

**15 March 2004**

## **THE 2005 UPDATE TO THE MODEL TAX CONVENTION**

### ***Public discussion draft***

This note includes the contents of the next update to the OECD Model Tax Convention, which will be finalized in the spring of 2005. The OECD Committee on Fiscal Affairs has a well-established policy of consulting with business and other interested parties. As part of this policy, it has been decided that prior to issuing an update to the Model Tax Convention, all the changes to the Articles and the Commentary that will be included in the update will be issued as a draft for a final round of public comments even if they have been previously released in separate reports.

The contents of the 2005 update result primarily from the following previously released documents:

- *"Proposed changes to the Commentary on Article 8"*: that report was first released for public comments in April 2004. A few changes were made on the basis of the comments received and the final version of the report was made public on 15 December 2004 (see <http://www.oecd.org/dataoecd/20/53/34083450.doc>).
- *"Cross-border income tax issues arising from employee stock-option plans"*: the final version of that report, which was approved by the Committee on Fiscal Affairs on 16 June 2004, was made public on 3 September 2004 (see <http://www.oecd.org/dataoecd/35/53/33700277.pdf>). The final version took into account comments received on two previous drafts of the report which had been made public in March 2002 and July 2003.
- *"Proposed changes to the Commentary on Article 5 concerning multiple permanent establishments"*: a draft version of that report was released for public comments on 12 April 2004 (see <http://www.oecd.org/dataoecd/34/9/31483903.pdf>). A number of changes were made on the basis of the comments received, which were supportive of the amendments to the Commentary proposed in the draft. This note includes the final version of the amendments (changes made to the April 2004 draft are underlined in this note).
- *"Changes to Articles 25 and 26 of the Model Tax Convention"*: the document that includes these changes was approved by the Committee on Fiscal Affairs on 1 June 2004 and made public on 23 July 2004 (see <http://www.oecd.org/dataoecd/28/4/33614065.pdf>).
- *"Technical issues related to cross-border pensions"*: a draft version of that report was released for public comments on 14 November 2003 (see <http://www.oecd.org/dataoecd/12/21/34562290.pdf>). A number of changes were made on the basis of the comments received. This note includes the final version of the amendments (changes made to the November 2003 draft are underlined in this note).

The update also includes the following technical changes to the Model Tax Convention:

- A change to paragraph 31 of the Introduction to clarify that no reservation is required to indicate that a country merely wishes to modify the wording of a provision of the Model to confirm or incorporate an interpretation of that provision put forward in the Commentary.

- The addition of commas to the French version of subparagraph 2 *b*) of Article 15 to conform to the English version.
- Changes to the Commentary on Article 11 to include alternative provisions that provide for the exclusive residence taxation of all interest or of some categories thereof and to explain the reasons underlying these provisions.
- Changes to paragraphs 29 and 30 of the Commentary on Article 11 to address more accurately the triangular problem arising in the case of interest borne by a permanent establishment located in a third state.
- Changes to the Commentary on Article 12 to clarify when payments for forbearance to grant rights to use property constitute royalties.
- Changes to the Commentary on Articles 10, 11 and 13 to include a cross-reference to the suggested provision dealing with the investment income of pension funds found in the Commentary on Article 18.
- A change to paragraph 4 of the Commentary on Article 15 to clarify how to take account of overlapping periods when applying the moving 12-month limit of subparagraph 2 *b*) of Article 15.
- A minor change to paragraph 10 of the Commentary on Article 15 to indicate that States may wish to deal bilaterally with the situation of employees working on trucks and trains travelling between countries.
- Changes to the Commentary on Article 20 to clarify the relationship between Articles 15 and 20.

This draft does not include changes to the observations and reservations of OECD Member countries and to the positions of non-Member countries that will be included in the Model Tax Convention as part of the final version of the update.

Comments on the 2005 update to the Model Tax Convention should be sent **before 27 April 2005** to:

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## CHANGES TO BE INCLUDED IN THE 2005 UPDATE TO THE MODEL TAX CONVENTION

[The changes to the existing text of the Model Tax Convention appear in ~~strike through~~ for deletions and ***bold italics*** for additions]

### A. INTRODUCTION

1. Replace paragraph 31 of the Introduction by the following:

"31. Although all Member countries are in agreement with the aims and the main provisions of the Model Convention, nearly all have entered reservations on some provisions, which are recorded in the Commentaries on the Articles concerned. There has been no need for countries to make reservations indicating their intent to use the alternative or additional provisions that the Commentaries allow countries to include in their bilateral conventions ***or to modify the wording of a provision of the Model to confirm or incorporate an interpretation of that provision put forward in the Commentary.*** It is understood that insofar as a Member country has entered reservations, the other Member countries, in negotiating bilateral conventions with the former, will retain their freedom of action in accordance with the principle of reciprocity."

### B. ARTICLES

#### Article 15

2. Replace the French version of subparagraph 15(2)b) by the following:

"b) les rémunérations sont payées par un employeur, ou pour le compte d'un employeur, qui n'est pas un résident de l'autre Etat, et"

#### Article 19

3. Replace the existing Article 19 by the following:

*Article 19*  
GOVERNMENT SERVICE

1. a) Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

- b) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:
  - (i) is a national of that State; or
  - (ii) did not become a resident of that State solely for the purpose of rendering the services.
- 2. a) *Notwithstanding the provisions of paragraph 1, a*Any pension *or other similar remuneration* paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
- b) However, such pension *or other similar remuneration* shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.
- 3. The provisions of Articles 15, 16, 17, and 18 shall apply to salaries, wages, ~~and other similar remuneration, and to pensions,~~ *and other similar remuneration* in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.”

## Article 26

- 4. Replace the existing Article 26 by the following:

### *"Article 26*

### **EXCHANGE OF INFORMATION**

- 1. The competent authorities of the Contracting States shall exchange such information as is ~~necessary~~ *foreseeably relevant* for carrying out the provisions of this Convention or *to the administration or enforcement* of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.
- 2. Any information received *under paragraph 1* by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, ~~or~~ the determination of appeals in relation to the taxes referred to *in paragraph 1, in the first sentence or the oversight of the above*. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.
- 3.2 In no case shall the provisions of paragraphs 1 *and 2* be construed so as to impose on a Contracting State the obligation:
  - a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
  - b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
  - c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).

4. *If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.*

5. *In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person."*

## C. COMMENTARY

### Commentary on Article 3

5. Replace paragraph 6.3 of the Commentary on Article 3 by the following:

"6.3 The definition of "international traffic" does not apply to any transport *by an enterprise which has its place of effective management in one Contracting State* when the ship or aircraft is operated between two places in the ~~same Contracting~~ other State, even if part of the transport takes place outside that State. Thus, for example, a cruise beginning and ending in ~~the same Contracting~~ that other State without a stop in a foreign port does not constitute a transport of passengers in international traffic. Contracting States wishing to expressly clarify that point in their conventions may agree bilaterally to amend the definition accordingly."

### Commentary on Article 5

6. Replace paragraph 33 of the Commentary on Article 5 by the following:

"33. The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated *or if the agent first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.* Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either."

7. Replace paragraphs 41 and 42 of the Commentary on Article 5 by the following:

*“41. A parent company may, however, be found, under the rules of paragraphs 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company (see paragraphs 4, 5 and 6 above) and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraph 3 and 4 of the Article (see for instance, the example in paragraph 4.3 above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent (see paragraphs 32, 33 and 34 above), unless these activities are limited to those referred to in paragraph 4 of the Article or unless the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of the Article applies. However, a subsidiary company will constitute a permanent establishment for its parent company under the same conditions stipulated in paragraph 5 as are valid for any other unrelated company, i.e. if it cannot be regarded as an independent agent in the meaning of paragraph 6, and if it has and habitually exercises an authority to conclude contracts in the name of the parent company. And the effects would be the same as for any other unrelated company to which paragraph 5 applies.*”

*41.1 42.—The same rules should apply to activities which one subsidiary carries on for any other subsidiary of the same company. The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal (see paragraphs 4, 5 and 6 above) and uses premises belonging to another company of the group, or if the former company is deemed to have a permanent establishment under paragraph 5 of the Article latter company acts on its behalf (see paragraphs 32, 33 and 34 above) so that a permanent establishment is deemed to exist under paragraph 5 of the Article. The determination of the existence of a permanent establishment under the rules of paragraphs 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.”*

8. Add the following new paragraph 42 immediately after paragraph 41.1 (see above change) of the Commentary on Article 5

*“42. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services (e.g. management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided. Indeed, the fact that a company’s own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through that location: clearly, a company that merely purchases parts produced or services supplied by another company in a different country would not have a permanent establishment because of that, even though it may benefit from the manufacturing of these parts or the supplying of these services.”*

## Commentary on Article 8

9. Replace the Commentary on Article 8 by the following:

### **"COMMENTARY ON ARTICLE 8 CONCERNING THE TAXATION OF PROFITS FROM SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT**

#### *Paragraph 1*

1. The object of paragraph 1 concerning profits from the operation of ships or aircraft in international traffic is to secure that such profits will be taxed in one State alone. The provision is based on the principle that the taxing right shall be left to the Contracting State in which the place of effective management of the enterprise is situated. The term "international traffic" is defined in subparagraph *d*) of paragraph 1 of Article 3.

2. In certain circumstances the Contracting State in which the place of effective management is situated may not be the State of which an enterprise operating ships or aircraft is a resident, and some States therefore prefer to confer the exclusive taxing right on the State of residence. Such States are free to substitute a rule on the following lines:

"Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State."

3. Some other States, on the other hand, prefer to use a combination of the residence criterion and the place of effective management criterion by giving the primary right to tax to the State in which the place of effective management is situated while the State of residence eliminates double taxation in accordance with Article 23, so long as the former State is able to tax the total profits of the enterprise, and by giving the primary right to tax to the State of residence when the State of effective management is not able to tax total profits. States wishing to follow that principle are free to substitute a rule on the following lines:

"Profits of an enterprise of a Contracting State from the operation of ships or aircraft, other than those from transport by ships or aircraft operated solely between places in the other Contracting State, shall be taxable only in the first-mentioned State. However, where the place of effective management of the enterprise is situated in the other State and that other State imposes tax on the whole of the profits of the enterprise from the operation of ships or aircraft, the profits from the operation of ships or aircraft, other than those from transport by ships or aircraft operated solely between places in the first-mentioned State, may be taxed in that other State."

4. ~~The profits covered consist in the first place of the profits obtained by the enterprise from the carriage of passengers or cargo. With this definition, however, the provision would be unduly restrictive, in view of the development of shipping and air transport, and for practical considerations also. The provision therefore covers other classes of profits as well, i.e. those which by reason of their nature or their close relationship with the profits directly obtained from transport may all be placed in a single category. Some of these classes of profits are mentioned in the following paragraphs.~~ ***The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to permit, facilitate or support their international traffic***

*operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise's ships or aircraft in international traffic as long as they are ancillary to such operation.*

*4.1 Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.*

*4.2 Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.*

*4.3 In light of these principles, the following paragraphs discuss the extent to which paragraph 1 applies with respect to some particular types of activities that may be carried on by an enterprise engaged in the operation of ships or aircraft in international traffic.*

~~5. Profits obtained by leasing a ship or aircraft on charter fully equipped, manned and supplied must be treated like the profits from the carriage of passengers or cargo. Otherwise, a great deal of business of shipping or air transport would not come within the scope of the provision. However, Article 7, and not Article 8, applies to profits from leasing a ship or aircraft on a bare boat charter basis except when it is an occasional source of income for an enterprise engaged in the international operation of ships or aircraft.~~ *Profits obtained by leasing a ship or aircraft on charter fully equipped, crewed and supplied must be treated like the profits from the carriage of passengers or cargo. Otherwise, a great deal of business of shipping or air transport would not come within the scope of the provision. However, Article 7, and not Article 8, applies to profits from leasing a ship or aircraft on a bare boat charter basis except when it is an ancillary activity of an enterprise engaged in the international operation of ships or aircraft.*

~~6. The principle that the taxing right should be left to one Contracting State alone makes it unnecessary to devise detailed rules, e.g. for defining the profits covered, this being rather a question of applying general principles of interpretation.~~

~~7. Shipping and air transport enterprises — particularly the latter — often engage in additional activities more or less closely connected with the direct operation of ships and aircraft. Although it would be out of the question to list here all the auxiliary activities which could properly be brought under the provision, nevertheless a few examples may usefully be given:~~

~~8. The provision applies, inter alia, to the following activities:~~

- ~~—— a) the sale of passage tickets on behalf of other enterprises;~~
- ~~—— b) the operation of a bus service connecting a town with its airport;~~
- ~~—— c) advertising and commercial propaganda;~~
- ~~—— d) transportation of goods by truck connecting a depot with a port or airport.~~

~~9. If an enterprise engaged in international transport undertakes to see to it that, in connection with such transport, goods are delivered directly to the consignee in the other Contracting State, such inland transportation is considered to fall within the scope of the international operation of ships or aircraft and, therefore, is covered by the provisions of this Article.~~



6. *Profits derived by an enterprise from the transportation of passengers or cargo otherwise than by ships or aircraft that it operates in international traffic are covered by the paragraph to the extent that such transportation is directly connected with the operation, by that enterprise, of ships or aircraft in international traffic or is an ancillary activity. One example would be that of an enterprise engaged in international transport that would have some of its passengers or cargo transported internationally by ships or aircraft operated by other enterprises, e.g. under code-sharing or slot-chartering arrangements or to take advantage of an earlier sailing. Another example would be that of an airline company that operates a bus service connecting a town with its airport primarily to provide access to and from that airport to the passengers of its international flights.*

7. *A further example would be that of an enterprise that transports passengers or cargo by ships or aircraft operated in international traffic which undertakes to have those passengers or that cargo picked up in the country where the transport originates or transported or delivered in the country of destination by any mode of inland transportation operated by other enterprises. In such a case, any profits derived by the first enterprise from arranging such transportation by other enterprises are covered by the paragraph even though the profits derived by the other enterprises that provide such inland transportation would not be.*

8. *An enterprise will frequently sell tickets on behalf of other transport enterprises at a location that it maintains primarily for purposes of selling tickets for transportation on ships or aircraft that it operates in international traffic. Such sales of tickets on behalf of other enterprises will either be directly connected with voyages aboard ships or aircraft that the enterprise operates (e.g. sale of a ticket issued by another enterprise for the domestic leg of an international voyage offered by the enterprise) or will be ancillary to its own sales. Profits derived by the first enterprise from selling such tickets are therefore covered by the paragraph.*

8.1 *Advertising that the enterprise may do for other enterprises in magazines offered aboard ships or aircraft that it operates or at its business locations (e.g. ticket offices) is ancillary to its operation of these ships or aircraft and profits generated by such advertising fall within the paragraph.*

9. *Containers are used extensively in international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers are usually either directly connected or ancillary to its operation of ships or aircraft in international traffic and in such cases fall within the scope of the paragraph. The same conclusion would apply with respect to profits derived by such an enterprise from the short-term storage of such containers (e.g. where the enterprise charges a customer for keeping a loaded container in a warehouse pending delivery) or from detention charges for the late return of containers.*

10. — ~~Recently, "containerisation" has come to play an increasing role in the field of international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers which is supplementary or incidental to its international operation of ships or aircraft fall within the scope of this Article.~~

10.1 — ~~Another case would be that of a transport enterprise that would be required to have assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic and that would derive income from providing goods or services in that country to other transport enterprises. This would include (for example) the provision of goods and services by engineers, ground staff, cargo handlers, catering staff and customer services personnel. Since the income so derived would not be related to the operation of ships or aircraft by the enterprise itself, that income would normally not fall within the scope of Article 8. Where, however, the enterprise provides goods~~

~~to, or performs services for, another person that are supplementary or incidental to its operation of ships or aircraft in international traffic, the profits from the provision of such goods or services will fall under Article 8. Although the same considerations apply to a pool, joint business or international operating agency for the purposes of paragraph 4, what is required in that case is to examine how closely the activity is connected with the international transport activities of the pool, joint business or international operating agency as opposed to the activities of the individual enterprises participating in such arrangements.~~

*10. An enterprise that has assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic may derive income from providing goods or services in that country to other transport enterprises. This would include (for example) the provision of goods and services by engineers, ground and equipment-maintenance staff, cargo handlers, catering staff and customer services personnel. Where the enterprise provides such goods to, or performs services for, other enterprises and such activities are directly connected or ancillary to the enterprise's operation of ships or aircraft in international traffic, the profits from the provision of such goods or services to other enterprises will fall under the paragraph.*

*10.1 For example, enterprises engaged in international transport may enter into pooling arrangements for the purposes of reducing the costs of maintaining facilities needed for the operation of their ships or aircraft in other countries. For instance, where an airline enterprise agrees, under an International Airlines Technical Pool agreement, to provide spare parts or maintenance services to other airlines landing at a particular location (which allows it to benefit from these services at other locations), activities carried on pursuant to that agreement will be ancillary to the operation of aircraft in international traffic.*

~~11. — On the other hand, the provision does not cover a clearly separate activity such as the keeping of a hotel as a separate business; the profits from such an establishment are in any case easily determinable. In certain cases, however, circumstances are such that the provision must apply even to a hotel business e.g. the keeping of a hotel for no other purpose than to provide transit passengers with night accommodation, the cost of such a service being included in the price of the passage ticket. In such a case, the hotel can be regarded as a kind of waiting room.~~

~~12. There is another activity which is excluded from the field of application of the provision, namely a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country. The paragraph does not apply to a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country.~~

~~13. — It may be agreed bilaterally that profits from the operation of vessels engaged in fishing, dredging or hauling activities on the high seas be treated as income falling under this Article. [this paragraph becomes 17.1]~~

~~14. Investment income of shipping, inland waterways or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment ordinarily applied to this class of income, except where the investment that generates the income is made as an integral part of the carrying on of the business of operating the ships or aircraft in international traffic in the Contracting State. Thus, the Article would apply to interest income generated, for example, by the cash required in a Contracting State for the carrying on of that business or by bonds posted as security where this is required by law in order to carry on the business; it would not apply, however, to interest income derived in the course of the handling of cash flow or other treasury activities for permanent establishments of the enterprise to which the income is not attributable or for associated enterprises, regardless of whether these are located within or outside that Contracting State, or for the head office (centralisation of treasury and investment activities), nor would it apply to interest income generated~~

~~by the short term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation.~~ *Investment income of shipping or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment ordinarily applied to this class of income, except where the investment that generates the income is made as an integral part of the carrying on of the business of operating the ships or aircraft in international traffic in the Contracting State so that the investment may be considered to be directly connected with such operation. Thus, the paragraph would apply to interest income generated, for example, by the cash required in a Contracting State for the carrying on of that business or by bonds posted as security where this is required by law in order to carry on the business: in such cases, the investment is needed to allow the operation of the ships or aircraft at that location. The paragraph would not apply, however, to interest income derived in the course of the handling of cash-flow or other treasury activities for permanent establishments of the enterprise to which the income is not attributable or for associated enterprises, regardless of whether these are located within or outside that Contracting State, or for the head office (centralisation of treasury and investment activities), nor would it apply to interest income generated by the short-term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation.*

#### *Paragraph 2*

15. The rules with respect to the taxing right of the State of residence as set forth in paragraphs 2 and 3 above apply also to this paragraph of the Article.

