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# Article 16 of the OECD Model Convention:

History, Scope and Future

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European and International  
Tax Law and Policy Series

IBFD

# Article 16 of the OECD Model Convention: History, Scope and Future

## Why this book?

Article 16 is one of the few provisions of the OECD Model that have remained virtually the same since the Model was first published in 1963 and consists of only one sentence: "Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State." OECD member countries as well as a considerable number of non-members accept Article 16 of the Model as a guideline for their bilateral treaty negotiations, often following it to the letter.

Nevertheless, the scope of this provision is still vague in many respects. Therefore, this book provides evidence on the interpretation and the legal effects of Article 16 by way of answering the following questions: Who might be a director? What activities are performed by a director? Under what conditions is a company resident in the other contracting state? Which company organs are comprised? What conditions exist for being a member of a board of directors? How to draw a line between Article 16 and other distribution rules for certain types of remuneration. What is the relation between Article 16 and domestic law provisions? How likely is it that double or non-taxation arises in triangular situations?

The last part of the book approaches Article 16 from a tax policy point of view. It analyses why Article 16 fulfils an important role within the OECD Model and provides modifications in order to compensate current shortcomings of the provision.

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## The History of Article 16 of the OECD Model Convention

### 2.1. Introductory remarks

In this section of my thesis, the evolution of the current version of Art. 16 of the OECD Model is analysed. The chapter begins with the Draft Conventions of the League of Nations, subsequently discusses the preparation of the 1963 OECD Draft Convention and finally looks at the evolution since 1963.<sup>115</sup> Even though the League of Nations is not a predecessor of the OEEC but of the United Nations, the Fiscal Committee of the OEEC (hereinafter FC) took the last draft of the League of Nations as a starting point.<sup>116</sup> Moreover, the 1959 Draft Report by the FC to the Council mentioned the Conventions of the League of Nations as adopting the same principles with regard to income from personal services as the later OECD Model.<sup>117</sup> Therefore, an analysis of the Draft Conventions published by the League of Nations might provide valuable insights for the interpretation of Art. 16 of the OECD Model.

### 2.2. The work of the League of Nations

#### 2.2.1. The 1927/28 Model of the League of Nations

The League of Nations started to deal with issues of double taxation in 1920.<sup>118</sup> In April 1927, the “Committee of Technical Experts on Double

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115. No reference will be made to the efforts to counter double taxation of the Institut de Droit International and the International Chamber of Commerce, since personal services and especially directors’ fees played only an insignificant role in their work. What is worth mentioning is that in 1929, the International Chamber of Commerce had already endorsed taxation of wages and salaries in the state where the work is carried out. See further on the achievements of these institutions A. Spitaler, *Das Doppelbesteuerungsproblem bei den direkten Steuern*, pp. 12 et seq. (Stiepel 1936); F. Gorgiev-Oberascher, *Die Arbeiten des Steuerausschusses der OEEC/OECD unter besonderer Berücksichtigung des Problems der Verteilung der Besteuerungsrechte zwischen Wohnsitz- und Quellenstaat in wirtschafts- und rechtshistorischer Perspektive bis 1963*, pp. 18 et seq. (unpublished doctoral thesis submitted at WU Vienna in 2007); Dziurdz, *supra* n. 24, at pp. 57 et seq.

116. F.P.G. Pötgens, *Income from International Private Employment*, ch. II.4.1. (IBFD 2006), Online Books IBFD with reference to Mitchell B Carroll.

117. FC(59)2, Draft Report to the Council, 21 May 1959, pp. 19 et seq.

118. Gorgiev-Oberascher, *supra* n. 115, at p. 20.

Taxation and Tax Evasion”, consisting of 13 experts from North and South America, Europe and Asia published a first Draft Model Convention and Commentary for the avoidance of double taxation.<sup>119</sup> This draft differentiated between personal and impersonal taxes.<sup>120</sup> In this draft the residence state of the taxable person retained the exclusive taxing right for personal taxes,<sup>121</sup> while the source state was granted the right to levy impersonal taxes under certain circumstances. With respect to directors’ fees, Art. 6 of this Model stipulated that “the fees of managers and directors of joint-stock companies shall be taxable in accordance with the rule laid down in Article 4.” Art. 4 dealt with “income from shares or similar interests” and allocated the right to tax to the “State where the real centre of management of the undertaking is situated”. In the Commentary, it was clarified that the term “real centre of management” as used in Art. 4 does not refer to a “purely nominal centre of management”, but to the place where the “management and control of the business” is situated. Moreover, the Commentary to Art. 6 provided that this article covers “the special tax on variable fees deducted from profits”. Apart from those fees, “fixed salaries, wages and other remuneration of any kind” were governed by Art. 7 and therefore taxable in the contracting state where the employment was carried out. The Commentary to Articles 6 and 7 mentioned as the reason for this distinction that the latter category of remuneration forms part of general expenditure and is “actually produced in that State [where the work is performed] and the tax can easily be levied at source.” These provisions remained virtually the same in the revised version of the Model number IA that was published in 1928.<sup>122</sup> In 1928 the League of Nations released two further Models number IB and number IC which were tailored to the needs of countries that do not distinguish between personal and impersonal taxes. The main difference between

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119. League of Nations, *Double Taxation and Tax Evasion*, Publications of the League of Nations II. Economic and Financial 1927. II. 40, Geneva, April 1927. For an overview of the work of the League of Nations from 1920-1927 see M. Görl, *Die freien Berufe im Internationalen Steuerrecht der Bundesrepublik Deutschland*, pp. 17 et seq. (Florentz 1983); J.G. Herndon Jr., *The Development of International Reciprocity for the Prevention of Double Income Taxation*, pp. 41 et seq. and 173 et seq. (University of Pennsylvania 1932); Spitaler, *supra* n. 115, at pp. 14 et seq.

