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**Committee of Experts on International Cooperation in Tax Matters**
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Item 5 (a) of the provisional agenda

**United Nations Model Tax Convention update**

# NOTE ON PROPOSED UPDATE OF UNITED NATIONS MODEL TAX CONVENTION

***Summary***

This note has been prepared by the Subcommittee on the United Nations Model Tax Convention Update. The Subcommittee is mandated to:

> "… collate all the work on the Model update that has been completed by the Committee, drawing upon the work of relevant Working Groups. It will also review the existing Commentary and identify desirable amendments to the Commentary. It will report back to the next annual session of the Committee with a report on work-in progress on the update. It will report back to the 2011 annual session with a proposed final draft of the Model Update."

This document reflects a text for discussion of the update, reflecting decisions already taken by the Committee as well as proposals to ensure that the new version of the UN Model best meets the needs of Member States.

Text that has already been agreed by the Committee to be deleted is denoted by black strikethrough type. Text now proposed for deletion is denoted by red strikethrough (matters regarded as substantive) and blue strikethrough (matters regarded as more editorial in nature).

Text already agreed for inclusion is denoted by black bold-faced type unless otherwise specifically noted. Text now proposed for inclusion is denoted by red bold-faced type (matters regarded as substantive) and blue bold-faced

*Article 12*

## ROYALTIES

### A. GENERAL CONSIDERATIONS

1. Article 12 of the United Nations Model Convention reproduces Article 12 of the OECD Model Convention, with the following exceptions: first, substantive differences appear in paragraphs 1 and 3; second, paragraphs 2 and 5 do not appear in the OECD Model Convention with the result that the paragraph numbers in the United Nations Model Convention differ from those in the OECD Model

State of residence and the State of source, the United Nations Model Convention departs from the principle of exclusive residence State's right to tax provided in the OECD Model Convention. In this context, it

**negotiations. [para. 4.2]**

6. During discussion by the **former** Group of Experts in 1999, members from developing countries argued that, in order to facilitate the conclusion of tax treaties between those countries and developed countries, the primary right to tax royalties should be given to the country where the income arose, that is, the source country. Patents and processes might be licensed to developing countries after they had been fully exploited elsewhere and, according to these members, after the expenses incurred in connection with their development had already been largely recouped.

7. Members from developed countries responded that it would be unrealistic to assume that enterprises selected the oldest patents for licensing to developing countries. Normally, an enterprise would license its patents to foreign subsidiaries and therefore select the most up-to-date inventions, in the hope of expanding existing markets or opening up new ones. Patents are not merchandise but instruments for promoting industrial production. Several members from developed countries held as a matter of principle that the country of residence of the owner of a patent or similar property should have the exclusive or primary right to tax royalties paid thereon.

8. Since the **former** Group **of Experts** reached no consensus on a particular rate for the withholding

hand, because a considerable part of film expenses represents high salaries paid to actors and other participants who were taxed solely by the country of residence, and not by the source country, these expenses might not justify any great reduction of the withholding tax at source. However, it could be said that the amounts involved were nevertheless real costs for the producer and should be taken into account, while at the same time all countries involved should join in efforts to make sure that such income did not escape tax. Further, while the write-off of expenses in the country of residence did not mean that the expenses should not be taken into account at source, at some point old films could present a different expense situation.

11. Some members of the **former** Group **of Experts** ~~believe~~ **expressed** that because copyright royalties represent cultural efforts, they should be exempted from taxation by the source country. Other members, however, argue**d** that tax would be levied by the residence country, and the reduction at source would not benefit the author. Other members favour exempting copyright royalties at the source, not necessarily for cultural reasons, but because the country of residence is in a better position to evaluate the expenses and personal circumstances of the creator of the royalties, including the period over which the books or other copyrighted items had been created; a reduction of the source

~~commercial~~ **business** profits and, in consequence, subjected to the provisions of Articles 7 and 9." [para. 10]

In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 ~~alludes~~ **is referring**

**very much greater level of expenditure by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services". [para 11.3]**

**"Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:**

- **payments obtained as consideration for after-sales service,**
- **payments for services rendered by a seller to the purchaser under a warranty,**
- **payments for pure technical assistance,**
- **payments for a list of potential customers, when such a list is developed specifically for the payer out of generally available information (a payment for the confidential list of customers to which the payee has provided a particular product or service would, however, constitute a payment for know-how as it would relate to the commercial experience of the payee in dealing with these customers),**
- **payments for an opinion given by an engineer, an advocate or an accountant, and**
- **payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with nonconfidential information in response to frequently asked questions or common problems that arise frequently". [para. 11.4]**

**"In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection". [para. 11.5]**

"In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then ~~it seems possible to apply to the whole amount of the consideration~~the treatment applicable to the principal **part should generally be applied to the whole amount of the**

~~instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing, on a magnetic tape or disk, or on a laser disk. It may be standardized with a wide range of applications or be tailor-made for single users. It can be transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware. The rights in computer software are a form of intellectual property. Research into t~~

~~"Three situations are considered. The first is of payments made where less than the full rights in software are transferred. In a partial transfer of rights the consideration is likely to represent a royalty only in very limited circumstances. One such case is where the transferor is the author of the software (or has acquired from the author his rights of distribution and reproduction) and he has placed part of his rights at the disposal of a third party to enable the latter to develop or exploit the software itself commercially, for example by development and distribution of it . . . [E]ven where a software payment is properly to be regarded as a royalty there are difficulties in applying the copyright provisions of the Article to software royalties since paragraph [3] requires that software should be classified as a literary, artistic or scientific work. None of these categories seems entirely apt but treatment as a scientific work might be the most realistic~~

**relation to computer programs under copyright law may differ from country to country. In some countries the act of copying the program onto the hard drive or random access memory of a computer would, without a license, constitute a breach of copyright. However, the copyright laws of many countries automatically grant this right to the owner of software which incorporates a computer program. Regardless of whether this right is granted under law or under a license agreement with the copyright holder, copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilising the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as commercial income in accordance with Article 7". [para. 14]**

**"The method of transferring the computer program to the transferee is not relevant. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the program or directly receives a copy on the hard disk of her computer via a modem connection. It is also of no relevance that there may be restrictions on the use to which the transferee can put the software". [para. 14.1]**

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**having the right to reproduce the software), or whether the software is subject to minor customisation for the purposes of its installation". [para. 14.4]**

