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# The OECD-Model- Convention and its Update 2014



Linde

# The OECD Model Convention and Its Update 2014

## Why this book?

The OECD published the 2014 Update of the OECD Model Convention in July 2014. The OECD Committee on Fiscal Affairs and its Working Parties have been working on the proposed changes to the OECD Model and the Commentary for some years. The Update in particular addresses issues regarding beneficial ownership, treatment of termination payments, changes to the exchange of information provision and questions arising in the context of emissions permits and credits.

This book includes 11 chapters which analyze the changes made by the Update and assesses their effects on international tax planning. Moreover, the book offers a future outlook of the concept of permanent establishment in the context of the BEPS project. It incorporates the perspective of leading scholars and practitioners dealing with international tax cases.

This book is designed to provide essential insights to academics, practitioners, tax officials and judges who deal with or are interested in the field of international taxation.

<b>Title:</b>	The OECD Model Convention and its Update 2014
<b>Editor(s):</b>	Michael Lang, Pasquale Pistone et. al
<b>Date of publication:</b>	February 2015
<b>ISBN:</b>	978-90-8722-301-4
<b>Type of publication:</b>	Print book
<b>Number of pages:</b>	288
<b>Terms:</b>	Shipping fees apply. Shipping information is available on our website
<b>Other:</b>	Joint publication between IBFD and Linde Verlag
<b>Price:</b>	EUR 78 / USD 95 (VAT excl.)

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# The Definition of Dividends, Interest, Royalties and Capital Gains

*Josef Schuch/Erik Pinetz*

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## I. Introduction

This chapter examines the amendments to the Commentary on the OECD Model Tax Convention resulting from the 2014 update with respect to the definition of dividends, interest and capital gains. Concerning the definition of dividends, under article 10(3) of the OECD Model, the new Commentary deals with proceeds from the redemption of shares and comes to the conclusion that they may be taxed as dividends or capital gains, depending on the classification under the national law of the state in which the distributing company is resident. The classification conflicts inevitably arising from this approach are “resolved” by requiring the state of residence of the shareholder to provide relief for double taxation, which literally means a binding of the residence state to the classification of the source state.

In addition, the new Commentary deals with the taxation of bonds under the definition of interest pursuant to article 11(3) of the OECD Model. In this respect, the Commentary indicates what constitutes interest yielded by a loan security. Furthermore, the Commentary also deals with the classification of income that is generated when bonds are sold before maturity, as some states tax the seller on interest that has been accrued up to the time of alienation of the bond. Again, according to the Commentary, potential conflicts of classification between the two contracting states should be resolved by the means mentioned before, namely by binding the residence state to the classification of the source state.

Finally, the Commentary addresses the issue of changes in the definition of capital gains due to an amendment of an income tax treaty. In this respect, an amendment of a provision similar to the provisions in article 13 of the OECD Model often leads to a change to the taxation rights over the respective assets from one contracting state to the other. Hence, after the amendment of the respective income tax treaty, one contracting state may be prohibited from taxing capital gains on hidden reserves which have been accumulated over a long period of time. Therefore, the Commentary deals with the effects on the taxation rights on certain items of income after an amendment of a specific income tax treaty. These issues will be analysed, after briefly presenting the relevant amendments to the Commentary.

## II. Amendments made to the new Model Tax Convention and Commentary

With respect to the definition of dividends, interest and capital gains, there are no changes to the OECD Model itself. Rather, the amendments to articles 10 and 11 of the OECD Model relate only to the concept of beneficial ownership, which are dealt with under a separate chapter in this book. Therefore, this chapter will ad-

dress only the amendments to the Commentary on the definitions of dividends, interest and capital gains. The following replacement of paragraph 28 will be implemented in the Commentary on Article 10(3) of the OECD Model:

Payments regarded as dividends may include not only distributions of profits decided 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 (see paragraph 31 of the Commentary on Article 13)** and disguised distributions of profits. The reliefs provided in the Article apply so long as the State of which the paying company is a resident taxes such benefits as dividends. It is immaterial whether any such benefits are paid out of current profits made by the company or are derived, for example, from reserves, i.e. profits of previous financial years. Normally, distributions by a company which have the effect of reducing the membership rights, for instance, payments constituting a reimbursement of capital in any form whatever, are not regarded as dividends.

In this paragraph, without providing much reasoning, the Commentary has included redemptions of shares in the definition of "dividends" under article 10(3) of the OECD Model. Therefore, one must analyse whether this amendment is merely declaratory or whether redemptions of shares must be treated differently under income tax treaties that have already been concluded.

Regarding the definition of "interest" in article 11(3) of the OECD Model, the Commentary will be changed in two paragraphs. First, paragraph 20 is replaced by the following wording:

As regards, more particularly, **government securities, and bonds and debentures**, the text specifies that **premiums or prizes attaching thereto constitute interest**. Generally speaking, what constitutes interest yielded by a loan security, and may properly be taxed as such in the State of source, is all that the institution issuing the loan pays over and above the amount paid by the subscriber, that is to say, the interest accruing plus any premium paid at redemption or at issue. It follows that when a bond or debenture has been issued at a premium, the excess of the amount paid by the subscriber over that repaid to him may constitute negative interest which should be deducted from the stated interest in determining the interest that is taxable. On the other hand, the **definition of interest does not cover any profit or loss that cannot be attributed to a difference between what the issuer received and paid** (e.g. 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 realises 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) does not enter into the concept of interest. Such profit or loss may, depending on the case, constitute either a business profit or a loss, a capital gain or a loss, or income falling under Article 21.

In addition, a new paragraph 20.1 has been introduced with the following wording:

The amount that the seller of a bond will receive will typically include the interest that has accrued, but has not yet become payable, at the time of the sale of the bond. In most

cases, the State of source will not attempt to tax such accrued interest at the time of the alienation and will only tax the acquirer of the bond or debenture on the full amount of the interest subsequently paid (it is generally assumed that in such a case, the price that the acquirer pays for the bond takes account of the future tax liability of the acquirer on the interest accrued for the benefit of the seller at the time of the alienation). In certain circumstances, **however, some States tax the seller of a bond on interest that has accrued at the time of the alienation** (e.g. when a bond is sold to a tax-exempt entity). Such accrued interest is **covered by the definition of interest and may therefore be taxed by the State of source**. In that case, that State should not again tax the same amount in the hands of the acquirer of the bond when the interest subsequently becomes payable.

As a result, the second area of interest will be the treatment of bonds under international tax law, which gives rise to two questions. First, one must analyse which payments from the issuer of a bond to the subscriber can be regarded as interest under article 11(3) of the OECD Model. Second, one must consider whether income generated from the sale of a bond before maturity constitutes a capital gain or interest under treaty law.

Finally, paragraph 3 of the Commentary on Article 13 of the OECD Model will have the following content:

The Article does not deal with the above-mentioned questions. It is left to the domestic law of each Contracting State to decide whether capital gains should be taxed and, if they are taxable, how they are to be taxed. The Article can in no way be construed as giving a State the right to tax capital gains if such right is not provided for in its domestic law. [rest of the paragraph is moved to new paragraph 3.1].

In addition, this paragraph is complemented by paragraph 3.1, which has the following wording:

The Article does not specify to what kind of tax it applies. It is understood that the Article must apply to all kinds of taxes levied by a Contracting State on capital gains. The wording of Article 2 is large enough to achieve this aim and to include also special taxes on capital gains. Also, **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 thereof that has accrued after the entry into force of a treaty** (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.

As a result, one must analyse the effects that income tax treaties have on the taxation rights of contracting states, in the case where the taxation rights on certain items of income change due to an amendment of a specific treaty provision.

Furthermore, paragraph 24 of the Commentary on Article 13 is replaced by the following:

Paragraph 2 deals with movable property forming part of the business property of a permanent establishment of an enterprise. The term “movable property” means all



property other than immovable property which is dealt with in paragraph 1. It includes also incorporeal property, such as goodwill, licences, **emissions permits** etc. Gains from the alienation of such assets may be taxed in the State in which the permanent establishment is situated, which corresponds to the rules for business profits (Article 7).