16. The object of this paragraph is to apply the same treatment to transport on rivers, canals and lakes as to shipping and air transport in international traffic. The provision applies not only to inland waterways transport between two or more countries, but also to inland waterways transport carried on by an enterprise of one country between two points in another country.

*16.1 Paragraphs 4 to 14 above provide guidance with respect to the profits that may be considered to be derived from the operation of ships or aircraft in international traffic. The principles and examples included in these paragraphs are applicable, with the necessary adaptations, for purposes of determining which profits may be considered to be derived from the operation of boats engaged in inland waterways transport.*

17. The provision does not prevent specific tax problems which may arise in connection with inland waterways transport, in particular between adjacent countries, from being settled specially by bilateral agreement.

*17.1 It may also be agreed bilaterally that profits from the operation of vessels engaged in fishing, dredging or hauling activities on the high seas be treated as income falling under this Article.*

#### **Enterprises not exclusively engaged in shipping, inland waterways transport or air transport**

18. It follows from the wording of paragraphs 1 and 2 that enterprises not exclusively engaged in shipping, inland waterways transport or air transport nevertheless come within the provisions of these paragraphs as regards profits arising to them from the operation of ships, boats or aircraft belonging to them.

19. If such an enterprise has in a foreign country permanent establishments exclusively concerned with the operation of its ships or aircraft, there is no reason to treat such establishments differently from the permanent establishments of enterprises engaged exclusively in shipping, inland waterways transport or air transport.

20. Nor does any difficulty arise in applying the provisions of paragraphs 1 and 2 if the enterprise has in another State a permanent establishment which is not exclusively engaged in shipping, inland waterways transport or air transport. If its goods are carried in its own ships to a permanent establishment belonging to it in a foreign country, it is right to say that none of the profit obtained by the enterprise through acting as its own carrier can properly be attributed to the permanent establishment. The same must be true even if the permanent establishment maintains installations for operating the ships or aircraft (e.g. consignment wharves) or incurs other costs in connection with the carriage of the enterprise's goods (e.g. staff costs). In this case, the permanent establishment's expenditure in respect of the operation of the ships, boats or aircraft should be attributed not to the permanent establishment but to the enterprise itself, since none of the profit obtained through the carrying benefits the permanent establishment.

21. Where ships or aircraft are operated in international traffic, the application of the Article to the profits arising from such operation will not be affected by the fact that the ships or aircraft are operated by a permanent establishment which is not the place of effective management of the whole enterprise (for example, ships or aircraft put into service by the permanent establishment or figuring on the balance sheet of the permanent establishment).

#### *Paragraph 3*

22. This paragraph deals with the particular case where the place of effective management of the enterprise is aboard a ship or a boat. In this case tax will only be charged by the State where the home harbour of the ship or boat is situated. It is provided that if the home harbour cannot be determined, tax will be charged only in the Contracting State of which the operator of the ship or boat is a resident.

#### *Paragraph 4*

23. Various forms of international co-operation exist in shipping or air transport. In this field international co-operation is secured through pooling agreements or other conventions of a similar kind which lay down certain rules for apportioning the receipts (or profits) from the joint business.

24. In order to clarify the taxation position of the participant in a pool, joint business or in an international operating agency and to cope with any difficulties which may arise the Contracting States may bilaterally add the following, if they find it necessary:

"but only to so much of the profits so derived as is attributable to the participant in proportion to its share in the joint operation."

25. [Renumbered as paragraph 34]"

### **Commentary on Article 10**

10. Add the following paragraph 13.1 immediately after paragraph 13 of the Commentary on Article 10:

***"7.10 Under the domestic laws of many States, pension funds and similar entities are generally exempt from tax on their investment income. In order to achieve neutrality of treatment as regards domestic and foreign investments by these entities, some States provide bilaterally that income, including dividends, derived by such an entity resident of the other State shall be exempt from source taxation. States wishing to do so may agree bilaterally on a provision drafted along the lines of the provision found in paragraph 69 of the Commentary on Article 18."***

## Commentary on Article 11

11. Replace paragraphs 7 to 17 of the Commentary on Article 11 by the following:

“7. Paragraph 2 reserves a right to tax interest to the State in which the interest arises; but it limits the exercise of that right by determining a ceiling for the tax, which may not exceed 10 per cent. This rate may be considered a reasonable maximum bearing in mind that the State of source is already entitled to tax profits or income produced on its territory by investments financed out of borrowed capital. The Contracting States may agree in bilateral negotiations upon a lower tax or on exclusive taxation in the State of the beneficiary's residence *with respect to all interest payments or, as explained below, as regards some specific categories of interest.*

7.1 [OLD 13] ~~It should, however, be pointed out that the solution adopted, given the combined effect of the right to tax accorded to the State of source and the allowance to be made for the tax levied there against that due in the State of residence, could, in certain cases, result in maintaining partial double taxation and lead to adverse economic consequences.~~ *In certain cases, the approach adopted in paragraph 2, which is to allow source taxation of payments of interest, can constitute an obstacle to international trade or may be considered inappropriate for other reasons. In fact For instance, when the beneficiary of the interest has himself had to borrowed in order to finance the operation which earns him the interest, the profit he will realised by way of interest will be much smaller than the nominal amount of interest he receives; if the interest he pays paid is equal to or exceeds the interest received and that which he receives balance, there will be either no profit at all or even a loss. The problem, in that case, cannot be solved by the State of residence, since little or no tax will be levied in that State where the beneficiary is taxed on the net profit derived from the transaction. That problem arises because the tax in the State of source is typically levied on the gross amount of the interest regardless of expenses incurred in order to earn such interest. In such a case, the allowance to be made under paragraph 2 of Article 23 A, or paragraph 1 of Article 23 B, raises a difficult and sometimes insoluble problem in view of the fact that the tax levied in the State the relief of double taxation by the State of residence will where the interest arises is calculated on the gross amount thereof, whereas the same interest is reflected in the beneficiary's business results at its net amount only. The result of this is that part, or sometimes even the whole amount, of the tax levied in the State where the interest arises cannot be allowed as a credit in the beneficiary's State of residence and so constitutes an excess charge for the beneficiary, who, to that extent, suffers double taxation. Moreover, the latter, iIn order to avoid that problem the disadvantage just mentioned, creditors will, in practice, tend to shift to the debtor the burden of the tax levied by the State of source on the interest and therefore increase the rate of interest he charged his to the debtor, whose financial burden is then increased by an amount corresponding to the tax payable to the State of source would then be increased to a corresponding extent. Thus in certain cases the practice of taxation at the source can constitute an obstacle to international trade. Furthermore, if the payer of the interest happens to be the State itself, a public sector institution, or an enterprise guaranteed by the State, the end result may well be that the tax levied at source is actually borne by the Treasury of the debtor's State, which latter thus derives no real benefit from its own taxation.*

7.2 [OLD 15] ~~If two Contracting States, in order to eliminate all risks of double taxation, should desire to avoid the imposition of a tax in the State of source on interest arising from the above mentioned categories of debts, their common intention can be expressed by an additional paragraph which would follow paragraph 2 of the Article, and which might be drafted in the following terms~~ *The Contracting States may wish to add an additional paragraph to provide for the exclusive taxation in the State of the beneficiary's residence of certain interest. The preamble of that paragraph, which would be followed by subparagraphs describing the various interest subject to that treatment (see below), might be drafted along the following lines:*

"3. Notwithstanding the provisions of paragraph 2, ~~any such interest as is mentioned in paragraph 1~~ **interest referred to in paragraph 1** shall be taxable only in the Contracting State of which the recipient is a resident **if the beneficial owner of the interest is a resident of that State**, ~~if such recipient is the beneficial owner of the interest and if such interest is paid and:~~

a) *[description of the relevant category of interest]* ...

~~a) in connection with the sale on credit of any industrial, commercial or scientific equipment,~~

~~b) in connection with the sale on credit of any merchandise by one enterprise to another enterprise, or~~

~~e) on any loan of whatever kind granted by a bank."~~

**7.3** *The following are some of the categories of interest that Contracting States may wish to consider for the purposes of paragraph 7.2 above.*

*Interest paid to State and State agencies, including central banks*

**7.4** *Some States refrain from levying tax on income derived by other States, at least to the extent that such income is derived from activities of a governmental nature. In their bilateral conventions, many States wish to confirm or clarify the scope of that exemption with respect to interest. States wishing to do so may therefore agree to include the following category of interest in a paragraph providing for exemption of certain interest from taxation in the State of source:*

*"a) is that State or the central bank, a political subdivision or local authority thereof;"*

*Interest paid by a State or its political subdivisions*

**7.5** ~~Furthermore,~~ *Where the payer of the interest happens to be the State itself, a political subdivision or a statutory body public sector institution or an enterprise guaranteed by the State, the end result may well be that the tax levied at source is ~~may~~ actually be borne by that by the Treasury of the debtor's State if the lender increases the interest rate to recoup the tax levied at source. In that case, any benefits for the State taxing the interest at source will be offset by the increase of its borrowing costs. For that reason, many States provide that such interest will be exempt from any tax at source. States wishing to do so may agree to include the following category of interest in a paragraph providing for exemption of certain interest from taxation in the State of source:*

*"b) if the interest is paid by the State in which the interest arises or by a political subdivision, a local authority or statutory body thereof;"*

*In this suggested provision, the phrase "statutory body" refers to any public sector institution. Depending on their domestic law and terminology, some States may prefer to use phrases such as "agency or instrumentality" or "legal person of public law" [personne morale de droit public] to refer to such an institution.*

*Interest paid pursuant to export financing programmes*

**7.6** *In order to promote international trade, many States have established export financing programmes or agencies which may either provide export loans directly or insure or guarantee export loans granted by commercial lenders. Since that type of financing is supported by public funds, a number of States provide bilaterally that interest arising from loans covered by these programmes shall be exempt from source taxation. States wishing to do so may agree to include*

*the following category of interest in a paragraph providing for exemption of certain interest from taxation in the State of source:*

*"c) if the interest is paid in respect of a loan, debt-claim or credit that is owed to, or made, provided, guaranteed or insured by, that State or a political subdivision, local authority or export financing agency thereof;"*

*Interest paid to financial institutions*

*7.7 The problem described in paragraph 7.1, which essentially arises because taxation by the State of source is typically levied on the gross amount of the interest and therefore ignores the real amount of income derived from the transaction for which the interest is paid, is particularly important in the case of financial institutions. [NEXT SENTENCE FROM OLD 14] For instance, similarly, the a banker generally finances the loan which he it grants with funds lent to it his bank and, in particular, funds accepted by him on deposit. Since the State of source, in determining the amount of tax payable on the interest, will usually ignore the cost of funds for the bank, the amount of tax may prevent the transaction from occurring unless the amount of that tax is borne by the debtor. For that reason, many States provide that interest paid to financial institution such as a bank will be exempt from any tax at source. States wishing to do so may agree to include the following-interest in a paragraph providing from exemption of certain interest from taxation in the State of source:*

*"d) is a financial institution;"*

*Interest on sales on credit*

*7.8 [OLD 14] The disadvantages just mentioned arise in business, particularly with the described in paragraph 7.1 also arise frequently in the case of sales on credit of equipment and, other commercial credit sales, and loans granted by banks. The supplier in such cases very often merely passes on to the customer, without any additional charge, the price he will himself have had to pay to a bank or an export finance agency to finance the credit; similarly, the banker generally finances the loan which he grants with funds lent to his bank and, in particular, funds accepted by him on deposit. In these cases especially of the person selling equipment on credit, the interest is more an element of the selling price than income from invested capital. In fact, in many cases, the interest incorporated in the amounts of instalments to be paid will be difficult to separate from the actual sale price. States may therefore wish to include interest arising from such sales on credit in a paragraph providing for exemption of certain interest from taxation in the State of source, which they can do by adding the following subparagraph :*

*"e) if the interest is paid with respect to indebtedness arising as a consequence of the sale on credit of any equipment, merchandise or services;"*

*7.9 [OLD 16] As regards, more particularly, the types of sales on credit sale referred to in subparagraph a) of the text suggested above this suggested provision, they comprise not only sales of complete units, but also sales of separate components thereof. Sales financed through a general line of credit provided by a seller to a customer constitute sales on credit as well for the purposes of the provision. Furthermore, as regards credit sales of the types referred to in sub-paragraphs a) and b) of the suggested text, Also, it is immaterial whether the interest is stipulated separately and as additional in addition to the sale price, or is included from the outset in the price payable by instalments.*

*Interest paid to some tax-exempt entities (e.g. pension funds):*

*7.10 Under the domestic laws of many States, pension funds and similar entities are generally exempt from tax on their investment income. In order to achieve neutrality of treatment as*

*regards domestic and foreign investments by these entities, some States provide bilaterally that income, including interest, derived by such an entity resident of the other State shall also be exempt from source taxation. States wishing to do so may agree bilaterally on a provision drafted along the lines of the provision found in paragraph 69 of the Commentary on Article 18.*

**7.11** *If the Contracting States do not wish to exempt completely any or all of the above categories of interest from taxation in the State of source, they may wish to apply to them a lower rate of tax than that provided for in paragraph 2 (that solution would not, however, seem very practical in the case of interest paid by a State or its political subdivision or statutory body). In that case, paragraph 2 might be drafted along the following lines:*

*"2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed:*

- a) [lower rate of tax] per cent of the gross amount of the interest in the case of interest paid [description of the relevant category of interest] ...*
- b) 10 per cent of the gross amount of the interest in all other cases.*

*The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation."*

*If the Contracting States agree to exempt some of the above categories of interest, this alternative provision would be followed by a paragraph 3 as suggested in paragraph 7.2 above.*

**7.12** [OLD 17] Contracting States may add to the categories of interest enumerated in the ~~text suggested in paragraph 15~~ **paragraphs** above, other categories in regard to which the imposition of a tax in the State of source might appear to them to be undesirable. ~~They may also agree that the exclusion of a right to tax in the State of source shall be limited to certain of the categories of interest mentioned.~~

**8. [OLD 12]** Attention is drawn generally to the following case: the beneficial owner of interest arising in a Contracting State is a company resident in the other Contracting State; all or part of its capital is held by shareholders resident outside that other State; its practice is not to distribute its profits in the form of dividends; and it enjoys preferential taxation treatment (private investment company, base company). The question may arise whether, in the case of such a company, it is justifiable to allow in the State of source of the interest the limitation of tax which is provided in paragraph 2. It may be appropriate, when bilateral negotiations are being conducted, to agree upon special exceptions to the taxing rule laid down in this Article, in order to define the treatment applicable to such companies.

**9. [OLD 8]** Under paragraph 2, the limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State. (The text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries.) States which wish to make this more explicit are free to do so during bilateral negotiations.

**10. [OLD 9]** The paragraph lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment. Procedural questions are not dealt with in this Article. Each State should be able to apply the procedure provided in its own law (see, however, paragraph 26.2 of the Commentary on Article 1). Specific questions arise with triangular cases (see paragraph 53 of the Commentary on Article 24).

**11. [OLD 10].** It does not specify whether or not the relief in the State of source should be conditional upon the interest being subject to tax in the State of residence. This question can be settled by bilateral negotiations.



**12. [OLD 11]** The Article contains no provisions as to how the State of the beneficiary's residence should make allowance for the taxation in the State of source of the interest. This question is dealt with in Articles 23 A and 23 B.