"~~The second situation is where the payments are made as consideration for the alienation of rights attached to the software. It is clear that where~~**Where** consideration is paid for the transfer of the full ownership **of the rights in the copyright**, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there ~~are extensive but partial alienation~~ **is a transfer** of rights involving:

— exclusive right of use **of the copyright** during a specific period or in a limited geographical area;

— additional consideration related to usage;

— consideration in the form of a substantial lump sum payment". [para. 15]

"Each case will depend on its particular facts but in general **if the payment is in consideration for the transfer of rights that constitute a distinct and specific property (which is more likely in the case of geographically-limited than time-limited rights),** such payments are likely to be ~~commercial income~~ **business profits** within Article 7 **(**or 14 **in the case of the UN Model)** or a capital gain~~s matter~~ within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated~~ in full or in part~~, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency". [para 16]

"~~The third situation is where software~~**Software** payments ~~are~~ **may be** made under mixed contracts. Examples of such contracts include sales of computer hardware with built-in software and concessions of the right to use software combined with the provision of services. The methods set out in paragraph 11 above for dealing with similar problems in relation to patent royalties and know-how are equally applicable to computer software. Where necessary the total amount of the consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part". [para. 17]

**"The principles expressed above as regards software payments are also applicable as regards transactions concerning other types of digital products such as images, sounds or text. The development of electronic commerce has multiplied the number of such transactions. In deciding whether or not payments arising in these transactions constitute royalties, the main question to be addressed is the identification of that for which the payment is essentially made". [para. 17.1]**

**"Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customeTc.0331.3(h, 6.3(e)-.6(u.-2.3( )6.7(:.-8.6( t6.3(eb-6.9(e -.6(u)7.6(ua.3( u-6.9(e)10.e carigh)5(7(t)to)6.4( m))6.7(lk )6.**

**essentially for the acquisition of data transmitted in the form of a digital signal and**

Revision of the Model Convention" adopted by the Council of the OECD on 23 July 1992. However, a number of OECD member countries have entered reservations on this point.

~~15~~**14**. **When** ~~T~~the **former** Group **of Experts** considered **this issue it** ~~**considered**~~ **addressed** the problems of distinguishing royalties from types of income properly subject to other articles of the Convention. A member from a developed country asserted that the problem was that the "royalties" definition makes an imperfect distinction between revenues that constituted royalties in the strict sense and payments received for brain-work and technical services, such as surveys of any kind (engineering, geological research etc.). The member also mentioned the problem of distinguishing between royalties akin to income from capital and payments received for services. Given the broad definition of "information concerning industrial, commercial or scientific experience", some countries tend to regard the provision of brain-work and technical services as the provision of "information concerning industrial, commercial or scientific experience" and to regard payment for it as royalties.

~~16~~**15**. In order to avoid those difficulties, this member proposed that the definition of royalties be

~~22~~**21**. **When this issue was last considered by the former Group of Experts, s**ome members ~~of the Group of Experts~~ pointed out that there are very artificial devices entered into by persons to take advantage of the provisions of ~~a~~**A**rticle 12 through, inter alia, creation or assignment of agreements for the use, right or information with respect to intangible assets for which royalties are charged. While substance over form rules, abuse of rights principles or any similar doctrine could be used to counter such arrangements, Contracting States which may want to specifically address the issue may include a clause on the following lines in their bilateral tax treaties:

> "The provisions of this ~~a~~**A**rticle shall not apply if it was the main purpose, or one of the main purposes, of any persons concerned with the creation or the assignment of the rights in respect of which the royalties are paid to take advantage of this ~~a~~**A**rticle by means of that creation or assignment."

*Article 13*

## CAPITAL GAINS

### A. GENERAL CONSIDERATIONS

1. Article 13 of the United Nations Model Convention consists of the first three paragraphs of Article 13 of the OECD Model Convention.~~, followed by two new paragraphs (paragraphs 4 and 5) and by the text of Article 13, paragraph 4~~**5**~~, of the OECD Model Convention renumbered as paragraph 6 and adjusted to take into account the insertion of the two new paragraphs.~~ **Paragraph 4 broadly corresponds with paragraph 4 of the OECD Model Convention and paragraph 5 is a distinct provision in the UN Model. Paragraph 6 is the same as paragraph 5 of the OECD Model Convention but adjusted**

assets of an enterprise. In a number of OECD ~~M~~**m**ember countries, however, capital gains are subject**ed** to special taxes, such as taxes on profits from the alienation of immovable property, or general capital gains taxes, or taxes on capital appreciation (increment taxes). Such taxes are levied principle should, as a rule, apply as

***16.*** ”Further problems may arise in connection with profits due to changes of the rate of exchange between the currencies of State A and State B. After the devaluation of the currency of State A, enterprises of such State A may, or may have to, increase the book value of the assets situated outside the territory of State A. Apart from any devaluation of the currency of a State, the usual fluctuations of the rate of exchange may give rise to so-called currency gains or losses. Take for example an enterprise of State A having bought and sold immovable property situated in State B. If the cost and the selling price, both expressed in the currency of State B, are equal, there will be no capital gain in State B. When the value of the currency of State B has risen between the purchase and the sale of the asset in relation to the currency of State A, in the currency of that State a profit will accrue to such enterprise. If the value of the currency of State B has fallen in the meantime, the alienator will sustain a loss which will not be recogni~~z~~sed in State B. Such makes use thereof. In such a case, paragraph [6] of the Article should be supplemented accordingly. Besides, a modification of Article 23 A as suggested in **[**…**]** the Commentary on Article 23 A is needed.~~” [para. 21]~~

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 13

*Paragraph 1*

5. This paragraph reproduces Article 13, paragraph 1, of the OECD Model Convention, the Commentary on which is as follows:

***22.*** ~~“~~Paragraph 1 states that gains from the alienation of immovable property may be taxed in express reference thereto. For the transfer of an asset from a permanent establishment in one State to a permanent establishment (or the head office) in another State, ~~cf~~ **see** paragraph 10 above.~~" [para. 25]~~

***26.*** "On the other hand, paragraph 2 may not always be applicable to capital gains from the alienation of a participation in achieve its objective, paragraph 4 would have to apply regardless of whether the company is a resident of the Contracting State in which the immovable property is situated or a resident of another State. In 1999, the **former** Group of Experts decided to amend paragraph 4 to expand its scope to include interests in

**should be allowed to tax the alienation of its shares only if a substantial portion of the company's assets are situated in that State and in bilateral negotiations might seek to include such a limitation.**

**15. Other countries engaged in bilateral negotiations might seek to have paragraph 5 omitted entirely, where they take the view that taxation in the source State of capital gains in these situations may create economic double taxation in the corporate chain, thus hampering foreign direct investment. This consideration is, in particular, relevant for countries that apply a participation exemption not only to dividends received from a substantial shareholding, but also to capital gains made on shares in relation to such substantial holdings.**

law of that State."