Even though this amendment would give rise to very interesting questions regarding the definition of capital gains, a discussion thereof is beyond the scope of this chapter, as another chapter in this book deals exclusively with the taxation of emission permits under international tax law. The last amendment concerns paragraph 31, which is replaced by the following:

If shares are alienated by a shareholder to the issuing company in connection with the **liquidation of the issuing such company or the redemption of shares or reduction of its paid-up capital** of that company, the difference between the selling price proceeds obtained by the shareholder and the par value of the shares may be treated in the State of which the company is a resident as a distribution of accumulated profits and **not as a capital gain**. The Article does not prevent the State of residence of the company from taxing such distributions at the rates provided for in Article 10: such taxation is permitted because such difference is covered by the definition of the term “dividends” contained in paragraph 3 of Article 10 and interpreted in paragraph 28 of the Commentary relating thereto, to the extent that the domestic law of that State treats that difference as income from shares. **As explained in paragraphs 32.1 to 32.7 of the Commentary on Articles 23 A and 23 B, where the State of the issuing company treats the difference as a dividend, the State of residence of the shareholder is required to provide relief of double taxation even though such a difference constitutes a capital gain under its own domestic law. The same interpretation may apply if bonds or debentures are redeemed by the debtor at a price which is higher than the par value or the value at which the bonds or debentures have been issued;** in such a case, the difference may represent interest and, therefore, be subjected to a limited tax in the State of source of the interest in accordance with Article 11 (see also paragraphs 20 and 21 of the Commentary on Article 11).

This paragraph again refers to the taxation of liquidation proceeds, redemptions of shares and redemptions of bonds, and explicitly deals with the elimination of double taxation in cases of classification conflicts. Therefore, this paragraph will be analysed with the amendments to Commentary on Article 10(3) of the OECD Model.

### III. Redemptions of shares

#### A. The definition of dividends under article 10(3) of the OECD-MC

The taxation of dividends is regulated under a separate allocation rule, namely article 10 of the OECD Model. This article contains a definition of the term “dividend” for treaty purposes in article 10(3) of the OECD Model, which is – according to the prevailing opinion – relevant for the whole treaty and binding on both

contracting states.<sup>1</sup> In interpreting this provision, the wording can be divided into three categories that are considered to be dividends for treaty purposes:<sup>2</sup>

- income from shares, “jouissance” shares or “jouissance” rights, mining shares or founders’ shares;
- other rights, not being debt-claims, participating in profits; and
- income from other corporate rights which is subject to the same tax treatment as income from shares under the laws of the state of which the company making the distribution is a resident.

Concerning the interpretation of this provision, the special feature of the dividend definition is the last part, which contains a reference to the national law of the state of which the company making the distribution is a resident.<sup>3</sup> On this basis, one could argue that the reference to national law covers the whole provision.<sup>4</sup> However, such an interpretation would render broad parts of the definition of dividends meaningless, as simply the national law of the residence state of the distributing company would always decide whether a dividend exists for treaty purposes. In addition, various classification conflicts would be the inevitable consequence.<sup>5</sup> Therefore – with the exception of the last part of the definition – under article 3(2) of the OECD Model, an autonomous interpretation of the treaty provisions should prevail over the decisiveness of the domestic law of the contracting states.<sup>6</sup> In this respect, already the wording of the provision reveals that the decisive criterion un-

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1 E.g. K. Daxkobler & E. Pamperl, *Der Dividendenbegriff im OECD-Musterabkommen*, Steuer und Wirtschaft International (SWI) (2011), at 474; W. Tischbirek, in *Doppelbesteuerungsabkommen (DBA)* (K. Vogel & M. Lehner eds., 5th edition, Beck 2008), Art. 10, para. 184 (with further references).

2 E.g. F. Wassermeyer, *Doppelbesteuerung (DBA)* (F. Wassermeyer, M. Lang & J. Schuch eds., 2nd edition, Linde 2010) Art. 10, para. 92; R. Portner, in *DBA* (H. Becker, H.-D. Höppner, S. Grotherr & H.-K. Kroppen eds., Beck 2005), Art. 10, para. 150; H. Schaumburg, *Internationales Steuerrecht* (3rd edition, Beck 2011), para. 16.329; B. Riegler & K. Salomon, *Der Dividenden- und der Zinsbegriff nach den Doppelbesteuerungsabkommen der Bundesrepublik Deutschland*, Der Betrieb (DB) (1991), at 2205; R. Thunshirn, *Einlagenrückzahlung im Internationalen Steuerrecht*, SWI (1996), at 437, 440f; S. Kirchmayr, *Besteuerung von Beteiligungserträgen* (Linde 2004), at 317; Tischbirek, *supra* n. 1, Art. 10, para. 185; J. Avery Jones et al., *The Definition of Dividends and Interest in the OECD Model: Something Lost in Translation?*, 1 World Tax J. 1 (2009), at 5, 6.

3 E.g. Tischbirek, *supra* n. 1, Art. 10, para. 184.

4 Wassermeyer, *supra* n. 2, Art. 10, para. 92 („In practice there is the tendency to interpret not only the third group of the definition in accordance with the national law of the source state, but the whole provision“) (authors’ translation). See also Schaumburg, *supra* n. 2, para. 16.330; G. Burmester, *Überlegungen zur Auflösung zur Schweizer Zwischengesellschaften*, Recht der Internationalen Wirtschaft (RIW) (1987), at 298 et seq.; D. Piltz, *Liquidation ausländischer Kapitalgesellschaften in den Doppelbesteuerungsabkommen*, Deutsches Steuerrecht (DStR) (1989), at 133 et seq.

5 C. Staringer, *Liquidation, Kapitalrückzahlung und Aktienrückkauf im Recht der Doppelbesteuerungsabkommen*, in *Praxis des Internationalen Steuerrechts: Festschrift für Helmut Loukota* (H. Jirousek & M. Lang eds., Linde 2005), at 483, 500 et seq.; J. Bauer & J. Schuch, *Die Überlegungen des OECD-Steuerausschusses zur Lösung von Qualifikationskonflikten, in Personengesellschaften im Recht der Doppelbesteuerungsabkommen* (W. Gassner, M. Lang & E. Lechner eds., Linde 2000), at 27, 30 et seq.

6 M. Lang, *Art. 3 (2) OECD-MA und die Auslegung von Doppelbesteuerungsabkommen*, Internationale Wirtschafts-Briefe (IWB) (2011), at 281, 287 (with additional references); M. Lang, *Introduction to the Law of Double Taxation Conventions* (2nd edition, Linde/IBFD 2013), paras. 117 et seq.; M. Lang, *Hybride Finanzierungen im Internationalen Steuerrecht* (Orac 1991), at 25; Wassermeyer, *supra* n. 2, Art. 10, Rz 91a f.

der this definition is the existence of a “corporate right”.<sup>7</sup> As the last part of the provision speaks of “other corporate rights”, one can conclude that also the explicitly mentioned dividend income types must originate from a corporate right.<sup>8</sup> This is emphasized by a systematic interpretation. It would be highly questionable why the reference to the national law of the distributing company should cover all parts of the definition, if it is explicitly set forth only for the last part.<sup>9</sup>

As a consequence, the prevailing opinion in the literature views the reference to national law as being relevant only for determining whether a certain payment falls within the scope of the last group of article 10(3) of the OECD Model, and only insofar as the term “corporate rights” is not affected.<sup>10</sup> Only under the last part of article 10(3) of the OECD Model, is the classification of the payment as a dividend due to the national law of the source state binding on the state of the recipient.<sup>11</sup> The simple reason behind this reference in the third group is that the enormous differences between the various national provisions in this area cannot be adequately taken into account by an overarching definition.<sup>12</sup>

In contrast, for the first two parts of the dividend definition under article 10(3) of the OECD Model, the existence of a corporate right is the decisive criterion<sup>13</sup> which must be interpreted in an autonomous way.<sup>14</sup> Therefore, the term “company” as defined in article 3(1)(b) of the OECD Model is decisive for falling under the definition of dividends in article 10(3) of the OECD Model, which requires a “body corporate or any entity that is treated as a body corporate for tax

7 J. Schuch, *Beteiligungen im Recht der Doppelbesteuerungsabkommen*, in *Beteiligungen in Rechnungswesen und Besteuerung* (R. Bertl, E. Eberhartinger, A. Egger, W. Gassner, M. Lang, C. Nowotny, C. Riegler, J. Schuch, C. Staringer eds., Linde 2004), at 181, 184; M. Lang & J. Schuch, *Doppelbesteuerungsabkommen Deutschland/Österreich* (Beck 1997), Art. 10a, paras. 62 ff; H.-J. Aigner, *Die verdeckte Gewinnausschüttung im DBA-Recht*, IStR (2003), at 154, 156; S. Kirchmayr, *Dividendenstripping im internationalen Steuerrecht*, in *Festschrift für Loukota*, *supra* n. 5, at 195, 207; M. Lang & C. Strasser, *Die Auslegung von Quellenstaatsregelungen in Doppelbesteuerungsabkommen* (Linde 2005), at 131 et seq.; F.M. Giuliani, *Article 10(3) of the OECD Model and Borderline Cases of Corporate Distributions*, 56 Bull. Intl. Fiscal Doc. 1 (2002), at 11, 14; E. Eberhartinger & M.A. Six, *Taxation of Cross-Border Hybrid Finance: A Legal Analysis*, 37 Intertax 1 (2009), at 4, 9; H. Pijl, *Interest from Hybrid Debts in Tax Treaties*, 65 Bull. Intl. Taxn. 9 (2011), at 482, 490 et seq.; M.A. Six, *Hybrid Finance and Double Taxation Treaties*, 63 Bull. Intl. Taxn. 1 (2009), at 22, 23.

