Executive Summary

On 21 November 2017, the Organisation for Economic Co-operation and Development (OECD) Council approved the contents of the 2017 update (the 2017 update) to the OECD Model Tax Convention (the OECD MTC). The 2017 update comprises the treaty-based recommendations developed through the Base Erosion and Profit Shifting (BEPS) project, and a few other changes that were not developed as part of the work on BEPS (e.g., changes to the international shipping provision and changes to the Commentary on Article 5 on Permanent Establishments). The 2017 update also includes the changes and additions made to the observations and reservations of OECD member countries and the positions of non-OECD economies.

The 2017 update, will be incorporated in the 2017 OECD MTC that will be published in the next few months.

Detailed discussion

Background

The OECD MTC has been regularly reviewed and updated to address new tax treaty issues. Working Party No. 1 of the OECD’s Committee on Fiscal Affairs (CFA) continuously works to update the Convention. The last update to the OECD MTC was in 2014.¹
On 21 November 2017, the OECD Council approved the contents of the 2017 update to the OECD MTC. The approved version incorporates the changes contained in the draft update with a few minor changes.

In response to the public comments received on the 2017 draft update, an addition with regard to Value Added Tax/Goods and Services Tax (VAT/GST) registration was made to the end of paragraph 5 of the Commentary on Article 5 (permanent establishment) which now explains that for the determination of a permanent establishment (PE), one should not draw any inference from the treatment of a foreign enterprise for VAT/GST purposes, including from the fact that a foreign enterprise has registered for VAT/GST purposes.

Most notably, the 2017 update includes the changes and additions made to the observations and reservations of OECD member countries and the positions of non-OECD economies, which were not included in the 2017 draft update. OECD member countries are invited to make reservations on the articles and/or observations on the commentaries to the OECD MTC, while some selected non-OECD economies are allowed to provide their positions on the articles of the OECD MTC and the Commentaries thereon. Hence, the reservations, observations and provisions provide insights on a country’s view or understanding of a specific point of the OECD MTC.

Since the last update to the OECD MTC in 2014, Latvia became a full-fledged member of the OECD in July 2016 and the OECD Council decided to open accession discussions with Costa Rica in April 2015. Therefore, one of the changes and additions made to the observations and reservations of member countries and the positions of non-OECD economies was the replacement of Latvia’s positions, as it became a member, and the addition of Costa Rica’s positions to the non-OECD economies’ positions on the OECD MTC.

With respect to the observations and reservations made by OECD members, the following positions are noted:

**Article 1 (persons covered)**
- France, Germany and Portugal reserve the right to not include Article 1(2) of the OECD MTC in their tax treaties.
- Article 1(2) deals with transparent entities and was introduced as part of the recommendation in the final report on BEPS Action 2. This provision corresponds to Article 3 of the MLI.
- Canada reserves the right to limit the entities or arrangements covered under Article 1(2).
- France, Germany, Hungary, Ireland, Luxembourg and Switzerland reserve the right to not include Article 1(3) of the OECD MTC in their tax treaties. Article 1(3) contains a saving clause (i.e., a tax treaty will not be construed to affect a Contracting State’s right to tax its own residents) and was introduced as part of the recommendations in the final report on BEPS Action 6. This provision corresponds to Article 11 of the MLI.

**Article 5 (permanent establishment)**
- Finland, Luxembourg, Sweden and Switzerland reserve the right to not include Article 5(4.1) of the OECD MTC in their tax treaties. Article 5(4.1) contains the anti-fragmentation rule which was introduced as part of the recommendation in the final report on BEPS Action 7. This provision corresponds to Article 13(4) of the MLI.
- Finland, Germany, Luxembourg, Sweden, Switzerland and the United States, reserve the right to follow Article 5(5) and 5(6) as they stood before the 2017 update. Article 5(5) defines Dependent Agent PE (DAPE) and Article 5(6) defines independent agent. The final report on BEPS Action 7 broadened the definition of DAPE while narrowing the definition of independent agent. These provisions correspond to Article 12 and 13(1) of the MLI respectively.
Finland and Sweden also reserve the right not to include the definition of closely related enterprises contained in Article 5(8). This provision corresponds to Article 15 of the MLI.

Article 10 (dividends)
Luxembourg reserves the right not to include the holding period in Article 10(2)(a) in order to apply the beneficial ownership tax limitation provisions. The final report on BEPS Action 6 added a holding period of 365 days to Article 10(2)(a). This provision corresponds to Article 8 of the MLI.

Article 25 (mutual agreement procedure)
Denmark, Israel, Korea, Mexico and Turkey reserve the right not to include Article 25(5) in their tax treaties. Article 25(5) provides that, in the cases where the competent authorities are unable to reach an agreement under a Mutual Agreement Procedure within two years, the unresolved issues will, at the request of the person who presented the case, be solved through an arbitration process.

Due to policy and administrative considerations, Chile and Hungary also reserve the right not to include Article 25(5) in their tax treaties.

Article 29 (entitlement to benefits)
Belgium, Hungary, Luxembourg and Switzerland reserve the right not to include the anti-abuse rule for PEs situated in third jurisdictions contained in Article 29(8) of the MTC, while the United States reserves the right to expand the scope of this anti-abuse rule. The final report on BEPS Action 6 added this specific anti-abuse rule for PEs situated in third jurisdictions. This provision corresponds to Article 10 of the MLI.

With respect to the positions by non-OECD economies, the following positions are noted:

Article 1 (persons covered)
India reserves the right not to include Article 1(2) of the OECD MTC on transparent entities in their tax treaties, while Costa Rica, Serbia and Singapore reserve their position on this article.
Costa Rica, Serbia and Singapore reserve their position on the savings clause in Article 1(3) of the OECD MTC.

Article 5 (permanent establishment)
Singapore reserves its right to use the Article 5(5) on commissionaire arrangements as it stood before the 2017 update.

India reserves the right not to include the word “routinely” in the definition of DAPE in Article 5(5).

India considers that treatment under VAT/GST can be a relevant factor for the interpretation and application of the definition of PE. Therefore, India disagrees with the part of the Commentary on Article 5 that states that treatment under VAT/GST is irrelevant for the purpose of interpretation and application of the definition of PE.

With the aim to deal with the challenges of digitalization, India reserves the right to include a provision in Article 5 to the effect that an enterprise having a significant economic presence in a Contracting State, based on criteria identified in Chapter VII of the final report on BEPS Action 1, will be deemed to have a PE in that State. Moreover, India is of the view that, depending on the facts, an enterprise can be considered to have acquired a place of business through a website on any equipment, if opening the website on that equipment includes downloading of automated software, such as cookies, which use that equipment to collect data from that equipment, process it in any manner or share it with the enterprise.

Article 25 (mutual agreement procedure)
Brazil, China, India, Indonesia, Serbia, South Africa and Hong Kong reserve the right not to include Article 25(5) in their tax treaties.

Singapore reserve the right to modify paragraph 5 in its tax treaties.

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

Businesses are therefore advised to read and understand the changes in the 2017 OECD MTC, including the observations and reservations of OECD member countries and the positions of non-OECD economies, and assess what impacts it may have on current or planned structures.
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