This alternative is equivalent to saying that either or both States may tax according to their own laws and that the State of residence will eliminate double taxation under ~~a~~**A**rticle 23. Countries choosing this alternative may wish through bilateral negotiations to clarify which particular source rules will apply to establish where a gain shall be considered to arise.

*Article 14*

INDEPENDENT PERSONAL SERVICES

1. Article 14 of the United Nations Model Convention reproduces in subparagraph 1(a) and paragraph 2 the essential provisions of Article 14 of the OECD Model Convention **(1997 version). The whole of Article 14 and the Commentary thereon were deleted from the OECD Model Convention on 29 April 2000.** Paragraph 1, subparagraph (b), allows the country of source to tax in one situation in addition to the one contained in Article 14, paragraph 1, of the **1997** OECD Model Convention. More

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**Contracting State should not be subjected to tax in the other State unless its business presence in that other State has reached a level sufficient to constitute a permanent establishment. The exception of paragraph 2 of Article 15 extends that principle to the taxation of the employees of such an enterprise where the activities of these employees are carried on in the other State for a relatively short period. Subparagraphs *b*) and *c*) make it clear that the exception is not intended to apply where the employment services are rendered to an enterprise the profits of which are subjected to tax in a State either because it is carried on by a resident of that State or because it has a permanent establishment therein to which the services are attributable.** ~~Paragraph 2 has given rise to numerous cases of abuse through adoption of the practice known as 'international hiring out~~

**of domestic law, would consider that employment services are only rendered where there is a formal employment relationship.**

***8.3*** **If States where this is the case are concerned that such approach could result in granting the benefits of the exception provided for in paragraph 2 in unintended situations (*e.g.* in so-called "hiring-out of labour" cases), they are free to adopt bilaterally a provision drafted along the following lines:**

> **Paragraph 2 of this Article shall not apply to remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and paid by, or on behalf of, an employer who is not a resident of that other State if:**
> ***a)***

**relationship with the individual so as to constitute his employer for purposes of subparagraph 2 *b*) and *c*). That conclusion is consistent with the object and purpose of paragraph 2 of Article 15 since, in that case, the employment services may be said to be rendered to a resident of the State where the services are performed.**

***8.8*** **As mentioned in paragraph 8.2, even where the domestic law of the State that applies the Convention does not offer the possibility of questioning a formal contractual relationship and therefore does not allow the State to consider that services rendered to a local enterprise by an individual who is formally employed by a non-resident are rendered in an employment relationship (contract of service) with that local enterprise, it is possible for that State to deny the application of the exception of paragraph 2 in abusive cases.**

***8.9*** **The various approaches that are available to States that want to deal with such abusive cases are discussed in the section "Improper use of the Convention" in the Commentary on Article 1. As explained in paragraph 9.4 of that Commentary, it is agreed that States do not have to grant the benefits of a tax convention where**

**resident where it is clear that that enterprise provides services, through its own personnel, to an enterprise carried on by a resident. Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer; this could be relevant, for example, for purposes of determining whether that enterprise has a permanent establishment at the place where the individual performs his activities.**

*8.12* **It will not always be clear, however, whether services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises. Any disagreement between States as to whether this is the case should be solved having regard to the following principles and examples (using, where appropriate, the mutual agreement procedure).**

*8.13* **The nature of the services rendered by the individual will be an important factor since it is logical to assume that an employee provides services which are an integral part of the business activities carried on by his employer. It will therefore be important to determine whether the services rendered by the individual constitute an integral part of the business of the enterprise to which these services are provided. For that purpose, a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual's work. Clearly, however, this analysis will only be relevant if the services of an individual are rendered directly to an enterprise. Where, for example, an individual provides services to a contract manufacturer or to an enterprise to which business is outsourced, the services of that individual are not rendered to enterprises that will obtain the products or services in question.**

*8.14* **Where a comparison of the nature of the services rendered by the individual with the business activities carried on by his formal employer and by the enterprise to which the services are provided points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:**

- **who has the authority to instruct the individual regarding the manner in which the work has to be performed;**
- **who controls and has responsibility for the place at which the work is performed;**
- **the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below);**
- **who puts the tools and materials necessary for the work at the individual's disposal;**
- **who determines the number and qualifications of the individuals performing the work;**
- **who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into**

**of determining whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. For instance, if the fees charged by the enterprise that formally employs the individual represent the remuneration, employment benefits and other employment costs of that individual for the services that he provided to the other enterprise, with no profit element or with a profit element that is computed as a percentage of that remuneration, benefits and other employment costs, this would be indicative that the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. That should not be considered to be the case, however, if the fee charged for the services bears no relationship to the remuneration of the individual or if that remuneration is only one of many factors taken into account in the fee charged for what is really a contract for services (*e.g.* where a consulting firm charges a client on the basis of an hourly fee for the time spent by one of its employee to perform a particular contract and that fee takes account of the various costs of the enterprise), provided that this is in conformity with the arm's length principle if the two enterprises are associated. It is important to note, however, that the question of whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided is only one of the subsidiary factors that are relevant in determining whether services rendered by that individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises.**

***8.16*** **Example 1: Aco, a company resident of State A, concludes a contract with Bco, a company resident of State B, for the provision of training services. Aco is specialised in training people in the use of various computer software and Bco wishes to train its personnel to use recently acquired software. X, an employee of Aco who is a resident of State A, is sent to Bco's offices in State B to provide training courses as part of the contract.**

***8.17***

***12.1***

**remuneration, even if the option is exercised after termination of the employment or retirement.**

***12.6*** **Paragraph 1 allows the State of source to tax salaries, wages and other similar**

***e.g.*** **where the employment is terminated by the employer or where the employee reaches retirement age, the stock-option benefit should be considered to relate only to the period of services actually performed when these circumstances have in fact occurred.**

***12.13*** **Finally, there may be situations in which some factors may suggest that an employee stock-option is rewarding past services but other factors seem to indicate that it relates to future services. In cases of doubt, it should be recognised that employee stock-options are generally provided as an incentive to future performance or as a way to retain valuable employees. Thus, employee stock-options are primarily related to future services. However, all relevant facts and circumstances will need to be taken into account before such a determination can be made and there may be cases where it can be shown that a stock-option is related to combined specific periods of previous and future services (*e.g.* options are granted on the basis of the employee having achieved specific performance targets for the previous year, but they become exercisable only if the employee remains employed for another three years).**

