United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

Appendix for Special Consideration Articles: A Proposed Protocol for Appendix Inclusion

PREAMBLE

At the Fourth meeting of the UN Committee of Experts on International Cooperation in Tax Matters in October of 2008, the Secretariat indicated that the development of this section of the Manual "...with a practical and solutions oriented focus..."[1] was very important and would be very valuable. It was also stated that "...the Manual needed, for full impact, to be an interactive web based product"[2]. At the conclusion of the discussion regarding the new

structure of the Manual, the suggested general format of the Manual, including this section was approved.

Further, it was requested at the closing meeting of the meeting that a first step towards implementation of this section of the newly formatted Manual would be the suggestion of a protocol whereby articles will be selected for inclusion. The following discussion is a preliminary proposal, mostly in general terms, to begin the discussion and evolution of such a protocol.

INTRODUCTION

Typically, the articles included in this section would arise from discussions at meetings of the Committee of Experts on International Cooperation in Tax Matters, but it is proposed that such articles could be proposed outside that specific venue, according to protocols agreed to by the Committee members.

enhanced with, and in some cases compromised without the availability of articles such as these. The manual should be both timely and accurate. If significant issues such as these are not available for guidance, the usefulness of the manual, their integrity or accuracy, may be sacrificed. The same result obtains if such information cannot be added on a timely basis. It would appear appropriate to have a designated repository for this type of article, a

GUIDELINES: A PROPOSAL

The following are very preliminary, but could serve as a starting point for the discussion:

oriented focus.

b. The articles should preserve and strengthen the integrity and accuracy of the Manual and the Commentaries.

particular inquiry.

f. The information must be timely and accurate.

g. The submission process should be transparent to and accessible by interested parties.

As stated in the principles for guidelines discussion, the article that is included should address issues that are relevant to the negotiation process, and the issues will have a high level of interest to stakeholders. They may consist of issues that are in discussion by the

Committee and observers or novel issues that stem from the experiences or expertise of

priority or emphasis on timeliness and accuracy. A dramatic shift in business or economic structures may warrant communication to the stakeholders on a more timely basis then

on its own as a separate and independent piece of work (unless a special section of contributions is called for by the Committee, as might be the case with a special topic).

1.Draft report of the Fourth Meeting of the UN Committee of Experts on International Cooperation in Tax Matters, paragraph 65, E/C18/2007/19

2.Draft report of the Fourth Meeting of the UN Committee of Experts on International Cooperation in Tax Matters, paragraph 67, E/C18/2007/19

[3] Ms. Ayala, statement made by Ms. Ayala during Manual Revision Subcommittee discussions, regarding proposal for a Mission Statement.

United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

---

Appendix for Special Consideration Articles:

A Proposed Timeline for Submission and Consideration of Articles for the Appendix for Special Consideration Articles

Revised for Comments Received up to October 1, 2009

As has generally been an issue, timeliness of submission of articles for inclusion in the proceedings of

discussion went forward at the meeting, there could be a vote for acceptance for inclusion in the

Special Appendix.

This [illegible] would be eligible to vote. One response is that the Committee

ISLAMIC FINANCIAL INSTRUMENTS

TREATMENT OF ISLAMIC FINANCIAL INSTRUMENTS UNDER THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES[v]

At the Third session of the Committee one of the items discussed was the taxation of income from Islamic financial instruments. The working group document stated, in its Summary that the "... current drafting of the United Nations Model Double Taxation Convention between Developed and Developing Countries seems to be capable to deal with Islamic financial instruments, but some language could be included in commentary to provide that the definition of interest would include income from some types of Islamic financial arrangements..." At different points after the Working Group presented its document, it was suggested that such definitional statements, while

perhaps not appropriate for inclusion in the Commentaries, would be the type of guidance oriented information that would be appropriate for the Special Appendix. Accordingly, the following items that emanate from the working group document have

Profits and losses are split according to a pre-agreed formula.
A variation of this arrangement is the "diminishing musharaka" that is a partnership type arrangement that provides for a gradual buyout of one or more of the partners.
In the context of such an arrangement, the profit/loss sharing ratio does not have to reflect the same ratio as the investment ratio. Similar to the partnership rules in the United States tax law, the agreement of the partners is deciding, and as long as there is agreement, generally, the discrepancy between the two ratios is valid.