120. See further on the distinction between “impersonal” (“real”) and “personal” taxes W.H. Coates, *Double Taxation and Tax Evasion*, 84 *Journal of the Royal Statistic Society* 3, pp. 406 et seq. (1925); Pötgens, *supra* n. 116, at ch. II.2.3.

121. League of Nations, *Double Taxation and Tax Evasion*, Publications of the League of Nations II. Economic and Financial 1927. II. 40, 11 and 16.

122. League of Nations, *Double Taxation and Tax Evasion*, Publications of the League of Nations II. Economic and Financial 1928. II. 49, Geneva, Oct. 1928.

those three drafts with regard to income from personal services is that under Models number IB and number IC, the right to levy personal taxes in the state of residence was abolished.<sup>123</sup>

In establishing the principle that the source state should be granted the right to tax income from personal services, the experts of the League of Nations departed from the general Anglo-American rule that a personal income tax should only be levied by the residence state. However, this innovation must be put into perspective as personal services were usually carried out in the residence state at that time.<sup>124</sup> Also, in their study on double taxation for the League of Nations, the economists Bruins, Einaudi, Seligman and Stamp voiced scepticism towards the principle of origin in 1923.<sup>125</sup> The draft Models of the League of Nations that contained the source principle were, however, not deemed to be of great significance for bilateral treaties. The acceptance of these Models by treaty concluding states was rather limited as most bilateral treaties signed during the Inter-War Years were based on the treaties signed before World War I.<sup>126</sup>

### 2.2.2. The 1943 Mexico Draft

From 1928 onwards, a Fiscal Committee dedicated to the avoidance of double taxation met regularly once a year.<sup>127</sup> In 1943, the Committee released another Model Convention, the so called “Mexico Draft”.<sup>128</sup> Due to the ongoing World War II the US, Canada, Central and South American countries were the driving forces behind the Mexico Draft.<sup>129</sup> In this Model, Art. VI was dedicated to directors’ fees. The first paragraph of Art. VI contained the general rule that “Directors’ percentages, attendance fees and other special remuneration paid to directors, managers and auditors of companies are taxable only in the State where the fiscal domicile of the

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123. See in detail Herndon, *supra* n. 119, at pp. 229 et seq.

124. W.H. Coates, *Double Taxation and Tax Evasion*, 88 Journal of the Royal Statistic Society 3, p. 588 (1929).

125. Bruins, Einaudi, Seligman and Stamp, *Report on Double Taxation*. Submitted to the Financial Committee. League of Nations. Geneva. 5 April 1923. E.F.S. 73 (F.19). p. 20. For a summary of this report with regard to income from employment see Pötgens, *supra* n. 116, at ch. II.2.2.; Görl, *supra* n. 119, at pp. 17 et seq.

126. Gorgiev-Oberascher, *supra* n. 115, at p. 22.

127. Gorgiev-Oberascher, *supra* n. 115, at pp. 21 et seq.

128. It was published together with the London Draft in Nov. 1946. League of Nations, Fiscal Committee London and Mexico Model Tax Conventions Commentary and Text, Nov. 1946, C 88 M 88 1946 II A, P.6 4326.

129. Gorgiev-Oberascher, *supra* n. 115, at p. 22.

enterprise is situated.”<sup>130</sup> The second paragraph of the clause explicitly dealt with cases involving PEs and provided that “If, however, such remuneration is paid for services rendered in a permanent establishment situated in the other contracting State, it shall be taxable only in that State.”<sup>131</sup> In contrast, Art. VII of that Model allocated the exclusive taxing right for “compensation for labour or personal services” to the treaty partner state where the services were rendered. Apart from directors’ fees, several other exceptions existed to this general rule. Where a taxpayer’s presence in the state of work amounted to less than 183 days during a calendar year,<sup>132</sup> the exclusive taxing right remained with his state of fiscal domicile. Moreover, members of liberal professions, who performed their services through a PE were only taxable in the PE state. Remuneration received for government services was only taxable in the paying state, but the definition of government services was more extensive compared with that in the former Models.<sup>133</sup> As regards pensions, a differentiation was made between public and private pensions as they were governed in different articles. The exclusive right to tax was nevertheless allocated to the State of the fund.<sup>134</sup> Also with regard to business income, the above described principles that had been introduced under the former Models of the League of Nations were followed, even though the wording of the respective provisions<sup>135</sup> was slightly altered.

### 2.2.3. The 1946 London Draft

Three years later, the so called “London Draft” was published under the auspices of capital exporting countries.<sup>136</sup> In this Model, no special provision dealing with directors’ fees was included. As regards most articles on income from services no differences to the principles stipulated in the Mexico Draft existed, even though the wording of some of these provisions

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130. In chapter 6.7.1. it is analysed whether Art. 16 should be amended to grant a taxing right to the residence state of the company again, irrespective of whether the director is a resident of the same or of the other contracting state.

131. Whether the current version of Art. 16 should be changed to provide a special rule for directors who exercise activities in a PE of the company is explored in chapter 6.6.3.

