OECD Council adopts 2014 update to the Model Tax Convention

Executive summary

On 16 July 2014, the Organization for Economic Co-operation and Development (the OECD) released the contents of the 2014 update (the 2014 Update) to the OECD Model Tax Convention and related Commentary (the OECD Model) [Link to the 2014 update]. The changes reflected in the 2014 Update will be incorporated in a revised version of the OECD Model that will be published in the next several months.

Areas addressed in the 2014 Update include the definition of the term “beneficial owner,” the treatment of termination payments, changes to the exchange of information provisions, and issues related to emissions permits and credits. The 2014 Update includes updates to the reservations and observations of OECD member countries to provisions of the OECD Model, as well as updates to the statement of positions of non-OECD member countries. The 2014 Update does not include any changes related to the OECD Base Erosion and Profit Shifting (BEPS) project.

Detailed discussion

Background

On 15 July 2014, the OECD Council approved the 2014 Update, which had been approved by the OECD’s Committee on Fiscal Affairs on 26 June 2014. The contents of the 2014 Update will be incorporated in a revised version of the OECD Model that will be published in the next few months. The 2014 Update reflects work carried out by the Committee of Fiscal Affairs between 2010 and the end of 2013 on a variety of issues, some of which were released as discussion drafts. Importantly, the update does not incorporate any changes to the OECD Model deriving from the ongoing work on the BEPS Action Plan.

While this 2014 Update affects both the Articles of the OECD Model and the Commentary, most of the changes are to the Commentary. Key changes approved in the 2014 Update include: clarification of the definition of the term “beneficial owner,” the treatment of termination payments, changes to the exchange of information provisions, and issues related to emissions permits and credits. The 2014 Update includes updates to the reservations and observations of OECD member countries to provisions of the OECD Model, as well as updates to the statement of positions of non-OECD member countries. The 2014 Update does not include any changes related to the OECD Base Erosion and Profit Shifting (BEPS) project.
owner;” treatment of employment termination payments; issues related to emissions permits and credits; application of the article on Artistes and Sportsmen; and updates to Article 26 (Exchange of Information). In addition, the 2014 Update includes a variety of technical changes to the Commentary language and updates to the reservations and observations of OECD member countries to provisions of the OECD Model, as well as updates to the statement of positions of non-OECD member countries.

**Beneficial owner**

The changes approved in the 2014 Update result from, and substantively incorporate, modifications proposed by the OECD to the concept of the “beneficial owner,” which were reflected in earlier discussion drafts (Beneficial Owner Discussion Drafts released on 29 April 2011 and 19 October 2012). The concept of “beneficial owner” found in Articles 10, 11, and 12 of the OECD Model (Dividends, Interest, and Royalties, respectively) is used to determine whether the recipient of a payment is entitled to treaty benefits with respect to the payment (as opposed to being a mere agent, nominee, etc.) and has given rise to different interpretations by courts and tax administrations. The OECD Model’s Commentary had stated, among other things, that such term was introduced to “clarify the meaning of the words “paid ... to a resident” as they are used in” Articles 10, 11, and 12 and that such “term is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purpose of the Convention.” However, the Commentary had not specified whether the term “beneficial owner” should be interpreted in accordance with domestic law or whether the term has an international tax treaty meaning. The changes reflected in the 2014 Update are described by the OECD as being aimed at settling the interpretation that should be given to in the context of the OECD Model to prevent the risks of double taxation and non-taxation arising from these different interpretations.

The 2014 Update indicates that the term, “beneficial owner,” as used in the OECD Model, is not intended to refer to any technical meaning that it could have under the domestic law of a specific country; rather, it should be understood in its treaty context. In particular the term “beneficial owner” should be interpreted in relation to the words “paid ... to a resident.” The 2014 Update also clarifies that the “beneficial owner” concept as used in instruments other than the OECD Model, such as the work of the Financial Action Task Force and the OECD Steering Group on Corporate Governance, should not apply to the term in the context of taxation under the OECD Model.

Furthermore, the 2014 Update clarifies that the recipient of a dividend, interest, or royalty is the “beneficial owner” of the payment in question when he has the right to use and enjoy the dividend, interest, or royalty unconstrained by a contractual or legal obligation to pass on the payment received to another person; this in effect rules out the possibility of considering as “beneficial owners” persons acting as fiduciaries, agents, or nominees. The updated Commentary further specifies that such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances; moreover, such an obligation must relate to the payment received and would not include contractual or legal obligations unrelated to the payment received. It also provides examples of such unrelated obligations, which would include unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles. The 2014 Update also distinguishes between the legal owner of the property giving rise to the income (i.e., shares, debt claim or property right) and the “beneficial owner” of such income, which may be different in some cases.

The 2014 Update clarifies that the concept of “beneficial owner” does not in itself grant the benefit of limiting tax imposed on the respective payment. It further notes that despite the fact that the beneficial ownership concept may address some forms of tax avoidance, it does not deal with other cases of treaty shopping which can be addressed through other means such as specific and general anti-abuse provisions, substance-over-form approaches,
and economic substance approaches. In this respect, the introduction to the 2014 Update specifically states that the changes to “beneficial owner” contained in the document “do not prejudge in any way the outcome of the work on Action 6 (Prevent Treaty Abuse)” of the BEPS project.

**Income from employment**
The 2014 Update also amends the Commentary to Article 15 (Income from Employment), providing rules on termination payments where treaty issues arise, including cases dealing with cross-border employees, employees that have worked in different jurisdictions during their career, and employees sent to work abroad and repatriated shortly before their employment is terminated. The changes in the 2014 Update reflect the 25 June 2013 Discussion Draft issued by the OECD on tax treaty treatment of termination payments and the comments on such draft.

The amended Commentary provides examples of common situations where termination payments may give rise to treaty issues, including bonuses accrued during employment; payments for unused vacation or sick days; remuneration after termination notice; severance payments; judicial awards, compensations or settlements related to an unlawful termination; non-compete clause payments; or pension or medical insurance contributions. The updated Commentary establishes that it is essential to identify the real consideration for such payment based on all facts and circumstances to determine whether such payment constitutes salaries, wages, or other similar remuneration. Likewise, the facts and circumstances will determine the extent to which such payment is derived from the exercise of employment in a given country.

The 2014 Update further clarifies that references to “fiscal year concerned” contained in Article 15(2) of the OECD Model must be interpreted as a reference to the fiscal year of the country in which the person has exercised his employment and during which the relevant employment services have been rendered.

**Entertainers and sportsperson**
Article 17 (Artistes and Sportsmen) is also modified with this 2014 Update and will now be titled “Entertainers and Sportspersons.” The edited Article would also eliminate the reference to Article 7 (Business Profits), and change “artiste” to “entertainer” and “sportsman” to “sportsperson” throughout. The 2014 Update incorporates the changes proposed as in the 2010 Discussion Draft on the “Application of Article 17,” which, among other issues:

- Addressed the concept of “entertainer” and “sportsman”
- Commented on the application of Article 17 to race prizes
- Distinguished between activities of an individual as an entertainer and sportsperson and personal activities of such individual
- Provided source and allocation rules for activities performed in various countries
- Described special categories of payments (including whether certain such payments are covered under Article 17 or another treaty provision)

**Emissions permits and credits**
Consistent with a Discussion Draft issued 19 October 2012 on treaty issues related to emissions permits and credits, the 2014 Update includes in the Commentary to Article 6 (Income From Immovable Property) a reference to income derived from the trading of “emissions permits and credits,” which is to be regarded as income derived from the carrying on of agriculture or forestry activities. The 2014 Update further notes that income from the issuance or trading of emissions permits and credits is generally covered by Article 7 (Business Profits) and Article 13 (Capital Gains), and in some instances Article 8 (Shipping, Inland Waterways Transport, and Air Transport).

**Exchange of information**
A set of amendments included in this 2014 Update which were not previously released as a discussion draft are the changes relating to exchange of information. The 2014 Update includes Commentary on instances where information may be regarded as relevant to be exchanged despite it not being primarily used for the purposes of the tax treaty: when it is legal to do so under the domestic laws of the two jurisdictions and when the competent authorities of such have agreed to it.
Other revisions and considerations

Among other technical changes, the 2014 Update includes revised Commentary to Article 11 (Interest) with respect to bonds with accrued but not yet paid interest and revised Commentary to Article 13 (Capital Gains) dealing with the right to tax the total amount of gain and gain derived from alienation of shares which now specifically includes a redemption of shares.

Finally, the 2014 Update now includes reservations and observations by countries that had not previously been included, such as Estonia, Israel, Turkey, and Chile, and also includes other updates to the reservations and observations. In addition, the 2014 Update includes additions to the section on positions with respect to the OECD Model by non-OECD member countries, including setting forth positions of Azerbaijan, Colombia, Georgia, and Singapore.

Notably, the 2014 Update does not include the changes included in the 15 November 2013 Discussion Draft on the operations of ships and aircraft in international traffic as the OECD believes further work is needed in this area before such changes are incorporated into the OECD Model. Additionally, the 2014 Update does not include any changes relating to the 19 October 2012 Discussion Draft on revised proposals concerning the interpretation and application of Article 5 (Permanent Establishment) because it is expected that work in connection with the BEPS project will result in changes to Article 5.

Implications

The OECD Model is the basis for many bilateral tax treaties. Furthermore, the OECD Model and its Commentary influence the interpretation of tax treaties in many countries. Although the Commentary to the OECD Model is generally not considered binding on taxpayers and the judiciary of OECD member countries, it can be important in understanding tax treaties that follow the OECD Model.

Note, income tax treaties with the United States are generally based on the US Model Treaty rather than the OECD Model (although the OECD Model is taken into account when the treaty partner is an OECD member). Accordingly, the US Model Treaty is typically accorded greater weight in the United States in terms of interpretative authority, although the United States Treasury Department will sometimes agree to include specific language from the OECD Model in its negotiated treaties and typically will reference distinctions between the two models in the US Technical Explanation to a particular treaty with the United States. US courts have also cited to the OECD Model for interpretative guidance. In that respect, the OECD Model may also be useful in situations that are not addressed in the US Technical Explanation to a specific treaty or the US Model Treaty.

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