8 For detail, see Lang, *Hybride Finanzierungen*, *supra* n. 6, at 90 ff.

9 Daxkobler & Pamperl, *supra* n. 1, at 474, 478.

10 E.g. Lang, *Hybride Finanzierungen*, *supra* n. 6, at 119 f; M.A. Six, *Hybride Finanzierung im Internationalen Steuerrecht – am Beispiel von Genussrechten* (Linde 2008) (with additional references at footnote 504); M. Helminen, *The International Tax Law Concept of Dividend* (Wolters Kluwer 2010), at 64, 175; Daxkobler & Pamperl, *supra* n. 1, at 474, 477 et seq.; Wassermeyer, *supra* n. 2, Art. 10, para. 92; Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 491; Tischbirek, *supra* n. 1, Art. 10, para. 184.

11 Wassermeyer, *supra* n. 2, Art. 10, para. 119; Daxkobler & Pamperl, *supra* n. 1, at 474, 477.

12 Staringer, in *Festschrift für Loukota*, *supra* n. 5, 483, 492; Tischbirek, *supra* n. 1, Art. 10, para. 199.

13 See references cited at *supra* n. 7.

14 Daxkobler & Pamperl, *supra* n. 1, at 474, 476 et seq.; Lang, *Hybride Finanzierungen*, *supra* n. 6, 90; Six, *Hybride Finanzierung*, *supra* n. 8, at 108; Helminen, *supra* n. 10, 175 et seq.; Tischbirek, *supra* n. 1, Art. 10, paras. 188 et seq.

purposes”.<sup>15</sup> This means that the establishment of a taxable entity is crucial for falling under the definition of articles 3(1)(b) and 10(3) of the OECD Model.<sup>16</sup> In addition, the term “right” in the sense of a share in the foreign company must be distinguished from a claim against the company, which mainly requires that the participation in the foreign entity (i) not become smaller because of a distribution of profits and (ii) contains a certain amount of entrepreneurial risk.<sup>17</sup>

In conclusion, article 10(3) of the OECD Model contains an autonomous definition of the term “dividend” in the first two parts of the definition.<sup>18</sup> Only the last part of the definition relates to the law of the state where the distributing company is resident in order to establish an equality of other corporate rights of this particular state with “ordinary” corporate rights.<sup>19</sup> However, such other corporate rights may be relevant only if the respective payment does not fall within the first two parts of the definition.<sup>20</sup> In this respect, an autonomous interpretation of article 10(3) of the OECD Model leads to the outcome that income from shares, “jouissance” shares or “jouissance” rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, are always covered by the definition of dividends for treaty purposes, if they stem from a “corporate right”.<sup>21</sup>

## B. Redemptions of shares

Concerning the redemption of shares, the new Commentary on the OECD Model states in paragraph 28:

Payments regarded as dividends may include not only distributions of profits decided 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 (see paragraph 31 of the Commentary on Article 13)** and disguised distributions of profits. **The reliefs provided in the Article apply so long as the State of which the paying company is a resident taxes such benefits as dividends.**

- 15 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 184. On the term „company“ under article 3(1)(b) of the OECD Model, *see also* Lang, *Hybride Finanzierungen*, *supra* n. 6, at 112 et seq.; C. Marchgraber, *Der Begriff „Gesellschaft“ im Recht der Doppelbesteuerungsabkommen*, SWI (2011), at 336 et seq.
- 16 DE: BFH, 20 Aug. 2008, I R 39/07; DE: BFH, 20 Aug. 2008, I R 34/08; DE: BFH, 6 June 2012, I R 51/11; E. Pinetz, E. Schaffer, M. Sedlacek & A. Zeiler, *BFH-Rechtsprechungsübersicht Teil 1*, ecolex (2014), at 78, 79 et seq.
- 17 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 185. For the limitation, *see also* references at *infra* n. 66. *See also* S.-E. Bärsch, *The Definition of Dividends and Interest Contained in the OECD Model, Actual Tax Treaties and the German Model*, 42 *Intertax* 6 & 7 (2014), at 433, 435; J. Bundgaard & K. Joo Dyppel, *Profit-Participating Loans in International Tax Law*, 38 *Intertax* 12 (2010), at 643, 659.
- 18 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 492; Lang, *Hybride Finanzierungen*, *supra* n. 6, at 119 f; Tischbirek, *supra* n. 1, Art. 10, para. 184.
- 19 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 491.
- 20 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 186.
- 21 *See* references cited at *supra* n. 7.

According to these assertions, the Commentary assumes that a redemption of shares falls under the last group of article 10(3) of the OECD Model, and thus the tax treatment of the state in which the paying company is resident, is decisive for the classification under treaty law. Classification conflicts arising due to the reference to the national law of one contracting state should be resolved under the method article by binding the state of residence of the shareholders to the classification by the residence state of the distributing company.<sup>22</sup>

Regarding the treatment of redemptions of shares under international tax law, the first question that arises concerns what is actually covered by this term. As the domestic laws of various jurisdictions contain many different approaches under company as well as under tax law for the redemptions of shares,<sup>23</sup> it is doubtful whether all forms of redemptions of shares can be subsumed under the same allocation rule. These doubts are confirmed by the necessary limitation on article 13 of the OECD Model, under which alienations of shares must be subsumed. In this respect, there is a need to distinguish between two situations.<sup>24</sup> First, in a narrow Anglo-Saxon understanding, the share is transferred back to the issuing entity and hereby ceases to exist. From an economic perspective, this is quite similar to liquidation of the foreign entity.<sup>25</sup> Second, redemptions of shares could also be understood in a broader sense, such that shares are transferred back to the entity and are available for sale to another person. This operation is quite similar to a buyback of shares by the company. These very different situations will be analysed separately below.

22 OECD, *2014 Update to the OECD Model Tax Convention* (15 July 2014), para. 57. According to the updated OECD Commentary on Article 13, paragraph 31: „[w]here the State of the issuing company treats the difference as a dividend, the State of residence of the shareholder is required to provide relief of double taxation even though such a difference constitutes a capital gain under its own domestic law“.

23 E.g. D. Krüger, *Seminar E: Erwerb eigener Aktien durch die Gesellschaft*, IStR (2002), at 552; A. Kroniger, *Liquidation einer ausländischen Gesellschaft als Alternative zur Dividendenausschüttung – Gestaltungsmöglichkeiten bei Unternehmenstransaktionen in den USA (Election I.R.C. § 338(h)(10))*, IStR (2003), at 729 et seq.; P. Ritzer-Angerer, *Zur Abgrenzung von Ausschüttungen und Kapitalrückzahlungen – Besteuerung von Aktienrückkäufen in den USA und Deutschland*, IStR (2005), at 318; W. Neyer & A. Gürzenich-Schmidt, *Liquidation einer ausländischen Kapitalgesellschaft: Deutsche Besteuerung unbeschränkt steuerpflichtiger Anteilseigner*, IStR (2005), at 295, 298 et seq.; I. Hofbauer, H. Loukota & M. Stefaner, *Tagungsbericht zum IFA-Kongress 2002 in Oslo, Österreichische Steuerzeitung (ÖStZ)* (2002), at 612, 615 et seq.; M. Tanzer, *Der Rückerwerb eigener Aktien – Rechtsgrundlagen und steuerrechtliche Auswirkungen*, in *Festschrift Krejci* (E. Bernat, E. Böhler & A. Weilingger eds., Verlag Österreich 2001), at 1713, 1722 et seq.; R. Betten, *Share Buy-backs by Listed Companies from Individual Minority Shareholders*, 38 Eur. Taxn. 11/12 (1998), at 363; G. Toifl, *Acquisition of Own Shares by a Listed Company in Austria*, 38 Eur. Taxn. 11/12 (1998), at 367.

24 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 497 et seq.

25 See also the wording of the new Commentary on Article 13, para. 31: „If shares are alienated by a shareholder to the issuing company in connection with the liquidation of the issuing such company or the redemption of shares or reduction of its paid-up capital of that company, the difference between the selling price proceeds obtained by the shareholder and the par value of the shares may be treated in the State of which the company is a resident as a distribution of accumulated profits and not as a capital gain“ (emphasis added). OECD, *2014 Update*, *supra* n. 22, para. 57.

## 1. Redemptions of shares where shares cease to exist

Generally, redemptions of shares that lead to the cessation of the respective shares are very similar to liquidations and capital reductions of companies.<sup>26</sup> Therefore, it seems reasonable to place these types of redemptions of shares on an equal footing with liquidations and capital reductions from a treaty law perspective. This is also acknowledged by the new Commentary.<sup>27</sup> Similarly, the Austrian Federal Ministry Finance asserts in an EAS<sup>28</sup> that certain forms of redemptions of shares should be treated identically to liquidations under treaty law.<sup>29</sup> However, even though economically comparable amounts should be subject to the same tax treatment, it is necessary to assess which specific allocation rule is applicable. In this respect, the Austrian Federal Ministry of Finance insists on its position that liquidations fall under article 13 of the OECD Model as capital gains,<sup>30</sup> which is in line with the tax treatment of liquidations in the hands of the owners under national law.<sup>31</sup> It is argued that liquidations are similar to a sale of shares and thus should fall under article 13 of the OECD Model.<sup>32</sup> This position is even maintained if only retained profits are distributed upon the liquidation, which profits could have been distributed as a dividend, as well.<sup>33</sup>

However, the reasons asserted by the Austrian tax administration for subsuming liquidation proceeds under article 13 of the OECD Model are not convincing.<sup>34</sup> Fundamentally, the application of article 13 of the OECD Model requires an “alienation”.<sup>35</sup> Even though this term has not been defined in the Convention, there is no reason why one should refer to concepts under national law for the interpre-

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26 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 497.

27 *Supra* n. 25.

28 The so-called EAS-information (Express Answer Service) for international tax law presents the legal opinion of the Austrian Federal Ministry of Finance in a rather detailed manner as regards a specific fact pattern. These documents are not legally binding.

29 AT: FMF, 7 Feb. 2000, EAS 1594; AT: FMF, 28 Nov. 2000, EAS 1758.

30 AT: FMF, 6 Aug. 1998, EAS 1229; AT: FMF, 7 Feb. 2000, EAS 1594; AT: FMF, 11 Jan. 2001, EAS 1784; AT: FMF, 2 July 2002, EAS 2086; AT: FMF, 5 Nov. 2002, EAS 2142; AT: FMF, 28 Oct. 2002, EAS 2147; AT: FMF, 13 Jan. 2003, EAS 2196; AT: FMF, 27 Oct. 2003, EAS 2363; 9 Dec. 2003, EAS 2390; AT: FMF, 6 Dec. 2004, EAS 2537; AT: FMF, 22 Sept. 2006, EAS 2782; AT: FMF, 14 May 2012, EAS 3279; AT: FMF, 4 May 2013, 3326.

31 AT: ITA art. 27 (6) N 2, under which the liquidation of an Austrian corporate body such as a corporation is taxed as a sale of the shares by the shareholder. *See also* E. Marschner, in *Jakom Einkommensteuergesetz (EStG)* (A. Baldauf, S. Kanduth-Kristen, M. Laudacher, C. Lenneis, & E. Marschner eds., 6th edition, Linde 2013), Art. 27, paras. 386 et seq.

32 *See* references at *supra* n. 30.

33 AT: FMF, 29 Sept. 1997, EAS 1131; AT: FMF, 14 Aug. 2000, EAS 1704.

34 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 190 (with additional references). *See also* Lang, *Hybride Finanzierungen*, *supra* n. 6, at 104 (with additional references); M. Lang, H. Loukota, R. Waldburger, M. Waters & U. Wolff, *Liquidation einer schweizer Kapitalgesellschaft mit deutschen, britischen und österreichischen Gesellschaftern*, SWI (2003), at 499 et seq.

35 E.g. Daxkobler & Pamperl, *supra* n. 1, at 474, 479; Wassermeyer, *supra* n. 2, Art. 13, para. 21; E. Reimer, in *DBA*, *supra* n. 1, Art. 13, paras. 11 et seq.; Lang, *Hybride Finanzierungen*, *supra* n. 6, 102; Lang, *Introduction to the Law of Double Taxation Conventions*, *supra* n. 6, paras. 313f.

tation of this term.<sup>36</sup> Rather, it has been convincingly shown in the literature that the term “alienation” in article 13 of the OECD Model has an autonomous content, which relates to the change in ownership of a certain business asset between two legal entities.<sup>37</sup> Such a transfer of the ownership of the share between two legal entities occurs neither under liquidations nor by the relevant form of redemptions of shares, as the shares are not transferred to another legal entity, but rather cease to exist.<sup>38</sup> As domestic fictitious sales do not fall under the concept of an alienation pursuant to article 13 of the OECD Model,<sup>39</sup> it is not convincing to make liquidations subject to this provision, merely because they are treated as alienations under domestic law.<sup>40</sup>

Rather, one must refer to the definition in article 10(3) of the OECD Model, under which dividend treatment is afforded if the income results from a corporate right in the foreign company.<sup>41</sup> As all payments from corporate rights are covered by this provision, income from shares in the case of liquidation or redemptions of shares are covered, as they result from a share in a foreign company.<sup>42</sup> This is emphasized by the fact that the shareholders received the payment solely because of their participation in the foreign company.<sup>43</sup> The only difference between dividends, the proceeds from liquidations and the here described type of redemptions of shares is the cessation of shares. Still, this difference is not relevant for the definition under article 10(3) of the OECD Model, as the cessation of the shares does not have an influence on the fact that the proceeds are granted because of the holding of a corporate right in the company.<sup>44</sup> As a result, better arguments speak for viewing liquidation proceeds as well as comparable redemptions of shares as falling under income from shares pursuant to article 10 of the OECD Model, irrespective of the classification under the national law of the distributing company.

This outcome is also supported by the treatment of capital reductions, where the shares cease to exist upon repayment of equity.<sup>45</sup> Also in the case of capital reduc-

36 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 488.

37 Lang, *Hybride Finanzierungen*, *supra* n. 6, at 102ff; G. Toifl, *Die Wegzugsbesteuerung* (Linde 1996), at 78; Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 190. *See also* Wassermeyer, *supra* n. 2, Art. 13, para. 21; Reimer, *supra* n. 35, Art. 13, paras. 11 et seq.

38 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 488.

39 Toifl, *Die Wegzugsbesteuerung*, *supra* n. 37, at 130; C. Staringer, *Besteuerung doppelt ansässiger Kapitalgesellschaften* (Linde 1999), at 214 et seq.

40 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 190; Lang, *Liquidationsgewinne nach dem Doppelbesteuerungsabkommen zwischen Deutschland und Österreich*, SWI (1993), at 51, 52 et seq.; Tischbirek, *supra* n. 1, Art. 10, Rz 218.

41 *See supra* section III.1.

42 E.g. Lang, SWI (1993), *supra* n. 40, at 51, 52; C. Staringer, *Kapitalrückzahlungen im Recht der Doppelbesteuerungsabkommen*, SWI (1993), at 186, 192 et seq.; Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 190.

43 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 488.

44 E.g. Thunshirn, SWI (1996), *supra* n. 2, at 437, 440; Lang *Hybride Finanzierungen*, *supra* n. 6, at 90.

45 At least under the Austrian system. *See* T. Bachner, in *Kommentar zum Aktiengesetz* (P. Doralt, C. Nowotny & S. Kalss eds., 2nd edition, Linde 2012), Art. 175, para. 12.

tions, there is no change in ownership of an asset as required by article 13 of the OECD Model because of the cessation of the relevant business asset.<sup>46</sup> The shares are not transferred to a different person, but merely their value is decreased – which means that article 13 of the OECD Model does not apply.<sup>47</sup> Still, as the payment has its origin in the participation in the foreign company and thus must be subsumed under income from corporate rights, it seems convincing to subsume it as income from shares under article 10(3) of the OECD Model.<sup>48</sup> In this area, the difference to ordinary dividends is even smaller compared to liquidation proceeds, as the appearance of the payment is nearly identical to a dividend.<sup>49</sup>

In conclusion, the economic comparability of redemptions of shares that lead to a cessation of the underlying assets requires an equal treatment with liquidations of companies and capital reductions. In this respect, such actions fall under income from shares pursuant to article 10 of the OECD Model. The reason behind this classification is an autonomous interpretation of the definition of dividends in article 10(3) of the OECD Model according to which all income resulting from corporate rights should fall under this provision. As the proceeds of the redemption of shares result from the corporate rights in the foreign company, they could be subsumed under dividends pursuant to article 10(3) of the OECD Model, irrespective of how the state of the paying company treats the payment under its domestic law.