***12.14*** **Where, based on the preceding principles, a stock-option is considered to be derived from employment exercised in more than one State, it will be necessary to determine which part of the stock-option benefit is derived from employment exercised in each State for purposes of the application of the Article and of Articles 23 A and 23 B. In such a case, the employment benefit attributable to the stock-option should be considered to be derived from a particular country in proportion of the number of days during which employment has been exercised in that country to the total number of days during which the employment services from which the stock-option is derived has been exercised. For that purpose, the only days of employment that should be taken into account are those that are relevant for the stock-option plan, *e.g.* those during which services are rendered to the same employer or to other employers the employment by whom would be taken into account to satisfy a period of employment required to acquire the right to exercise the option.**

***12.15*** **It is possible for member countries to depart from the case-by-case application of the above principles (in paragraphs 12.7 to 12.14) by agreeing to a specific approach in a bilateral context. For example, two countries that tax predominantly at exercise of an option may agree, as a general principle, to attribute the income from an option that relates primarily to future services to the services performed by an employee in the two States between date of grant and date of exercise. Thus, in the case of options that do not become exercisable until the employee has performed services for the employer for a specific period of time, two States could agree to an approach that attributes the income from the option to each State based on the number of days worked in each State by the employee for the employer in the period between date of grant and date of exercise. Another example would be for two countries that have similar rules for the tax treatment of employee stock-options to adopt provisions that would give to one of the Contracting States exclusive taxation rights on the employment benefit even if a minor part of the employment services to which the option relates have been rendered in the other State. Of course, member countries should be careful in adopting such approaches because they may result in double taxation or double non-taxation if part of the employment is exercised in a third State that does not apply a similar approach.**

2. Although ~~a~~**A**rticles 14, 15, 19 and 23 may generally be adequate to prevent double taxation of

Reference is made to paragraphs 11 to 13 of the Commentary on ~~a~~**A**rticle 20 for a comprehensive treatment of this subject.

*Article 16*

DIRECTORS' FEES AND REMUNERATION OF TOP-LEVEL MANAGERIAL OFFICIALS

1. Article 16, paragraph 1, of the United Nations Model Convention reproduces Article 16 of the OECD Model Convention.

2. Since ~~a~~**A**rticle 16, paragraph 1, of the United Nations Model Convention reproduces the whole of Article 16 of the OECD Model Convention, the Commentary on the latter Article, which reads as follows, is relevant:

> ***1.*** ~~"~~This Article relates to remuneration received by a resident of a Contracting State, whether an individual or a legal person, in the capacity of a member of a board of directors of a company which is a resident of the other Contracting State. Since it might sometimes be difficult to ascertain where the services are performed, the provision treats the services as performed in the State of residence of the company.~~" [para. 1]~~
>
> ***1.1*** ~~"~~Member countries have generally understood the term 'fees and other similar payments' to include benefits in kind received by a person in that person's capacity as a member of the board of directors of a company (e.g.~~,~~ **stock-options** the use of a residence or automobile, health or life insurance coverage and club memberships).~~" [para. 1.1]~~
>
> **2.** ~~"~~

**directors in his capacity of investor-shareholder and will be covered by Article 13. Indeed, it is at the time of exercise that the option, which is what the director obtained in his capacity as such, disappears and the recipient obtains the status of shareholder (and usually invests money in order to do so).**

3. Article 16 of the United Nations Model Convention also includes a second paragraph not in the OECD Model Convention, dealing with remuneration received by top-level managerial officials.

4. The **former** Group of Experts decided that where a top-level managerial position of a company resident in a Contracting State is occupied by a resident of the other Contracting State, the remuneration paid to that official should be subject to the same principle as directors' fees.

the hands of the person receiving the remuneration. If the person receiving the income ~~is an enterprise~~ **carries on business activities**, tax may be applied by the source country even if the

> subdivisions or local authorities thereof. In such a case, the income is taxable only in the Contracting State in which the artiste or the sportsman is a resident.' "[para. 14]

3. ~~Some members of the Group~~ **When this issues was last considered by the former Group of Experts, some members** indicated that the examples given in the Commentary on Article 17, paragraph 2, of the OECD Model Convention should not be understood as limiting the field of application of taxation to

~~relevant~~ **applicable**. ~~However, since the United Nations Model Convention provides a separate rule in paragraph 2, dealing with social security benefits, the discussion in the OECD Commentary of social security benefits is moved in this Commentary to the discussion of paragraph 2. The OECD Commentary observes:~~

> ~~"According to this Article, pensions paid in respect of private employment are taxable only in the State of residence of the recipient. The provision also covers widows' and orphans' pensions and other similar payments such as annuities paid in respect of past employment. It also applies to pensions in re~~

**[5.] While the word "pension", under the ordinary meaning of the word, covers only periodic payments, the words "other similar remuneration" are broad enough to cover non-periodic payments. For instance, a lump-sum payment in lieu of periodic pension payments that is made on or after cessation of employment may fall within the Article.**

**[6.] Whether a particular payment is to be considered as other remuneration similar to a**

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compensation for services performed in the **State of** source ~~country~~, they should be taxed at source as normal employment income would be. **When tax relief is granted for pension contributions, the tax on part of the employment income is deferred until retirement and the tax so deferred should be recovered even if the individual has ceased to be a resident before all or part of the pension**

**recipient** to tax pensions and other similar remuneration, leaves open the possibility that the ~~country~~ **State** of source may also be given the right to tax in certain conditions which are defined in paragraph 2. **Paragraph 4 of the Commentary on paragraph 1 of Article 18 A is applicable in order to determine the scope of the Article 18 B and to consider the cross-border issues related to pensions.**

*Paragraph* 2

~~11~~**15**. As indicated above, the ~~country~~ **State** of source may ~~be allowed to~~ tax **pensions and other similar remuneration paid in consideration of past employment** ~~but only~~ if the payments involved are made by a resident of that ~~country~~ **State** or a permanent establishment situated therein.

