

STEP Lunch Meeting / Lausanne

BEPS – What's in for trusts?

Agenda

The issue

The recommendations of the OECD Partnership Report

Limitations

The proposed new provision of the OECD MC

Critical analysis

Implications for trust relationships

Conclusion

The issue

States may characterise hybrid entities differently from a taxation standpoint.

This may result in:

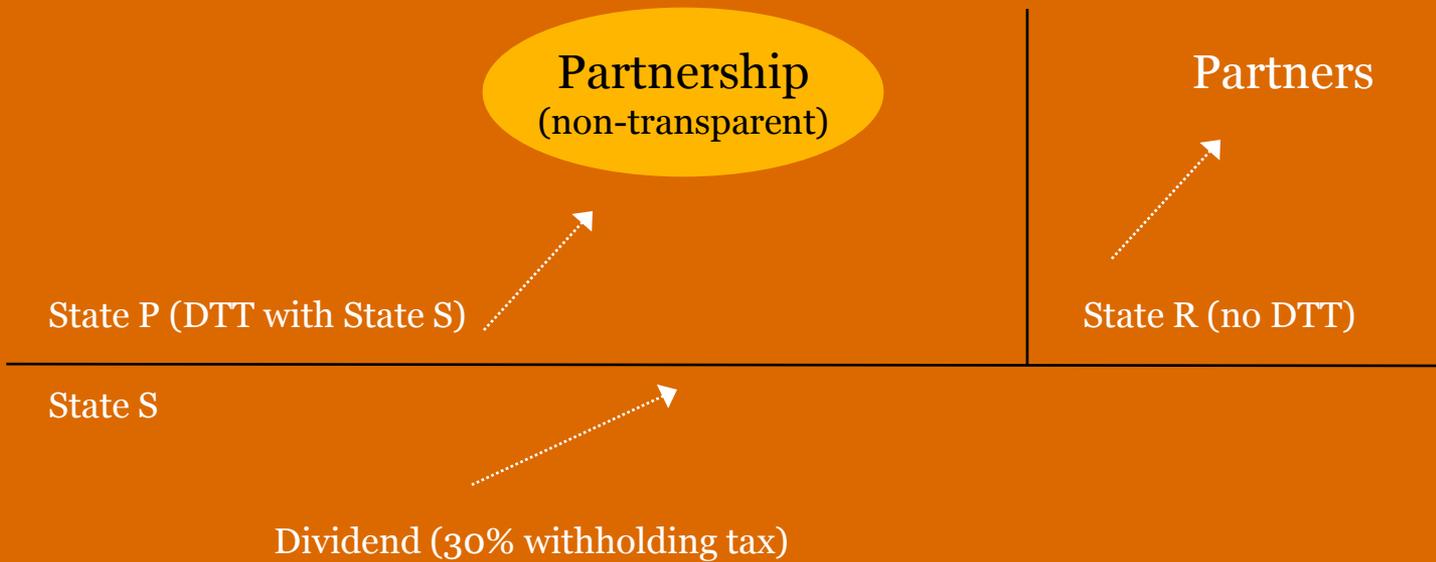
- States attributing income items to different taxpayers (conflicts of attribution)
- States qualifying income items differently from a taxation standpoint (conflicts of qualification)

Such conflicts may lead to the inconsistent application of double taxation treaties (DTTs), which may result in double taxation or double non-taxation situations.

These issue were first addressed by the OECD Partnership Report in 1999. The conclusions of this report were inserted in the OECD MC Commentary.

Several Member States made observations regarding the relevant paragraphs of the OECD MC Commentary. The issue has been a controversial subject in scholarly writings.