132. See further on the origin of the 183-day threshold Pötgens, *supra* n. 116, at ch. II.3.3.

133. Cf Art. 7(2) 1927 Model with Art. VIII Mexico Draft.

134. See Art. VIII for public pensions and Art. XI for private pensions.

135. Cf Art. 5 1927 Draft and Art. IV Mexico Draft.

136. Gorgiev-Oberascher, *supra* n. 115, at p. 22; A.J. van den Tempel, *Beseitigung der Doppelbesteuerung*, p. 12 (IBFD 1967).

was changed.<sup>137</sup> However, similar to the 1927 and 1928 Models, the influence of the Mexico and London Draft Models on the bilateral tax treaty network was limited.<sup>138</sup>

#### 2.2.4. Conclusions from these early Models

When analysing the Models for avoiding double taxation that were drafted by the League of Nations in 1927, 1928, 1943 and 1946 it becomes obvious that no clear trend had evolved during that period: in some respects, the provisions were already further developed than the current version of Art. 16 but not in others. It is explicitly mentioned in the 1927 and 1928 Drafts that residency of the company depends on the place of effective management (POEM) and the Mexico Draft contained a rule for PEs. In the Commentary to the 1927 Model, two main reasons for including a special provision for directors' fees in a bilateral treaty were mentioned: Difficulties when locating the state of performance of services rendered by a director and fiscal cohesion.<sup>139</sup> Conversely, in the London Draft no provision specifically dedicated to directors' fees was included at all. Only the brief statement that "some articles have been suppressed because they contained provisions already implied in other clauses"<sup>140</sup> can be cited as the reason for this omission. As regards the other provisions for the taxation of present or past income from services, the evolution seems more straight-lined: with every revision of the Model, these provisions became more refined.<sup>141</sup>

With regard to the interpretation of undefined terms in the current version of Art. 16, the following conclusions can be drawn: Every Model that contained a special clause on directors' fees listed both directors and managers in the respective provision. This can be interpreted as indicating that both terms are not based on their typical common law meanings,<sup>142</sup> as "manag-

137. Cf e.g. Art. IV of both Models on business income and cf Art. VIII of the Mexico Draft on government services with Art. VII of the London Draft.

138. C. Freiherr von Roenne, *The Very Beginning – The First Tax Treaties*, in *History of Tax Treaties*, pp. 29 et seq. (T. Ecker/G. Ressler eds., Linde 2011).

139. For the same conclusion see also R. Prokisch, *Directors' Fees (Article 16 of the OECD Model Convention)*, in *Source versus Residence: Problems Arising from Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives*, pp. 231 et seq. (M. Lang et al. eds., Kluwer 2008). See further on these two principles chapter 3.2.2.

140. League of Nations, Fiscal Committee London and Mexico Model Tax Conventions Commentary and Text, Nov. 1946, C 88 M 88 1946 II A, P.6 4326.

141. Concurring Görl, *supra* n. 119, at pp. 22 et seq.

142. This opinion was e.g. raised by Prokisch, *supra* n. 139, at p. 223.

ers“ would otherwise be covered by the term “directors”.<sup>143</sup> This conclusion emphasizes the need for an autonomous treaty interpretation of both terms. However, the materials of the League of Nations do not provide any clues for defining the difference between directors and managers. One possible distinction might be that directors fulfil supervisory functions while managers perform operational activities.<sup>144</sup> In chapter 3.2.3. the conclusion is drawn that directors must be members of the board, while all other top level executives are managers. This result is also in accordance with the early Models.

As regards the assessment of the residence state of the company, only the 1927 and 1928 Models specify the decisive criteria by way of referring to the “real center of management” while the Mexico Draft allocates a taxing right to the “fiscal domicile of the enterprise”. A similar development occurred in the Mexico Draft for dividends and interest: The taxing right was no longer granted to the “state in which the real center of management of the undertaking is situated”,<sup>145</sup> but to “the contracting state where such capital is invested”.<sup>146</sup> It might be inferred from this change of terminology that with the use of “fiscal domicile” in the Mexico Draft, a shift to formal criteria for defining residency was intended. To my mind, however, it seems correct to explain the differences in terminology by reference to the changes in the structure of the provision on residency. The 1927 and 1928 Models and Commentaries stipulate that in order to fulfil the personal scope of the Convention nationality and fiscal domicile are decisive.<sup>147</sup> Hence, where more specific criteria were deemed necessary for granting the right to tax to a contracting state, this was done in the respective distribution rules. Art. II of the Protocol to the Mexico Draft, however, includes an indication that the fiscal domicile of companies is situated in the contracting state where the real center of management is situated, which should be applicable throughout the Model. Therefore, it can be concluded that under all Models of the League of Nations, only the real center of management was taken into account for defining residency of the company irrespective of the formulation of the provision for directors’ fees.

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143. F.-P. Sutter/E. Burgstaller, *Der Manager im DBA-Recht*, in *Arbeitnehmer im Recht der Doppelbesteuerungsabkommen*, pp. 53 and 64 (W. Gassner et al. eds., Linde 2003); E. Burgstaller, *Mitarbeiter-Stock-Options im Recht der Doppelbesteuerungsabkommen*, pp. 107 et seq. (Linde 2006).

144. S.A. Arora, *Article 16 and Article 17 – Directors Fees and Sportsmen*, in *History of tax treaties*, p. 588 (T. Ecker/G. Ressler eds., Linde 2011).

