

Public Discussion Draft

# TREATY RESIDENCE OF PENSION FUNDS

29 February 2016



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**DISCUSSION DRAFT ON CHANGES TO THE OECD MODEL TAX CONVENTION  
CONCERNING THE TREATY RESIDENCE OF PENSION FUNDS**

Paragraph 12 of the final version of the Report on Action 6 of the BEPS Action Plan ([Preventing the Granting of Treaty Benefits in Inappropriate Circumstances](#)) indicates that:

Additional work will also ensure that a pension fund should be considered to be a resident of the State in which it is constituted regardless of whether that pension fund benefits from a limited or complete exemption from taxation in that State. This will be done through changes to the OECD Model Tax Convention, to be also finalised in the first part of 2016, that will ensure that outcome for funds that will meet a definition of “recognised pension fund”...

This discussion draft includes draft changes to Articles 3 and 4 of the OECD Model Tax Convention, and to the Commentary on these Articles, that will ensure that a pension fund is considered to be a resident of the State in which it is constituted for the purposes of tax treaties. These changes were discussed by Working Party 1 on Tax Conventions and Related Questions (which is the subgroup of the OECD Committee on Fiscal Affairs in charge of the Model Tax Convention) at its meeting of February 2016; it was then decided to release the changes for public comments.

The Committee therefore invites interested parties to send their comments on this discussion draft. The discussion draft and the comments received on it will be discussed by Working Party 1 at its next meeting, when the Working Party will be asked to finalise the changes included in the draft.

Comments should be sent by **1 April 2016** at the latest by email to [taxtreaties@oecd.org](mailto:taxtreaties@oecd.org) in Word format (in order to facilitate their distribution to government officials). They should be addressed to the Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA.

Please note that all comments on this discussion draft will be made publicly available. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective group, or the person(s) on whose behalf the commentator(s) are acting.

***The proposals included in this discussion draft do not, at this stage, represent the consensus views of the CFA or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comment.***

## PROPOSED CHANGES TO THE OECD MODEL TAX CONVENTION CONCERNING THE TREATY RESIDENCE OF PENSION FUNDS

### Introduction

1. Paragraphs 12 and 13 of the final version of the Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), which was presented to the G20 in October 2015, indicates that follow-up work would be carried on with respect to the treaty residence of pension funds. These paragraphs read as follows:

12. Additional work will also ensure that a pension fund should be considered to be a resident of the State in which it is constituted regardless of whether that pension fund benefits from a limited or complete exemption from taxation in that State. This will be done through changes to the OECD Model Tax Convention, to be also finalised in the first part of 2016, that will ensure that outcome for funds that will meet a definition of “recognised pension fund” which will likely include the following elements:

- the definition will refer to entities or arrangement established in a State and constituted and operated exclusively or almost exclusively to administer or provide retirement or similar benefits to individuals;
- the entities or arrangements to which the definition will apply will need to be treated as separate persons under the taxation laws of that State;
- in order to cover only funds that the tax law recognises as pension funds, these entities will need to be regulated as pensions funds by the State in which they are established;
- the definition will also need to cover entities and arrangements that are constituted and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements that will themselves qualify as “recognised pension funds”.

13. That definition will need to be accompanied by detailed Commentary that will explain some of these requirements, in particular the requirement that a pension fund “be regulated as such”. Consultation with stakeholders will be necessary to ensure that the definition and its Commentary cover the main forms of pension funds that currently exist.

2. At its meetings of October 2015 and February 2016, Working Party 1 on Tax Conventions and Related Questions discussed the changes to the OECD Model Tax Convention that should be made in accordance with the above paragraphs. The changes below, which resulted from that work, are now released for public comments. Comments are invited, in particular, on the following questions:

- a) *As regards the phrase “that is treated as a separate person under the taxation laws of that State” included in the definition of “recognised pension fund” in proposed Art. 3(1) j):* Does that phrase deal adequately with pension funds established in your State? If not, what other formulation would ensure that pension funds, the income of which is not otherwise attributed to another person for tax purposes, are treated as residents?
- b) *As regards the phrase “that is constituted and operated exclusively to administer or provide retirement or similar benefits” included in subdivision i) of the definition of “recognised pension fund” in proposed Art. 3(1) j):* Is the word “exclusively” too restrictive given the normal operations of a pension fund? If yes, please describe the operations that might not be covered, taking into account the fact that the subparagraph refers not only to “retirement benefits” but also to “similar benefits”?

- c) *As regards the phrase “similar benefits” included in subdivision i) of the definition of “recognised pension fund” in proposed Art. 3(1) j):* Are there examples of “benefits” that are typically granted by pension funds that would not be covered by the phrase “similar benefits”? If yes, please describe these benefits?
- d) *As regards the phrase “that is constituted and operated exclusively to invest funds for the benefit of entities or arrangements” included in subdivision ii) of the definition of “recognised pension fund” in proposed Art. 3(1) j):* Is the word “exclusively” too restrictive given the normal operations of an intermediary that invests on behalf of pension funds and, in particular, the possibility that these operations would include activities that are not related to the investment of funds and the possibility that non-resident pension funds would be investing through such an intermediary? If yes, please describe the operations that might not be covered?