13-17. [Renumbered and amended]"

12. Replace paragraphs 29 and 30 of the Commentary on Article 11 by the following:

~~“29. It has not, however, been considered possible to refer to such a case in a bilateral convention and provide for it a solution consisting for example, in obliging *been decided not to deal with that case in the Convention*. The Contracting State of the payer's residence *does not, therefore, have to* relinquish its tax at the source in favour of the third State in which is situated the permanent establishment for the account of which the loan was effected and by which the interest is borne. *If this were not the case and the third State did not subject the interest borne by the permanent establishment to source taxation, there could be attempts to avoid source taxation in the Contracting State through the use of a permanent establishment situated in such a third State. States for which this is not a concern and that wish to address the issue described in the paragraph above may do so by agreeing to use, in their bilateral convention, the alternative formulation of paragraph 5 suggested in paragraph 30 below.* The risk of double taxation just referred to ~~can~~ *could also* only be fully avoided through a bilateral convention containing a similar provision to that in paragraph 5 or through a multilateral convention, containing such a provision. 30. ~~Moreover, in the case not settled in paragraph 5 where~~ whichever of the two Contracting States is that of the payer's residence *Also, if in the case described in paragraph 28, the State of the payer's residence* and the third State in which is situated the permanent establishment for the account of which the loan is effected and by which the interest is borne, together claim the right to tax the interest at the source, there would be nothing to prevent those two States together with, where appropriate, the State of the beneficiary's residence from concerting measures to avoid the double taxation that would result from such claims *using, where necessary, the mutual agreement procedure (as envisaged in paragraph 3 of Article 25).* The proper remedy, it must be said again, would be the establishment between these different States of bilateral conventions, or a multilateral convention, containing a provision similar to that in paragraph 5. Another~~

**30. As mentioned in paragraph 29, any such double taxation could be avoided either through a multilateral convention or if solution would be for two Contracting States the State of the beneficiary's residence and the State of the payer's residence agreed to word the second sentence of paragraph 5 in the following way, which would have the effect of ensuring that paragraphs 1 and 2 of the Article did not apply to the interest, which would then typically fall under Article 7 or 21:**

"Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated."

## Commentary on Article 12

13. Add the following paragraph 8.1 to the Commentary on Article 12:

**“8.1 Where information referred to in paragraph 2 is supplied or where the use or the right to use a type of property referred to in that paragraph is granted, the person who owns that information or property may agree not to supply or grant to anyone else that information or right. Payments made as consideration for such an agreement constitute payments made to**

*secure the exclusivity of that information or an exclusive right to use that property, as the case may be. These payments being payments “of any kind received as a consideration for [...] the right to use” the property “or for information”, fall under the definition of royalties.”*

### Commentary on Article 13

14. Replace paragraphs 28.8 of the Commentary on Article 13: by the following:

*"28.8 Another possible exception relates to shares held by pension funds and similar entities. Under the domestic laws of many States, pension funds and similar entities are generally exempt from tax on their investment income. In order to achieve neutrality of treatment as regards domestic and foreign investments by these entities, some States provide bilaterally that income derived by such an entity resident of the other State, which would include capital gains on shares referred to in paragraph 4, shall be exempt from source taxation. States wishing to do so may agree bilaterally on a provision drafted along the lines of the provision found in paragraph 69 of the Commentary on Article 18.*

~~28.9~~ 28.8 Since the domestic laws of some States do not allow them to tax the gains covered by paragraph 4, States that adopt the exemption method should be careful to ensure that the inclusion of the paragraph does not result in a double exemption of these gains. These States may wish to exclude these gains from exemption and apply the credit method, as suggested by paragraph 35 of the Commentary on Articles 23 A and 23 B."

15. Add the following paragraph 32 to the Commentary on Article 13:

*"32. There is a need to distinguish the capital gain that may be derived from the alienation of shares acquired upon the exercise of a stock-option granted to an employee or member of a board of directors from the benefit derived from the stock-option that is covered by Articles 15 or 16. The principles on which that distinction is based are discussed in paragraphs 12.2 to 12.5 of the Commentary on Article 15 and paragraph 3.1 of the Commentary on Article 16."*

### Commentary on Article 15

16. Replace paragraph 2.1 of the Commentary on Article 15 by the following:

"2.1. Member countries have generally understood the term "salaries, wages and other similar remuneration" to include benefits in kind received in respect of an employment (e.g. *stock-options*, the use of a residence or automobile, health or life insurance coverage and club memberships)."

17. Add the following paragraph 2.2 to the Commentary on Article 15:

*"2.2 The condition provided by the Article for taxation by the State of source is that the salaries, wages or other similar remuneration be derived from the exercise of employment in that State. This applies regardless of when that income may be paid to, credited to or otherwise definitively acquired by the employee."*

18. Replace paragraph 4 of the Commentary on Article 15 by the following:

"4. The three conditions prescribed in this paragraph must be satisfied for the remuneration to qualify for the exemption. The first condition is that the exemption is limited to the 183 day

period. It is further stipulated that this time period may not be exceeded "in any twelve month period commencing or ending in the fiscal year concerned". This contrasts with the 1963 Draft Convention and the 1977 Model Convention which provided that the 183 day period should not be exceeded "in the fiscal year concerned", a formulation that created difficulties where the fiscal years of the Contracting States did not coincide and which opened up opportunities in the sense that operations were sometimes organised in such a way that, for example, workers stayed in the State concerned for the last 5 1/2 months of one year and the first 5 1/2 months of the following year. The present wording of subparagraph 2 a) does away with such opportunities for tax avoidance. ***In applying that wording, all possible periods of twelve consecutive months must be considered, even periods which overlap others to a certain extent. For instance, if an employee is present in a State during 150 days between 1 April 01 and 31 March 02 but is present there during 210 days between 1 August 01 and 31 July 02, the employee will have been present for a period exceeding 183 days during the second 12 month period identified above even though he did not meet the minimum presence test during the first period considered and that first period partly overlaps the second.***

19. Replace paragraph 7 of the Commentary on Article 15 by the following:

"7. Under the third condition, if the employer has ***a permanent establishment*** in the State in which the employment is exercised ~~a permanent establishment~~, the exemption is given ~~only on condition that the remuneration is not borne by that a permanent establishment which he has in that State~~. The phrase "borne by" must be interpreted in the light of the underlying purpose of subparagraph c) of the Article, which is to ensure that the exception provided for in paragraph 2 does not apply to remuneration that ~~is deductible~~ ***could give rise to a deduction***, having regard to the principles of Article 7 ***and the nature of the remuneration***, in computing the profits of a permanent establishment situated in the State in which the employment is exercised. In this regard, it must be noted that the fact that the employer has, or has not, actually ~~deducted the claimed a deduction for the~~ remuneration in computing the profits attributable to the permanent establishment is not necessarily conclusive since the proper test is whether ***any deduction otherwise available for that remuneration would be allocated to the permanent establishment*** ~~the remuneration would be allowed as a deduction for tax purposes~~. ***That*** ~~that~~ test would be met, for instance, even if no amount were actually deducted as a result of the permanent establishment being exempt from tax in the source country or of the employer simply deciding not to claim a deduction to which he was entitled. ***The test would also be met where the remuneration is not deductible merely because of its nature (e.g. where the State takes the view that the issuing of shares pursuant to an employee stock-option does not give rise to a deduction) rather than because it should not be allocated to the permanent establishment.***

20. Replace paragraph 10 of the Commentary on Article 15 by the following:

"10. It should be noted that no special rules regarding the taxation of income of frontier workers ***or of employees working on trucks and trains travelling between States*** are included as it would be more suitable for the problems created by local conditions to be solved directly between the States concerned."

21. Add the following heading and paragraphs 12 to 12.15 to the Commentary on Article 15:

***"The treatment of employee stock-options***

***12. The different country rules for taxing employee stock-options create particular problems which are discussed below. While many of these problems arise with respect to other forms of employee remuneration, particularly those that are based on the value of shares of the employer or a related company, they are particularly acute in the case of stock-options. This is***

*largely due to the fact that stock-options are often taxed at a time (e.g. when the option is exercised or the shares sold) that is different from the time when the employment services that are remunerated through these options are rendered.*

*12.1 As noted in paragraph 2.2, the Article allows the State of source to tax the part of the stock-option benefit that constitutes remuneration derived from employment exercised in that State even if the tax is levied at a later time when the employee is no longer employed in that State.*

*12.2 While the Article applies to the employment benefit derived from a stock-option granted to an employee regardless of when that benefit is taxed, there is a need to distinguish that employment benefit from the capital gain that may be derived from the alienation of shares acquired upon the exercise of the option. This Article, and not Article 13, will apply to any benefit derived from the option itself until it has been exercised, sold or otherwise alienated (e.g. upon cancellation or acquisition by the employer or issuer). Once the option is exercised or alienated, however, the employment benefit has been realized and any subsequent gain on the acquired shares (i.e. the value of the shares that accrues after exercise) will be derived by the employee in his capacity of investor-shareholder and will be covered by Article 13. Indeed, it is at the time of exercise that the option, which is what the employee obtained from his employment, disappears and the recipient obtains the status of shareholder (and usually invests money in order to do so). Where, however, the option that has been exercised entitles the employee to acquire shares that will not irrevocably vest until the end of a period of required employment, it will be appropriate to apply this Article to the increase in value, if any, until the end of the required period of employment that is subsequent to the exercise of the option.*

*12.3 The fact that the Article does not apply to a benefit derived after the exercise or alienation of the option does not imply in any way that taxation of the employment income under domestic law must occur at the time of that exercise or alienation. As already noted, the Article does not impose any restriction as to when the relevant income may be taxed by the State of source. Thus, the State of source could tax the relevant income at the time the option is granted, at the time the option is exercised (or alienated), at the time the share is sold or at any other time. The State of source, however, may only tax the benefits attributable to the option itself and not what is attributable to the subsequent holding of shares acquired upon the exercise of that option (except in the circumstances described in the last sentence of the preceding paragraph).*

*12.4 Since paragraph 1 must be interpreted to apply to any benefit derived from the option until it has been exercised, sold or otherwise alienated, it does not matter how such benefit, or any part thereof, is characterized for domestic tax purposes. As a result, whilst the Article will be interpreted to allow the State of source to tax the benefits accruing up to the time when the option has been exercised, sold or otherwise alienated, it will be left to that State to decide how to tax such benefits, e.g. as either employment income or capital gain. If the State of source decides, for example, to impose a capital gains tax on the option when the employee ceases to be a resident of that country, that tax will be allowed under the Article. The same will be true in the State of residence. For example, while that State will have sole taxation right on the increase of value of the share obtained after exercise since this will be considered to fall under Article 13 of the Convention, it may well decide to tax such increase as employment income rather than as a capital gain under its domestic law.*

*12.5 The benefits resulting from a stock-option granted to an employee will not, as a general rule, fall under either Article 21, which does not apply to income covered by other Articles, or Article 18, which only applies to pension and other similar remuneration, even if the option is exercised after termination of the employment or retirement.*

**12.6** Paragraph 1 allows the State of source to tax salaries, wages and other similar remuneration derived from employment exercised in that State. The determination of whether and to what extent an employee stock-option is derived from employment exercised in a particular State must be done in each case on the basis of all the relevant facts and circumstances, including the contractual conditions associated with that option (e.g. the conditions under which the option granted may be exercised or disposed of). The following general principles should be followed for that purpose.

**12.7** The first principle is that, as a general rule, an employee stock-option should not be considered to relate to any services rendered after the period of employment that is required as a condition for the employee to acquire the right to exercise that option. Thus, where a stock-option is granted to an employee on the condition that he provides employment services to the same employer (or an associated enterprise) for a period of three years, the employment benefit derived from that option should generally not be attributed to services performed after that three-year period.

**12.8** In applying the above principle, however, it is important to distinguish between a period of employment that is required to obtain the right to exercise an employee stock-option and a period of time that is merely a delay before such option may be exercised (a blocking period). Thus, for example, an option that is granted to an employee on the condition that he remains employed by the same employer (or an associated enterprise) during a period of three years can be considered to be derived from the services performed during these three years while an option that is granted, without any condition of subsequent employment, to an employee on a given date but which, under its terms and conditions, can only be exercised after a delay of three years, should not be considered to relate to the employment performed during these years as the benefit of such an option would accrue to its recipient even if he were to leave his employment immediately after receiving it and waited the required three years before exercising it.

**12.9** It is also important to distinguish between a situation where a period of employment is required as a condition for the acquisition of the right to exercise an option, i.e. the vesting of the option, and a situation where an option that has already vested may be forfeited if it is not exercised before employment is terminated (or within a short period after). In the latter situation, the benefit of the option should not be considered to relate to services rendered after vesting since the employee has already obtained the benefit and could in fact realise it at any time. A condition under which the vested option may be forfeited if employment is terminated is not a condition for the acquisition of the benefit but, rather, one under which the benefit already acquired may subsequently be lost. The following examples illustrate this distinction:

- **Example 1:** On 1 January of year 1, a stock-option is granted to an employee. The acquisition of the option is conditional on the employee continuing to be employed by the same employer until 1 January of year 3. The option, once this condition is met, will be exercisable from 1 January of year 3 until 1 January of year 10 (a so-called “American” option<sup>1</sup>). It is further provided, however, that any option not previously exercised will be lost upon cessation of employment. In that example, the right to exercise that option has been acquired on 1 January of year 3 (i.e. the date of vesting) since no further period of employment is then required for the employee to obtain the right to exercise the option.

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<sup>1</sup> Under an “American” stock-option, the right to acquire a share may be exercised during a certain period (typically a number of years) while under a “European” stock-option, that right may only be exercised at a given moment (i.e. on a particular date).

- *Example 2: On 1 January of year 1, a stock-option is granted to an employee. The option is exercisable on 1 January of year 5 (a so-called “European” option). The option has been granted subject to the condition that it can only be exercised on 1 January of year 5 if employment is not terminated before that date. In that example, the right to exercise that option is not acquired until 1 January of year 5, which is the date of exercise, since employment until that date is required to acquire the right to exercise the option (i.e. for the option to vest).*

*12.10 There are cases where that first principle might not apply. One such case could be where the stock-option is granted without any condition to an employee at the time he either takes up an employment, is transferred to a new country or is given significant new responsibilities and, in each case, the option clearly relates to the new functions to be performed by the employee during a specific future period. In that case, it may be appropriate to consider that the option relates to these new functions even if the right to exercise the option is acquired before these are performed. There are also cases where an option vested technically but where that option entitles the employee to acquire shares which will not vest until the end of a period of required employment. In such cases, it may be appropriate to consider that the benefit of the option relates to the services rendered in the whole period between the grant of the option and the vesting of the shares.*

*12.11 The second principle is that an employee stock-option should only be considered to relate to services rendered before the time when it is granted to the extent that such grant is intended to reward the provision of such services by the recipient for a specific period. This would be the case, for example, where the remuneration is demonstrably based on the employee’s past performance during a certain period or is based on the employer’s past financial results and is conditional on the employee having been employed by the employer or an associated enterprise during a certain period to which these financial results relate. Also, in some cases, there may be objective evidence demonstrating that during a period of past employment, there was a well-founded expectation among participants to an employee stock-option plan that part of their remuneration for that period would be provided through the plan by having stock-options granted at a later date. This evidence might include, for example, the consistent practice of an employer that has granted similar levels of stock-options over a number of years, as long as there was no indication that this practice might be discontinued. Depending on other factors, such evidence may be highly relevant for purposes of determining if and to what extent the stock-option relates to such a period of past employment.*

*12.12 Where a period of employment is required to obtain the right to exercise an employee’s stock-option but such requirement is not applied in certain circumstances, e.g. where the employment is terminated by the employer or where the employee reaches retirement age, the stock-option benefit should be considered to relate only to the period of services actually performed when these circumstances have in fact occurred.*

*12.13 Finally, there may be situations in which some factors may suggest that an employee stock-option is rewarding past services but other factors seem to indicate that it relates to future services. In cases of doubt, it should be recognised that employee stock-options are generally provided as an incentive to future performance or as a way to retain valuable employees. Thus, employee stock-options are primarily related to future services. However, all relevant facts and circumstances will need to be taken into account before such a determination can be made and there may be cases where it can be shown that a stock-option is related to combined specific periods of previous and future services (e.g. options are granted on the basis of the employee having achieved specific performance targets for the previous year, but they become exercisable only if the employee remains employed for another three years).*

*12.14 Where, based on the preceding principles, a stock-option is considered to be derived from employment exercised in more than one State, it will be necessary to determine which part of the stock-option benefit is derived from employment exercised in each State for purposes of the application of the Article and of Articles 23A and 23B. In such a case, the employment benefit attributable to the stock-option should be considered to be derived from a particular country in proportion of the number of days during which employment has been exercised in that country to the total number of days during which the employment services from which the stock-option is derived has been exercised. For that purpose, the only days of employment that should be taken into account are those that are relevant for the stock-option plan, e.g. those during which services are rendered to the same employer or to other employers the employment by whom would be taken into account to satisfy a period of employment required to acquire the right to exercise the option.*

*12.15 It is possible for Member countries to depart from the case-by-case application of the above principles (in paragraphs 12.7 to 12.14) by agreeing to a specific approach in a bilateral context. For example, two countries that tax predominantly at exercise of an option may agree, as a general principle, to attribute the income from an option that relates primarily to future services to the services performed by an employee in the two States between date of grant and date of exercise. Thus, in the case of options that do not become exercisable until the employee has performed services for the employer for a specific period of time, two States could agree to an approach that attributes the income from the option to each State based on the number of days worked in each State by the employee for the employer in the period between date of grant and date of exercise. Another example would be for two countries that have similar rules for the tax treatment of employee stock-options to adopt provisions that would give to one of the Contracting States exclusive taxation rights on the employment benefit even if a minor part of the employment services to which the option relates have been rendered in the other State. Of course, Member countries should be careful in adopting such approaches because they may result in double taxation or double non-taxation if part of the employment is exercised in a third State that does not apply a similar approach.”*

## **Commentary on Article 16**

22. Replace paragraph 1.1 of the Commentary on Article 16 by the following:

"1.1 Member countries have generally understood the term "fees and other similar payments" to include benefits in kind received by a person in that person's capacity as a member of the board of directors of a company (e.g. *stock-options*, the use of a residence or automobile, health or life insurance coverage and club memberships)."