145. Art. 4 1927 and 1928 Model.

146. Art. IX Mexico Draft.

147. See Art. 1 and the Commentary to Art. 1.

Moreover, the exact wording of the kind of remuneration covered by the provision was changed in these early Models. However, as concluded in chapter 3.10. this is of little relevance for determining the scope of the clause.

## 2.3. The preparation of the 1963 OECD Draft Double Taxation Convention on Income and Capital

### 2.3.1. Introductory remarks

In 1947, the United Nations Organization (hereinafter UNO) tried to continue the work done by the League of Nations on the avoidance of double taxation, but failed to compose another Model Convention until 1980.<sup>148</sup> In 1956, the Fiscal Committee of the Organisation for European Economic Co-operation (hereinafter OEEC) was founded and assumed responsibility for dealing with double taxation.<sup>149</sup> During the subsequent years, all member states participated in the preparation of a Draft Double Taxation Convention which was released in 1963. The reorganization of the OEEC into the OECD in 1961 did not give rise to any changes regarding the Fiscal Committee.<sup>150</sup> For reasons of simplification, the Organization is only referred to in this study as the OECD. As already mentioned in chapter 1.3.4., there are two official languages of the OECD Model; not only English, but also French. Moreover, the historic OECD documents are also available in French. Hence, this study refers to the French version of the OECD Model and the historic documents whenever they are considered to facilitate assessment of the scope of Art. 16.

### 2.3.2. The year 1957

In June 1957, Working Party (WP) 10 (consisting solely of delegates from Sweden) was appointed in the 4th session of the FC to draft the articles on dependent and independent personal services. The first report to the FC was

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148. Gorgiev-Oberascher, *supra* n. 115, at pp. 24 et seq.

149. See further on the reasons for the foundation of the OEEC and the member states Tempel, *supra* n. 123, at pp. 10 et seq.; Gorgiev-Oberascher, *supra* n. 115, at pp. 37 et seq.

150. The 1963 Model and Commentary remained influenced by the legal systems of the European member countries. See further Tempel, *supra* n. 123, at pp. 12 et seq.

delivered as early as three months later.<sup>151</sup> The report analysed the existing provisions in bilateral tax treaties. WP 10 came to the conclusion that these treaties often included special rules for remuneration received by members of a board of directors and that the taxing right was in most cases attributed to the residence state of the company. In Annex I to the report, a first proposal containing sample provisions for income from services was submitted to the FC. Art. E provided that “Remuneration derived by an individual resident of one of the Contracting States in his capacity as a member of the board of management of a company resident in the other Contracting State shall be exempt from tax in that other Contracting State.” Art. C dealt with income from private employment and contained a proviso in respect of Art. E. In Annex II which contained notes on the sample provisions, WP 10 conceded that the proposal for Art. E was not in conformity with the usual pattern of the then current bilateral treaties. This is explained by reference to the difficulties of interpretation that would arise if directors’ fees were taxable in the state where the services were performed. Such difficulties might arise due to the fact that e.g. some jurisdictions permit that board meetings are conducted by mail. Moreover, taxation in the state where the company is domiciled would be likely to lead to double non-taxation in cases where no tax at source is stipulated under the laws of the source state. However, WP 10 assumed that all countries tax their residents, so that the danger of double non-taxation was mitigated under the proposed version of Art. E. The submitted draft articles were discussed by the FC in November 1957. The minutes of this 6th session of the FC documented the criticism received from some delegates that the articles on income from personal services neither followed the source nor the residence principle, but contained a mixture of both concepts and also took nationality into account.<sup>152</sup> In this light, it is understandable that delegates from Austria, Belgium, Germany, Italy, Luxembourg and Portugal refused to accept Art. E and argued in favour of granting the right to tax to the state where the POEM of the company is situated. In contrast to this, the French delegate argued that under French domestic law “*tantièmes*” are treated like dividends and should therefore fall under the progressive income tax rate in the state of residence. The delegate from the United Kingdom deemed no special provision for directors’ fees necessary, since he considered company directors as persons falling under the article dealing with income from employment.<sup>153</sup>

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151. FC/WP10(57)1, FC, WP 10 of the FC. Report on the taxation of profits or remuneration in respect of dependent and independent personal services.

152. FC/M(58)1, FC, 6th session, 25-27 Nov. 1957, p. 4.

153. FC/M(58)1, FC, 6th session, 25-27 Nov. 1957, pp. 5 et seq.



### 2.3.3. The year 1958

WP 10 presented a revised clause – Art. D – on directors’ fees in its second report in January 1958. According to this article “Remuneration derived by an individual who is a resident of one of the Contracting States, in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State, shall be subjected to tax in that other State.”<sup>154</sup> In the Commentary to this article, WP 10 stated that the reason for this article was to ensure the application of the principle of tax at source for directors’ fees: the provision was based on the assumption that directors always perform their services in the residence state of the company. However, due to the different domestic parameters regarding the ambit of the provision, WP 10 challenged the usefulness of the provision. Hence, WP 10 suggested considering the deletion of the special article and leaving it to bilateral treaties to settle the matter. Given these doubts about Art. D, the report recommended that the personal scope of the provision should not go beyond including members of the board of directors.<sup>155</sup> The FC dealt with this second report of WP 10 in its 7th session in February 1958 and asked the delegates to directly address WP 10 with further observations on the draft articles.<sup>156</sup> Based mainly on the proposal of the Swiss Delegation,<sup>157</sup> the new draft articles were submitted in December 1958. Compared with the version in the second report of WP 10, Art. D was changed to provide an exclusive taxing right for the residence state of the company and to further specify what was meant by the term remuneration. It read as follows: “Remuneration (director’s percentages, attendance fees or similar compensation) derived by an individual in his capacity as a member of the board of directors of a company resident in a Contracting State shall be taxable only in that State.”<sup>158</sup> The only changes to the Commentary on Art. D were that the expression of doubt regarding the necessity of the article was removed.<sup>159</sup>

### 2.3.4. The years 1959-1963

During the 11th session of the FC in January 1959, the report from 30 December 1958 was examined and the delegates agreed on replacing the

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154. FC/WP10(58)1, Second report on the taxation of profits or remuneration in respect of dependent and independent personal services.