## 2. Redemptions of shares where shares do not cease to exist

In a broader understanding of the term “redemptions of shares”, this operation does not necessarily lead to a cessation of the involved shares.<sup>50</sup> For instance a company could also buy back shares for the sole purpose of selling them to other shareholders or employees, or use them as treasury stock at a later stage.<sup>51</sup> From

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46 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 192.

47 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 494 et seq.; C. Staringer, *Seminar D: Abkommensrechtliche Behandlung von Veräußerungsgewinnen aus Anteilen an Kapitalgesellschaften*, IStR (2003), at 521, 522 et seq.

48 Thunshirn, SWI (1996), *supra* n. 2, at 437, 439 et seq. (with additional references).

49 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 494.

50 For the different types of redemptions of shares and share buy-back, *see* references at *supra* n. 23. *See also* K. Grechenig, E. Lembeck & J. Oelkers, *Rückerwerbbarer Aktien: eine rechtsvergleichende Betrachtung mit Berichten aus England, Spanien und Italien*, Zeitschrift für Rechtsvergleichung (ZfRV) (2004), at 144.

51 For Austria, *see* art. 65 PLCA. For instance shares might be bought back by the company pursuant to article 65 (1) N 4 of the PLCA to hand them out to certain employees. *See also* J. Zehetner & C. Wolf, *Die Besteuerung von Stock Options*, *ecolex* (2001), at 24; J. Zehetner & C. Wolf, *Gesellschaftsrechtliche Rahmenbedingungen für Stock Options*, *ecolex* (2001), at 4; M. Achatz, *Mitarbeiterbeteiligung aus steuerlicher Sicht*, in *Mitarbeiterbeteiligung – Aktienoptionen* (M. Achatz, P. Jabornegg & R. Resch eds., Manz 2002), at 33; A. Bauer, *Aktienrückerwerb einer Gesellschaft aus steuerrechtlicher Sicht*, *taxlex* (2008), at 417; R. Bertl & K. Hirschler, *Der Erwerb eigener Anteile*, Zeitschrift für Recht und Rechnungswesen (RWZ) (2011), at 7; P. Jabornegg, *Mitarbeiterbeteiligung aus gesellschaftsrechtlicher Sicht*, in *Mitarbeiterbeteiligung – Aktienoptionen*, at 1.



the perspective of the involved company, this type of redemption of shares is not equivalent to a capital reduction or liquidation, but rather to an ordinary asset purchase.<sup>52</sup> Conversely, from the perspective of the seller, the measure is not different to the sale of the share to any other third person. In the case of a sale on the capital market, the seller might not even know about the buy-back of the shares. In addition, these transactions contain the characteristics of an alienation under article 13 of the OECD Model, as there is a change in the ownership of a certain business asset between two legal entities.<sup>53</sup> In light of these assertions, it seems more convincing to subsume this type of redemption of shares, where the assets are merely transferred to a different person, as falling under article 13 of the OECD Model, so as to treat sales to the company and to other third persons equally.<sup>54</sup>

## C. Resolution of classification conflicts

In light of the above demonstrated uncertainties as to the treatment of redemptions of shares, liquidations and capital reductions under treaty law, it is not surprising that conflicts of classification arise in practice.<sup>55</sup> For instance the Austrian Federal Ministry of Finance sought to apply article 13 of the OECD Model to a buy-back of shares of a Swedish corporation from an Austrian shareholder.<sup>56</sup> However, as Swedish national law treated this buy-back as a dividend distribution, the Austrian Federal Ministry of Finance viewed itself as being bound by the classification of the source state and also treated the amount as a dividend under article 10 of the OECD Model. Such an approach proves to be in error for two reasons.

First, the reasoning behind the binding of Austria to the classification of the source state is not convincing. This can be illustrated by the following example. If a shareholder is resident in Austria and receives liquidation proceeds from a foreign company that are treated as a dividend locally in the treaty partner state, the resolution of the classification conflict will lead to the crediting of the foreign taxes in Austria due to a binding to the classification of the source state as a dividend. Even though the outcome is then identical to the autonomous interpretation of article 10(3) of the OECD Model, the different reasoning is questionable, as there is no legal basis for such a binding to the classification of the source

52 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 498.

53 Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 193; *see also* the references at *supra* n. 35.

54 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 498; Schuch, in *Beteiligungen*, *supra* n. 7, at 183, 193; AT: FMF, 7 Feb. 2000, EAS 1594.

55 E.g. T. Pick, *Aktienrückkäufe in der Schweiz und in Österreich: ein aktien- und steuerrechtlicher Vergleich*, SWI (2010), at 17.

56 AT: FMF, 28 Nov. 2000, EAS 1758.

state.<sup>57</sup> In contrast to the opinion of the Austrian Federal Ministry of Finance and the Commentary on the OECD Model,<sup>58</sup> neither the reference to the national law of the source state under article 10(3) of the OECD Model nor the method article contain a legal basis for such a binding of the residence state to the classification of the source state. Rather, an autonomous interpretation of the provision should lead to the outcome that redemptions of shares fall under one specific allocation rule, and this interpretational outcome is binding on both contracting states, instead of interpreting a binding to the classification of the other contracting state into the treaty that is simply not there. Otherwise, the source state would always have the possibility to claim more taxation rights simply by amending its national laws, effectively undermining its treaty commitments.<sup>59</sup>

Second, the binding to the classification of the source state can lead to a different result than an autonomous interpretation under certain circumstances. This can also be illustrated by an example. In an outbound situation where the liquidation proceeds of an Austrian company are paid to a foreign shareholder, the application of article 13(5) of the OECD Model will lead to a loss of the whole taxation right of Austria and conversely to the full taxation right of the residence state of the shareholder. Therefore, the application of a different allocation rule to the redemption of shares can lead to a different amount of taxation. In this respect, it does not seem necessary to further analyse the opinion of the OECD on the resolution of classification conflicts in this section, but reference can be made to the criticism of the literature on the opinions presented in the OECD Partnership Re-

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57 Staringer, in *Festschrift für Loukota*, *supra* n. 5, at 483, 491; Wassermeyer, *supra* n. 2, Art. 10, para. 91b; M. Lang, *Thin Capitalisation*, in *Aktuelle Entwicklungen im Internationalen Steuerrecht* (W. Gassner, M. Lang & E. Lechner eds., Linde 1994), at 127, 145 et seq.; M. Lang, *The Application of the OECD Model Tax Convention to Partnerships: A Critical Analysis of the Report Prepared by the OECD Committee on Fiscal Affairs* (Kluwer Law Intl. 2000), at 41f; M. Lang, *Qualifikationskonflikte im Recht der Doppelbesteuerungsabkommen*, in P. Kirchhof, M. Lehner, A. Raupach & M. Rodi, *Staaten und Steuern: Festschrift für Klaus Vogel* (C.F. Müller Verlag 2000), at 907; M. Lang, *IFA Cashiers de Droit Fiscal International 2004 – Volume 89a. Double Non-taxation*, General Report (2004), at 21, 49 et seq.; M. Lang, *Conflicts of Qualification and Double non-taxation*, 63 Bull. Intl. Taxn. 5 (2009), at 204, 205 et seq.; M. Lang, *Qualifikations- und Zurechnungskonflikte im DBA-Recht*, IStR (2010), at 114, 117 et seq.; G. Kofler, H. Moshhammer & M. Tumpel, *Zurechnungs- und Qualifikationskonflikte im DBA-Recht: Behandlung in der österreichischen Verwaltungspraxis, in Einkünftezurechnung im Internationalen Steuerrecht* (M. Lang, J. Schuch & C. Staringer eds., Linde 2012), at 261, 269, 278 et seq.; Avery Jones et al., *Credit and Exemption under Tax Treaties in Cases of Differing Income Characterization*, 36 Eur. Taxn. 4 (1996), at 118, 141 et seq.; K. Vogel, *Probleme der Auslegung von Doppelbesteuerungsabkommen*, SWI (2000), at 103, 111 et seq.; H. Loukota, *Der Einfluss des österreichischen Ertragsteuerrechts auf die Auslegung von Doppelbesteuerungsabkommen*, in *Ertragsteuern in Wissenschaft und Praxis: Festschrift für Werner Doralt* (R. Beiser, S. Kirchmayr, G. Mayr & N. Zorn eds., LexisNexis 2007), at 263, 280 et seq.

58 E.g. AT: FMF, 12 June 2000, EAS 1670; AT: FMF, 18 July 2001, EAS 1891. For the opinion in the Commentary, see *supra* n. 55.

59 E.g. M. Lang, *DBA und Personengesellschaften – Grundfragen der Abkommensauslegung*, IStR (2007), at 606, 608.

port.<sup>60</sup> Instead, as a result of the mentioned reasons, it is necessary to ascertain and apply the correct tax treatment to the respective items of income by an interpretation of the relevant provisions, instead of simply following the interpretation of one contracting state, whatever it may be.

## IV. Taxation of bonds

### A. The definition of interest under article 11(3) of the OECD-MC

Similar to the allocation rule for dividends, the allocation rule on interest under article 11(3) of the OECD Model also contains a definition of its substantive scope:

The term “interest” as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

In contrast to the definition of dividends, this provision does not contain a reference to the national law of one of the contracting states.<sup>61</sup> Thus, the scope of the provision must be determined by an autonomous treaty interpretation.<sup>62</sup> In this regard, from the wording of the provision one can conclude that in order to fall under this definition of interest, the establishment of a debt-claim is essential.<sup>63</sup> In contrast to dividends under article 10 of the OECD Model, the income must not result from a corporate right in the foreign company, but from a claim against the foreign entity.<sup>64</sup> To fulfil this requirement, there must be (i) a contractual or statutory obligation of the borrower to repay the borrowed amount of money at a certain point in the future and (ii) a limited amount of entrepreneurial risk.<sup>65</sup> In short, the definition of interest covers all debt-claims against third parties for which a certain remuneration is granted as consideration for the surrender of money.<sup>66</sup>

60 C. Staringer, *Leistungsbeziehungen zwischen der Personengesellschaft und den Gesellschaftern aus abkommensrechtlicher Sicht, in Personengesellschaften im Recht der Doppelbesteuerungsabkommen*, *supra* n. 5, at 101, 112 et seq. See also references cited at *supra* n. 59.

61 Bärsch, *supra* n. 17, at 436.

62 M. Lang & C. Strasser, *supra* n. 7, at 152; A. Philipp, H. Loukota & H. Jirousek, *Internationales Steuerrecht* (Manz 2013), I/1 Z 11, para. 88; *OECD Model Tax Convention on Income and on Capital: Commentary on Article 11*, para. 21.

63 M. Lang, *Gewinnanteile aus internationalen Schachtelbeteiligungen am Beispiel Brasiliens*, SWI (2013), at 95, 99; R. Pöllath & A. Lohbeck, in *DBA*, *supra* n. 1, Art. 11, para. 56; AT: FMF, 7 July 1994, EAS 465; Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 11, para. 89.

64 Lang, *Hybride Finanzierungen*, *supra* n. 6, at 92; Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 11, para. 93.

65 Lang, in *Aktuelle Entwicklungen im Internationalen Steuerrecht*, *supra* n. 57, at 127, 140; Wassermeyer, *supra* n. 2, Art. 11, para. 80.

66 Pöllath & Lohbeck, *supra* n. 63, Art. 11, para. 56; Wassermeyer, *supra* n. 2, Art. 11, para. 79.

The new Commentary addresses two questions in the area of the taxation of bonds. First, it deals with the treatment of premiums and other special payments of the issuing person. Second, it contains assertions with respect to the taxation of sales of bonds before maturity. Concerning the definition of interest in article 11(3) of the OECD Model, bonds typically establish a debt-claim against the issuing person and thus this aspect is fulfilled.<sup>67</sup> Nevertheless, two other issues related to the definition must be assessed due to the amendment to the Commentary. With regard to premiums and special payments in connection with bonds, one must analyse whether these forms of remunerations are covered by the term “income” in article 11(3) of the OECD Model. With respect to sales of bonds, one must assess whether the income arising from these transactions leads to income “from” a debt-claim and so as to fall under the definition of interest. These issues will be dealt with separately below.

### **B. Taxation of premiums and other additional payments by the issuing person**

Concerning premium payments of bonds, the new Commentary on Article 11 contains the following assertions in paragraph 20:

what constitutes interest yielded by a loan security, and may properly be taxed as such in the State of source, is all that the institution issuing the loan pays over and above the amount paid by the subscriber, that is to say, the interest accruing plus any premium paid at redemption or at issue. [In contrast,] the definition of interest does not cover any profit or loss that cannot be attributed to a difference between what the issuer received and paid.

In other words, the new Commentary subsumes everything that is paid by the issuing person to the borrowing person as falling under the term “income” of article 11(3) of the OECD Model, so as to constitute interest for treaty purposes. This typically comprises interest and other premiums paid at redemption or at issue.

Taking a look at the definition of interest in article 11(3) of the OECD Model, the intention of the provision is to include all income that is paid by the borrower to the lender for the surrender of money.<sup>68</sup> In addition to excluding interest for penalty charges (which evidently do not fall under the surrender of money),<sup>69</sup> the wording refers in a very general way to income from debt-claims.<sup>70</sup> Therefore, an autonomous interpretation of the term “income” can only lead to the outcome that all payments for the surrender of money from the borrower to the lender

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67 Wassermeyer, *supra* n. 2, Art. 11, para. 85.

68 U. Woywode, *Die abkommensrechtliche Einordnung von Einkünften aus Forward-/Future- und Optionsverträgen*, IStR (2006), at 325, 328; Lang, *Hybride Finanzierungen*, *supra* n. 6, at 94 et seq.; Pöllath & Lohbeck, *supra* n. 63, Art. 11, para. 59a; Wassermeyer, *supra* n. 2, Art. 11, para. 74.

69 Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 11, para. 92.

70 Para. 18 *OECD Model: Commentary on Article 11* (2010); Pöllath & Lohbeck, *supra* n. 63, Art. 11, para. 59a.

constitute income from a debt-claim pursuant to article 11(3) OECD and thus fall under the definition of interest.<sup>71</sup> Decisive for the definition is the claim against another person for which certain remuneration is granted in whatever form.<sup>72</sup> In other words, it is irrelevant how or when the remuneration is paid by the borrower; the only relevant factor concerns whether the legal basis for the remuneration is a debt-claim. If this essential criterion is fulfilled, any amount received by the lender from the borrower for the surrender of money – at whatever point of time and in whatever form – falls under the definition of interest pursuant to article 11(3) of the OECD Model.

This far reaching scope of the provision with respect to the term “income” covers premiums and other special remuneration as long as they arise from the debt-claim.<sup>73</sup> As already the wording of the definition covers “government securities and income from bonds or debentures, including premiums and prizes attaching to such securities”, there is no doubt that these types of income are covered by article 11(3) of the OECD Model, which is then binding for both contracting states. Therefore, the amendments in the new Commentary can be seen as having a clarifying nature.

### C. Taxation of sales of bonds before maturity

Concerning the sale of bonds to a third party before maturity, the new Commentary on Article 11 contains the following statement in paragraph 20:

Some States tax the seller of a bond on interest that has accrued at the time of the alienation (e.g. when a bond is sold to a tax-exempt entity). Such accrued interest is covered by the definition of interest and may therefore be taxed by the State of source. In that case, that State should not again tax the same amount in the hands of the acquirer of the bond when the interest subsequently becomes payable.

In other words, the Commentary assumes that the sale of a bond before maturity might not constitute a capital gain for the seller, but is considered to be interest. Potential classification conflicts caused by the possibility to subsume such gains under different allocation rules should then be resolved by applying the method article, which leads to a binding of the residence state of the buyer to the classification by the residence state of the seller.<sup>74</sup>

71 Wassermeyer, *supra* n. 2, Art. 11, para. 72.

72 Woywode, *supra* n. 68, at 368, 371; Pöllath & Lohbeck, *supra* n. 63, Art. 11, para. 57: It is not necessary that the interest is paid as interest, but also other types of financing costs must be considered as income from debt-claims.

73 Wassermeyer, *supra* n. 2, Art. 11, para. 85; Pöllath & Lohbeck, *supra* n. 63, Art. 11, para. 60.

74 *OECD Model: Commentary on Article 13* para. 20: „If shares are alienated by a shareholder to the issuing company in connection with the liquidation of the issuing such company or the redemption of shares or reduction of its paid-up capital of that company, the difference between the selling price proceeds obtained by the shareholder and the par value of the shares may be treated in the State of which the company is a resident as a distribution of accumulated profits and not as a capital gain. **The same interpretation may apply if bonds or debentures are redeemed by the debtor at a price which is higher than the par value or the value at which the bonds or debentures have been issued.**“

However, as the of the OECD Model explicitly contains a definition of interest, similar to the assertions on classification conflicts in the area of redemptions of shares,<sup>75</sup> it is not convincing to allow the source state to decide – based on its national law – whether a certain amount of the purchase price constitutes interest or falls under capital gains for tax treaty purposes.<sup>76</sup> Rather, an autonomous interpretation of the provisions must be conducted in order to determine whether such parts of the purchase price constitute interest or must be considered as a capital gain.<sup>77</sup> In this respect, the phrase “income from debt-claims of every kind” in article 11(3) of the OECD Model will be interpreted first, and then the outcome will be validated by an interpretation of article 13 of the OECD Model.