23. Add the following paragraph 3.1 to the Commentary on Article 16:

*"3.1 Many of the issues discussed under paragraphs 12 to 12.15 of the Commentary on Article 15 in relation to stock-options granted to employees will also arise in the case of stock-options granted to members of the board of directors of companies. To the extent that stock-options are granted to a resident of a Contracting State in that person's capacity as a member of the board of directors of a company which is a resident of the other State, that other State will have the right to tax the part of the stock-option benefit that constitutes director's fees or a similar payment (see paragraph 1.1. above) even if the tax is levied at a later time when the person is no longer a member of that board. While the Article applies to the benefit derived from a stock-option granted to a member of the board of directors regardless of when that benefit is taxed, there is a need to distinguish that benefit from the capital gain that may be derived from the alienation of shares acquired upon the exercise of the option. This Article,*

*and not Article 13, will apply to any benefit derived from the option itself until it has been exercised, sold or otherwise alienated (e.g. upon cancellation or acquisition by the company or issuer). Once the option is exercised or alienated, however, the benefit taxable under this Article has been realized and any subsequent gain on the acquired shares (i.e. the value of the shares that accrues after exercise) will be derived by the member of the board of directors in his capacity of investor-shareholder and will be covered by Article 13. Indeed, it is at the time of exercise that the option, which is what the director obtained in his capacity as such, disappears and the recipient obtains the status of shareholder (and usually invests money in order to do so)."*

## Commentary on Article 18

24. Replace the existing Commentary on Article 18 of the OECD Model Tax Convention by the following:

“1. According to this Article, pensions paid in respect of private employment are taxable only in the State of residence of the recipient. *Various policy and administrative considerations support the principle that the taxing right with respect to this type of pension, and other similar remuneration, should be left to the State of residence. For instance, the State of residence of the recipient of a pension is in a better position than any other State to take into account the recipient’s overall ability to pay tax, which mostly depends on worldwide income and personal circumstances such as family responsibilities. This solution also avoids imposing on the recipient of this type of pension the administrative burden of having to comply with tax obligations in States other than that recipient’s State of residence.*

2. *Some States, however, are reluctant to adopt the principle of exclusive residence taxation of pensions and propose alternatives to the Article. Some of these alternatives and the issues that they raise are discussed in paragraphs 12 to 21 below, which deal with the various considerations related to the allocation of taxing rights with respect to pension benefits and the reasons supporting the Article as drafted.*

### Scope of the Article

3. ~~According to this Article, pensions paid in respect of private employment are taxable only in the State of residence of the recipient. The provision also covers~~ *The types of payment that are covered by the Article include not only pensions directly paid to former employees—widows' and orphans' pensions—but also to other beneficiaries (e.g. surviving spouses, companions or children of the employees)* and other similar payments, such as annuities, paid in respect of past employment. ~~The provision~~ *Article* also applies to pensions in respect of services rendered to a State or a political subdivision or local authority thereof which are not covered by the provisions of paragraph 2 of Article 19. *The Article only applies, however, to payments that are in consideration of past employment; it would therefore not apply, for example, to an annuity acquired directly by the annuitant from capital that has not been funded from an employment pension scheme. The Article applies regardless of the tax treatment of the scheme under which the relevant payments are made; thus, a payment made under a pension plan that is not eligible for tax relief could nevertheless constitute a “pension or other similar remuneration” (the tax mismatch that could arise in such a situation is discussed below).*

4. *Various payments may be made to an employee following cessation of employment. Whether or not such payments fall under the Article will be determined by the nature of the payments, having regard to the facts and circumstances in which they are made, as explained in the following two paragraphs.*



5. While the word “pension”, under the ordinary meaning of the word, covers only periodic payments, the words “other similar remuneration” are broad enough to cover non-periodic payments. For instance, a lump-sum payment in lieu of periodic pension payments that is made on or after cessation of employment may therefore fall within the Article.

6. Whether a particular ~~lump-sum payment made on or after the cessation of employment~~ is to be considered as other remuneration similar to a pension or as final remuneration for work performed falling under Article 15 is a question of fact. For example, if-If it is shown that the consideration for the lump-sum payment is the commutation of the pension or the compensation for a reduced pension then the payment may be characterised as “other similar remuneration” falling under the Article. This would be the case, for example, where a person was entitled to elect upon retirement between the payment of a pension or a lump-sum computed either by reference to the total amount of the contributions or to the amount of pension to which that person would otherwise be entitled under the rules in force for the pension scheme. The source of the payment is an important factor-consideration; payments made from a pension scheme would normally be covered by the Article. Other factors which could assist in determining whether a payment or series of payments the payment falls under the Article include: whether a payment is made on or after the cessation of the employment giving rise to the payment, whether the recipient continues working, whether the recipient has reached the normal age of retirement with respect to that particular type of employment, the status of other recipients who qualify for the same type of lump-sum payment and whether the recipient is simultaneously eligible for other pension benefits. Reimbursement of pension contributions (e.g. after temporary employment) does not constitute “other similar remuneration” under Article 18. Some of these factors are also relevant in determining whether a series of payments may be considered as a pension within Article 18 or as deferred remuneration within Article 15. Where cases of difficulty arise in the taxation of such payments, the Contracting States should solve the matter by recourse to the provisions of Article 25.

7. Since the Article applies only to pensions and other similar remuneration that are paid in consideration for past employment, it does not cover other pensions such as those that are paid with respect to previous independent personal services. Some States, however, extend the scope of the Article to cover all types of pension, including Government pensions; States wishing to do so are free to agree bilaterally to include provisions to that effect .

#### Cross-border issues related to pensions

8. The globalisation of the economy and the development of international communications and transportation have considerably increased the international mobility of individuals, both for work-related and personal reasons. This has significantly increased the importance of cross-border issues arising from the interaction of the different pension arrangements which exist in various States and which were primarily designed on the basis of purely domestic policy considerations. As these issues often affect large numbers of individuals, it is desirable to address them in tax conventions so as to remove obstacles to the international movement of persons, and employees in particular.

9. Many such issues relate to mismatches resulting from differences in the general tax policy that States adopt with respect to retirement savings. In many States, tax incentives are provided for pension contributions. Such incentives frequently take the form of a tax deferral so that the part of the income of an individual that is contributed to a pension arrangement as well as the income earned in the scheme or any pension rights that accrue to the individual are exempt from tax. Conversely, the pension benefits from these arrangements are taxable upon receipt. Other States, however, treat pension contributions like other forms of savings and neither exempt these contributions nor the return thereon; logically, therefore, they do not tax pension benefits. Between

these two approaches exist a variety of systems where contributions, the return thereon, the accrual of pension rights or pension benefits are partially taxed or exempt.

10. Other issues arise from the existence of very different arrangements to provide retirement benefits. These arrangements are often classified under the following three broad categories:

- statutory social security schemes;
- occupational pension schemes;
- individual retirement schemes.

The interaction between these three categories of arrangements presents particular difficulties. These difficulties are compounded by the fact that each State may have different tax rules for the arrangements falling in each of these categories as well as by the fact that there are considerable differences in the extent to which States rely on each of these categories to ensure retirement benefits to individuals (e.g. some States provide retirement benefits almost exclusively through their social security system while others rely primarily on occupational pension schemes or individual retirement schemes).

11. The issues arising from all these differences need to be fully considered in the course of bilateral negotiations, in particular to avoid double taxation or non-taxation, and, where appropriate, addressed through specific provisions. The following sections examine some of these cross-border issues.

#### *Allocation of taxing rights with respect to pension benefits*

12. As explained in paragraph 9 above, many States have adopted the approach under which, subject to various restrictions, tax is totally or partially deferred on contributions to, and earnings in, pension schemes or on the accrual of pension rights, but is recovered when pension benefits are paid.

~~13. Some of these States are concerned about the loss of tax revenues that may result, under the provisions of the Article, because they would not be able to recoup the tax so deferred where the individual has ceased to be a resident before the payment of all or part of the pension benefits.~~

13. Some of these States consider that because a deduction for pension contributions is a deferral of tax on the part of the employment income that is saved towards retirement, they should be able to recover—the tax so deferred where the individual has ceased to be a resident before the payment of all or part of the pension benefits. This view is particularly prevalent where the benefits are paid through a lump-sum amount or over a short period of time as this increases risks of double non-taxation.

14. If the other State of which that individual then becomes a resident has adopted a similar approach and therefore taxes these pension benefits when received, the issue is primarily one of allocation of taxing rights between the two States. If, however, the individual becomes a resident of a State which adopts a different approach so as not to tax pension benefits, the mismatch in the approaches adopted by the two States will result in a situation where no tax will ever be payable on the relevant income.

15. For these reasons, some States seek to include in their tax conventions alternative provisions designed to secure either exclusive or limited source taxation rights with respect to pensions in consideration of past employment. The following are examples of provisions that some members have adopted in consequence of these policy and administrative considerations; States are free to agree bilaterally to include such provisions:

a) *Provisions allowing exclusive source taxation of pension payments*

*Under such a provision, the Article is drafted along the following lines:*

*“Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration arising in a Contracting State and paid to a resident of the other Contracting State in consideration of past employment shall be taxable only in the first-mentioned State.”*

b) *Provisions allowing non-exclusive source taxation of pension payments*

*Under such a provision, the State of source is given the right to tax pension payments and the rules of Articles 23A or 23B results in that right being either exclusive or merely prior to that of the State of residence. The Article is then drafted along the following lines:*

*“Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State. However such pensions and other similar remuneration may also be taxed in the other Contracting State if they arise in that State.”*

c) *Provisions allowing limited source taxation of pension*

*Under such a provision, the State of source is given the right to tax pension payments but that right is subjected to a limit, usually expressed as a percentage of the payment. The Article is then drafted along the following lines:*

*“1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment may be taxed in that State.*

*2. However such pensions and other similar remuneration may also be taxed in the Contracting State in which they arise and according to the laws of that State but the tax so charged shall not exceed [percentage] of the gross amount of the payment.”*

*Where such a provision is used, a reference to paragraph 2 of Article 18 is added to paragraph 2 of Article 23 A to ensure that the residence State, if it applies the exemption method, is allowed to tax the pension payments but needs to provide a credit for the tax levied by the source State.*

d) *Provisions allowing source taxation of pension payments only where the State of residence does not tax these payments*

*Such a provision is used by States that are primarily concerned with the structural mismatch described in paragraph 14 above. A paragraph 2 is then added along the following lines:*

*“2. However such pensions and other similar remuneration may also be taxed in the Contracting State in which they arise if these payments are not subject to tax in the other Contracting State under the ordinary rules of its tax law.”*

*16. Apart from the reasons presented in paragraphs 13 and 14 above, various policy and administrative considerations should be taken into account when considering such provisions.*

*17. First, the State of residence is in a better position to provide for adequate taxation of pension payments as it is easier for that State to take into account the worldwide income, and therefore the overall ability to pay tax, of the recipient so as to apply appropriate rates and personal allowances. By contrast, the source taxation of pensions may well result in excessive taxation where the source State imposes a final withholding tax on the gross amount paid. If little or no tax is levied in the residence State (e.g. because of available allowances), the pensioner may not be able to claim a*

credit in the residence State for the tax paid. However, some States have sought to relieve that problem by extending their personal allowances to non-residents who derive almost all their income from these States. Also, some States have allowed the pension payments made to non-resident recipients to be taxed at the marginal rate that would be applicable if that recipient were taxed on worldwide income (that system, however, involves administrative difficulties as it requires a determination of the worldwide income of the non-resident only for the purpose of determining the applicable rate of tax).

18. Second, equity considerations could be relevant since the level of pensions paid in the source State will generally have been set factoring local rates of tax. In this situation, an individual who has emigrated to another State with different tax rates will either be advantaged or disadvantaged by receiving an after-tax pension that will be different from that envisaged under the pension scheme.

~~19. Third, alternative provisions under which there is either exclusive or limited source taxation rights with respect to pensions having their source in a State or being derived from that State may create difficulties in the case of individuals who work in more than one State, change residence during their career or derive pensions from funds established in a State other than that in which they have worked. For example, many individuals now spend significant parts of their careers outside the State in which their pension funds are established and from which their pension benefits are ultimately paid. In such triangular cases, if taxation rights are not allocated exclusively to the residence State, it would seem fair to regard as the State of source the State of employment which has previously allowed deductions, as opposed to the State in which the fund has been established. This solution, however, would raise considerable administrative difficulties for both taxpayers and tax authorities, particularly in the case of individuals who have worked in many States during their career. States that wish to use such alternative provisions may therefore want to clarify which State should be considered the State of source of a pension payment. They may also want to deal with the administrative aspects of the solution that they adopt in that respect. Since a reference to a pension "arising in" a Contracting State could be construed as meaning either a pension paid by a fund established in that State or a pension derived from work performed in that State, clarification is necessary to avoid situations where two States would claim to have source taxation rights on the same pension.~~

19. Third, alternative provisions under which there is either exclusive or limited source taxation rights with respect to pensions require a determination of the State of source of pensions. Since a mere reference to a pension "arising in" a Contracting State could be construed as meaning either a pension paid by a fund established in that State or a pension derived from work performed in a State, States using such wording should clarify how it should be interpreted and applied.

19.1 Conceptually, the State of source might be considered to be the State in which the fund is established, the State where the relevant work has been performed or the State where deductions have been claimed. Each of these approaches would raise difficulties in the case of individuals who work in more than one State, change residence during their career or derive pensions from funds established in a State other than that in which they have worked. For example, many individuals now spend significant parts of their careers outside the State in which their pension funds are established and from which their pension benefits are ultimately paid. In such a case, treating the State in which the fund is established as the State of source would seem difficult to justify. The alternative of considering as the State of source the State where the work has been performed or deductions claimed would address that issue but would raise administrative difficulties for both taxpayers and tax authorities, particularly in the case of individuals who have worked in many States during their career, since it would create the possibility of different parts of the same pension having different States of source.

19.2 States that wish to use provisions under which there is either exclusive or limited source taxation rights with respect to pensions should take account of these issues related to the determination of the State of source of pensions. They should then address the administrative difficulties that will arise from the rule that they adopt for that purpose, for example to avoid situations where two States would claim to have source taxation rights on the same pension.

20. Fourth, another argument against these alternative provisions is that exclusive taxation by the State of residence means that pensioners only need to comply with the tax rules of their State of residence as regards payments covered by Article 18. Where, however, limited or exclusive source taxation of pensions is allowed, the pensioner will need to comply with the tax rules of both Contracting States.

21. Exclusive residence taxation may, however, give rise to concerns about the non-reporting of foreign pension income. Exchange of information coupled with adequate taxpayer compliance systems will, however, reduce the incidence of non-reporting of foreign pension payments.

#### *Exempt pensions*

22. As mentioned in paragraph 9 above, some States do not tax pension payments generally or otherwise exempt particular categories or parts of pension payments. In these cases, the provisions of the Article, which provides for taxation of pensions in the State of residence, may result in the taxation-by that State of pensions which were designed not to be taxed and the amount of which may well have been determined having regard to that exemption. This may result in undue financial hardship for the recipient of the pension.

23. To avoid the problems resulting from this type of mismatches, some States include in their tax treaties provisions to preserve the exempt treatment of pensions ~~arising in a Contracting State~~ when the recipient is a resident of the other Contracting State. These provisions may be restricted to specific categories of pensions or may address the issue in a more comprehensive way. An example of that latter approach would be a provision drafted along the following lines:

“Notwithstanding any provision of this Convention, any ~~amount~~ pension or other similar remuneration paid ~~from a pension scheme~~ to a resident of a Contracting State in respect of past employment exercised ~~which arises from sources~~ in the other Contracting State shall be exempt from tax in the first-mentioned State if that pension or other amount would be exempt from tax in the other State if the recipient were a resident of that other State.”

#### *Issues related to statutory social security schemes*

24. Depending on the circumstances, social security payments can fall under the Article as “pensions and other similar remuneration in consideration of past employment”, under Article 19 as “pension[s] paid by, or out of funds created by, a Contracting State [...] in respect of services rendered to that State...” or under Article 21 as “items of income [...] not dealt with in the foregoing Articles”. Social security pensions fall under the Article when they are paid in consideration of past employment, unless paragraph 2 of Article 19 applies (see below). A social security pension may be said to be “in consideration of past employment” if employment is a condition for that pension. For instance, this will be the case where, under the relevant social security scheme:

- the amount of the pension is determined on the basis of either or both the period of employment and the employment income so that years when the individual was not employed do not give rise to pension benefits,

- *the amount of the pension is determined on the basis of contributions to the scheme that are made under the condition of employment and in relation to the period of employment, or*
- *the amount of the pension is determined on the basis of the period of employment and either or both the contributions to the scheme and the investment income of the scheme.*

25. *Paragraph 2 of Article 19 will apply to a social security pension that would fall within Article 18 except for the fact that the past employment in consideration of which it is paid constituted services rendered to a State or a political subdivision or a local authority thereof, other than services referred to in paragraph 3 of Article 19.*

26. *Social security payments that do not fall within Articles 18 or 19 fall within Article 21. This would be the case, for instance, ~~of~~for payments made to self-employed persons as well as a pension purely based on resources, on age or disability which would be paid regardless of past employment or factors related to past employment (such as years of employment or contributions made during employment).*

27. Some States, *however*, consider pensions paid out under a public pension scheme which is part of their social security system similar to Government pensions. Such States argue on that basis that the State of source, i.e. the State from which the pension is paid, should have a right to tax *all* such pensions. Many conventions concluded by these States contain provisions to that effect, sometimes including also other payments made under the social security legislation of the State of source. ~~Such payments are for instance sickness benefits, unemployment benefits and benefits on account of industrial injury.~~ Contracting States having that view may agree bilaterally on an additional paragraph to the Article giving the State of source a right to tax payments made under its social security legislation. A paragraph of that kind could be drafted along the following lines:

"Notwithstanding the provisions of paragraph 1, pensions and other payments made under the social security legislation of a Contracting State may be taxed in that State."

