CONFEDERATION FISCALE EUROPEENNE

Opinion Statement of the CFE

on technical changes to be included in the next update

to the OECD Model Tax Convention

Prepared by the CFE Fiscal Committee

Submitted to the OECD, Tax Treaties, Transfer Pricing and Financial Transactions Division

in January 2014

CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 32 professional organisations from 25 European countries (21 EU member states) with 180,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.

CFE is registered in the EU Transparency Register (no. 3543183647-05).

This Opinion Statement relates to the Public Discussion Draft "*Technical Changes to be included in the next update to the OECD Model Tax Convention*" released by the OECD on 15 November 2013.

Cover letter:

Double taxation is the imposition of tax by two or more jurisdictions on the same declared income, asset, or financial transaction. Countries usually stipulate tax treaties to mitigate double taxation.

Double taxation also refers to the fact that profits are taxed at the corporate level, while the shareholders of the corporation are subject to personal taxation when they receive dividends out of the abovementioned profits.

It is common for an enterprise (or an individual) resident in one country to earn profits in another jurisdiction. In order to prevent the same profit from being subject to tax twice (*i.e.*, in the source State and in the country of residence), States stipulate bilateral double taxation agreements with each other. In some cases, they require that tax be paid in the country of residence and be exempt in the country in which the income arises (source State). In other cases, the country where the profit arises applies a withholding tax, whereas the taxpayer receives a compensating foreign tax credit in the country of residence, to reflect the fact that tax has already been paid.

The identification of the taxpayer's residence for tax purposes is a key factor. Corporate persons, owning foreign subsidiaries, can be simultaneously resident in multiple countries (so-called "*dual residence*").

At the same time, countries need to tackle double non-taxation situations benefiting multinational enterprises that implement aggressive tax planning schemes.

Bilateral tax treaties stipulated by countries to mitigate the effects of double taxation may cover income taxes, inheritance taxes, value added taxes, tax on property, or other taxes.

With the aim of tackling aggressive tax planning schemes and, in general, of fighting against tax avoidance and tax evasion at the international level, the OECD and the Council of Europe jointly developed the 1988 Convention on Mutual Administrative Assistance in Tax Matters, amended by Protocol in 2010. The Convention is the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance, a priority for all countries.

In order to avoid double taxation of the same income, tax treaties tend to reduce taxes that are applied, in one Contracting State, to residents of the other Contracting State. Although provisions and goals may vary, most treaties:

- define which taxes are covered and who is a resident and eligible for benefits;
- reduce the amounts of tax withheld on interest, dividends, and royalties paid by a resident of one Contracting State to a resident of the other Contracting State;
- limit tax, in one Contracting State, on business income of a resident of the other Contracting State to the income attributed to a permanent establishment in the first country;

- define circumstances in which income (including salary, self-employment, pension, other income) of individuals resident in a Contracting State will be taxed in the other Contracting State;
- provide for exchange of information in tax matters between tax authorities;
- provide procedural frameworks for enforcement and dispute resolution.

Although the main goals for entering into a tax treaty often include reduction of double taxation and the tackling of tax evasion, double conventions also encourage cross-border trade efficiency and increase certainty for taxpayers and tax authorities in their international dealings.

The OECD Model Tax Convention is often used by countries as a starting point for their negotiations, while the official commentaries serve as a guidance as to interpretation of provisions included in bilateral tax treaties.

The CFE is pleased to provide input on the contents of the Public Discussion Draft "*Technical Changes to be included in the next update to the OECD Model Tax Convention*".

The CFE strongly supports the OECD action aimed at:

- preventing double taxation;
- tackling tax avoidance and tax evasion;
- promoting administrative cooperation on tax matters.

The CFE´s comments on the Discussion Draft are outlined below.

In commenting on the Discussion Draft, the CFE has been influenced by the proposed timeline. As a result, our comments are not a comprehensive list of all issues and areas of uncertainty, but instead they focus on the significant issues that we believe can be addressed within the said timeline. This does not preclude the discussion of other issues if it is deemed convenient to include them in the project.