Example 1



Example 1

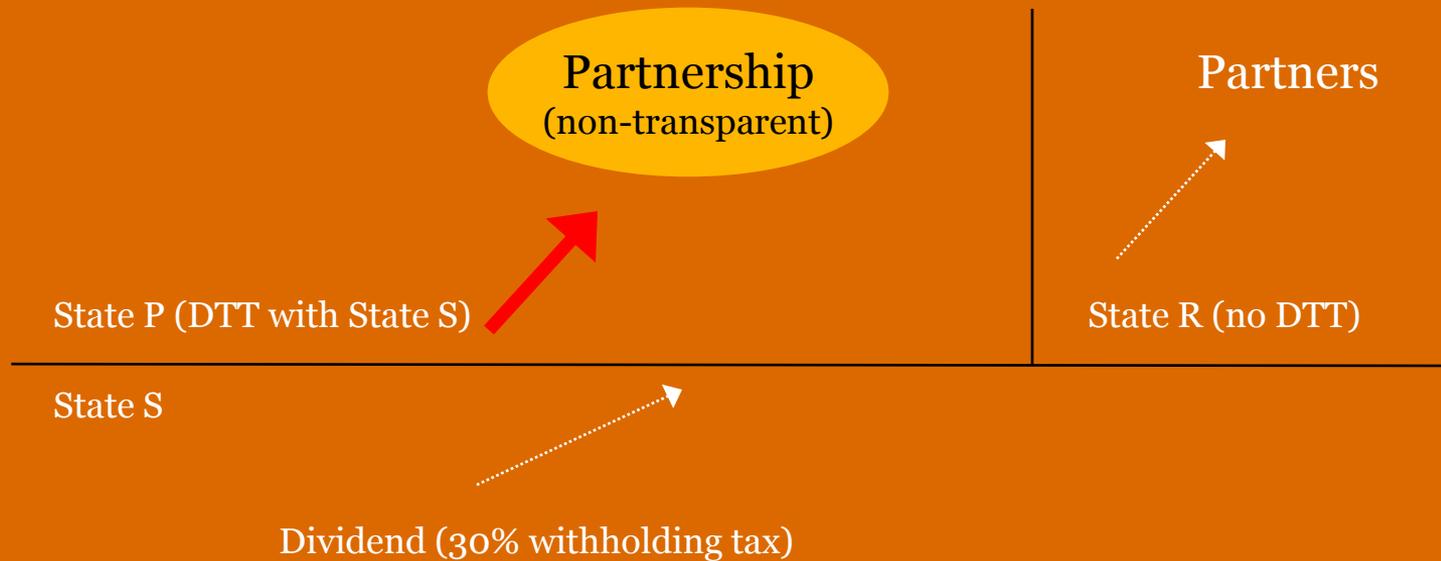
Treaty benefits are subject to the following conditions:

- The person claiming treaty benefits should be a “person” in the sense of the treaty
- This person should be a “resident” of one of the contracting States
- Income should be “paid to”, “derived by”... that person
- This person should be the “beneficial owner” of the item of income for which treaty benefit is claimed
- No anti-abuse rule should apply

Example 1

- Should State S take the view that the dividend is ‘paid to’ a resident of State P and restrict its taxation rights based on the DTT S-P?
- Whom should the income be regarded as paid to? How should the term ‘paid to’ be interpreted?
- Solution proposed by the OECD Partnership Report

Example 1 – solution proposed by the OECD Partnership Report



→ State S should reduce its taxation rights based on DTT concluded with State P

Example 2

Partnership
(non-transparent)

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graph TD; S[State S] -- Dividend --> P[Partnership (non-transparent)]; P --> Partners[Partners];
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State P (DTT with State S)

State S

Dividend



Partners

Example 2

Para. 6.1 OECD MC Commentary: “*Where a partnership is treated as a resident of a Contracting State, the provisions of the Convention that restrict the other Contracting State’s right to tax the partnership on its income do not apply to restrict that other State’s right to tax the partners who are its own residents on their share of the income of the partnership.*”

The majority of OECD Member States’ delegates took the view that the general recommendation of the Report does not apply in such a case → States rights to tax their own residents cannot be restricted by DTTs

Example 2

Partnership
(non-transparent)

State P (DTT with State S)

State S

Dividend



Partners

Limitations

The application of the OECD's recommendations with regard to the application of DDTs to partnerships has some limitations:

- Several Member States made observations regarding the relevant paragraphs of the OECD MC Commentary.
- The issue has been a controversial subject in scholarly writings
- The Partnership Report deals exclusively with partnerships => what about trusts?

Proposed new provision of the OECD MC

In the context of BEPS Actions 2 and 6, the OECD proposes to insert a new provision in the OECD MC (art. 1, para. 2 and 3):

Para. 2: “For the purpose of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for the purpose of taxation by that State, as income of a resident of that State.”

Para. 3: “This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 A [23 B], 24 and 25 and 28”.