Concerning the income received by the seller of a bond before maturity, it is questionable whether the remuneration paid for the lending of the money necessarily must come from the borrower in order to classify the profits as interest. As the wording requires only income *from* debt-claims, it could already be fulfilled if anyone pays remuneration to the lender of the money for obtaining the respective debt-claim. In this respect, the Austrian Federal Ministry of Finance asserts that exit taxation on a bond in the case of an emigration of a natural person, constitutes interest under treaty law.<sup>78</sup> However, an autonomous interpretation of the term “from” in article 11(3) of the OECD Model – in light of the context as well as the aim and purpose of the provision – leads to a different outcome. As the provision shows a very strong relation to debt-claims, it is more convincing to require that the income stem from the debt-claim against the borrower of the money.<sup>79</sup> The definition of interest mainly relates to this form of relationship between the borrower and the lender of money, while the form and timing of the remuneration is irrelevant.<sup>80</sup> Therefore, the aim and purpose of the provisions require delineating the taxation of remuneration paid by the borrower from remuneration paid by third parties.<sup>81</sup> In other words, the term “income *from* debt claims” must be understood in a narrow sense so as to comprise only income arising from the debt-claim. Consequently, a mere connection of the income to the asset, for instance by a sale of the account receivable, is not sufficient.

This outcome is emphasized by the fact that gains from the alienation of an asset such as an account receivable fulfil all the requirements for falling under article 13 of the OECD Model as a capital gain.<sup>82</sup> As a consequence, in order to ensure de-

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75 See section III.C.

76 For a critical view of such an approach, see e.g. Lang, IStR (2007), *supra* n. 59, at 606, 608.

77 In this direction of an autonomous interpretation, see also Lang, IStR (2010), *supra* n. 57, at 114, 117 et seq.

78 AT: FMF, 15 June 2004, EAS 2480; AT: FMF, 5 Jan. 2005, EAS 2550; AT: FMF, 24 Aug. 2012, EAS 3293.

79 DE: BFH, 9 June 2010, I R 94/09, para. 11.

80 See also section IV.1.

81 DE: BFH, 9 June 2010, I R 94/09, with reference to literature in Germany: Wassermeyer, *supra* n. 2, Art. 11, para. 79; Pöllath & Lohbeck, *supra* n. 63, Art. 11, para. 72; M. Wenz & A. Linn, in *Außensteuergesetz/Doppelbesteuerungsabkommen* (F. Haase ed., C.F. Müller Verlag 2009), Art. 11, para. 76.

82 DE: BFH, 9 June 2010, I R 94/09, Rz 10.

limitation from the allocation rule of article 11 of the OECD Model, it seems convincing to generally view profits received from the selling of any asset as falling under the allocation rule of capital gains. It does not matter whether the alienation concerns a movable asset or a bond.<sup>83</sup> Still, the change of ownership of an asset should be taxable only under article 13 of the OECD Model, irrespective of whether the increase in value has been because of the already accrued interest, the closer maturity of the bond or any other reason.

Income received by the lender of money for the sale of a bond to another person does not fall under the definition of article 11(3) of the OECD Model, as it cannot be considered as income *from* debt-claims. An autonomous interpretation of the provision, as well as a systematic interpretation in relation to the aim and purpose of article 13 of the OECD Model, gives rise to the outcome that such income falls under article 13 of the OECD Model as a capital gain.<sup>84</sup> The income originates from a transfer of ownership of an asset and thus must be considered as an alienation that falls under article 13 of the OECD Model.

## D. Resolution of classification conflicts

As a result of the above-described uncertainties regarding the taxation of sales of bonds before maturity, it is again not surprising that conflicts of classification arise in practice.<sup>85</sup> In this respect, the new Commentary on Article 13 stipulates how such issues should be resolved in paragraph 31, namely by a binding of the residence state of the buyer of the bond to the classification of the residence state of the seller of the bond.<sup>86</sup> In addition, in the case of taxation as interest, the Commentary on Article 11 of the OECD Model contains an additional requirement for the source state in paragraph 20.1: “Some States tax the seller of a bond on interest that has accrued at the time of the alienation. In that case, that State should not again tax the same amount in the hands of the acquirer of the bond when the interest subsequently becomes payable”. According to the Commentary, the possibility to tax the sale of the account receivable as interest is connected with a prohibition to tax the interest paid by the lender to the new borrower upon repayment of the whole loan.

In this respect, just as it is highly questionable whether there is a legal basis for the binding of the residence state to the classification of the source state,<sup>87</sup> such an in-

83 Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 13, para. 24; para. 24 *OECD Model: Commentary on Article 13* (2010) („The term „movable property“ means all property other than immovable property which is dealt with in paragraph 1. It includes also incorporeal property, such as goodwill, licences, etc.“).

84 DE: FMF, 6 Dec. 2011, IV B 3 – S 2293/10/10001:001, in DStR (2011), 2407 et seq.; DE: FMF, 8 Oct. 1996, IV C 6 – S 1301-41/96; DE: FMF, 12 May 1998, IV C 6-S 1301-18/98; J. Höring, *Keine Anrechnung fiktiver (brasilianischer) Quellensteuer auf Stückzinsen*, Steuerrecht kurzgefaßt (SteuK) (2011), at 87 et seq.

85 E.g. E. Huisman & N. Oberbauer, *SWI-Jahrestagung: Besteuerung anteiliger Anleihezinsen bei Wohnsitzverlegung nach Deutschland*, SWI (2013), at 59 et seq.; R. Obermann, *Zinsen aus deutschen Wandelanleihen: Wege und Irrwege aus der Doppelbesteuerung*, SWI (2012), at 4, 6 et seq.

86 For the wording, see *supra* n. 75.

87 See section III.C.

Interpretation of article 11 of the OECD Model raises many doubts. There is simply no indication in the definition under article 11(3) of the OECD Model that the payment of interest by the issuing person to the borrower of the money does not fall under this provision. Therefore, it is highly questionable whether such an outcome as proposed by the Commentary can be deduced by merely interpreting the relevant provision. Rather, it seems more convincing to require a change to the wording of the treaty in order to implement such a restriction on the state of which the issuing person of the loan is a resident. Overall, the solution proposed in the Commentary has the character of a workaround to disguise the issues that arise if an autonomous interpretation of the provisions in the treaty is replaced by giving the source state a choice as regards the classification of certain types of income. Therefore, the only convincing solution is to refer to an autonomous interpretation of the treaty provisions, which leads to the outcome that the income generated from the sale of bonds before maturity must be taxed as an alienation of an asset under article 13 of the OECD Model and thus as a capital gain. Under such an approach, classification conflicts are already prevented before solutions such as that presented in the new Commentary must be invented.

## V. Treaty Changes under Article 13 of the OECD-MC

The Commentary on Article 13 of the OECD Model contains the following amendment with respect to the definition in paragraph 3.1:

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 thereof that has accrued after the entry into force of a treaty (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.

This amendment relates to the taxation of capital gains, where the increase in value in comparison to the book value has accumulated over a certain period of time. In this respect, the Commentary takes the position that the taxation rights are allocated solely to the state to which the tax treaty allocates the taxation rights at the time of the realization of the profit. Conversely, it is irrelevant whether the other state had the taxation right over these profits before, as either there was no treaty concluded at all or the former treaty provided for a different allocation of the taxation rights.

This question will be analysed here by looking at article 13(5) of the OECD Model, which states as follows: “Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident”. Concerning the question as to whether a change of the taxation rights leads to (i) an apportionment of the taxation rights of the contracting states or (ii) a full taxation right for the state that has



the taxation rights at the time of the alienation, the term “gains” relates to the tax base under national law.<sup>88</sup> Under the wording of the provision, the taxes levied on these gains are taxable only in the contracting state of which the alienator is a resident.<sup>89</sup> There is no indication in the provision that the gain – seen as the tax base under national law – taxed by a contracting state must be subject to an apportionment of the taxation rights under which the profits are taxable in the state in which the respective increase in value has accrued. Rather, article 13 of the OECD Model allocates the taxation rights in a certain manner without taking the past into account.<sup>90</sup> If the amendment of a treaty results in a partner state’s losing the taxation rights over certain assets, this does not affect the treaty application. Instead, after the entry into force of the new provision, solely this provision is relevant for allocating the taxation rights.

This outcome is emphasized by the implementation of deviations from the provisions in the OECD Model in treaty practice, which has led to an apportionment of the income generated by an alienation of an asset.<sup>91</sup> For instance article 13(6) of the Austria-Germany income tax treaty stipulates that natural persons who have been resident in a contracting state for at least five years are subject to taxation in their former residence state with respect to all gains arising up to the time of emigration to the other contracting state. In other words, the immigration state may tax all the increases in value upon sale of an asset from the point of immigration on, but must give credit for the taxation in the other contracting state for increases in value up to the immigration. As such, an apportionment of the gain is implemented.<sup>92</sup> Similar provisions have also been introduced in other Austrian tax treaties, such as the Austria-Switzerland, Austria-Poland and Austria-Sweden treaties.<sup>93</sup> All these additional provisions lead to an apportionment of the taxation

88 Lang, *Hybride Finanzierungen*, *supra* n. 6, at 100 f; B. Brugger, *Wegzugsbesteuerung und Abkommensrecht*, SWI (2007), at 510, 516.

89 Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 13, para. 112; AT: FMF, 1 Mar. 1999, EAS 1423; AT: FMF, 7 Feb. 2000, EAS 1595; DE: BFH, 19 Mar. 1996, VIII R 15/94.

90 M. Lang, *Zeitliche Zurechnung bei der DBA-Anwendung*, SWI (1999), at 282, 285 et seq. (with additional references).

91 DE: BFH, 19 Mar. 1996, VIII R 15/94.

92 Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 13, para. 112; C. Staringer, *Die Wegzugsbesteuerung für Beteiligungen nach dem Entwurf zum DBA Österreich-Deutschland*, SWI (1999), at 399. For a detailed elaboration of the provision, see C. Staringer, *Veräußerungsgewinne nach dem neuen DBA Österreich-Deutschland*, in *Das neue Doppelbesteuerungsabkommen Österreich-Deutschland* (W. Gassner, M. Lang & E. Lechner eds., Linde 1999), at 97 et seq.

93 M. Tumpel & R. Jahn, *Gewinne aus der Veräußerung von Vermögen*, in *Die österreichische DBA-Politik* (M. Lang, J. Schuch & C. Staringer eds., Linde 2013), at 201, 218 et seq.; M. Steindl & T. Stradinger, *SWI-Jahrestagung: Auswirkungen des DBA Österreich-Großbritannien auf die Wegzugsbesteuerung*, SWI (2012), at 162. For a detailed elaboration of the situation in Austria, Germany and Switzerland, see M. Lang, J. Lüdicke & M. Reich, *Beteiligungen im Privatvermögen: Die Besteuerung des Wegzugs aus Österreich und Deutschland in die Schweiz – Teil 1*, IStR (2008), at 673; M. Lang, J. Lüdicke & M. Reich, *Beteiligungen im Privatvermögen: Die Besteuerung des Wegzugs aus Österreich und Deutschland in die Schweiz – Teil 2*, IStR (2008), at 709; M. Hasanovic & K. Spies, *SWI-Jahrestagung: Wegzugsbesteuerung*, SWI (2011), at 207; M. Lang, *Zweifelsfragen der Wegzugsbesteuerung*, SWI (2006), at 565, 568 et seq.

rights. As a result, absent a deviation from the OECD Model, the taxation rights for alienations under article 13 of the OECD Model are allocated in full to the contracting state to which the provision in force allocates the taxation rights at the time when the tax is levied.

Nevertheless, even without a deviation from the OECD Model, the contracting states are not exposed to the risk of losing their taxation right due to an amendment of the treaty provisions, if they implement exit tax provisions compatible with the treaty.<sup>94</sup> Generally, exit taxation is fully compatible with article 13 of the OECD Model, as the levy of the tax does not concern assets over which the other contracting state has taxation rights.<sup>95</sup> As a result, a loss of tax revenue due to a change of the taxation rights in the basis of assets from one contracting state to the other through an amendment of the treaty provisions, can be prevented by implementing appropriate exit tax provisions. This is fully in line with article 13 of the OECD Model.<sup>96</sup> By contrast, without the implementation of such exit tax provisions, the emigration state loses its taxation rights and thus is subsequently prevented by the tax treaty from levying any tax on the income generated from the alienation of the transferred asset. As a result, the assertions in the new Commentary in this area are merely clarifying the current legal situation.

## VI. Conclusion

The updated Commentary has brought about quite a few amendments with regard to the definition of dividends, interest and capital gains. To a certain extent, they can be seen as a clarifications of the current legal situation. This mainly relates to the change of the assertions on article 13 of the OECD Model which stipulate an immediate change of the allocation of taxation rights for both involved states, if the respective provisions in the tax treaty are amended. Without a deviation from the OECD Model, the emigration state is fully competent to levy an exit tax on the assets falling outside its possible scope of taxation, while the immigration state is fully competent to tax the alienation under its domestic law without being limited by the tax treaty.

In contrast, other parts of the updated Commentary are not always in line with an autonomous interpretation of the respective provisions. Concerning the profits generated from the redemption of shares in a narrow understanding, the require-

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94 Reimer, *supra* n. 35, Art. 13, para. 202; AT: FMF, 26 May 2010, EAS 3157; AT: FMF, 21 June 2010, EAS 3163; AT: FMF, 9 Dec. 2010, EAS 3188; AT: FMF, 2 July 2013, EAS 3328; F. Wassermeyer, *Merkwürdigkeiten bei der Wegzugsbesteuerung*, IStR (2007), at 833 et seq.; M. Schütz, *Wegzugsbesteuerung bei natürlichen Personen – Steuerliche Gestaltungsmöglichkeiten*, *SteuK* (2013), at 331 et seq.; F. Wassermeyer, *Der Meinungsstreit um die Wegzugsbesteuerung iS des § 6 AStG*, IStR (2013), at 1 et seq.

95 Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 13, para. 107; Reimer, *supra* n. 35, Art. 13, para. 202.

96 Staringer, SWI (1999), *supra* n. 92, at 399; Toifl, *Die Wegzugsbesteuerung*, *supra* n. 37, at 128 et seq.; Staringer, *Besteuerung doppelt ansässiger Kapitalgesellschaften*, *supra* n. 39, at 214; Philipp, Loukota & Jirousek, *supra* n. 62, I/1 Z 13, para. 107; Reimer, *supra* n. 35, Art. 13, para. 202.

ments of income from shares under article 10(3) of the OECD Model are fulfilled. Hence, similar to liquidations and capital reductions, these redemptions of shares lead to a cessation of the shares against remuneration, and thus fall under the definition of dividends – irrespective of the treatment under the national law of the involved contracting states. Still, a redemption of shares could also be understood in a broader meaning. In such case, a redemption of shares, where the shares do not cease to exist, but where the shares are simply sold to the company instead of a third party, must be treated equally to any other sale of shares. This leads to a transfer in the ownership of an asset which entails the application of article 13 of the OECD Model.

Profits generated from the sale of bonds before maturity do not fall under the definition of article 11(3) of the OECD Model, as income generated from the sale of the debt-claim does not lead to income from the debt-claim, but instead must be subsumed as an alienation under article 13 of the OECD Model. Again, the ownership of an asset is transferred from one person to another and thus the characteristic feature of a capital gain is present. Conversely, the typical feature of interest, namely the payment of money by the borrower to the lender for the surrender of money is not present if a third person pays money to the lender for acquiring ownership of an account receivable.

Finally, for purposes of resolving classification conflicts, the OECD adheres to the approach developed in the so-called Partnership Report, namely requiring that the residence state accept the classification of the source state under certain circumstances. This method is applied to classification conflicts arising in the area of redemptions of shares, as well as sales of bonds before maturity. However, as has been criticised in literature for many years now, it is highly questionable whether there is a legal basis for such an approach. In addition, this method leads to the application of the wrong allocation rule in some situations – which is especially questionable if the residence state is bound to virtually any classification of the source state. Furthermore, as the example of the taxation of profits from the sale of bonds before maturity impressively shows, the implementation of such a binding requires further steps to prevent double taxation that go beyond the legal basis that the interpretation of the OECD Model can offer. Therefore, convincing reasons speak for adopting an autonomous interpretation of the treaty provisions in order to ascertain and apply the correct tax treatment without establishing the need to bind one state to the classification of the other, unless this is explicitly provided for in the applicable treaty.

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