**16. Some countries could, however, consider that the State which has given tax relief with regard to contributions to the pension scheme or to the accrual of pension rights should have the right to tax the resultant pension. This could be the case where countries grant also tax relief with respect to contributions to or pension rights within foreign pension funds. The following provision is an example of such a provision:**

question. **[ Similarly, individuals who move to other countries to provide independent services are often confronted with cross-border tax issues related to the pension arrangements that they have established in their home country.]**~~" [para. 4]~~

**[32]** ~~Employees sent abroad to work~~ **Individuals working abroad** will often wish to continue contributing to a pension scheme **(including a social security scheme that provides pension benefits)** in their home country during their absence abroad. This is **both** because switching

**an employer's contribution constitutes and whether or not the investment income derived from the contributions should be taxed in the hands of the individual. It does not, however,**

**immediately before beginning to provide services in that State, and**

**b) the pension scheme is accepted by the competent authority of that State as generally corresponding to a pension scheme recognised as such for tax purposes by that State.**

**2. For the purposes of paragraph 1:**

**a) the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the services referred to in paragraph 1; and**

**b) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State.**

**[38] The above provision is restricted to pension schemes established in one of the two Contracting States. As it is not unusual for individuals to work in a number of different countries in succession, some States may wish to extend the scope of the provision to cover situations where aones-.025g0al movos from one Contracting State to another while continuing to make contributions to a pension scheme established in a third State. Such an extension may, however, create administrative difficulties if the host State cannot haveeaccess to information concerning the pension scheme (e.g. through the exchange of information provos of a tax convention concluded with the third State); it may also create a situation where relief would be given on a non-reciprocal basis because the third State would not grant similar relief to an individual contributing to a pension scheme established in the host State. States which, notwithstanding these difficulties, want to extend the suggested provods established in third States can do so by adopting an alternative version of the suggested provision drafted along the following lines:**

**1. Contributions mad byeor on behalf of an individual who renders services in a Contracting State to a pension scheme**

**a) recognised for tax purposes in the other Contracting State,**

**b) in which the s-.025d0al participated 5mmediately before beginning to pro25de servoces in the first-mentioned State,**

**c) in which the individual participated at a time when that ind025dual was providing services in, or was a resident of, the other State, and**

**d) thatesseaccepted by the competent author ity of the first-mentioned State as generally corresponding to a pension scheme recognized as such for tax purposes by that State,**

**shall, for the purpos of**

**e) determining the 5ndividual's tax payable in the first-mentioned State, and**

**f) determining the profits of an enterprise which may be taxed in the first-mentioned State,**

**be treated in that State in the same way and subject to the same conditionseand limitations as contributions made to a pension scheme thatess recognised for tax purposes in thatefirst-mentioned State.**

**2. For the purposes of paragraph 1:**

**a) the term "a pension scheme" means an arrangement in which the indivodual participates in order to secure retirement benefits payable in respect of the services referred to in paragraph 1; and**

**b) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State.**

## D. Charactristics of th suggested provision

**[39] The follow5ng paragraphs discuss the main characteristics of the suggested provision found in paragraph 37 above.**

**[40]** ~~Subparagraph (a)~~ **Paragraph 1** of the suggested provision lays down the characteristics of both the ~~employee~~ **individual** and the contributions ~~to~~ **in respect of** which the provision applies. It also provides the principle that contributions ~~borne by~~ **made by or on behalf of** an individual rendering ~~dependent personal~~ services ~~within the meaning of Article 15~~ in one Contracting State (the host State) to a defined pension scheme in the other Contracting State (the home State) are to be ~~relieved from tax~~ **treated for tax purposes** in the host State, **in the same way and** subject to the same conditions and limitations as ~~relief for~~ contributions to domestic pension schemes of the host State.~~" [para. 12]~~

~~employee/ employer~~ pension schemes to cases where the ~~seconded employees~~ **individuals** are present on a temporary basis.~~" [para. 19]~~

**[48]** In addition, the inclusion of a time limit may be helpful in preventing the possibility of abuse outlined in paragraph ~~17~~**45** above. In bilateral negotiations, individual countries may find it appropriate to include a limit on the length of time for which an ~~employee~~ **individual** may ~~exercise an employment~~ **provide services** in the host State after which reliefs granted by the suggested provision would no longer apply.~~" [para. 20]~~

**[49]** In looking at the characteristics of the contributions, ~~subparagraph (a)~~ **paragraph 1** provides a number of tests. It makes **it** clear that the provision applies only to contributions ~~borne by~~ **made by or on behalf of** an individual to a pension scheme established in and recogni~~z~~**s**ed for tax purposes in the home State. The phrase 'recogni~~z~~**s**ed for tax purposes' is further defined in ~~subdivision (b)(ii)~~ **subparagraph 2b)** of the suggested prision. **The phrase "made by or on behalf of" is intended to apply to contributions that are made directly by**

interpretation the competent authority places on the term 'generally corresponding'; for example how widely it is interpreted and what tests are imposed.~~" [para. 24]~~

**[53]** The contributions covered by the provision are limited ~~to~~ **in** payments to schemes to which the ~~employee~~ **individual** was ~~contributing~~ **participating** before ~~he~~ ~~began~~ **beginning** to ~~exercise his employment~~ **provide services** in the host State. This means that contributions to new pension schemes which an ~~employee~~ **individual** joins while in the host State are excluded from the suggested provision.~~" [para. 25]~~

**[54]** It is, however, recogni~~z~~sed that special rules may be needed to cover cases where new pension schemes are substituted for previous ones. For instance, in some Member countries the common practice may be that, if a company employer is taken over by another company, the existing company pension scheme for its employees may be ended and a new scheme opened by the new employer. In bilateral negotiations, therefore, individual States may wish to schemes whilst working in the home country whereas in others these contributions remain exempt. ~~The provision, therefore, is silent on the treatment of such contributions, although Member countries may wish to extend the suggested provision in bilateral treaties, to~~ **Since it applies to both employees' and employers' contribution, the suggested provision** ensures that ~~the~~ employers'~~s~~ contributions in the context of **the** employees' tax liability are accorded the same treatment that such contributions to domestic schemes would receive.~~" [para. 30]~~

**[59]** ~~Subdivision (b)(i)~~

domestic laws of the treaty partners. **They may also wish to define other terms used in the provision, such as "renders services" and "provides services~~" [para. 37]~~**

**Tax obstacles to the portability to pension rights**

**[66] Another issue, which also relates to international labour mobility, is that of the tax consequences that may arise from the transfer of pension rights from a pension scheme established in one Contracting State to another scheme located in the other Contracting State. When an individual moves from one employer to another, it is frequent for the pension rights that this individual accumulated in the pension scheme covering the first employment to be transferred to a different scheme covering the second employment. Similar arrangements may exist to allow for the portability of pension rights to or from an individual retirement scheme.**