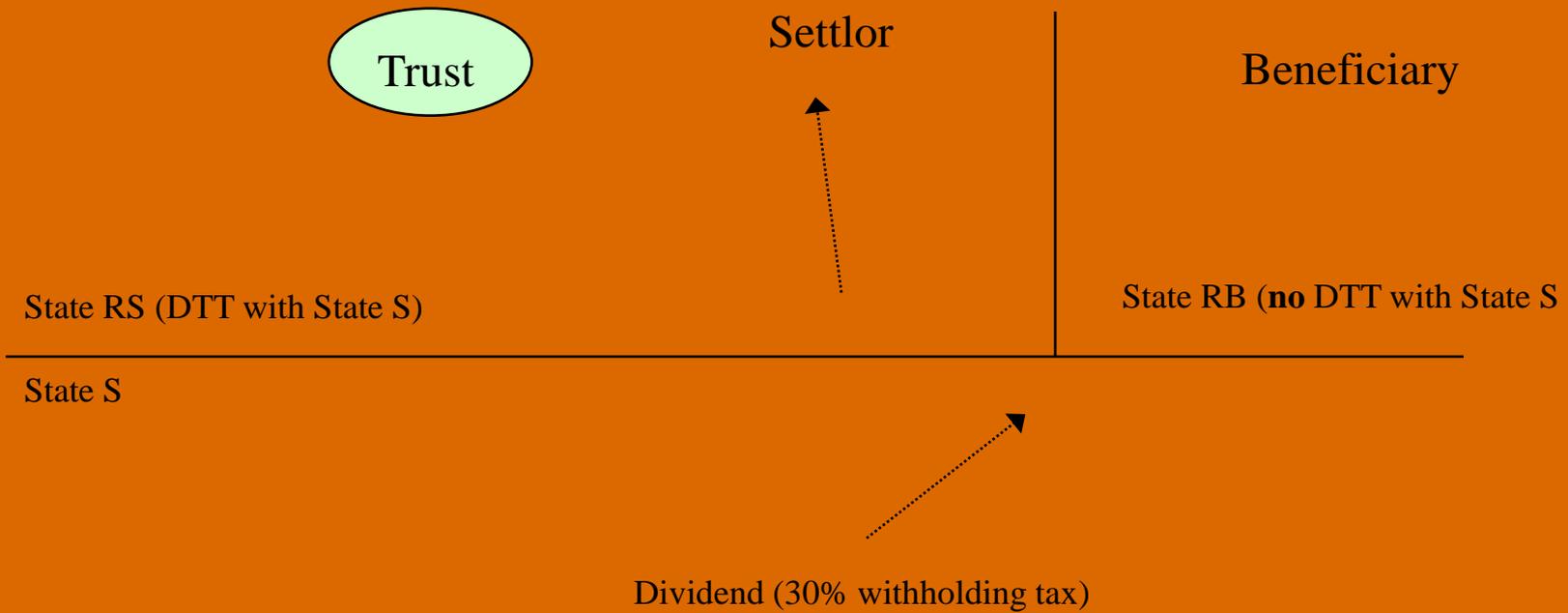
Critical analysis

The proposed provision enables the resolution of conflicts of attribution arising from the use of hybrid entities other than partnerships, such as trusts.

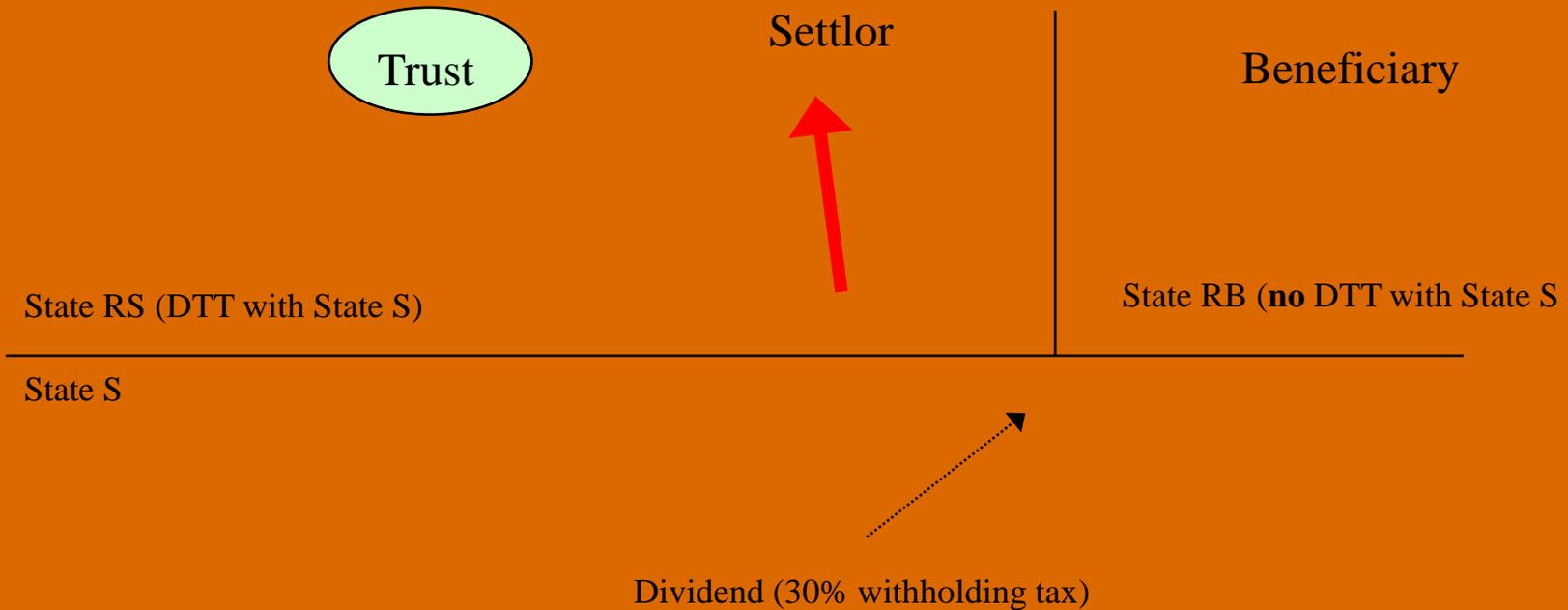
However ...