Where the State of which the recipient of such payments is a resident applies the exemption method the payments will be taxable only in the State of source while States using the credit method may tax the payments and give credit for the tax levied in the State of source. Some States using the credit method as the general method in their conventions may, however, consider that the State of source should have an exclusive right to tax such payments. Such States should then substitute the words "shall be taxable only" for the words "may be taxed" in the above draft provision.

28. *Although the above draft provision refers to the social security legislation of each Contracting State, there are limits to what it covers. "Social security" generally refers to a system of mandatory protection that a State puts in place in order to provide its population with a minimum level of income or retirement benefits or to mitigate the financial impact of events such as unemployment, employment-related injuries, sickness or death. A common feature of social security systems is that the level of benefits is determined by the State. Payments that may be covered by the provision include retirement pensions available to the general public under a public pension scheme, old age pension payments as well as unemployment, disability, maternity, survivorship, sickness, social assistance, and family protection payments that are made by the State or by public entities constituted to administer the funds to be distributed. As there may be substantial differences in the social security systems of the Contracting States, it is important for the States that intend to use the draft provision to verify, during the course of bilateral negotiations, that they have a common understanding of what will be covered by the provision.*

## *Issues related to individual retirement schemes*

29. *In many States, preferential tax treatment (usually in the form of the tax deferral described in paragraph 9 above) is available to certain individual private saving schemes established to provide retirement benefits. These individual retirement schemes are usually available to individuals who do not have access to occupational pension schemes; they may also, however, be available to employees who wish to supplement the retirement benefits that they will derive from their social security and occupational pension schemes. These schemes take various legal forms. For example, they may be bank savings accounts, individual investment funds or individually subscribed full life insurance policies. Their common feature is a preferential tax treatment which is subject to certain contribution limits.*

30. *These schemes raise many of the cross-border issues that arise in the case of occupational schemes, such as the tax treatment, in one Contracting State, of contributions to such a scheme established in the other State (see paragraphs 31 to 65 below). There may be, however, issues that are specific to individual retirement schemes and which may need to be addressed separately during the negotiation of a bilateral convention. One such issue is the tax treatment, in each State, of income accruing in such a scheme established in the other State. Many States have rules (such as foreign ~~income~~ investment funds (FIF) rules, rules that attribute the income of a trust to a settlor or beneficiary in certain circumstances or rules that provide for the accrual taxation of income with respect to certain types of investment, including full life insurance policies) that may, in certain circumstances, result in the taxation of income accruing in an individual retirement scheme established abroad. States which consider that result inappropriate in light of their approach to the taxation of retirement savings may wish to prevent such taxation. A provision dealing with the issue and restricted to those schemes which are recognised as individual retirement schemes could be drafted along the following lines:*

*“For purposes of computing the tax payable in a Contracting State by an individual who is a resident of that State and who was previously a resident of the other Contracting State, any income accruing under an arrangement*

- a) ~~that has been~~ entered into with a person established outside that State in order to secure retirement benefits for that individual ,*
- b) in which the individual participates and had participated when ~~he~~ the individual was a resident of the other State,*
- c) that is accepted by the competent authority of the first-mentioned State as generally corresponding to an individual retirement scheme recognized as such for tax purposes by that State,*

*shall be treated as income accruing in an individual retirement scheme established in that State. This paragraph shall not restrict in any manner the taxation of any benefit distributed under the arrangement.”*

## *The tax treatment of contributions to foreign pension schemes*

### *A. General comments*

4 31. *It is characteristic of multinational enterprises that their staff are expected to be willing to work outside their home country from time to time. The terms of service under which staff are sent to work in other countries are of keen interest and importance to both the employer and the employee. One consideration is the pension arrangements that are made for the employee in question. **Similarly, individuals who move to other countries to provide independent services are often confronted with***

*cross-border tax issues related to the pension arrangements that they have established in their home country.*

~~5 32. Employees sent abroad to work~~ *Individuals working abroad* will often wish to continue contributing to a pension scheme (*including a social security scheme that provides pension benefits*) in their home country during their absence abroad. This is both because switching schemes can lead to a loss of rights and benefits, and because many practical difficulties can arise from having pension arrangements in a number of countries.

~~6 33. The tax treatment accorded to pension contributions~~ *made by or for individuals working outside* of employees who are assigned to work outside their home country varies both from country to country and depending on the circumstances of the individual case. Before taking up an overseas assignment *or contract, pension contributions made by or for these individuals* employees commonly qualify for tax relief on pension contributions paid in the home country. When *the individual works* assigned abroad, ~~employees~~ *the contributions* in some cases continue to qualify for relief. Where ~~an~~ *the* individual, for example, remains resident and fully taxable in the home country, pension contributions made to a pension scheme established in the home country will generally continue to qualify for relief there. But frequently, contributions paid in the home country by an individual assigned to working abroad do not qualify for relief under the domestic laws of either the home country or the host country. Where this is the case it can become expensive, if not prohibitive, to maintain membership of a pension scheme in the home country during a foreign *assignment or contract*. Paragraph ~~44~~ *37* below suggests a provision which Member countries can, if they wish, include in bilateral treaties to provide reliefs for the pension contributions *made by or for individuals* of employees assigned to working outside their home country.

~~7 34. However, some Member countries may not consider that the solution to the problem lies in a treaty provision, preferring, for example, the pension scheme to be amended to secure deductibility of contributions in the host State. Other countries may be opposed to including the provision~~ *below* in treaties where domestic legislation allows deductions only for relief only with respect to contributions paid to residents. In such cases it may be inappropriate to include the suggested provision in a bilateral treaty.

~~8 35. The suggested provision does not address itself to contributions made to social security schemes (general State pension schemes dependent upon contribution records, whether or not contributors are employees) as the right or obligation to join a social security scheme is primarily a matter of social legislation rather than tax law. Many Member countries have entered into bilateral social security totalisation agreements which may help to avoid the problem with respect to contributions to social security schemes. The provision also does not contain provisions relating either to the deductibility by the employer of employer pension contributions in respect of employees working abroad or to the treatment of income accrued within the plan. All of these issues can be dealt with in bilateral negotiations. The suggested provision covers contributions made to all forms of pension schemes, including individual retirement schemes as well as social security schemes. Many Member countries have entered into bilateral social security totalisation agreements which may help to partially avoid the problem with respect to contributions to social security schemes; these agreements, however, usually do not deal with the tax treatment of cross-border contributions. In the case of an occupational scheme to which both the employer and the employees contribute, the provision covers both these contributions. Also, the provision is not restricted to the issue of the deductibility of the contributions as it deals with all aspects of the tax treatment of the contributions as regards the individual who derive benefits from a pension scheme. Thus the provision deals with issues such as whether or not the employee should be taxed on the employment benefit that an employer's contribution constitutes and whether or not the investment income derived from the contributions should be taxed in the hands of the individual. It does not, however, deal with the taxation of the pension fund on its income (this issue is dealt with in paragraph 69 below).~~



*Contracting States wishing to modify the scope of the provision with respect to any of these issues may do so in their bilateral negotiations.*

9. ~~The provision is confined to the tax treatment of contributions to pension schemes by or on behalf of individuals who exercise employments within the meaning of Article 15 away from their home State. It does not deal with contributions by individuals who perform business activities covered by Article 7. However, States may wish, in bilateral negotiations, to agree on a provision covering individuals rendering services within both Article 7 and Article 15.~~

**B. Aim of the provision**

~~¶ 36.~~ The aim of the provision is to ensure that, as far as possible, ~~an employee is~~ **individuals are** not discouraged from taking up ~~an overseas~~ **work assignment** by the tax treatment of ~~his~~ **their** contributions ~~made to a home country pension scheme by an employee working abroad.~~ The provision seeks, first, to determine the general equivalence of pension plans in the two countries and then to establish limits to the ~~deductibility of employee contributions~~ **contributions to which the tax relief applies** based on the limits in the laws of both countries.

**C. Suggested provision**

~~¶ 37.~~ The following is the suggested text of the provision that could be included in bilateral conventions to deal with the problem identified above:

~~“a) Contributions borne by an individual who renders services in the course of an employment in a Contracting State to a pension scheme established in and recognised for tax purposes in the other Contracting State shall be deducted, in the first mentioned State, in determining the individual's taxable income, and treated in that 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 first mentioned State, provided that:~~

~~1. Contributions to a pension scheme established in and recognised for tax purposes in a Contracting State that are ***made by or on behalf of*** an individual who renders services in the other Contracting State shall, ***for the purposes of determining the individual's tax payable and the profits of an enterprise which may be taxed in that State, be*** treated in that 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 State, provided that:~~

~~a) (i) the individual was not a resident of that State, and was ~~contributing to~~ ***participating in*** the pension scheme, immediately before ***beginning to provide services*** ~~he began to exercise employment~~ in that State, and~~

~~b) (ii) the pension scheme is accepted by the competent authority of that State as generally corresponding to a pension scheme recognised as such for tax purposes by that State.~~

~~2.b) For the purposes of ***paragraph 1*** sub-paragraph a):~~

~~a) (i) the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the ***services employment*** referred to in ***paragraph 1*** sub-paragraph a); and~~

~~b) (ii) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State."~~

~~" 1.a) Contributions borne by *made by or on behalf of* an individual who renders services in the course of an employment in a Contracting State to a pension scheme established in and recognised for tax purposes in the other Contracting State shall, *for the purposes of*~~

~~a) *determining the individual's tax payable in the first-mentioned State and,*~~

~~b) *determining the profits of an enterprise which may be taxed in the first-mentioned State,*~~

~~be deducted, in the first mentioned State, in determining the individual's taxable income, and *be* treated in that 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 first mentioned State, provided that:~~

~~e) (i) the individual was not a resident of that State, and was contributing to *participating in* the pension scheme, immediately before *beginning to provide services* he began to exercise employment in that State; and~~

~~d) (ii) the pension scheme is accepted by the competent authority of that State as generally corresponding to a pension scheme recognised as such for tax purposes by that State.~~

~~2.b) For the purposes of *paragraph 1* sub-paragraph a):~~

~~a)(i) the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the *services* employment referred to in *paragraph 1* sub-paragraph a); and~~

~~b)(ii) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State."~~

38. *The above provision is restricted to pension schemes established in one of the two Contracting States. As it is not unusual for individuals to work in a number of different countries in succession, some States may wish to extend the scope of the provision to cover situations where an individual moves from one Contracting State to another while continuing to make contributions to a pension scheme established in a third State. Such an extension may, however, create administrative difficulties if the host State cannot have access to information concerning the pension scheme (e.g. through the exchange of information provisions of a tax convention concluded with the third State); it may also create a situation where relief would be given on a non-reciprocal basis because the third State would not grant similar relief to an individual contributing to a pension scheme established in the host State. States which, notwithstanding these difficulties, want to extend the suggested provision to funds established in third States can do so by adopting an alternative version of the suggested provision drafted along the following lines:*

*"1. Contributions made by or on behalf of an individual who renders services in a Contracting State to a pension scheme*

*a) recognised for tax purposes in the other Contracting State,*

*b) in which the individual participated immediately before beginning to provide services in the first-mentioned State,*

*c) in which the individual participated at a time when that individual was employed in, or was a resident of, the other State, and*

*d) that is accepted by the competent authority of the first-mentioned State as generally corresponding to a pension scheme recognized as such for tax purposes by that State,*

*shall, for the purposes of*

*e) determining the individual's tax payable in the first-mentioned State and,*

f) *determining the profits of an enterprise which may be taxed in the first-mentioned State, be treated in that 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 first-mentioned State.*

2. *For the purposes of paragraph 1:*

a) *the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the services ~~employment~~ referred to in paragraph 1-sub-paragraph a); and*

b) *a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State."*

#### D. *Characteristics of the suggested provision*

39. *The following paragraphs discuss the main characteristics of the suggested provision found in paragraph 37 above.*

~~12~~ 40. ~~Sub-paragraph a)~~ *Paragraph 1* of the suggested provision lays down the characteristics of both the *individual* employee and the contributions *in respect of* ~~to~~ which the provision applies. It also provides the principle that contributions *made by or on behalf of* ~~borne by~~ an individual rendering services ~~in the course of an employment within the meaning of Article 15~~ in one Contracting State (the host State) to a defined pension scheme in the other Contracting State (the home State) are to be ~~relieved from tax~~ *treated for tax purposes* in the host State, *in the same way and* subject to the same conditions and limitations as ~~relief for~~ contributions to domestic pension schemes of the host State.

~~13~~ 41. *Tax relief for* ~~with respect~~ to contributions to the home country pension scheme under the conditions outlined can be given by either the home country, being the country where the pension scheme is situated or by the host country, where the economic activities giving rise to the contributions are carried out.

~~14~~ 42. A solution in which relief would be given by the home country might not be effective, since the ~~employee~~ *individual* might have no or little taxable income in that country. Practical considerations therefore suggest that it would be preferable for relief to be given by the host country and this is the solution adopted in the suggested provision.

~~15~~ 43. In looking at the characteristics of the ~~employee~~ *individual*, ~~sub-paragraph a)~~ *paragraph 1* makes it clear that, in order to get the relief from taxation in the host State, the ~~employee~~ *individual* must not have been resident in the host State immediately prior to working there.

~~16~~ 44. ~~Sub-paragraph a)~~ *Paragraph 1* does not, however, limit the application of the provision to ~~seconded~~ *individuals* who become resident in the host State. In many cases, ~~employees~~ *individuals* working abroad who remain resident in their home State will continue to qualify for relief there, but this will not be so in all cases. The suggested provision therefore applies to non-residents working in the host State as well as to ~~seconded~~ *individuals* ~~to the host State~~ who attain residence status there. In some Member countries the domestic legislation may restrict deductibility to contributions borne by residents, and these Member countries may wish to restrict the suggested provision to cater for this. Also, States with a special regime for non-residents (e.g. taxation at a special low rate) may, in bilateral negotiations, wish to agree on a provision restricted to residents.

~~17~~ 45. In the case where individuals temporarily cease to be resident in the host country in order to join a pension scheme in a country with more relaxed rules, individual States may want a provision which would prevent the possibility of abuse. One form such a provision could take would be a nationality test which could exclude from the suggested provision individuals who are nationals of the host State.

~~18~~ 46. As *already noted*, it is not unusual for ~~employees to be seconded to~~ *individuals to work in* a number of different countries in succession; *for that reason*, the suggested provision is not limited to ~~employees~~ *individuals* who are residents of the home State immediately prior to ~~exercising employment~~ *providing services* in the host State. The provision covers an ~~employee~~ *individual* coming to the host State from a third country as it is only limited to ~~employees~~ *individuals* who were not resident in the host country before ~~taking up employment~~ *starting to work* there. However, Article 1 restricts the scope of the Convention to residents of one or both Contracting States. An ~~employee~~ *individual* who is neither a resident of the host State nor of the home State where the pension scheme is established is therefore outside the scope of the Convention between the two States.

~~19~~ 47. The suggested provision places no limits on the length of time for which an ~~employee~~ *individual* can work in a host State. It could be argued that, if an ~~employee~~ *individual* works in the host State for long enough, it in effect becomes his home country and the provision should no longer apply. Indeed, some host countries already restrict relief for contributions to foreign ~~employee/employer~~ pension schemes to cases where the ~~seconded employees~~ *individuals* are present on a temporary basis.

~~20~~ 48. In addition, the inclusion of a time limit may be helpful in preventing the possibility of abuse outlined in paragraph ~~17~~ 45 above. In bilateral negotiations, individual countries may find it appropriate to include a limit on the length of time for which an ~~employee~~ *individual* may ~~exercise an employment~~ *provide services* in the host State after which reliefs granted by the suggested provision would no longer apply.

~~21~~ 49. In looking at the characteristics of the contributions, ~~sub-paragraph a)~~ *paragraph 1* provides a number of tests. It makes it clear that the provision applies only to contributions ~~borne by~~ *made by or on behalf of* an individual to a pension scheme established in and recognised for tax purposes in the home State. The phrase "recognised for tax purposes" is further defined in ~~subdivision b)(ii)~~ *sub-paragraph 2b*) of the suggested provision. *The phrase "made by or on behalf of" is intended to apply to contributions that are made directly by the individual as well as to those that are made for that individual's benefit by an employer or another party (e.g. a spouse). While paragraph 4 of Article 24 ensures that the employer's contributions to a pension fund resident of the other Contracting State are deductible under the same conditions as contributions to a resident pension fund, that provision may not be sufficient to ensure the similar treatment of employer's contributions to domestic and foreign pension funds. This will be the case, for example, where the employer's contributions to the foreign fund are treated as a taxable benefit in the hands of the employee or where the deduction of the employer's contributions is not dependent on the fund being a resident but, rather, on other conditions (e.g. registration with tax authorities or the presence of offices) which have the effect of generally excluding foreign pension funds. For these reasons, employer's contributions are covered by the suggested provision even though paragraph 4 of Article 24 may already ensure a similar relief in some cases.*

~~22~~ 50. The second test applied to the characteristics of the contributions is that the contributions should be made to a home State scheme recognised by the competent authority of the host State as generally corresponding to a scheme recognised as such for tax purposes by the host State. This operates on the premise that only contributions to recognised schemes qualify for relief in Member countries. This limitation does not, of course, necessarily secure equivalent tax treatment of contributions paid where an ~~employee~~ *individual* was working abroad and of contributions while working in the home country. If the host State's rules for recognising pension schemes were narrower

than those of the home State, the ~~employee~~ **individual** could find that contributions to his home country pension scheme were less favourably treated when he was working in the host country than when working in the home country.

