociétés des personnes)
(cf. OECD PS Report par. 2)

Entities that qualify as such under civil law or commercial law as opposed to tax law. Thus the term “partnership”, as used in this report, should not be confused with a reference to entities, whether partnerships or not, which are treated as transparent for tax purposes”

46

4. HYBRID MISMATCHES (13)

§ CONCLUSION

- § Model already provides for solutions (f.ex. Article 23A par. 4) dealing with non-taxation
- § Extension of partnership report requires further to be examined
- § Further examination : inclusion of a provision in the Model dealing with hybrid entities (cf. OECD Commentary article 4 - 8.8)

47

5. Various issues under consideration (1)

- n Should a Mutual Agreement under Art. 25(3) be binding on the States?
- n **German Court decisions: the court rejected an interpretation adopted in mutual agreements reached with Belgium and Switzerland concerning the tax treaty treatment of termination payments.**
- n **Par. 53 of the Commentary.**

48

5. Various issues under consideration (2)

- n Under Art. 25(3) Contracting States have delegated to their competent authorities the power to agree on the interpretation of the treaty.
- n The mutual agreement constitutes a “subsequent agreement between parties” or “a subsequent practice ...which establishes the agreement of the parties” under Art. 31(3) a) or b) of the Vienna Convention.
- n Mandatory character for the Contracting States (including their courts).

49

5. Various issues under consideration (3)

- n Tax treatment of termination payments
 - ∅ Remuneration for previous work: taxable in the State where the relevant work was carried on
 - ∅ Payment for unused holidays or sick leaves: remuneration relating to employment activities performed during the last year
 - ∅ Payment in lieu of notice of termination: compensation for work in the State where it is reasonable to assume that the employee would have worked during the period of notice (most often where work was performed at the time of the termination)

50

5. Various issues under consideration (4)

- ∅ **Severance payments: absent facts and circumstances indicating otherwise, remuneration derived from the State where the employment was exercised when the employment was terminated**
- ∅ **Damages for unlawful dismissal: depending on what the damage award seeks to compensate; damages for discriminatory treatment or injury to one's reputation fall under Art. 21**
- ∅ **Non-competition payment: 3 options (Art 15: State of residence; Art. 15: State of activity; Art. 21)**
- ∅ **Payments related to pension rights: Art. 18; but reimbursement of pension contributions would be remuneration derived from the State where the employment was exercised when terminated.**

51

5. Various issues under consideration (5)

n Scope of Article 16

n **A joint-stock company is managed by:**

∅ **A board of directors (Conseil d'administration)**

Power to achieve any action for the purposes of the company, except those which the law reserves for the assembly general. Action for the company towards third parties and before courts.

∅ **An executive committee (Comité de direction)**

The statutes may allow the board of directors to delegate its management powers to an executive committee.

Such delegation may not cover the general policy of the company neither the entirety of the prerogatives of the board of directors. If an executive committee exists, the board of directors is in charge of its supervision.

52

5. Various issues under consideration (6)

- n Would the board of directors and the executive committee be covered by Article 16 of the OECD Model?
- n The English text refers only to “the board of directors”.
- n The French text refers to both organs (membre du conseil d’administration ou de surveillance).
- n Belgian tax treaties contain the following wording: *“Directors’ fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors or a similar organ of a company which is a resident of the other Contracting State may be taxed in that other State.”*

53

5. Various issues under consideration (7)

- n Meaning of liable to tax
- n The concept of liable to tax is not very clear.
- n Par. 8.6 and 8.7 of the Commentary on Art. 4 reflect two diverging views.
- n Par. 8.6 (majority view): pension funds, charities and other organisations are liable to tax if they are exempt from tax where they meet all the requirements specified in the tax laws but are required to pay tax if they do not meet those requirements.
- n Par. 8.7 (minority view): these entities are not liable to tax if they are exempt from tax under domestic laws.

54

5. Various issues under consideration (8)

- n A try at clarifying the concept based on the distinction between:
 - ∅ a personal exemption (specific entities exempted as such under specified conditions)
 - ∅ an exemption applicable to specific income derived from specified purposes and under specified requirements (not applicable to other income that these entities may derive).
- n Not enough support:
 - ∅ a different treatment based on the way that an exemption is structured should not be encouraged
 - ∅ the suggested changes could not be endorsed by the countries that share the minority view.
- n The clarification should be abandoned.

55