155. FC/WP10(58)1, Annex II, pp. 6 et seq.

156. FC/M(58)2, 29 March 1958, p. 4.

157. TFD/FC/35, 26 April 1958, pp. 1 et seq.

158. FC(58)7, Taxation of profits or remuneration in respect of dependent and independent personal services, p. 4.

159. FC(58)7, p. 7.

word “individual”<sup>160</sup> with “person”.<sup>161</sup> This new wording was thought necessary for the provision to encompass also companies managing other companies.<sup>162</sup> However, the draft article that was finally submitted to the Council contained the term “resident”<sup>163</sup> and the Commentary was changed to use “individual or legal person”.<sup>164</sup> In spring 1959, before the Draft Report by the FC was submitted to the Council on 21 May 1959, the Drafting Group of the FC further amended the wording of the article on directors’ fees and the associated commentary,<sup>165</sup> but no reasons were given for these changes.<sup>166</sup> Possibly, they can be explained in terms of the Drafting Group’s desire to harmonize the terminology used in the various draft articles.<sup>167</sup> In the Draft Report to the Council, Art. IX on directors’ fees stipulated that “Directors’ percentages, attendance fees and similar payments derived by a resident of a Contracting State in his capacity as a Member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.”<sup>168</sup> As the underlying principle of all articles on personal services, the principle of origin was mentioned and the article on directors’ fees was considered necessary for applying this principle to members of company boards.<sup>169</sup> The Commentary to Art. IX already corresponded to the 1963 Commentary to Art. 16 and highlighted the difficulty of ascertaining the place where the services are rendered as the reason for the special provision.<sup>170</sup> During the 13th Session held from 9-12 June, the FC adopted Art. IX with a minor deviation from its previous version, namely that the scope of application was reworded to read “directors’ fees and similar payments”.<sup>171</sup> Neither the 1961 Draft Summary of the Convention<sup>172</sup> nor the 1963 OECD Draft Double Taxation Convention on Income and Capital (1963 OECD Model) encompassed further changes with regard to directors’ fees, except for the re-numbering of the provision: the position of the article was moved to number 16. In the brief analysis of the draft articles, the OECD stated that

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160. In the French version “*personne physique*”.

161. In the French version “*personne*”.

162. FC/M(59)1, Minutes of the 11th session, 20-23 Jan. 1959, p. 11.

163. In the French version of the provision which would form the future Art. 16, the term “*un résident*” was already used in the second report by WP 10, but was again replaced by “*personne physique*” in the draft articles submitted for adoption in December 1958.

164. In French “*une personne physique ou morale*”.

165. See TFD/FC/64, 11 April 1959; TFD/FC/64 (1st Revision), 5 May 1959.

166. FC(59)2, 21 May 1959.

167. TFD/FC/62, 11 April 1959.

168. FC(59)2, Draft Report to the Council, 21 May 1959, Annex B, p. 27.

169. FC(59)2, 21 May 1959, pp. 19 et seq.

170. FC(59)2, Annex F, p. 39.

171. C(59)147, Second report by the FC to the Council, 18 June 1959, Annex B, p. 22.

172. TFC/FC/132, Draft Summary of the Convention, 12 Sept. 1961.

the object of Articles 14 to 20 is the implementation of the source principle for income from personal services and to achieve similar conditions under Articles 7 and 14.<sup>173</sup>

## 2.4. Conclusions from the drafting process of Article 16

Uncertainties about whether a special provision for directors' fees should be included in a model convention had already been expressed at the time of drafting the Models of the League of Nations and were mentioned for the last time in the second report of WP 10 to the FC in January 1958. Chapter 5.2.2. shows that doubts about the need for a separate article for directors' fees might still be raised today.

Like the Commentaries to the Models of the League of Nations it was explicitly mentioned in the course of drafting Art. 16 of the OECD Model that the provision is based on the principle of taxation at source and is aimed at avoiding difficulties when defining where a director actually performs his work. Unlike the Commentaries drafted by the League of Nations, an explicit reference to the principle of fiscal cohesion is missing. This underlines the subsidiary nature of the principle with respect to other guiding principles of Art. 16.<sup>174</sup>

The exact wording of Art. 16 changed a few times during the drafting of the OECD Model before the adoption of the final version. To some extent these changes shed light on the scope of the current version of Art. 16: in the first report on the provision which was later to become Art. 16, WP 10 used the term "board of management" as well as the term "board of directors": the sample article which was submitted to the FC contained only a reference to "board of management", while the commentary to it included both terms. "Board of directors" was also used in the OECD summary of recently concluded bilateral tax treaties.<sup>175</sup> Since WP 10 provided no expla-

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173. FC(63) 4 Part I (1st Revision), Draft Report to the Council on the Draft Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital between the Member Countries of the OECD, 13 June 1963, p. 11.