We will be pleased to answer any questions you may have concerning the CFE's comments outlined below. For further information, please contact Mr. Piergiorgio Valente, Chairman of the Fiscal Committee of the CFE, at brusselsoffice@cfe-eutax.org.

Comments to the Public Discussion Draft "*Technical Changes to be included in the next update to the OECD Model Tax Convention*"

1. Introduction

On 15 November 2013, the OECD published the Public Discussion Draft "*Technical Changes to be included in the next update to the OECD Model Tax Convention*" (hereinafter, the Discussion Draft). Changes proposed in the Discussion Draft include:

- Minor clarification of the French definition of "*activité*" and "*affaires*" in subparagraph 1 h) of Article 3;
- Minor editorial corrections in paragraph 23 of the Introduction; to the last part of paragraph 7.7 of the Commentary on Article 11; to the drafting of paragraph 12 of the Commentary on Article 27; to the alternative provision in paragraph 68 of the Commentary on Article 7;
- Replacement of the word "*income*" in paragraphs 35-36 of the Commentary on Article 7, and of the word "*ascribable*" in paragraph 72 of the Commentary on Article 24;
- Addition to the Commentary on Article 11 (application of Article 11 to accrued interest); to the Commentary on Article 13 (application to capital gains accrued before the Article is included in a bilateral treaty); to the Commentary on Articles 10 and 13 (application in case of redemption of shares);
- Correction of the Commentary on Article 3 as regards the reference to the State whose laws govern the definition of company;
- Update of the wording of paragraph 31 of the Commentary on Article 24;
- Clarification of the meaning of the expression "*fiscal year concerned*" in Article 15; clarification concerning paragraph 63 of the Commentary on Articles 23A and 23B, and clarification concerning Article 20 and payments from the host State.

The CFE appreciates the OECD work which intends to provide taxpayers and Tax Administrations with clear provisions and legal certainty in the application of treaty provisions.

2. Minor clarifications, editorial corrections, word replacement and update

In CFE´s view, clear and complete provisions favor legal certainty and allow a proper regulation of economic relations between Contracting States. To this purpose, any effort aimed at including a wording that prevents misunderstandings in the application of treaty provisions is most welcome.

Therefore, the CFE appreciates and supports:

- the minor clarification to the French definition of "*activité*" and "*affaires*" in subparagraph 1 h) of Article 3, by also referring to "*l'exercice d'autres activités de caractère indépendant*";
- the minor editorial corrections in paragraph 23 of the Introduction, in paragraph 7.7 of the Commentary on Article 11, in paragraph 12 of the Commentary on Article 27 and in paragraph 68 of the Commentary on Article 7;
- the replacement of the word "*income*" with the word "*profit*" in paragraphs 35-36 of the Commentary on Article 7, and of the word "*ascribable*" with the word "*attributed*" in paragraph 72 of the Commentary on Article 24. Within the context of Article 7, the word "*profit*" – as the surplus remaining after total costs are deducted from revenue, and the basis on which tax is computed and dividend is paid – seems more appropriate than the word "*income*", which refers to money

or other forms of payment (received periodically or regularly) from commerce, employment, endowment, investment, royalties, etc..

The CFE welcomes the expression "*for the purposes of the tax law of the Contracting State of which it is a resident*" (in paragraph 3 of the Commentary on Article 3), since it provides for more clarity when defining the word "*company*".

The CFE also welcomes the minor update to the wording in paragraph 31 of the Commentary on Article 24.

3. Additions

According to the Discussion Draft, the definition of interest does not cover any profit or loss that cannot be attributed to a difference between what the issuer (of the bond) received and paid (*i.e.*, a profit or loss, not representing accrued interest or original issue discount or premium, which a holder of such a security such as a bond or debenture realizes by the sale thereof to another person or by the repayment of the principal of a security that he has acquired from a previous holder for an amount that is different from the amount received by the issuer of the security) (paragraph 20 of the Commentary on Article 11).