*[Proposed changes to the existing text of the OECD Model Tax Convention appear below in **bold italics** for additions and in ~~strikethrough~~ for deletions]*

### ***Proposed changes to the Articles of the OECD Model Tax Convention***

*Add the following definition of “recognised pension fund” to paragraph 1 of Article 3:*

- j) ***the term “recognised pension fund” of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:***
- (i) that is constituted and operated exclusively to administer or provide retirement or similar benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities; or***
  - (ii) that is constituted and operated exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision i).***

*Replace paragraph 1 of Article 4 of the OECD Model Tax Convention by the following:*

1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof ***as well as a recognised pension fund of that State***. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

### ***Proposed changes to the Commentary on Articles 3 and 4***

*Add the following paragraphs 10.3 to 10.7 to the Commentary on Article 3 by the following:*

#### ***The term “recognised pension fund”***

***10.3 The definition of the term “recognised pension fund” found in subparagraph j) was included in [2017] when this term was added to paragraph 1 of Article 4 in order to ensure that a pension fund that meets the definition is considered as a resident of the Contracting State in which it is established.***

***10.4 The first part of the definition refers to “an entity or arrangement established in that State”. There is considerable diversity in the legal and organisational characteristics of pension funds around the world and it is therefore necessary to adopt a broad formulation.***

*The reference to an “arrangement” is intended to cover cases where pension benefits are provided through vehicles such as a trust which, under the relevant trust law, would not constitute an entity: the definition will apply as long as the trust or the body of trustees is treated, for tax purposes, as a separate entity recognised as a separate person. It is required, however, that the entity or arrangement be treated as a separate person under the taxation laws of the State in which it is constituted: if that is not the case, it is not necessary to deal with the issue of the residence of the pension fund itself as the income of that fund is treated as the income of another person for tax purposes.*

*10.5 Subdivision (i) first provides that in order to qualify as a “recognised pension fund”, an entity or arrangement must be constituted and operated exclusively to administer or provide retirement or similar benefits to individuals. It does not matter how many individuals are entitled to such retirement benefits: a recognised pension fund may be set up, for instance, for a large group of employees or for a single self-employed individual. It is important, however, that the entity or arrangement be constituted and used solely for the purpose of administering or providing retirement or similar benefits to individuals. A pension paid upon retirement from active employment would be the typical example of a “retirement benefit” but this term is broad enough to cover one or more payments made at or after retirement to a self-employed person even if these payments are not made in the form of regular pension payments. Examples of other “similar benefits” would include payments made as a result of the death or invalidity of an individual.*

*10.6 Subdivision (i) also requires that the entity or arrangement constituted and operated exclusively to administer or provide retirement or similar benefits to individuals be “regulated as such”. The requirement is intended to restrict the definition to entities or arrangements that are subject to some conditions imposed by the State where it is established (or one of its political subdivisions or local authorities) in order to ensure that the entity or arrangement is used as a vehicle for investment in order to provide retirement or similar benefits to individuals. That part of the definition would therefore exclude an entity, such as a private company, that might be set up and used by a person to invest funds in order to provide retirement benefits to persons related to, or employed by, that person but that would not be subject to any special treatment or to rules imposed by the State, political subdivision or local authority concerning the use of that entity as a vehicle to provide retirement benefits. It does not matter whether the regulatory framework to which the entity or arrangement is subjected is provided in tax laws or in other legal instruments; what matters is that the entity or arrangement be recognised by law as a vehicle constituted to finance retirement benefits for individuals and be subject to conditions intended to ensure that it is used solely for that purpose.*

*10.7 An example of an entity or arrangement that would satisfy the requirements of the definition of “recognised pension fund” is an agency or instrumentality of a State set up exclusively to administer or provide retirement benefits under the social security legislation of that State. Another example would be a company or other entity that is established in a State solely for the purpose of administering or providing retirement or similar benefits to individuals and whose only assets include funds that are covered by a retirement scheme regulated by the tax laws of that State which provide that the income from that scheme is exempt from tax. The definition of recognised pension fund would apply to that company or entity regardless of whether that company or entity is a person liable to tax (i.e. with respect to income not derived from the scheme) and therefore qualifies as a resident of that State under the first sentence of paragraph 1 of Article 4.*

**10.8 Subparagraph (ii) of the definition covers entities that pension funds covered by subparagraph (i) use to invest indirectly. Pension funds often invest together with other pension funds pooling their assets in certain arrangements or entities and may, for various commercial, legal or regulatory reasons, invest via wholly owned entities or arrangements that are residents of the same State. Since such arrangements and entities act only as intermediaries for the investment of funds used to provide retirement benefits to individuals, it is appropriate to treat them like the pension funds that invest through them..**

*Replace paragraph 8.6 of the Commentary on Article 4 by the following (and renumber paragraphs 8.7 and 8.8 as paragraphs 8.8 and 8.9 respectively):*

**8.6 Paragraph 1 also refers expressly to a “recognised pension fund”. Most member countries have long considered that a pension fund established in a Contracting State is a resident of that State regardless of the fact that it may benefit from a limited or complete exemption from taxation in that State. Until [2017], that view was reflected in the following paragraph, which referred to “pension funds, charities and other organisations” as entities that most countries viewed as residents. Paragraph 1 of the Article was modified in 2017 to remove any doubt about the fact that a pension fund that meets the definition of “recognised pension fund” in paragraph 1 of Article 3 constitutes a resident of the Contracting State in which it is established. [existing text of paragraph 8.6 is moved to new paragraph 8.7]**

**8.7 Paragraph 1 refers to persons who are “liable to tax” in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, ~~pension funds~~, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such entities as residents for purposes of the Convention (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).**