- Risk that if such a provision isn't included in DTT, States can refuse to apply the recommendations of the OECD Partnership Report to other cases.
- No application of these principles to other types of conflicts of attribution, i.e. those not resulting from divergences in the classification of entities for tax purposes.

Example 3



Example 3



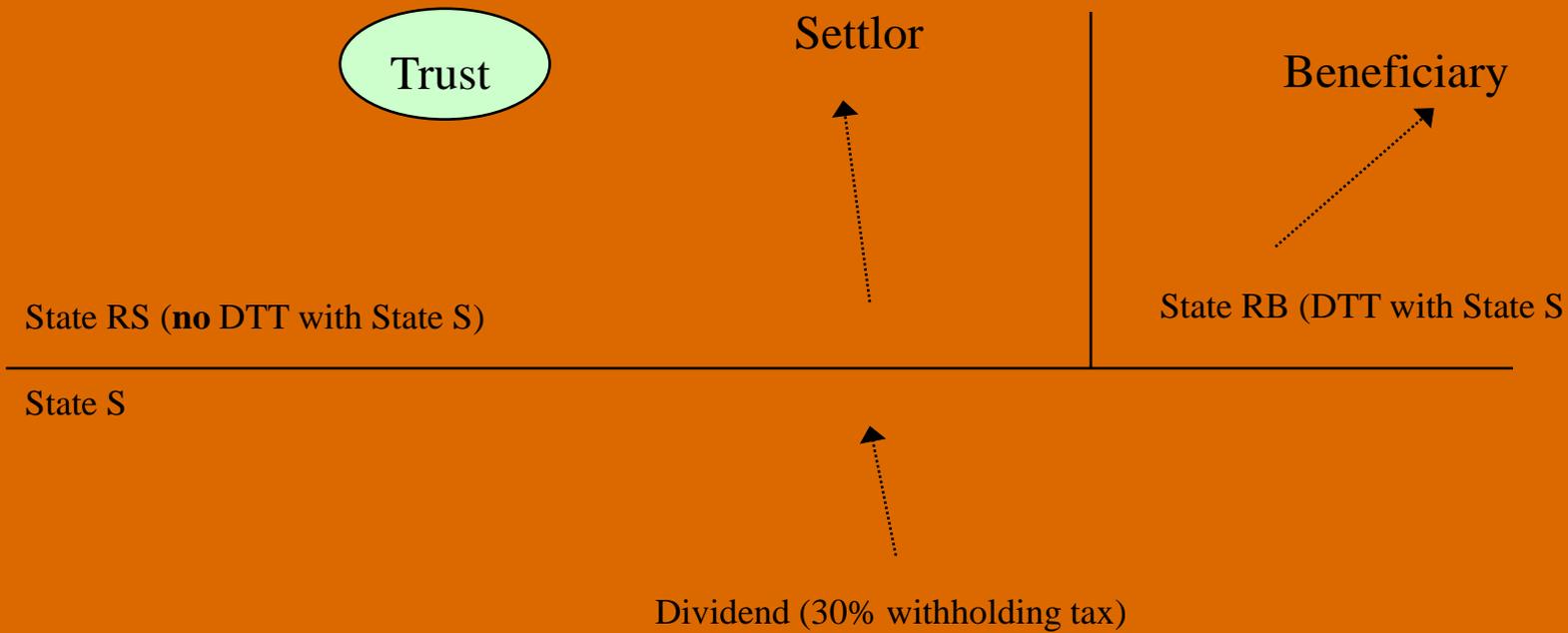
⇒ State S should accept that the dividend is « paid to » the Settlor for thre purpose of DTT S-RS