In CFE´s view, a clearer definition of interest, as regards government securities, bonds and debentures could be the following:

"*only profit or loss that can be attributed to a difference between what the issuer received and paid may be included in the definition of interest*".

The Discussion Draft proposes to specify, under paragraph 3 of the Commentary on Article 13, that where the Article allows a Contracting State to tax a capital gain, this right applies to the entire gain and not only to the part of the gain that has accrued after the entry into force of the applicable treaty, even in the case of a new treaty that replaces a previous one that did not allow such taxation.

The CFE understands that the aim of the provision is to ensure an equal and common treaty treatment to the entire capital gains amount, and not only to the part that is accrued after the entry into force of the treaty. However, it should be considered that the rule proposed under paragraph 3 of the Commentary on Article 13 attributes a retroactive effect to the provision, which needs to be specifically and on a case-by-case basis addressed at the bilateral level.

According to the Discussion Draft, payments regarded as dividends may include not only distributions of profits resolved upon by annual general meetings of shareholders, but also other benefits in money or money's worth, such as bonus shares, bonuses, profits on a liquidation or redemption of shares and disguised distributions of profits (paragraph 28 of the Commentary on Article 10).

The CFE supports the inclusion, within the definition of "*dividends*", of the profits from the "*buyback*" of shares. However, since the proposed provision definitely widens the scope of the abovementioned paragraph:

- a clear definition of "*redemption of shares*" or "*redeemable shares*" should be provided as well;
- countries should be allowed to exclude the reference to "*redemption of shares*" during their bilateral negotiations.

4. Substantial clarifications

The Discussion Draft proposes to include a definition of the expression "*fiscal year concerned*". For the purposes of the application of Article 15, it must be interpreted as a reference "*to a fiscal year of the Contracting State in which a resident of the other Contracting State has exercised his employment and during which the relevant employment services have been rendered*". For clarity's sake, some examples are also provided:

"*Assume, for example, that the fiscal year of State S runs from 1 January to 31 December and that a resident of State R is present and performs employment services in State S between 1 August 00 and 28 Febru-*

ary 01. For the purposes of subparagraph 2 a), any twelve month period that begins between 1 January and 31 December 00 or ends between 1 January and 31 December 01 and that includes any part of the period of employment services would be relevant. For instance, the twelve month period of 1 August 00 to 31 July 01, which begins in the fiscal year 00 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 August and 31 December 00; similarly, the twelve month period of 1 March 00 to 28 February 01, which ends in the fiscal year 01 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 January and 28 February 01. The taxation of the remuneration for the relevant services need not take place in the fiscal year concerned: as explained in paragraph 2.2 above and 12.1 below, the Article allows a State to tax the remuneration derived from employment exercised in that State in a particular year even if the remuneration for these employment services is acquired, or the tax is levied, in a different year".

The CFE believes that the reference to the fiscal year in which a resident has exercised his employment (and during which the relevant employment services have been rendered) ensures an equal treatment of the various situations, while the examples provided allow for more clarity.

The Discussion Draft proposes to clarify, under paragraph 4 of the Commentary on Article 20, that the Article only applies to payments arising from sources outside the State where the student or business apprentice is present solely for the purposes of education or training. Payments arising from sources within that State are covered by other Articles of the Convention: for instance, if, during his presence in the first-mentioned State, the student or business apprentice remains a resident of the other State according to Article 4, payments such as grants or scholarships that are not covered by other provisions of the Convention (such as Article 15) will be taxable only in his State of residence under paragraph 1 of Article 21.

The CFE believes that it is important to make clear that any payment outside the scope of Article 20 should be taxed according to treaty provisions set forth for each relevant income item. To this purpose, the proposed provision under paragraph 4 of the Commentary on Article 20 should be completed by referring not only to grants or scholarship, but also to any other income item (*i.e.*, dividends, royalties, interests, remuneration, etc.) that is specifically addressed in the applicable treaty.