**[67] Such transfers usually give rise to a payment representing the actuarial value, at the time of the transfer, of the pension rights of the individual or representing the value of the contributions and earnings that have accumulated in the scheme with respect to the individual. These payments may be made directly from the first scheme to the second one; alternatively, they may be made by requiring the individual to contribute to the new pension scheme all or part of the amount received upon withdrawing from the previous scheme. In both cases, it is frequent for tax systems to allow such transfers, when they are purely domestic, to take place on a tax-free basis.**

**[68] Problems may arise, however, where the transfer is made from a pension scheme located in one Contracting State to a scheme located in the other State. In such a case, the Contracting State where the individual resides may consider that the payment arising upon the transfer is a taxable benefit. A similar problem arises when the payment is made from a scheme established in a State to which the relevant tax convention gives source taxing rights on pension payments arising therefrom as that State may want to apply that taxing right to any benefit derived from the scheme. Contracting States that wish to address that issue are free to include a provision drafted along the following lines:**

> **Where pension rights or amounts have accumulated in a pension scheme established in and recognised for tax purposes in one Contracting State for the benefit of an**

**these States, in order to achieve greater neutrality with respect to the location of capital, may want to extend that exemption to the investment income that a pension fund established in one State derives from the other State. In order to do so, States sometimes include in their conventions a provision drafted along the following lines:**

> **Notwithstanding any provision of this Convention, income arising in a Contracting State that is derived by a resident of the other Contracting State that was constituted and is operated exclusively to administer or provide pension benefits and has been accepted by the competent authority of the first-mentioned State as generally corresponding to a pension scheme recognised as such for tax purposes by that State, shall be exempt from tax in that State.**

*Article 19*

GOVERNMENT SERVICE

1. In 1999, three changes were made in ~~a~~**A**rticle 19. Firstly, the title of ~~a~~**A**rticle 19 was changed from "Remuneration and pensions in respect of government service" to "Government service". Secondly, in paragraphs 1 and 3, the word "remuneration" was replaced by the expression "salaries, wages and other similar remuneration". Thirdly, paragraph 3 was amended to refer to ~~a~~**A**rticle 17. **In 2011, some other changes were made in Article 19. Firstly, the words "other than a pension" were deleted in paragraph 1. Secondly, the words "Notwithstanding the provisions of paragraph 1" were added in paragraph 2. Thirdly, in paragraphs 2 and 3, the word "pension" was replaced by the words "pensions and other similar remuneration".** As a result, ~~a~~**A**rticle 19 of the United Nations Model Convention reproduces Article 19 of the OECD Model Convention. ~~The Group observed that, while the provisions of the article were generally acceptable to its members, some developing countries might in bilateral negotiations desire to place a monetary ceiling on the amount subject to subparagraph 2(b), which precludes a Contracting State from taxing pension payments that it makes to a resident or a national of the other State. The Group also felt that some developing countries might prefer that payments dealt with in a~~**A**rticle 19 should be taxed only by the beneficiary's

double taxation, they can continue to use the expression ‘may be taxed’ instead of ‘shall be taxable only’. In relation to such countries the effect will of course ~~will~~ be the same

**paragraph 2 in 2005, are broad enough to cover non-periodic payments. For example, a lump-sum payment in lieu of periodic pension payments that is made to a former State**

**Alternatively Contracting States may address the concern by subjecting all pensions to a common treatment.**

**[6]** “

business apprentices for the purpose of their maintenance, education or training. All such payments received from sources outside the State in which the student or business apprentice concerned is staying shall be exempted from tax in that State.~~" [para. 1]~~

**[2]** ~~"~~The word "immediately". . . *[makes]* clear that the Article does not cover a person who has once been a resident of a Contracting State but has subsequently moved his residence to a third State before visiting the other Contracting State.~~" [para. 2]~~

**[3] The Article covers only payments received for the purpose of the recipient's maintenance, education or training. It does not, therefore, apply to a payment, or any part thereof, that is remuneration for services rendered by the recipient and which is covered by Article 15 (or by *[14 or]* Article 7 in the case of independent services). Where the recipient's training involves work experience, however, there is a need to distinguish between a payment for services and a payment for the recipient's maintenance, education or training. The fact that the amount paid is similar to that paid to persons who provide similar services and are not students or business apprentices would generally indicate that the payment is a remuneration for services. Also, payments for maintenance, education or training should not exceed the level of expenses that are likely to be incurred to ensure the recipient's maintenance, education or training.**

**[4] For the purpose of the Article, payments that are made by or on behalf of a resident of a Contracting State or that are borne by a permanent establishment which a person has in that State are not considered to arise from sources outside that State.**

3. ~~5.~~ **Article 20** ~~Paragraph 2 in~~ **of** the 1980 version of the United Nations Model Convention **contained a paragraph 2 which** read as follows:

**Comment [MB32]:** It is suggested to move paragraph 5 to paragraph 3.

~~"~~(2) in respect of grants, scholarships and remuneration from employment not covered by paragraph 1, a student or business apprentice described in paragraph 1 shall, in addition, be entitled during such education or training to the same exemptions, reliefs or reductions in respect of taxes available to residents of the State which he is visiting.~~"~~

The question whether paragraph 2 of ~~a~~**A**rticle 20 should be deleted from the United Nations Model Convention had engaged the attention of the **former** Group of Experts for some time. In this connection, it is relevant to reproduce paragraphs 25 to 29 of the Report of the Ad Hoc Group of Experts on International Cooperation in Tax Matters on the Work of its Seventh Meeting held in December 1995 (ST/ESA/250):

"At its July 1995 meeting, the Steering Coetn()-1.1(e)694(Cod(rin)4(Co)-6.7(d61)-6(o)-.6(m)6(etn()-1.e)-6.1(n)-7ed)-.6(ed)-7( tha)- deleting from the Model Convention article 20, paragraph 2, which provided that if a visiting student had ind61ome not exempted byd6 paragraph 1 from taxation in thd6e visited country, the student should, in the taxation of non-exempted income, be entitled to the same exemptions, reliefs, and reductions as wed6 allowed to res1(e)694dents of that country." [para. 25]

"A participant argued that the provision should be retained because it allowed visiting students to be taxed in the same way as resident students. Another participant responded that such parity was sometimes elusive because the resident student was taxable on all income, whereas a visiting student was taxable only on ine from sources inhe visited country." [para. 26]

"A proponent of deleting the provis1(e)(on not)eed that article 24, paragraph 4 (second sentence), stated that a country is not required to allow non-residents any personal allowances or other reliefs 'on account of civil status or family responsibilities' which might be allowed to residents; article 20, paragraph 2, it was argued, contradicted the provision of article 24." [para. 27]

"A participant noted that, as an alternative to article 14, paragraph 1(c), a treaty might provide for exemption in the host State, for the normal duration of studies, of remuneration not exceeding a certain annual amount, but only to the extent wishing to broaden the scope of article 20 to cover sources of income arising in the country visited should aim to draft a suitable provision as tightly as possible to meet their specific circumstances.