174. Cf chapter 6.3.2. for other arguments in favour of limiting the impact of the base erosion rationale for the purpose of interpreting Art. 16.

175. In contrast to this, the French version of Art. E and its Commentary only contained references to a "*conseil d'administration d'une société*". The same holds true for the minutes of the 6th session of the FC in Nov. 1957. However, some relevant parts of these documents are not legible anymore, so that it cannot be entirely excluded that the "*conseil de surveillance*" was also mentioned at that time. The first verifiable reference to the "*conseil de surveillance*" can be found in the draft version from December 1958,

nation for employing both phrases, it can be assumed that WP 10 considered them to be synonyms. That “board of management” and “board of directors” were regarded as synonyms leads to the conclusion that managerial activities should also be covered by Art. 16.<sup>176</sup> This conclusion is supported by the minutes of the 11th session of the FC in January 1959 that refer to “companies managing other companies”<sup>177</sup> instead of “companies supervising other companies”. In documents released after 1957 only the phrase “board of directors” is used. This might imply that WP 10 wanted to give the term the meaning it has under common law, as there is no “board of management” concept under that jurisdiction. On the other hand, assuming an intention of the drafters to restrict the scope to supervisory activities seems unlikely as it seems reasonable to expect that there would have been some further explanation of this in the historic materials in the case of such a major change. If the intention was indeed to adopt the common law meaning or to restrict the scope to cover only supervisory activities, the lack of elaboration on this issue documented in the historic materials would be surprising given the severity of such a modification to the scope of the provision.

The inclusion in the second report in January 1958 of WP 10’s remark that it is not possible to go further than to include “the members” of boards of directors indicates that persons who are not official members of company organs are excluded from the provision.<sup>178</sup> As the reason for this limitation of the personal scope, the many differences in the treatment of directors under domestic law of the member countries are mentioned.

As with the development of the article on directors’ fees in the Models of the League of Nations, changes in the wording of the provision which would form the future Art. 16 with regard to the kind of remuneration covered by the provision are of little importance as demonstrated in chapter 3.10. From the drafting history of Art. 16 it cannot be inferred that the substantive scope of the article should be limited to payments derived while being an active

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but until May 1959, the Commentary still only mentioned the “*conseil d’administration*”. The late adjustment of the provision which was later to become Art. 16 to cover also company organs exclusively devoted to supervisory activities might indicate that Art. 16 was primarily designed to cover organs performing both supervisory and management activities. The inclusion of the “*conseil de surveillance*”, however, raises the question why the “*directoire*”, i.e. a company organ exclusively dealing with management activities, was not mentioned. For a further analysis of this issue, see chapter 3.2.1.

176. See also Arora *supra* n. 144, at p. 589.

177. In the French version of the minutes, the term “*d’une société qui serait administration* [emphasize added by the author] *d’une autre société*” is used.

178. See further on this chapter 3.3.2.

member of a board of directors. Where neither Art. 18 nor Art. 19 is applicable, remuneration for past services should also be covered by Art. 16, as is further elaborated in chapter 4.1.4.

The phrase which denotes who might be regarded as a director should have been changed according to the minutes of the 11th session of the FC in January 1959 from “individual” to “person” in order to ensure that apart from natural persons companies<sup>179</sup> would also fall under the personal scope of the clause. The draft article submitted to the Council and adopted by it nevertheless uses the term “resident” without providing any further explanation. A possible reason for this change in terminology might be that under Art. 3(1)(a) of the OECD Model, the term “person” also comprises in addition to individuals and companies, “any other bodies of persons” and it was not intended to cover such entities in Art. 16. Such reasoning is supported by the fact that a first draft of Art. 3 containing a definition of “person” had already been submitted by WP 14 in March 1959 to the FC<sup>180</sup> and the term “resident” appears to have been used by the Drafting Group of the FC for the first time in the session in April 1959.<sup>181</sup> Hence, it can be assumed that the Drafting Group of the FC was informed about the draft definition of “person” when it chose to use “resident”. The OECD Commentary, however, deviates from the terminology of the draft article to this day because the term “legal person” is used instead of “company”. Since the function of the OECD Commentary is to support the interpretation of the OECD Model and there is a lack of indication in the historic documents for this discrepancy it can be deduced that both expressions were intended to have the same meaning.<sup>182</sup>

## 2.5. The evolution since 1963

### 2.5.1. The preparation of the 1977 update of the OECD Model and Commentary

In September 1967, WP 28 was entrusted with dealing with outstanding issues concerning inter alia the articles on income from personal services. In June 1971, the denomination was changed due to a reorganization of

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179. For the historic evolution of the definition of “company”, see chapter 3.5.1.

180. FC/WP14(59)1, 2 March 1959, p. 4. In this version of the provision which would form the future Art. 3, the term person was defined as “individual and any body of persons, corporate or not corporate”.