~~23~~ **51.** However, it would not be in accordance with the stated aim of securing, as far as possible, equivalent tax treatment of ~~employee~~ contributions to **foreign schemes** to give relief for contributions which do not—at least broadly—correspond to domestically recognised schemes. To do so would mean that the amount of relief in the host State would become dependent on legislation in the home State. In addition, it could be hard to defend treating ~~employees~~ **individuals** working side by side differently depending on whether their pension scheme was at home or abroad (and if abroad, whether it was one country rather than another). By limiting the suggested provision to schemes which generally correspond to those in the host country such difficulties are avoided.

~~24~~ **52.** The suggested provision makes it clear that it is for the competent authority of the host State to determine whether the scheme in the home State generally corresponds to recognised schemes in the host State. Individual States may wish, in bilateral negotiations, to **specify expressly to which existing schemes the provision will apply or to** establish what interpretation the competent authority places on the term "generally corresponding"; for example how widely it is interpreted and what tests are imposed.

~~25~~ **53.** The contributions covered by the provision are limited to payments to schemes ~~to~~ **in** which the ~~employee~~ **individual** was ~~contributing~~ **participating** before **beginning** to ~~exercise his employment~~ **provide services** in the host State. This means that contributions to new pension schemes which an ~~employee~~ **individual** joins while in the host State are excluded from the suggested provision.

~~26~~ **54.** It is, however, recognised that special rules may be needed to cover cases where new pension schemes are substituted for previous ones. For instance, in some Member countries the common practice may be that, if a company employer is taken over by another company, the existing company pension scheme for its employees may be ended and a new scheme opened by the new employer. In bilateral negotiations, therefore, individual States may wish to supplement the provision to cover such substitution schemes; **this could be done by adding the following sub-paragraph to paragraph 2 of the suggested provision:**

**“c) a pension scheme that is substituted for, but is substantially similar to, a pension scheme accepted by the competent authority of a Contracting State under subparagraph b) of paragraph 1 shall be deemed to be the pension scheme that was so accepted.”**

~~27~~ **55.** ~~Sub-paragraph a)~~ **Paragraph 1** also sets out the relief to be given by the host State if the characteristics of the ~~employee~~ **individual** and the contributions fall within the terms of the provision. In brief, the relief is to be given in a way which corresponds to the manner in which relief would be given contributions **must be treated for tax purposes in a way which corresponds to the manner in which they would be treated** if these contributions were to a scheme established in the host State. **Thus, the contributions will qualify for the same tax relief (e.g. be deductible), for both the individual and the his employer (where the individual is employed and contributions are made by the employer) as if these contributions had been made to a scheme in the host State. Also, the same treatment has to be given as regards the taxation of an employee on the employment benefit derived from an employer’s contribution to either a foreign or a local scheme (see paragraph 58 below).**

~~28~~ **56.** This measure of relief does not, of course, necessarily secure equivalent tax treatment given to contributions paid when an ~~employee~~ **individual** is working abroad and contributions paid when he is working in the home country. Similar considerations apply here to those discussed in paragraphs ~~22~~ **and 23 50 and 51** above. The measure does, however, ensure equivalent treatment of the contributions of ~~colleagues~~ **co-workers**. The following example is considered. The home country allows relief for pension contributions subject to a limit of 18 % of income. The host country allows relief subject to a

limit of 20 %. The suggested provision in paragraph ~~41~~**37** would require the host country to allow relief up to its domestic limit of 20 %. Countries wishing to adopt the limit in the home country would need to amend the wording of the provision appropriately.

~~29~~**57.** The amount and method of giving the relief would depend upon the domestic tax treatment of pension contributions by the host State. This would settle such questions as whether contributions qualify for relief in full, or only in part, and whether relief should be given as a deduction in computing taxable income (and if so, which income, e.g. *in the case of an individual*, only employment *or business* income or all income) or as a tax credit.

~~30~~**58.** *For an individual who participates in an occupational pension scheme*, ~~B~~being assigned to work abroad may not only mean that ~~an~~ *this* employee's contributions to a pension scheme in his home country cease to qualify for tax relief. It may also mean that contributions to the pension scheme by the employer are regarded as the employee's income for tax purposes. In some Member countries employees are taxed on employer's contributions to domestic schemes whilst working in the home country whereas in others these contributions remain exempt. ~~The provision, therefore, is silent on the treatment of such contributions, although Member countries may wish to extend the suggested provision in bilateral treaties, to~~ *Since it applies to both employees' and employers' contributions*, the suggested provision ensures that employers' contributions in the context of the employees' tax liability are accorded the same treatment that such contributions to domestic schemes would receive.

~~31~~**59.** ~~Subdivision b)(i) Sub-paragraph 2 a)~~ defines a pension scheme for the purposes of ~~sub-paragraph 1 a)~~. It makes it clear that, for these purposes, a pension scheme is an arrangement in which the individual who makes the payments participates in order to secure retirement benefits. These benefits must be payable in respect of *services* ~~exercise of the employment~~ *provided* in the host State. All the above conditions must apply to the pension scheme before it can qualify for relief under the suggested provision.

~~32~~**60.** ~~Subdivision b)(i) Sub-paragraph 2 a)~~ refers to the participation of the individual in the pension scheme in order to secure retirement benefits. This definition is intended to ensure that the proportion of contributions made to secure benefits other than periodic pension payments on retirement, e.g. a lump sum on retirement, will also qualify for relief under the provision.

~~33~~**61.** The initial definition of a pension scheme is "an arrangement". This is a widely drawn term, the use of which is intended to encompass the various forms which pension schemes (*whether social security, occupational or individual retirement schemes*) may take in ~~individual~~ *different* Member countries.

~~34~~**62.** Although ~~subdivision b)(i) sub-paragraph 2 a)~~ sets out that participation in this scheme has to be by the individual who ~~exercises the employment~~ *provides services* referred to in *paragraph 1 sub-paragraph a)*, there is no reference to the identity of the recipient of the retirement benefits secured by participation in the scheme. This is to ensure that any proportion of contributions intended to generate a widow's or dependent's pension may be eligible for relief under the suggested provision.

~~35~~**63.** The definition of a pension scheme makes no distinction between pensions paid from State-run occupational pension schemes and similar privately-run schemes. Both are covered by the scope of the provision. *Social security schemes are therefore covered by the provision to the extent that contributions to such schemes can be considered to be with respect to the services provided in the host State by an individual, whether as an employee or in an independent capacity.* ~~Any pensions, such as pensions from general State pension schemes dependent on contribution records whether or not contributors are employees, are excluded from the provision as the individual will not contribute to such schemes in order to receive benefits payable in respect of his employment.~~

36 ~~64. Subdivision b)(i)~~ **Sub-paragraph 2 b)** further defines the phrase "recognised for tax purposes". As the aim of the provision is, so far as possible, to ensure that contributions are neither more nor less favourably treated for tax purposes than they would be if the ~~employee-individual~~ **individual** ~~was~~ **were** resident in his home State, it is right to limit the *scope of the* provision to contributions which would have qualified for relief if the ~~employee-individual~~ **individual** had remained in the home State. The provision seeks to achieve this aim by limiting its scope to contributions made to a scheme only if contributions to this scheme would qualify for tax relief in that State.

37 **65.** This method of attempting to achieve parity of treatment assumes that in all Member countries only contributions to recognised pension schemes qualify for relief. The tax treatment of contributions to pension schemes under Member countries' tax systems may differ from this assumption. It is recognised that, in bilateral negotiations, individual countries may wish to further define the qualifying pension schemes in terms that match the respective domestic laws of the treaty partners. *They may also wish to define other terms used in the provision, such as "renders services" and "provides services"*.

#### *Tax obstacles to the portability of pension rights*

**66.** *Another issue, which also relates to international labour mobility, is that of the tax consequences that may arise from the transfer of pension rights from a pension scheme established in one Contracting State to another scheme located in the other Contracting State. When an individual moves from one employer to another, it is frequent for the pension rights that this individual accumulated in the pension scheme covering the his first employment to be transferred to a different scheme covering the his second employment. Similar arrangements may exist to allow for the portability of pension rights to or from an individual retirement scheme.*

**67.** *Such transfers usually give rise to a payment representing the actuarial value, at the time of the transfer, of the pension rights of the individual or representing the value of the contributions and earnings that have accumulated in the scheme with respect to the individual. These payments may be made directly from the first scheme to the second one; alternatively, they may be made by requiring the individual to contribute to the new pension scheme all or part of the amount ~~that he has~~ received upon withdrawing from the previous scheme. In both cases, it is frequent for tax systems to allow such transfers, when they are purely domestic, to take place on a tax-free basis.*

**68.** *Problems may arise, however, where the transfer is made from a pension scheme located in one Contracting State to a scheme located in the other State. In such a case, the Contracting State where the individual resides may consider that the payment arising upon the transfer is a taxable benefit. A similar problem arises when the payment is made from a scheme established in a State to which the relevant tax convention gives source taxing rights on pension payments arising therefrom as that State may want to apply that taxing right to any benefit derived from the scheme. Contracting States that wish to address that issue are free to include a provision drafted along the following lines:*

*“Where pension rights or amounts have accumulated in a pension scheme established in and recognised for tax purposes in one Contracting State for the benefit of an individual who is a resident of the other Contracting State, any transfer of these rights or amounts to a pension scheme established in and recognised for tax purposes in that other State shall, in each State, be treated for tax purposes in the same way and subject to the same conditions and limitations as if it had been made from one pension scheme established in and recognised for tax purposes in that State to another pension scheme established in and recognised for tax purposes in the same State.”*

*The above provision could be modified to also cover transfers to or from pensions funds established and recognised in third States (this, however, could raise similar concerns as those described in the preamble of paragraph 38 above).*

#### *Exemption of the income of a pension fund*

69. *Where, under their domestic law, two States follow the same approach of generally exempting from tax the investment income of pension funds established in their territory, these States, in order to achieve greater neutrality with respect to the location of capital, may want to extend that exemption to the investment income that a pension fund established in one State derives from the other State. In order to do so, States sometimes include in their conventions a provision drafted along the following lines:*

*“Notwithstanding any provision of this Convention, income arising in a Contracting State that is derived by a resident of the other Contracting State that was constituted and is operated exclusively to administer or provide pension benefits and has been accepted by the competent authority of the first-mentioned State as generally corresponding to a pension scheme recognised as such for tax purposes by that State, shall be exempt from tax in the first-mentioned State.”*

#### **Commentary on Article 19**

25. Replace the existing paragraphs 4 to 6 of the Commentary on Article 19 by the following:

“4. An exception from the principle of giving exclusive taxing power to the paying State is contained in sub-paragraph *b*) of paragraph 1. It is to be seen against the background that, according to the Vienna Conventions mentioned above, the receiving State is allowed to tax remuneration paid to certain categories of personnel of foreign diplomatic missions and consular posts, who are permanent residents or nationals of that State. Given that pensions paid to retired government officials ought to be treated for tax purposes in the same way as salaries or wages paid to such employees during their active time, an exception like the one in sub-paragraph *b*) of paragraph 1 is incorporated also in sub-paragraph *b*) of paragraph 2 regarding pensions. Since the condition laid down in subdivision *b*)(*ii*) of paragraph 1 cannot be valid in relation to a pensioner, the only pre-requisite for the receiving State's power to tax the pension is that the pensioner must be one of its own residents and nationals. ~~It should be noted that the expression "out of funds created by" in sub-paragraph *a*) of paragraph 2 covers the situation where the pension is not paid directly by the State, a political subdivision or a local authority but out of separate funds created by them.~~

5. According to Article 19 of the 1963 Draft Convention, the services rendered to the State, political subdivision or local authority had to be rendered "in the discharge of functions of a governmental nature". That expression was deleted in the 1977 Model Convention. Some OECD Member countries, however, thought that the exclusion would lead to a widening of the scope of the Article. Contracting States who are of that view and who feel that such a widening is not desirable may continue to use, and preferably specify, the expression "in the discharge of functions of a governmental nature" in their bilateral conventions.

**5.1** *While the word “pension”, under the ordinary meaning of the word, covers only periodic payments, the words “other similar remuneration”, which were added to paragraph 2 in 2005, are broad enough to cover non-periodic payments. For example, a lump-sum payment in lieu of periodic pension payments that is made to a former State employee after cessation of employment may fall within paragraph 2 of the Article. Whether a particular lump-sum payment made in these circumstances is to be considered as other remuneration similar to a pension falling under*



*paragraph 2 or as final remuneration for work performed falling under paragraph 1 is a question of fact which can be resolved in light of the factors presented in paragraph 5 of the Commentary on Article 18.*

*5.2 It should be noted that the expression "out of funds created by" in sub-paragraph a) of paragraph 2 covers the situation where the pension is not paid directly by the State, a political subdivision or a local authority but out of separate funds created by a government body. In addition, the original capital of the fund would not need to be provided by the State, a political subdivision or a local authority. The phrase would cover payments from a privately administered fund established for the government body.*

*5.3 An issue arises where pensions are paid for combined private and government services. This issue may frequently arise where a person has been employed in both the private and public sector and receives one pension in respect of both periods of employment. This may occur either because the person participated in the same scheme throughout the employment or because the person's pension rights were portable. A trend towards greater mobility between private and public sectors may increase the significance of this issue.*

*5.4 Where a civil servant having rendered services to a State has transferred ~~his~~ a right to a pension from a public scheme to a private scheme the pension payments would be taxed only under Article 18 because such payment would not meet the technical requirement of subparagraph 2 a).*

*5.5 Where the transfer is made in the opposite direction and the pension rights are transferred from a private scheme to a public scheme, some States tax the whole pension payments under Article 19. Other States, however, apportion the pension payments based on the relative source of the pension entitlement so that part is taxed under Article 18 and another part under Article 19. In so doing, some States consider that if one source has provided by far the principal amount of the pension, then the pension should be treated as having been paid exclusively from that source. Nevertheless, it is recognised that apportionment often raises significant administrative difficulties.*

*5.6 Contracting States may be concerned about the revenue loss or the possibility of double non-taxation if the treatment of pensions could be changed by transferring the fund between public and private schemes. Apportionment may counter this; however, to enable apportionment to be applied to pensions rights that are transferred from a public scheme to a private scheme, Contracting States may, in bilateral negotiations, consider extending subparagraph 2 a) to cover the part of any pension or other similar remuneration that it is paid in respect of services rendered to a Contracting State or a political subdivision or a local authority thereof. Such a provision could be drafted as follows:*

*"2. a) Notwithstanding the provisions of paragraph 1, the part of any pension or other similar remuneration that is paid in respect of services rendered to a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that Contracting State."*

*Alternatively Contracting States may address the concern by subjecting all pensions to the same a common treatment.*

*6. Paragraphs 1 and 2 do not apply if the services are performed in connection with business carried on by the State, or one of its political subdivisions or local authorities, paying the salaries, wages, ~~or other similar remuneration or the pensions~~ or other similar remuneration. In such cases the ordinary rules apply: Article 15 for wages and salaries, Article 16 for directors' fees and other similar payments, Article 17 for artistes and sportsmen, and Article 18 for pensions. Contracting States, wishing for specific reasons to dispense with paragraph 3 in their bilateral conventions, are free to do so thus*

bringing in under paragraphs 1 and 2 also services rendered in connection with business. In view of the specific functions carried out by certain public bodies, e.g. State Railways, the Post Office, State-owned theatres etc., Contracting States wanting to keep paragraph 3 may agree in bilateral negotiations to include under the provisions of paragraphs 1 and 2 salaries, wages, ~~and other similar remuneration,~~ **and pensions, and other similar remuneration** paid by such bodies, even if they could be said to be performing business activities.”

### Commentary on Article 20

26. Add the following paragraphs 2.1 and 2.2 to the Commentary on Article 20:

*"2.1 The Article covers only payments received for the purpose of the recipient's maintenance, education or training. It does not, therefore, apply to a payment, or any part thereof, that is remuneration for services rendered by the recipient and which is covered by Article 15 (or by Article 7 in the case of independent services). Where the recipient's training involves work experience, however, there is a need to distinguish between a payment for services and a payment for the recipient's maintenance, education or training. The fact that the amount paid is similar to that paid to persons who provide similar services and are not students or business apprentices would generally indicate that the payment is a remuneration for services. Also, payments for maintenance, education or training should not exceed the level of expenses that are likely to be incurred to ensure the recipient's maintenance, education or training.*

*2.2 For the purpose of the Article, payments that are made by or on behalf of a resident of a Contracting State or that are borne by a permanent establishment which a person has in that State are not considered to arise from sources outside that State."*

### Commentary on Articles 23A and 23B

27. Add the following paragraphs 4.1 to 4.3 to the Commentary on Articles 23 A and 23 B:

*"4.1 Article 4, however, only deals with cases of concurrent full liability to tax. The conflict in case a) may therefore not be solved if the same item of income is subject to the full liability to tax of two countries but at different times. The following example illustrates that problem. Assume that a resident of State R1 derives a taxable benefit from an employee stock-option that is granted to that person. State R1 taxes that benefit when the option is granted. The person subsequently becomes a resident of State R2, which taxes the benefit at the time of its subsequent exercise. In that case, the person is taxed by each State at a time when he is a resident of that State and Article 4 does not deal with the issue as there is no concurrent residence in the two States.*

*4.2 The conflict in that situation will be reduced to that of case b) and solved accordingly to the extent that the employment services to which the option relates have been rendered in one of the Contracting States so as to be taxable by that State under Article 15 because it is the State where the relevant employment is exercised. Indeed, in such a case, the State in which the services have been rendered will be the State of source for purposes of elimination of double taxation by the other State. It does not matter that the first State does not levy tax at the same time (see paragraph 32.8). It also does not matter that the other State considers that it levies tax as a State of residence as opposed to a State of source (see the last sentence of paragraph 8).*

*4.3 Where, however, the relevant employment services have not been rendered in either State, the conflict will not be one of source-residence double taxation. The mutual agreement procedure could be used to deal with such a case. One possible basis to solve the case would be for the competent authorities of the two States to agree that each State should provide relief as regards the residence-based tax that was levied by the other State on the part of the benefit that relates to services rendered during the period while the employee was a resident of that other State. Thus, in the above example, if the relevant services were rendered in a third State before the person became a resident of State R2, it would be logical for the competent authority of State R2 to agree to provide relief (either through the credit or exemption method) for the State R1 tax that has been levied on the part of the employment benefit that relates to services rendered in the third State since, at the time when these services were rendered, the taxpayer was a resident of State R1 and not of State R2 for purposes of the convention between these two States.”*

28. Add the following paragraph 32.8 and the preceding heading to the Commentary on Articles 23 A and 23 B:

**“F. Timing Mismatch**

*32.8 The provisions of the Convention that allow the State of source to tax particular items of income or capital do not provide any restriction as to when such tax is to be levied (see, for instance, paragraph 2.2 of the Commentary on Article 15). Since both Articles 23 A and 23 B require that relief be granted where an item of income or capital may be taxed by the State of source in accordance with the provisions of the Convention, it follows that such relief must be provided regardless of when the tax is levied by the State of source. The State of residence must therefore provide relief of double taxation through the credit or exemption method with respect to such item of income or capital even though the State of source taxes it in an earlier or later year. Some States, however, do not follow the wording of Article 23A or 23B in their bilateral conventions and link the relief of double taxation that they give under tax conventions to what is provided under their domestic laws. These countries, however, would be expected to seek other ways (the mutual agreement procedure, for example) to relieve the double taxation which might otherwise arise in cases where the State of source levies tax in a different taxation year.”*

**Commentary on Article 25**

29. Replace paragraph 4 of the Commentary on Article 25 by the following:

*“4. Finally, as regards the practical operation of the mutual agreement procedure, the Article, in paragraph 4, merely authorises the competent authorities to communicate with each other directly, without going through diplomatic channels, and, if it seems advisable to them, to have an oral exchange of opinions through a joint commission appointed especially for the purpose. Article 26 applies to the exchange of information for the purposes of the provisions of this Article. The confidentiality of information exchanged for the purposes of a mutual agreement procedure is thus ensured.”*

**Commentary on Article 26**

30. Replace the existing Commentary on Article 26 by the following:

## "COMMENTARY ON ARTICLE 26 CONCERNING THE EXCHANGE OF INFORMATION

### *I. Preliminary remarks*

1. There are good grounds for including in a convention for the avoidance of double taxation provisions concerning co-operation between the tax administrations of the two Contracting States. In the first place it appears to be desirable to give administrative assistance for the purpose of ascertaining facts in relation to which the rules of the convention are to be applied. Moreover, in view of the increasing internationalisation of economic relations, the Contracting States have a growing interest in the reciprocal supply of information on the basis of which domestic taxation laws have to be administered, even if there is no question of the application of any particular article of the Convention.

2. Therefore the present Article embodies the rules under which information may be exchanged to the widest possible extent, with a view to laying the proper basis for the implementation of the domestic *tax* laws of the Contracting States ~~concerning taxes covered by the Convention~~ and for the application of specific provisions of the Convention. The text of the Article makes it clear that the exchange of information is not restricted by Articles 1 *and* 2, so that the information may include particulars about non-residents *and may relate to the administration or enforcement of taxes not referred to in Article 2.*

3. The matter of administrative assistance for the purpose of tax collection is dealt with in Article 27.

~~4. Experience between 1963 and 1977 had shown that the text of the Article in the 1963 Draft Convention left room for differing interpretations. Therefore it was felt desirable to clarify its meaning in the 1977 Model Convention by a change in the wording of the Article and its Commentary without altering its effects. Apart from a single point of substance (cf. paragraph 13 below) the main purpose of the changes made has been to remove grounds for divergent interpretations.~~

*4. In 2002 the Committee on Fiscal Affairs undertook a comprehensive review of Article 26 to ensure that it reflects current country practices. That review also took into account recent developments such as the Model Agreement on Exchange of Information on Tax Matters<sup>2</sup> developed by the OECD Global Forum Working Group on Effective Exchange of Information and the ideal standard of access to bank information as described in the report *Improving Access to Bank Information for Tax Purposes*.<sup>3</sup> As a result, several changes to both the text of the Article and the Commentary were made in [2005.]*

*4.1. Many of the changes that were then made to the Article were not intended to alter its substance, but instead were made to remove doubts as to its proper interpretation. For instance, the change from "necessary" to "foreseeably relevant" and the insertion of the words "to the administration or enforcement" in paragraph 1 were made to achieve consistency with the Model Agreement on Exchange of Information on Tax Matters and were not intended to alter the effect of the provision. New paragraph 4 was added to incorporate into the text of the Article the general understanding previously expressed in the Commentary (cf. paragraph 19.6). New paragraph 5 was added to reflect current practices among the vast majority of*

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<sup>2</sup> Available on [www.oecd.org/taxation](http://www.oecd.org/taxation)

<sup>3</sup> *Improving Access to Bank Information for Tax Purposes*, OECD 2000. Available on [www.oecd.org/taxation](http://www.oecd.org/taxation).

*OECD member countries (cf. paragraph 19.10). The insertion of the words “or the oversight of the above” into new paragraph 2, on the other hand, constitutes a reversal of the previous rule.*

*4.2. The Commentary also has been expanded considerably. This expansion in part reflects the addition of new paragraphs 4 and 5 to the Article. Other changes were made to the Commentary to take into account recent developments and current country practices and more generally to remove doubts as to the proper interpretation of the Article.*

## *II. Commentary on the provisions of the Article*

### *Paragraph 1*

5. The main rule concerning the exchange of information is contained in the first sentence of the paragraph. The competent authorities of the Contracting States shall exchange such information as is ~~necessary~~ *foreseeably relevant* to secure the correct application of the provisions of the Convention or of the domestic laws of the Contracting States concerning taxes of every kind and description imposed in these States even if, in the latter case, a particular Article of the Convention need not be applied. ~~Some countries replace “necessary” with “relevant” in their bilateral conventions regarding this as a better way to express the sense of the provision: in the view of the Committee on Fiscal Affairs, either word may be used in that context. The standard of “foreseeable relevance” is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Contracting States are not at liberty to engage in “fishing expeditions” or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer. Contracting States may agree to an alternative formulation of this standard that is consistent with the scope of the Article (e.g. by replacing, “foreseeably relevant” with “necessary” or “relevant”). The scope of exchange of information covers all tax matters without prejudice to the general rules and legal provisions governing the rights of defendants and witnesses in judicial proceedings. Exchange of information for criminal tax matters can also be based on bilateral or multilateral treaties on mutual legal assistance (to the extent they also apply to tax crimes).~~ In order to keep the exchange of information within the framework of the Convention, a limitation to the exchange of information is set so that information should be given only insofar as the taxation under the domestic taxation laws concerned is not contrary to the Convention.

*5.1 The information covered by paragraph 1 is not limited to taxpayer-specific information. The competent authorities may also exchange other sensitive information related to tax administration and compliance improvement, for example risk analysis techniques or tax avoidance or evasion schemes.*

*5.2 [FROM OLD 11.2]The possibilities of assistance provided by Article 26 do not limit, nor are they limited by, those contained in existing international agreements or other arrangements between the Contracting States which relate to co-operation in tax matters. Since the exchange of information concerning the application of custom duties has a legal basis in ~~is governed by~~ other international ~~conventions~~ instruments, the provisions of these more specialised instruments ~~conventions~~ will generally prevail and the exchange of information concerning custom duties will not, in practice, be governed by the Article.*

6. The following examples may clarify the principle dealt with in paragraph 5 above. In all such cases information can be exchanged under paragraph 1.

7. Application of the Convention

- a) When applying Article 12, State A where the beneficiary is resident asks State B where the payer is resident, for information concerning the amount of royalty transmitted.
- b) Conversely, in order to grant the exemption provided for in Article 12, State B asks State A whether the recipient of the amounts paid is in fact a resident of the last-mentioned State and the beneficial owner of the royalties.
- c) Similarly, information may be needed with a view to the proper allocation of taxable profits between associated companies in different States or the adjustment of the profits shown in the accounts of a permanent establishment in one State and in the accounts of the head office in the other State (Articles 7, 9, 23 A and 23 B).
- d) ***Information may be needed for the purposes of applying Article 25.***
- e) ***When applying Articles 15 and 23 a), State A, where the employee is resident, informs State B, where the employment is exercised for more than 183 days, of the amount exempted from taxation in State A.***

8. Implementation of the domestic laws

- a) A company in State A supplies goods to an independent company in State B. State A wishes to know from State B what price the company in State B paid for the goods with a view to a correct application of the provisions of its domestic laws.
- b) A company in State A sells goods through a company in State C (possibly a low-tax country) to a company in State B. The companies may or may not be associated. There is no convention between State A and State C, nor between State B and State C. Under the convention between A and B, State A, with a view to ensuring the correct application of the provisions of its domestic laws to the profits made by the company situated in its territory, asks State B what price the company in State B paid for the goods.
- c) State A, for the purpose of taxing a company situated in its territory, asks State B, under the convention between A and B, for information about the prices charged by a company in State B, or a group of companies in State B with which the company in State A has no business contacts in order to enable it to check the prices charged by the company in State A by direct comparison (e.g. prices charged by a company or a group of companies in a dominant position). It should be borne in mind that the exchange of information in this case might be a difficult and delicate matter owing in particular to the provisions of subparagraph c) of paragraph 23 relating to business and other secrets.
- d) ***State A, for the purpose of verifying VAT input tax credits claimed by a company situated in its territory for services performed by a company resident in State B, requests confirmation that the cost of services was properly entered into the books and records of the company in State B.***

9. The rule laid down in paragraph 1 allows information to be exchanged in three different ways:

- a) on request, with a special case in mind, it being understood that the regular sources of information available under the internal taxation procedure should be relied upon in the first place before a request for information is made to the other State;
- b) automatically, for example when information about one or various categories of income having their source in one Contracting State and received in the other Contracting State is transmitted systematically to the other State (cf. the OECD Council Recommendation C(81)39, dated 5 May 1981, entitled "Recommendation of the Council concerning a standardised form for automatic exchanges of information under international tax agreements", the OECD Council Recommendation C(92)50, dated 23 July 1992, entitled "Recommendation of the Council concerning a standard magnetic format for automatic

exchange of tax information"<sup>1</sup>, *the OECD Council Recommendation on the use of Tax Identification Numbers in an international context C(97)29/FINAL dated 13 March 1997, the OECD Council Recommendation C(97)30/FINAL dated 10 July 1997 entitled "Recommendation of the Council of the OECD on the Use of the Revised Standard Magnetic Format for Automatic Exchange of Information" and the OECD Council Recommendation on the use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes C(2001)28/FINAL*;<sup>4</sup>

- c) spontaneously, for example in the case of a State having acquired through certain investigations, information which it supposes to be of interest to the other State.

9.1 These three forms of exchange (on request, automatic and spontaneous) may also be combined. It should also be stressed that the Article does not restrict the possibilities of exchanging information to these methods and that the Contracting States may use other techniques to obtain information which may be relevant to both Contracting States such as simultaneous examinations, tax examinations abroad and industry-wide exchange of information. These techniques are fully described in the publication *Tax Information Exchange between OECD Member Countries: A Survey of Current Practices*<sup>5</sup> and can be summarised as follows:

- a simultaneous examination is an arrangement between two or more parties to examine simultaneously each in its own territory, the tax affairs of (a) taxpayer (s) in which they have a common or related interest, with a view of exchanging any relevant information which they so obtain (see the OECD Council Recommendation C(92)81, dated 23 July 1992, on an OECD Model agreement for the undertaking of simultaneous examinations);
- a tax examination abroad allows for the possibility to obtain information through the presence of representatives of the competent authority of the requesting Contracting *State*. ***To the extent allowed by its domestic law, a Contracting State may permit authorised representatives of the other Contracting State to enter the first Contracting State to interview individuals or examine a person's books and records, -- or to be present at such interviews or examinations carried out by the tax authorities of the first Contracting State -- in accordance with procedures mutually agreed upon by the competent authorities. Such a request might arise, for example, where the taxpayer in a Contracting State is permitted to keep records in the other Contracting State.*** This type of assistance is granted on a reciprocal basis. Countries' laws and practices differ as to the scope of rights granted to foreign tax officials. For instance, there are States where a foreign tax official will be prevented from any active participation in an investigation or examination on the territory of a country; there are also States where such participation is only possible with the taxpayer's consent. ***The Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters specifically addresses tax examinations abroad in its Article 9;***
- an industry-wide exchange of information is the exchange of tax information especially concerning a whole economic sector (e.g. the oil or pharmaceutical industry, the banking sector, etc.) and not taxpayers in particular.

10. The manner in which the exchange of information agreed to in the Convention will finally be effected can be decided upon by the competent authorities of the Contracting States. ***For example, Contracting States may wish to use electronic or other communication and information technologies, including appropriate security systems, to improve the timeliness***

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<sup>1</sup> These two recommendations are reproduced and discussed in *Tax Information Exchange between OECD Member Countries: A Survey of Current Practices*, OECD, Paris, 1994.

<sup>4</sup> *OECD Recommendations are available on [www.oecd.org/taxation](http://www.oecd.org/taxation)*

<sup>5</sup> *OECD, 1994.*

*and quality of exchanges of information. Contracting States which are required, according to their law, to observe data protection laws, may wish to include provisions in their bilateral conventions concerning the protection of personal data exchanged. Data protection concerns the rights and fundamental freedoms of an individual, and in particular, the right to privacy, with regard to automatic processing of personal data. See, for example, the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data of 28 January 1981<sup>6</sup>.*

11. — Reciprocal assistance between tax administrations is feasible only if each administration is assured that the other administration will treat with proper confidence the information which it will receive in the course of their co-operation. At the same time maintenance of such secrecy in the receiving Contracting State is a matter of domestic laws. It is therefore provided in paragraph 1 that information communicated under the provisions of the Convention shall be treated as secret in the receiving State in the same manner as information obtained under the domestic laws of that State. Sanctions for the violation of such secrecy in that State will be governed by the administrative and penal laws of that State.

**10.1** 11.1—Before 2000, the paragraph only authorised the exchange of information, and the use of the information exchanged, in relation to the taxes covered by the Convention under the general rules of Article 2. As drafted, the paragraph did not oblige the requested State to comply with a request for information concerning the imposition of a sales tax as such a tax was not covered by the Convention. The paragraph was then amended so as to apply to the exchange of information concerning any tax imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, and to allow the use of the information exchanged for purposes of the application of all such taxes. Some Contracting States may not, however, be in a position to exchange information, or to use the information obtained from a treaty partner, in relation to taxes that are not covered by the Convention under the general rules of Article 2. Such States are free to restrict the scope of paragraph 1 of Article 26 *to the taxes covered by the Convention*. by adopting bilaterally the following previous wording of the paragraph:

~~"1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions."~~

~~11.2. Since the exchange of information concerning the application of custom duties is governed by other international conventions, the provisions of these more specialised conventions will generally prevail and the exchange of information concerning custom duties will not, in practice, be governed by the Article.~~

**10.2** *In some cases, a Contracting State may need to receive information in a particular form to satisfy its evidentiary or other legal requirements. Such forms may include depositions of witnesses and authenticated copies of original records. Contracting States should endeavour as far as possible to accommodate such requests. Under paragraph 3, the requested*

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<sup>6</sup> see <http://conventions.coe.int>.



*State may decline to provide the information in the specific form requested if, for instance, the requested form is not known or permitted under its law or administrative practice. A refusal to provide the information in the form requested does not affect the obligation to provide the information.*

*10.3 Nothing in the Convention prevents the application of the provisions of the Article to the exchange of information that existed prior to the entry into force of the Convention, as long as the assistance with respect to this information is provided after the Convention has entered into force and the provisions of the Article have become effective. Contracting States may find it useful, however, to clarify the extent to which the provisions of the Article are applicable to such information, in particular when the provisions of that convention will have effect with respect to taxes arising or levied from a certain time.*

#### **Paragraph 2**

11. Reciprocal assistance between tax administrations is feasible only if each administration is assured that the other administration will treat with proper confidence the information which it will receive in the course of their co-operation. ***The confidentiality rules of paragraph 2 apply to all types of information received under paragraph 1, including both information provided in a request and information transmitted in response to a request.*** ~~At the same time~~ The maintenance of such secrecy in the receiving Contracting State is a matter of domestic laws. It is therefore provided in paragraph 2~~1~~ that information communicated under the provisions of the Convention shall be treated as secret in the receiving State in the same manner as information obtained under the domestic laws of that State. Sanctions for the violation of such secrecy in that State will be governed by the administrative and penal laws of that State.