Article for teachers

~~11~~**10**. During the course of discussions in the Seventh Meeting of the Ad Hoc Group of Experts, several participants argued for the addition to the Model Convention of an article dealing with visiting teachers. Currently, under the Model Convention visiting teachers ~~were~~ **are** subject to ~~a~~**A**rticle 14, if the teaching services ~~were~~ **are** performed in an independent capacity; ~~a~~**A**rticle 15, if the services ~~were~~ **are** dependent; or ~~a~~**A**rticle 19, if the remuneration ~~was~~ **is** paid by a Contracting State. Many treaties have an additional article or paragraph dealing specifically with teachers and, sometimes, researchers, which typically exempted them from taxation in the source country if their stay did not exceed a prescribed length. It was noted that ~~a~~**A**rticles 14 and 15 commonly did not exempt a visiting teacher's compensation from taxation at source because they generally allowed source taxation of service performers who were present in the host country for more than 183 days, and many teaching assignments exceeded that period of time.

~~12~~**11**. There was considerable controversy among participants about the need to provide an independent article in the United Nations Model Convention dealing exclusively with visiting teachers. But substantially, all participants agreed that an article on teachers, if included in the Model Convention, should not have the effect of exempting a teacher from tax both in the home country and the country visited. One member suggested a compromise on the issue: that the Model Convention should not be amended to include a provision on visiting teachers but that an addition should be made in the Commentary, noting that many treaties contained such articles and providing advice for bilateral negotiations on the subject. There was general consensus for this suggestion.

~~13~~**12**. Accordingly, the **former** Group **of Experts** appointed a drafting committee to formulate language for inclusion in the Commentary on the Model Convention. After being discussed and amended, the following inclusion was adopted by the Group in 1999:

> "No special Model Convention provision has been made regarding remuneration derived by visiting professors and other teachers. In the absence of a special provision, articles 14,15,19 or 23 of the Model Convention, depending on the circumstances, would apply.

institutions 'recognized' by the Contracting States in which the services are performed;

(d) Whether, in the case of visiting professors and other teachers who also do research, to limit benefits remuneration for research performed in the public (vs. private) interest;

(e) Whether an individual may be entitled to the benefits of the article more than once.~~"~~

*Article 21*

OTHER INCOME

1. Article 21 of the United Nations Model Convention reproduces Article 21 of the OECD Model Convention ~~in its entirety~~ **with the exception that paragraph 2 of the United Nations Model Convention also covers the case where the income is attributed to a fixed base which the beneficiary of the income has in the other Contracting State according to Article 14.** ~~and~~ **Article 21 of the United Nations Model Convention** also has an additional ~~paragraph (~~paragraph 3~~)~~ containing a general provision relating to items of income of a resident of a Contracting State not dealt with in the preceding articles and arising in the other Contracting State.

2. The ~~a~~**A**rticle covers ~~not only~~ income of a class not expressly dealt with in the preceding articles **(e.g. an alimony; a pension that is neither paid in consideration of past employment nor under a public scheme part of a social security system) as well as**~~, but also~~ income from sources not expressly referred to therein **(e.g. a rent paid by a resident of a Contracting State for the use of immovable property situated in a third State)**. The ~~a~~**A**rticle covers income arising in third States as well as income from a Contracting State.

Paragraph 1

3. This paragraph reproduces Article 21, paragraph 1, of the OECD Model Convention. ~~Part of the Commentary on the latter paragraph, quoted below, is relevant~~ **The Committee considers therefore that the following part of the OECD Commentary is applicable**:

> **[2]** ~~"~~Under this paragraph the exclusive right to tax is given to the State of residence. In cases of conflict between two residences, Article 4 will also allocate the taxation right in respect of third-State income.~~"~~ ~~[para. 2]~~
>
> **[3]** ~~"~~ . . . [W]hen income arises in a third State and the recipient of this income is considered as a resident by both Contracting States under their domestic law, the application of Article 4 will result in the recipient being treated as a resident of one Contracting State only and being liable to comprehensive taxation ("full tax liability") in that State only. In this case, the other Contracting State may not impose tax on the income arising from the third State, even if the recipient is not taxed by the State of which he is considered a resident under Article 4. In order to avoid non-taxation, Contracting States may agree to limit the scope of the Article to income which is taxed in the Contracting State of which the recipient is a resident and may modify the provisions of the paragraph accordingly . . .~~" [para. 3]~~

A reference is also invited to paragraph 5 of the Commentary below.

Paragraph 2

4. This paragraph reproduces Article 21, paragraph 2, of the OECD Model Convention **with the difference that paragraph 2 of the United Nations Model Convention also covers the case where the income is attributed to a fixed base which the beneficiary of the income has in the other Contracting State according to Article 14**. ~~The Commentary on the latter paragraph, quoted below, is therefore relevant~~ **The Committee considers that the following part of the OECD Commentary is applicable (the additional comments that appear in italics between square brackets, which are not part of the**

**OECD Commentary, have been inserted in order to reflect the difference described)**:

**[4]** ~~“~~This paragraph provides for an exception from the provisions of paragraph 1 where the income is associated with the activity of a permanent establishment ***[**or a fixed base**]*** which a resident of a Contracting State has in the other Contracting State. The paragraph includes income from third States. In such a case, a right to tax is given to the Contracting State in which the permanent establishment ***[**or the fixed base**]*** is situated. Paragraph 2 does not apply to immovable property for which, according to paragraph 4 of Article 6, the State of situs has a primary right to tax . . . Therefore, immovable property situated in a Contracting State and forming part of the business property of a permanent establishment of an enterprise of that State situated in the other Contracting State shall be taxable only in the first-mentioned State in which the property is situated and of which the recipient of the income is a resident. This is in consistency with the rules laid down in Articles 13 and 22 in respect of immovable property since paragraph 2 of those Articles applies only to movable property of a permanent establishment.~~” [para. 4]~~

**[5]** ~~“~~The paragraph also covers the case where the beneficiary and the payer of the income are both residents of the same Contracting State, and the income is attributed to a permanent establishment ***[**or a fixed base,**]***

in double taxation. In such a situation, the provisions of ~~a~~**A**rticle 23 A or 23 B as appropriate ~~would be~~ **are** applicable, as in other cases of double taxation. In some cases paragraphs 2 and 3 may overlap; they would then produce the same result.