181. TFD/FC/63 (1st Revision), 21 April 1959, p.4.

182. For further elaborations to this question see chapter 3.3.1.

the structures of the OECD into “Working Group No. 28 of Working Party No. 1” (hereinafter WG 28).<sup>183</sup> In its report from December 1971, open issues with regard to Art. 16 were analysed. As the main problem, WG 28 identified that the wording of the provision left the kind of remuneration covered by the provision ambiguous. In the opinion of WG 28, which was supported by an analysis of bilateral treaties which had, at that time, been recently concluded, Art. 16 was intended only to apply to actual directors’ fees, whereas e.g. a salary received by a managing director as an ordinary employee of a company should not be covered.<sup>184</sup> Hence, WG 28 suggested supplementing Art. 16 with a second paragraph, to provide that either “The provisions of paragraph 1 of this Article shall not apply to remuneration derived by a member of the board of directors of a company in respect of his exercise on behalf of the company of day-to-day functions of a managerial or technical nature.” or that “The provisions of paragraph 1 of this Article shall not apply to remuneration in respect of services rendered to the company other than remuneration in respect of such services as are referred to under paragraph 1.”<sup>185</sup> Moreover, the Belgian Delegation proposed that organs similar to a board of directors should also fall within the scope of Art. 16. WG 28 endorsed this suggestion and argued for an amendment of the Commentary to provide that such a clause might be included in bilateral treaties. However, due to Art. 16 being an “exception from the main principle on taxation of income from employment”, WG 28 rejected the call for the wording of Art. 16 of the OECD Model to be changed to include “similar organs”.<sup>186</sup> Another issue raised by the Belgian Delegation concerned the issue of supplementing Art. 16 with a provision regarding regular activities performed by a director for a PE of the company. Since day-to-day activities of directors were deemed to fall under the more general rules for income from personal services, WG 28 decided against proceeding further with such an amendment to the provision.<sup>187</sup> During the fifth meeting held from 6-9 June 1972, WP 1 dealt with the report by WG 28 and concurred with it. Nevertheless, since the problems raised in the report were not deemed to be of such significance as to require an amendment of the wording of Art. 16, WP 1 only sanctioned the preparation of changes to the Commentary.<sup>188</sup> These new paragraphs were inserted into the Commentary in 1977 and equal

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183. CFA/WP1(71)7, 23 December 1971, Report on Articles 16, 17 and 19 and the question concerning residence of diplomats, 23 December 1971, p. 1.

184. Cf also chapter 3.10.1.

185. CFA/WP1(71)7, p. 2 et seq. Both proposals were deemed to amount to the same thing, but it was argued that the phrase “day-to-day functions” used in the first suggestion might lead to qualification conflicts.

186. CFA/WP1(71)7, pp. 3 et seq.

187. CFA/WP1(71)7, p. 4.

188. DAF/CFA/WP1/72.9, 28 July 1972.

paragraphs 2 and 3 of the 2014 OECD Model Commentary. Since 1959, the only amendment to the wording of Art. 16 also occurred in 1977. In course of the update of the OECD Model, an “other” was inserted, so that the article has since read, “Directors’ fees and *other* [emphasis added by the author] similar payments ...” The historic materials on the update of the OECD Model do not elucidate the reasons for this change. As demonstrated in chapter 3.10. this insertion of “other” does not affect the scope of the provision.

### 2.5.2. Further changes to the OECD Commentary

Since 1977, some changes to the OECD Commentary have affected Art. 16. In 1997, the Commentary to Art. 16 was supplemented with the current paragraph 1.1 on benefits in kind and in 2005 with the current paragraph 3.1 dealing with stock options. Hence, the delimitation between Art. 16 and other distribution rules in the event of stock options should work according to the standards developed for the OECD Commentary to Art. 15.<sup>189</sup> Similarly the notion that benefits in kind are covered by a treaty provision applies also to other distribution rules and is necessary for ensuring that the intention that Art. 16 should cover all kinds of remuneration in return for the performance of activities whose place of performance is difficult to identify is fulfilled.<sup>190</sup>

The Commentary to Art. 15 of the 1963 OECD Model provided in paragraph 2 that Art. 16 is a “special provision” with respect to Art. 15, whereas Articles 18 and 19 are labelled “exceptions” to Art. 15. In 1977, the terminology was changed to “Remuneration of members of a board of directors is subject to Article 16.” With the 1997 update of the Commentary, the addition of the indication that this relation between Art. 15 and Art. 16 applies only to “non-employment” remuneration was made. Articles 18 and 19 are still referred to as exceptions to Art. 15.

### 2.5.3. Conclusions from the evolution since 1963

Even though the continuous upgrading of the Commentary after 1963 was intended to facilitate the interpretation of Art. 16, some questions arise from the evolution of these amendments. Paragraph 2 of the 2014 OECD

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189. For a critical examination of these proposals by the OECD see chapter 4.3.2.

190. Burgstaller, *supra* n. 143, at p. 115.

Commentary to Art. 16 to my mind does not indicate that even though the job description of a member of a board of directors might contain managerial as well as supervising functions, Art. 16 only applies to consideration for supervisory activities. This can be derived from the wording that “the Article does not apply to remuneration paid to such a person on account of [...] *other functions* [emphasis added by the author]” and the examples given that only comprise activities that are not part of the job profile of a director. Also the insertion of “non-employment” in the Commentary to Art. 15 does not conflict with the assumption that the allocation of income to Art. 15 or 16 depends on the type of activity for which it is received. Consequently, “non-employment income” exists only where remuneration for operative work is paid as compensation for activities forming part of the functions of the respective board member and the other conditions of Art. 16 are met. Furthermore, the reference to “non-employment income” might be deemed to indicate that only remuneration received by self-employed directors is covered by Art. 16. However, such an assumption must be dismissed as otherwise the proviso in respect of Art. 16 in Art. 15 would be superfluous.<sup>191</sup>

With regard to the reports of WG 28 of WP 1 that lead to the inclusion of the current paragraph 2 of the Commentary to Art. 16, the delimitation between Articles 15 and 16 seems questionable. What is to my mind most ambiguous is that according to the second report from December 1971, consideration for “day-to-day work” is excluded from the scope of the clause. Uncertainties most notably stem from a lack of clarification of what is meant with a director’s “day-to-day work”. The problem that a different understanding of the term day-to-day management is possible has yet to be solved at the OECD level.<sup>192</sup> A distinction between the different levels of management is of paramount importance in the case of companies with a decentralized management structure in which management duties are vested in different hands and therefore are likely to be carried out in different locations.<sup>193</sup> In the following analysis, it is assumed that day-to-day management is characterized by the duty to implement strategic corporate policy goals and the authority to decide on the daily progress of the company’s business. Day-to-day management thus neither refers to decisions on fundamental

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191. S. Dommès, *Pensionen im Recht der Doppelbesteuerungsabkommen*, p. 201 (Linde 2012).

192. Cf I.J.J. Burgers, *Some Thoughts on Further Refinement of the Concept of Place of Effective Management for Tax Treaty Purposes*, 35 Intl. Tax Review 6/7, pp. 385 et seq. (2007).

193. The issue of determining corporate residence according to Art. 4(3) in the case of decentralized management structures is dealt with in detail in chapter 3.8.4.



policy nor to the immediate supervision of day-to-day operations.<sup>194</sup> When attributing such a meaning to “day-to-day work” of directors the proposed changes to the OECD Commentary to Art. 16 might indicate the following: Either that any operative work that goes beyond strategic decisions is detrimental or – as mentioned above – that operative work does not preclude the application of Art. 16 as long as it is part of the function of a director. The first alternative is to my mind supported by the first proposal of WG 28 for a second paragraph of Art. 16<sup>195</sup> and the second one by the second proposal.<sup>196</sup> The example of a director working in a PE seems to indicate that only remuneration for non-executive managers and members of supervisory boards is covered by Art. 16, as otherwise the reasoning of WG 28 would not make sense under all circumstances: The statement that day-to-day income of directors performing services in a PE of the company is never covered by Art. 16 implies that WG 28 assumed that directors typically perform their services to the company and not to a single PE. This holds true for non-executive managers and members of supervisory boards, but might not be correct for executive directors.

From the statement that “similar organs” might be included in bilateral treaties, it can be inferred that they do not fall under Art. 16 of the OECD Model. The historic materials, however, do not provide information on the characteristics of such similar organs.<sup>197</sup>

Despite the changes in the wording of the OECD Commentary to Art. 15 in 1977, Art. 16 is apparently still not treated as being on the same footing as Articles 18 and 19 according to the Commentary. Otherwise, no reason exists for not integrating Art. 16 into the first sentence about the relation between Art. 15 and Articles 18 and 19.<sup>198</sup> F.P.G. Pötgens tries to explain the wording of the 1963 OECD Commentary with, inter alia, the historical evolution of the provisions: The phrase “special” was used several times by the League of Nations in the context of directors’ fees<sup>199</sup> and apparently

194. L. de Broe, *Corporate Tax Residence in Civil Law Jurisdictions*, in *Residence of Companies under Tax Treaties and EC Law*, pp. 102 et seq. (G. Maisto ed., IBFD 2009).

195. “The provisions of paragraph 1 of this Article shall not apply to remuneration derived by a member of the board of directors of a company in respect of his exercise on behalf of the company of day-to-day functions of a managerial or technical nature.”

196. “The provisions of paragraph 1 of this Article shall not apply to remuneration in respect of services rendered to the company other than remuneration in respect of such services as are referred to under paragraph 1.”

197. For an analysis of the demarcation between “board of directors” and “similar organ”, see chapter 3.5.5.

198. Pötgens, *supra* n. 116, at ch. V.2.1.2.

199. The Commentary to Art. 6 of the 1927 Model provided that this article covers “the special [emphasis added by the author] tax on variable fees deducted from profits”, the

the OECD abided by this terminology.<sup>200</sup> To my mind, this argument is not convincing, since many distribution rules were called “special provisions” only during the drafting process and not in the final version of the OECD Commentary.<sup>201</sup> Moreover, the clause on directors’ fees is also sometimes referred to as an “exception” to the principle stipulated in Art. 15 in interim reports by WP of the OECD.<sup>202</sup> However, if the differentiation between the terms “special provision” and “exception” was intended to be of significance, it is most likely that some debate about the possible material consequences of this would have been documented in the historic materials on the drafting process of the provisions on income from personal services as such consequences are not self-evident.<sup>203</sup>

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Commentary on Art. VI of the Mexico Draft states that directors’ fees are treated in a *special* [emphasis added by the author] article.

200. Pötgens, *supra* n. 116, at ch. V.2.1.2.

201. Cf. e.g. FC(59)2, 21 May, 1959, p. 20 where “remuneration and pensions paid by a State, remuneration of members of company boards [...] and [inserted by the author] income of public entertainers” are viewed as “special provisions” with respect to “income from professional services and to remuneration from employment in the form of salaries, wages or the like (including pensions)”.

202. See e.g. CFA/WP1(71)7, Report on Articles 16, 17 and 19 and the question concerning residence of diplomats, 23 December 1971, p. 4.

203. Apparently due to a lack of access to the records of the historical development of the Models, Pötgens considered the distinction between “special provision” and “exception” of importance in 2001. Cf F.P.G. Pötgens, *The “Closed System” of the Provisions on Income from Employment in the OECD Model*, 41 Eur. Taxn. 7, sec. III (2001), Journals IBFD.



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