12. The information obtained may be disclosed only to persons and authorities involved in the assessment or collection of, the enforcement or prosecution in respect of, ~~or~~ the determination of appeals in relation to the taxes with respect to which information may be exchanged according to the first sentence of ~~the~~ paragraph 1, ***or the oversight of the above.*** This means that the information may also be communicated to the taxpayer, his proxy or to the witnesses. ***This also means that information can be disclosed to governmental or judicial authorities charged with deciding whether such information should be released to the taxpayer, his proxy or to the witnesses.*** The information received by a Contracting State may be used by such persons or authorities only for the purposes mentioned in paragraph 2~~1~~. ***Furthermore, information covered by paragraph 1, whether taxpayer-specific or not, should not be disclosed to persons or authorities not mentioned in paragraph 2, regardless of domestic information disclosure laws such as freedom of information or other legislation that allows greater access to governmental documents.*** ~~If the information appears to be of value to the receiving State for other purposes than those referred to, that State may not use the information for such other purposes but it must resort to means specifically designed for those purposes (e.g. in case of a non-fiscal crime, to a treaty concerning judicial assistance).~~

***12.1 Information can also be disclosed to oversight bodies. Such oversight bodies include*** ~~Under this Article, information may not be disclosed to authorities that supervise tax administration and enforcement authorities as part of the general administration of the Government of a Contracting State, but are not involved specifically in tax matters. In their bilateral negotiations, however, Contracting States may depart from this principle and Member countries may agree to exclude the provide for disclosure of information to such supervisory bodies.~~

**12.2** *The information received by a Contracting State may not be disclosed to a third country unless there is an express provision in the bilateral treaty between the Contracting States allowing such disclosure.*

**12.3** *Similarly, if the information appears to be of value to the receiving State for other purposes than those referred to in paragraph 12, that State may not use the information for such other purposes but it must resort to means specifically designed for those purposes (e.g. in case of a non-fiscal crime, to a treaty concerning judicial assistance). However, Contracting States may wish to allow the sharing of tax information by tax authorities with other law enforcement agencies and judicial authorities on certain high priority matters (e.g., to combat money laundering, corruption, terrorism financing). Contracting States wishing to broaden the purposes for which they may use information exchanged under this Article may do so by adding the following text to the end of paragraph 2:*

*“Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorises such use.”*

13. As stated ~~above~~ *in paragraph 12*, the information obtained can be communicated to the persons and authorities mentioned ~~but it does not follow from this that it~~ *and on the basis of the last sentence of paragraph 2 of the Article* can be disclosed by them in court sessions held in public or in decisions which reveal the name of the taxpayer. ~~The last sentence of the paragraph, however, opens up this possibility.~~ Once information is used in public court proceedings or in court decisions and thus rendered public, it is clear that from that moment such information can be quoted from the court files or decisions for other purposes even as possible evidence. But this does not mean that the persons and authorities mentioned in paragraph ~~1-2~~ are allowed to provide on request additional information received. If either or both of the Contracting States object to the information being made public by courts in this way, or, once the information has been made public in this way, to the information being used for other purposes, because this is not the normal procedure under their domestic laws, they should state this expressly in their convention.

*Paragraph 2*

*Paragraph 3*

14. This paragraph contains certain limitations to the main rule in favour of the requested State. In the first place, the paragraph contains the clarification that a Contracting State is not bound to go beyond its own internal laws and administrative practice in putting information at the disposal of the other Contracting State. ~~However, types of administrative measures authorised for the purpose of the requested State's tax must be utilised, even though invoked solely to provide information to the other Contracting State.~~ *However* Likewise, internal provisions concerning tax secrecy should not be interpreted as constituting an obstacle to the exchange of information under the present Article. As mentioned above, the authorities of the requesting State are obliged to observe secrecy with regard to information received under this Article. ~~A Contracting State that under its domestic law is required to notify the taxpayer that an exchange of information is proposed should inform its treaty partners in writing that it has this requirement and what the consequences are for its obligations in relation to mutual assistance.~~

**14.1** *Some countries' laws include procedures for notifying the person who provided the information and/or the taxpayer that is subject to the enquiry prior to the supply of information. Such notification procedures may be an important aspect of the rights provided under domestic law. They can help prevent mistakes (e.g. in cases of mistaken identity) and facilitate exchange*

*(by allowing taxpayers who are notified to co-operate voluntarily with the tax authorities in the requesting State). Notification procedures should not, however, be applied in a manner that, in the particular circumstances of the request, would frustrate the efforts of the requesting State. In other words, they should not prevent or unduly delay effective exchange of information. For instance, notification procedures should permit exceptions from prior notification, e.g. in cases in which the information request is of a very urgent nature or the notification is likely to undermine the chance of success of the investigation conducted by the requesting State. A Contracting State that under its domestic law is required to notify the person who provided the information and/or the taxpayer that an exchange of information is proposed should inform its treaty partners in writing that it has this requirement and what the consequences are for its obligations in relation to mutual assistance. Such information should be provided to the other Contracting State when a convention is concluded and thereafter whenever the relevant rules are modified.*

15. Furthermore, the requested State does not need to go so far as to carry out administrative measures that are not permitted under the laws or practice of the requesting State or to supply items of information that are not obtainable under the laws or in the normal course of administration of the requesting State. It follows that a Contracting State cannot take advantage of the information system of the other Contracting State if it is wider than its own system. *Thus, a State may refuse to provide information where the requesting State would be precluded by law from obtaining or providing the information or where the requesting State's administrative practices (e.g., failure to provide sufficient administrative resources) result in a lack of reciprocity. However, it is recognised that too rigorous an application of the principle of reciprocity could frustrate effective exchange of information and that reciprocity should be interpreted in a broad and pragmatic manner. Different countries will necessarily have different mechanisms for obtaining and providing information. Variations in practices and procedures should not be used as a basis for denying a request unless the effect of these variations would be to limit in a significant way the requesting State's overall ability to obtain and provide the information if the requesting State itself received a legitimate request from the requested State.*

*15.1 The principle of reciprocity has no application where the legal system or administrative practice of only one country provides for a specific procedure. For instance, a country requested to provide information could not point to the absence of a ruling regime in the country requesting information and decline to provide information on a ruling it has granted, based on a reciprocity argument. Of course, where the requested information itself is not obtainable under the laws or in the normal course of the administrative practice of the requesting State, a requested State may decline such a request.*

*15.2 Most countries recognise under their domestic laws that information cannot be obtained from a person to the extent that such person can claim the privilege against self-incrimination. A requested State may, therefore, decline to provide information if the requesting State would have been precluded by its own self-incrimination rules from obtaining the information under similar circumstances. In practice, however, the privilege against self-incrimination should have little, if any, application in connection with most information requests. The privilege against self-incrimination is personal and cannot be claimed by an individual who himself is not at risk of criminal prosecution. The overwhelming majority of information requests seek to obtain information from third parties such as banks, intermediaries or the other party to a contract and not from the individual under investigation. Furthermore, the privilege against self-incrimination generally does not attach to persons other than natural persons.*

16. Information is deemed to be obtainable in the normal course of administration if it is in the possession of the tax authorities or can be obtained by them in the normal procedure of tax

determination, which may include special investigations or special examination of the business accounts kept by the taxpayer or other persons, provided that the tax authorities would make similar investigations or examinations for their own purposes. ~~This means that the requested State has to collect the information the other State needs in the same way as if its own taxation was involved, under the proviso mentioned in paragraph 15 above. This obligation is clearly evidenced by the practices followed by Member countries which show that, when collecting information requested by a treaty partner, Contracting States often use the special examining or investigative powers provided by their laws for purposes of the application of their domestic taxes even though they do not themselves need the information for applying these taxes.~~

17. The requested State is at liberty to refuse to give information in the cases referred to in the paragraphs above. However if it does give the requested information, it remains within the framework of the agreement on the exchange of information which is laid down in the Convention; consequently it cannot be objected that this State has failed to observe the obligation to secrecy.

18. If the structure of the information systems of two Contracting States is very different, the conditions under subparagraphs *a)* and *b)* of paragraph 32 will lead to the result that the Contracting States exchange very little information or perhaps none at all. In such a case, the Contracting States may find it appropriate to broaden the scope of the exchange of information.

***18.1 Unless otherwise agreed to by the Contracting States, it can be assumed that the requested information could be obtained by the requesting State in a similar situation if that State has not indicated to the contrary.***

19. In addition to the limitations referred to above, subparagraph *c)* of paragraph 32 contains a reservation concerning the disclosure of certain secret information. Secrets mentioned in this subparagraph should not be taken in too wide a sense. Before invoking this provision, a Contracting State should carefully weigh if the interests of the taxpayer really justify its application. Otherwise it is clear that too wide an interpretation would in many cases render ineffective the exchange of information provided for in the Convention. The observations made in paragraph 17 above apply here as well. The requested State in protecting the interests of its taxpayers is given a certain discretion to refuse the requested information, but if it does supply the information deliberately the taxpayer cannot allege an infraction of the rules of secrecy. ~~It is open to the Contracting States to add further dispensations from the obligation to supply information to the items listed in subparagraph *e)*, for example, information protected by provisions on banker's discretion. It has been felt necessary also to prescribe a limitation with regard to information which concerns the vital interests of the State itself. To this end, it is stipulated that Contracting States do not have to supply information the disclosure of which would be contrary to public policy (*ordre public*).~~

***19.1 In its deliberations regarding the application of secrecy rules, the Contracting State should also take into account the confidentiality rules of Article 26, paragraph 2. The domestic laws and practices of the requesting State together with the obligations imposed under Article 26, paragraph 2, may ensure that the information cannot be used for the types of unauthorised purposes against which the trade or other secrecy rules are intended to protect. Thus, a Contracting State may decide to supply the information where it finds that there is no reasonable basis for assuming that a taxpayer involved may suffer any adverse consequences incompatible with information exchange.***

***19.2 In most cases of information exchange no issue of trade, business or other secret will arise. A trade or business secret is generally understood to mean facts and circumstances that are of considerable economic importance and that can be exploited practically and the unauthorised use of which may lead to serious damage (e.g. may lead to severe financial***

*hardship). The determination, assessment or collection of taxes as such could not be considered to result in serious damage. Financial information, including books and records, does not by its nature constitute a trade, business or other secret. In certain limited cases, however, the disclosure of financial information might reveal a trade, business or other secret. For instance, a request for information on certain purchase records may raise such an issue if the disclosure of such information revealed the proprietary formula used in the manufacture of a product. The protection of such information may also extend to information in the possession of third persons. For instance, a bank might hold a pending patent application for safe keeping or a secret trade process or formula might be described in a loan application or in a contract held by a bank. In such circumstances, details of the trade, business or other secret should be excised from the documents and the remaining financial information exchanged accordingly.*

*19.3 A requested State may decline to disclose information relating to confidential communications between attorneys, solicitors or other admitted legal representatives in their role as such and their clients to the extent that the communications are protected from disclosure under domestic law. However, the scope of protection afforded to such confidential communications should be narrowly defined. Such protection does not attach to documents or records delivered to an attorney, solicitor or other admitted legal representative in an attempt to protect such documents or records from disclosure required by law. Also, information on the identity of a person such as a director or beneficial owner of a company is typically not protected as a confidential communication. While the scope of protection afforded to confidential communications might differ among states, it should not be overly broad so as to hamper effective exchange of information. Communications between attorneys, solicitors or other admitted legal representatives and their clients are only confidential if, and to the extent that, such representatives act in their capacity as attorneys, solicitors or other admitted legal representatives and not in a different capacity, such as nominee shareholders, trustees, settlors, company directors or under a power of attorney to represent a company in its business affairs. An assertion that information is protected as a confidential communication between an attorney, solicitor or other admitted legal representative and its client should be adjudicated exclusively in the Contracting State under the laws of which it arises. Thus, it is not intended that the courts of the requested State should adjudicate claims based on the laws of the requesting State.*

*19.4 Contracting States wishing to refer expressly to the protection afforded to confidential communications between a client and an attorney, solicitor or other admitted legal representative may do so by adding the following text at the end of paragraph 3:*

*“d) to obtain or provide information which would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative where such communications are:*

- (i) produced for the purposes of seeking or providing legal advice or*
- (ii) produced for the purposes of use in existing or contemplated legal proceedings.”*

*19.5 Paragraph 3 also includes a limitation with regard to information which concerns the vital interests of the State itself. To this end, it is stipulated that Contracting States do not have to supply information the disclosure of which would be contrary to public policy (ordre public). However, this limitation should only become relevant in extreme cases. For instance, such a case could arise if a tax investigation in the requesting State were motivated by political, racial, or religious persecution. The limitation may also be invoked where the information constitutes a state secret, for instance sensitive information held by secret services the disclosure of which would be contrary to the vital interests of the requested State. Thus, issues*

*of public policy (ordre public) rarely arise in the context of information exchange between treaty partners.*

#### **Paragraph 4**

*19.6 Paragraph 4 was added in [2005] to deal explicitly with the obligation to exchange information in situations where the requested information is not needed by the requested State for domestic tax purposes. Prior to the addition of paragraph 4 this obligation was not expressly stated in the Article, but was clearly evidenced by the practices followed by Member countries which showed that, when collecting information requested by a treaty partner, Contracting States often use the special examining or investigative powers provided by their laws for purposes of levying their domestic taxes even though they do not themselves need the information for these purposes. This principle is also stated in the Report Improving Access to Bank Information for Tax Purposes, OECD 2000.<sup>7</sup>*

*19.7 According to paragraph 4, Contracting States must use their information gathering measures, even though invoked solely to provide information to the other Contracting State. The term “information gathering measures” means laws and administrative or judicial procedures that enable a Contracting State to obtain and provide the requested information.*

*19.8 The second sentence of paragraph 4 makes clear that the obligation contained in paragraph 4 is subject to the limitations of paragraph 3 but also provides that such limitations cannot be construed to form the basis for declining to supply information where a country’s laws or practices include a domestic tax interest requirement. Thus, while a requested State cannot invoke paragraph 3 and argue that under its domestic laws or practices it only supplies information in which it has an interest for its own tax purposes, it may, for instance, decline to supply the information to the extent that the provision of the information would disclose a trade secret.*

*19.9 For many countries the combination of paragraph 4 and their domestic law provide a sufficient basis for using their information gathering measures to obtain the requested information even in the absence of a domestic tax interest in the information. Other countries, however, may wish to clarify expressly in the convention that Contracting States must ensure that their competent authorities have the necessary powers to do so. Contracting States wishing to clarify this point may replace paragraph 4 with the following text:*

*“4. In order to effectuate the exchange of information as provided in paragraph 1, each Contracting State shall take the necessary measures, including legislation, rule-making, or administrative arrangements, to ensure that its competent authority has sufficient powers under its domestic law to obtain information for the exchange of information regardless of whether that Contracting State may need such information for its own tax purposes.”*

#### **Paragraph 5**

*19.10 Paragraph 1 imposes a positive obligation on a Contracting State to exchange all types of information. Paragraph 5 is intended to ensure that the limitations of paragraph 3 cannot be used to prevent the exchange of information held by banks, other financial institutions, nominees, agents and fiduciaries as well as ownership information. While paragraph 5, which was added in [2005], represents a change in the structure of Article 26 it should not be interpreted as suggesting that the previous version of Article 26 did not authorise the exchange*

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<sup>7</sup> See paragraph 21b.

*of such information. The vast majority of OECD member countries already exchanged such information under the previous version of Article 26 and the addition of paragraph 5 merely reflects current practice.*

*19.11 Paragraph 5 stipulates that a Contracting State shall not decline to supply information to a treaty partner solely because the information is held by a bank or other financial institution. Thus, paragraph 5 overrides paragraph 3 to the extent that paragraph 3 would otherwise permit a requested Contracting State to decline to supply information on grounds of bank secrecy. The addition of this paragraph to Article 26 reflects the international trend in this area as reflected in the Model Agreement on Exchange of Information on Tax Matters<sup>8</sup> and as described in the report, *Improving Access to Bank Information for Tax Purposes*, OECD 2000. In accordance with that report, access to information held by banks or other financial institutions may be by direct means or indirectly through a judicial or administrative process. The procedure for indirect access should not be so burdensome and time-consuming as to act as an impediment to access to bank information.*

*19.12 Paragraph 5 also provides that a Contracting State shall not decline to supply information solely because the information is held by persons acting in an agency or fiduciary capacity. For instance, if a Contracting State had a law under which all information held by a fiduciary was treated as a “professional secret” merely because it was held by a fiduciary, such State could not use such law as a basis for declining to provide the information to the other Contracting State. A person is generally said to act in a “fiduciary capacity” when the business which the person transacts, or the money or property which the person handles, is not its own or for its own benefit, but for the benefit of another person as to whom the fiduciary stands in a relation implying and necessitating confidence and trust on the one part and good faith on the other part, such as a trustee. The term “agency” is very broad and includes all forms of corporate service providers (e.g. company formation agents, trust companies, registered agents, lawyers).*

*19.13 Finally, paragraph 5 states that a Contracting State shall not decline to supply information solely because it relates to an ownership interest in a person, including companies and partnerships, foundations or similar organisational structures. Information requests cannot be declined merely because domestic laws or practices may treat ownership information as a trade or other secret.*

*19.14 Paragraph 5 does not preclude a Contracting State from invoking paragraph 3 to refuse to supply information held by a bank, financial institution, a person acting in an agency or fiduciary capacity or information relating to ownership interests. However, such refusal must be based on reasons unrelated to the person’s status as a bank, financial institution, agent, fiduciary or nominee, or the fact that the information relates to ownership interests. For instance, a legal representative acting for a client may be acting in an agency capacity but for any information protected as a confidential communication between attorneys, solicitors or other admitted legal representatives and their clients, Article 26, paragraph 3, continues to provide a possible basis for declining to supply the information.*

*19.15 The following examples illustrate the application of paragraph 5:*

- a) Company X owns a majority of the stock in a subsidiary company Y, and both companies are incorporated under the laws of State A. State B is conducting a tax examination of business operations of company Y in State B. In the course of this*

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<sup>8</sup> Available on [www.oecd.org/taxation](http://www.oecd.org/taxation)

*examination the question of both direct and indirect ownership in company Y becomes relevant and State B makes a request to State A for ownership information of any person in company Y's chain of ownership. In its reply State A should provide to State B ownership information for both company X and Y.*

- b) *An individual subject to tax in State A maintains a bank account with Bank B in State B. State A is examining the income tax return of the individual and makes a request to State B for all bank account income and asset information held by Bank B in order to determine whether there were deposits of untaxed earned income. State B should provide the requested bank information to State A."*