Mudaraba

This arrangement is characterized as an "investment partnership"[xii] where the investor agrees to provide money to another party, an entrepreneur, in order to invest the funds or to undertake a business venture. Profits are distributed on the basis of a pre-agreed formula, while losses are born solely by the investor partner.
The profit sharing scheme is described as perfectly *sharia* compliant.[xiii] The scheme is described as: a depositor deposits money with a financial institution (an Islamic bank), which would be used by the institution with the intent to

The Ijara is a mode of financing to the lessee and a mode of investment for the

lessor. The essential rules for a basic Ijara transaction include[xvii]:

1. The term of the lease and consideration must be specified.

2. Liabilities given rise through the use of the asset/property will be the responsibility of the lessee. Liabilities surfacing from the ownership of the

In Islam, there are three mandatory elements to a sale in order for it to be legitimate. At the time of sale, the product 1: must exist, 2: the seller must own it, and 3: it must be in the seller's possession. The only two exceptions to this general rule are the contracts of *salam* and *istisna'*. Historically, the salam

arrangement was used in situations where the seller of the commodity needed the cash to finance the production of the commodity. One example of such a

and harvesting of a crop xx. The benefit to the buyer was generally realized in

generally applies to manufactured commodities.[xxiii] The requisite elements and conditions of validity for the istisna'a are the same as those for the salam

The fourth school, the Hanafi school, offers forth the currently prevailing opinion that the istisna'a and salam are separate and distinct forms of contract. The differences between the two are, primarily: advance payment is not a condition of the istisna'a, the time of delivery is not necessarily fixed in the terms of the istisna'a while such element is essential in the salam contract, and once signed, the salam cannot be cancelled unilaterally while the istisna'a can be cancelled

to the amount of the asset investment in the same proportion that is represented by the holders subscription to the total asset investment.[xxv] A primary purpose of this arrangement is to spread the risk of the investment. Ownership shares in

subscribers as a way to generate the capital and spread the risk. The subscribers then share in the profits. The arrangement, in its pure form, is likened to a western joint stock company.[xxvi]

the discussion of whether or not the certificates themselves can be sold. While the debate continues, it appears that most scholars of Islamic financial arrangements take the position that the certificates cannot be transferred as they represent future interests in a commodity that has not been reduced to possession by the purchaser in the salam contract.[xxix]

Istisna'a sukuk[xxx]

The istisna'a involves financing a project consisting of manufacturing or constructing an asset at a price to be paid in future installments. The total amount of these installments includes a profit margin. The istisna'a sukuk is a fractional share in the istisna'a project financing.

The project customer provides the Islamic bank (the capital source) with the details of the project and the bank then engages contractors to submit bids which include specifications as to the timing of delivery of their

product and the payment schedule which covers their costs and a profit margin. The bank issues the sukuk certificates based on the expected future income streams from the project.

fixed income stream. The ijara sukuk represents a fractional ownership in this income stream.

Since the ijara sukuk represent an ownership in an existing tangible asset it may be traded in a secondary market.

Musharaka and *mudaraba sukuk* [xxxii]

The musharaka and mudaraba represent equity instruments. The

[i] E/C.18/2007/CRP2, page 3.
[ii] E/C.18/2007/CRP2, page 4.
[iii] E/C.18/2007/CRP2

Tax Convention, OECD, R(6)-1, at page R (6)-4, paragraph 4.
[v] E/C.18/2007/9
[vi] E/c.18/2007/9, "Summary."
[vii] "Islamic Banking and Accounting," a research paper submitted by Ms. Sarah Tantawy in partial fulfillment of a course for

UN MODEL TREATY

United Nations

2001 U.N. Model Income and Capital Tax Convention

PUBLICATION-DATE: January 11, 2001

2001 WTD 116-41; Doc 2001-16597

2001 U.N. Model Income and Capital Tax Convention

TEXT:
CONVENTION BETWEEN (STATE A) AND (STATE B) WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL n1

Preamble of the Convention n2

Chapter I
Scope of the Convention

Article 1
Persons Covered

This Convention shall apply to persons who are residents of one or both of the Contracting States.

Article 2
Taxes Covered

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its

(a) The term "person" includes an individual, a company and any other body of persons;

(b) The term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;

enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(d) The term "international traffic" means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the

Article 5

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

(f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term "permanent establishment" also encompasses:

(a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;

(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.

4. Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include:

(a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from

6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate

independently with the enterprise of which it is a permanent establishment.

4. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 8 (Alternative B)

1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the

place of effective management of the enterprise is situated.

2. Profits from the operation of ships in international traffic shall be taxable only in the Contracting State in which the

Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a

securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this article.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a

exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this article shall apply only to the last-mentioned amount. In such case, the excess part of

provisions of this Convention.

Article 13
Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in article 6 and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment

2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15
Dependent Personal Services

1. Subject to the provisions of articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is

may be taxed in that other State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in

the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply.

3. Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing articles of this Convention and arising in the other Contracting State may also be taxed in that other State.

Chapter IV
Taxation of Capital

Article 22
Capital

1. Capital represented by immovable property referred to in article 6, owned by a resident of a Contracting State and

Article 23 B

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the

resident or, if his case comes under paragraph 1 of article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to

Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.

Chapter VII
Final Provisions

Article 28
Entry Into Force

1. This Convention shall be ratified and the instruments of ratification shall be exchanged at _____ as soon as possible.

effect: