Public Discussion Draft on the tax treatment of termination payments - changes to the commentaries to article 15 of the OECD model tax convention Income from Employment

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1. Preliminary statement

Dear Sir,

EY appreciates the opportunity to comment on the recently issued public discussion draft regarding the interpretation of article 15 of the OECD Model Tax Convention.

Firstly, we would like to commend the OECD for their efforts in proposing texts that provide updated guidance for the interpretation of article 15 of its Model Tax Convention, with the goal of providing greater clarity with respect to the taxation of termination payments. In the interest and spirit of providing such clarity and in the interest of fairness to internationally mobile employees and their employer(s), we provide the following comments and recommendations regarding the OECD public discussion draft document issued on June 25, 2013.

Please note that although EY has clients who would be affected by the comments and recommendations made below, no client has engaged EY to provide such comments or recommendations nor reviewed them before they were submitted. The comments and recommendations below have, however, been provided based on real situations and experiences that EY professionals have come across in practice.

The comments below were prepared by the EY Human Capital professionals globally and collected as well as summarized by Jean Nicolas Lambert and Kevin Cornelius, partners EY Belgium and EY Switzerland respectively.

2. Our understanding of the current playing field

We understand that termination payments are discussed in paragraph 4, 5 and 6 of the Commentary on Article 18 dealing with pensions but that these paragraphs do not sufficiently address the interaction of other Treaty provisions, notably Article 15, with payments made at the occasion of the termination of an employment relationship.

Such absence of specific guidance leads to inconsistent characterization of payments received as a result of the termination of an employment or following the termination of an employment. Besides possible inconsistent characterization of such income, different views are adopted by OECD members as to the source of such payments which may lead to double taxation or instances of double non-taxation.

The OECD has for many years deployed its best efforts to remediate possible source of inconsistency leading to double taxation or non taxation, the former being detrimental to a flawless application of Treaty provisions, the latter being more than ever unacceptable for OECD members by creating a loss for the Revenue authorities and an unintended application of the Treaty provisions.

3. Our understanding of the changes to paragraph 2 of Article 15

The proposed changes indicate that the intention is to provide guidance for the sourcing of various payments made as a result of or following the termination of employment such as non competition payments, payment in lieu of notice, severance payments or deferred compensation arrangements.

Based on this draft comments and the examples used to illustrate the proposed change, it does provide explicit guidance to give preference to a sourcing aligned with the most recent OECD work on article 15.

The draft as it stands, provide useful guidance for the determination of the competent State having the primary taxing rights in light of the nature of the different types of payments.

We understand that an appreciation of the facts and circumstances may still be necessary but we do welcome the fact that the Discussion Draft provides useful guidelines in the absence of other conclusive facts.

4. Discussion of the proposed changes

We understand that in the vein of other significant amendment recently made to the Commentary on Article 15, the objective of the proposed additions to the Commentary is to emphasize the **predominant character conferred to the nexus between termination payments and the Source State** rather than giving precedence to the Residency State.

Although this does entail a greater complexity for the debtor as well as for the beneficiary of those payments, it is aligned with the general framework provided by the Commentary on Article 15 and does not add an uncumbersome layer of complexity since sourcing of post employment benefits shall generally be aligned with the sourcing of employment income.

I. Remuneration for previous work, deferred compensation and payment under an incentive arrangement

Although a number of jurisdictions have endorsed the sourcing principles contained in paragraphs 12.6 through 12.13 to determine –mutatis mutandis - the source of other type of incentives, we do welcome the clarification provided by paragraph 2.4 of the draft as providing an agreeable and workable framework for all OECD members to apply a consistent causality determination to allocate taxing rights on incentive compensation other than stock option income

II. Payment in lieu of notice and severance payment

A distinction is made between a payment in lieu of notice supplemented by a garden leave and a severance payment required by law, by virtue of a contract or by a collective agreement. We understand and support the rationale behind the allocation methodology to be applied on severance payment since it refers to the nexus created by the fact that a severance or redundancy entitlement is often "accrued" during the exercise of the employment. We do however not understand why the sourcing of a payment in lieu of notice would depart from the geographical nexus. If an employee being given notice performs duties, the right of taxation should be allocated to the Working State, if he is not, the taxing right should by default be allocated to the Residency State.

In addition, although the wording of the proposed Draft explicitly refers to the State where the employment was exercised before the employee was made redundant, as the State where the severance entitlement arise for the purpose of allocating the taxing right to that jurisdiction, we suggest to be even more specific in the wording to avoid a multiple state allocation for

employees having performed their careers in many jurisdiction and having possibly partly or indirectly accrued part of their severance entitlement in other States than the one where the employment was performed before termination.

III. Non Competition payments

Although the majority of OECD members agree on the allocation of taxing rights in such a payment to the residency State, there are a number of jurisdictions applying the Source State principle which causes double taxation and the unnecessary recourse to the MAP. Whereas the link with past employment is in most instance obvious for a severance payment, at least in the circumstances described by the Draft, it is often not sufficiently present in the non competition arrangements to justify an allocation to the Source State. We do therefore welcome the recommendation as fair, agreeable in light of the rest of article 15 framework and as a step forward in preventing double taxation.

IV. Payments related to pension rights

We believe that point 7 of the proposed draft does not add clarity to the comments included under paragraph 4 to 6 of the Commentary to article 18. It is worth considering redrafting this part of the paragraph to set up a clear line of demarcation between the funding of future pension benefits as opposed to pension benefits, the former naturally belongs to article 15 whereas the latter is being dealt with by article 18.

V. Partial retirement

We believe that this part of the proposed addition to the Commentary is confusing since it departs from the geographical principle contained in §1 of article 15. As outlined above in respect of payment made in lieu of notice, we suggest to refer to the place where the beneficiary of the payment is present for the period covered by the payment as the jurisdiction being allocated the right of taxation, unless the right to such a payment was accrued during the period of service in which case the payment would be taxable in the Country where the duties had been performed during the accrual period. This would simplify the reading of the Commentary for payments other than payments accrued during the employment and benefits paid as post retirement replacement income, which are paid for consideration of no active duties (same reading as for non compete).

VI. Instances not sufficiently captured by the Draft

In practice, we often come across instances where an employee posted outside of his home base for a period of time, is not made redundant while on assignment but is rather repatriated to his home base before being severed. In order to streamline those instance where redundancy follows closely repatriation and to minimize exposure to double taxation, we recommend to incorporate a comment to help competing jurisdictions (the former assignment country and the country where the assignee is repatriated) to deal with those situations. Equally we should be grateful for your comments on the situation where an individual is legally employed in one state, assigned and has been working in a second state, but then moves and receives the termination payment in a third state.

5. Conclusion

We welcome the Public Discussion draft as a positive step forward to minimize the potential for frictions between competing jurisdictions even if it comes at a cost being the ending of a couple of loopholes leadings to instances of double non taxation. We do however believe that there is still room to marginally improve the draft and it is why we are respectfully making the suggestions above.

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