Example 3

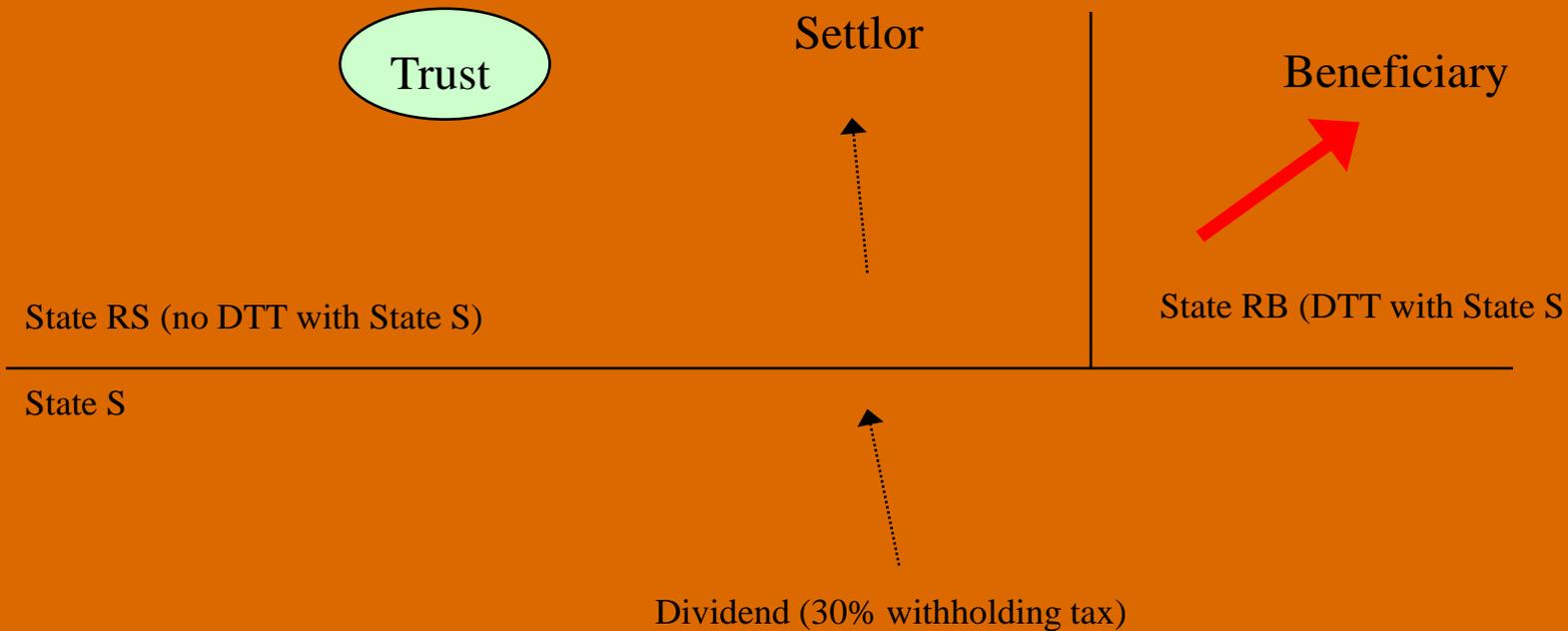
Treaty benefits will be granted only to the extent that the Settlor satisfies the beneficial ownership requirement

*“The ‘beneficial owner’ is he who is free to **decide** (1) whether or not the capital or other assets should be used or made available for use by others or (2) on how the yields therefrom should be used or (3) both” (Klaus Vogel in Double Taxation Conventions, Den Hague, 1997, p. 562)*

Example 4



Example 4



⇒ State S should accept that the dividend is « paid to » the Beneficiary for the purpose of DTT S-RB

Conclusion

- Through the multilateral instrument (BEPS Action 15), the proposed new provision of the OECD MC would be a pragmatic way (hopefully) to encourage OECD Member States to apply the recommendations of the Partnership Report to conflicts of attribution involving hybrid entities.
- However, introducing the proposed provisions in double tax treaties will most likely not facilitate the application of the principles conveyed by the OECD Partnership Report to other types of conflicts of attribution.
- Need to carefully look at the beneficial ownership requirement. Definition of “beneficial owner” should be further “relaxed” to accommodate double taxation cases where treaty benefits are claimed in bona fide situations.

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