6. During the Ninth Meeting of the **former** Group of Experts held in 1999, there was extensive discussion regarding inclusion of a new paragraph dealing with ~~new~~ financial instruments. Three options were identified. First, the Contracting States could adopt ~~a~~**A**rticle 21 of the United Nations Model Convention with the three paragraphs. Second, the Contracting States could adopt paragraph 3 of ~~a~~**A**rticle 21 but add a reduced rate of tax in respect of income referred to in paragraph 3. Third, the Contracting States could adopt the United Nations Model Convention with the OECD version with paragraphs 1 and 2 only. These alternatives were considered useful in dealing with this subject. It was noted that the application of ~~new~~ financial products is relevant for options 2 and 3.

Optional additional paragraph

7. **The Committee considers that the following part of the OECD Commentary** ~~The following Commentary to Article 21 in the OECD Model Convention~~ is relevant:

> **[7]** ~~“~~Some countries have encountered difficulties in dealing with income arising from certain nontraditional financial instruments when the parties to the instrument have a special relationship. These countries may wish to add the following paragraph to Article 21:
>
> > ~~‘~~[4]. Where, by reason of a special relationship between the person referred to in paragraph 1 and some other person, or between both of them and some third person, the amount of the income referred to in paragraph 1 exceeds the amount (if any) which would have been agreed upon between them in the absence of such a relationship, the

Procedure)~~,~~ and Article 26 (Exchange of Information).~~" [para. 11]~~

~~"The Committee on Fiscal Affairs is actively studying the taxation of non-traditional financial instruments. Further changes to the Model or Commentaries may be necessary. The inclusion of proposed paragraph [4] carries no implication about the treatment of innovative financial transactions between independent persons or under other provisions of the Convention." [para. 12]~~

8. Some members of the **former** Group of Experts pointed out that there are very artificial devices entered into by persons to take advantage of the provisions of ~~a~~**A**rticle 21—especially if paragraph 3 is omitted or provides for only a reduced rate of tax in the source State—through, inter alia, creation or assignment of rights with respect to which income from, e.g., financial instruments arises. While substance over form rules, abuse of rights principles or any similar doctrine could be used to counter such arrangements, Contracting States which may want to address the issue specifically may include a clause on the following lines in their bilateral tax treaties:

~~"The provisions of this aArticle shall not apply if it was the main purpose or~~ one of the main purposes of any person concerned with the creation or assigtnmaa0 9.459wome

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**3. Capital represented by property forming part of the business property of an enterprise the place of effective management of which is situated in a Contracting State, and consisting of ships and aircraft operated by such enterprise in international traffic and of movable property pertaining to the operation of such ships and aircraft shall be taxable only in that State.**

**[5]** ~~“~~As regards elements of capital other than those listed in paragraphs 1 to 3, the ~~a~~**A**rticle provides that they are taxable only in the Contracting State of which the person to whom they belong is a resident (paragraph 4).~~“ [para. 5]~~

**[6]** ~~“~~If, when the provisions of paragraph 4 are applied to elements of movable property under usufruct, double taxation subsists because of the disparity between domestic laws, the States concerned may resort to the mutual agreement procedure or settle the question by means of bilateral negotiations.~~“ [para. 6]~~

**[7]** ~~“~~The Article does not provide any rule about the deductions of debts. The laws of OECD **m**~~M~~ember countries are too different to allow a common solution for such a deduction. The problem of the deduction of debts which could arise when the taxpayer and the creditor are not residents of the same State is dealt with in paragraph 4 of Article 24.~~“ [para. 7]~~

## Commentary on chapter V

## METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

*Article 23*

| |
|---|
| NOTE BY THE SECRETARIAT: CLAUDINE DEVILLET HAS PREPARED A SEPARATE CONFERENCE ROOM PAPER (CRP.2. ADD. 3) ON POTENTIALLY INCLUDING ARTICLE 23A (4) OF THE OECD MODEL IN ARTICLE 23A OF THE UNITED NATIONS MODEL. |

### METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

### A. GENERAL CONSIDERATIONS

1. The United Nations Model Convention **provides** ~~takes the same approach as the OECD Model Convention concerning methods for the elimination of double taxation and therefore reproduces the~~ two alternative versions of Article 23 **for the elimination of double taxation** ~~embodied in that Convention~~, namely ~~a~~**A**rticle 23 A on the exemption method and ~~a~~**A**rticle 23 B on the credit method.

2. The method by which a country gives relief from double taxation depends primarily on its general tax policy and the structure of its tax system. Owing to the differences which exist in the various tax systems, bilateral tax treaties provide the most flexible instrument for reconciling conflicting tax systems and for avoiding or mitigating double taxation.

3. **When the Model was earlier revised,** ~~M~~**m**embers ~~of the Group~~ from developing countries felt that, as regards relief measures to be applied by developed countries, the methods of tax exemption and tax credit could be used as appropriate. The exemption method was considered eminently suitable where exclusive tax jurisdiction over certain income was allotted to the country of source under a

countries or of special tax concessions granted by them may in large part inure to the benefit of the treasury of the capital-exporting country rather than to the foreign investor for whom the benefits were designed. Thus, revenue is shifted from the developing country to the capital-exporting country.

10. On the other hand, some members contended that, theoretically, it could be argued that the effectiveness of the tax incentive measures introduced by many developing countries thus depends, in part, on the interrelationship between the tax systems of the developing countries and those of the capital-exporting countries which use the foreign tax credit system, that their tax incentives are "matched" by means of a "tax-sparing" credit, granted by the developed country. By a "tax-sparing" credit is meant a credit granted in respect of tax not only actually paid, but actually forgone under its incentive legislation.

11 ~~In some 20 years which have elapsed s~~**S**ince the original publication of the United Nations Model Convention, there have been various studies undertaken of the economic justification for adopting fiscal incentives with the objective of stimulating investment. According to ~~these~~ **some** members, these studies have demonstrated that tax factors may not themselves be decisive in the process of investment decisions made by the enterprises and therefore, in their view, tax sparing may not be an appropriate policy. Other factors play a greater role in forming the so-called "investment climate" of any given country, for example, political and economic stability, a judicial system perceived as impartial, the availability of a skilled workforce, and labour laws and social security costs that do not serve as unintended obstacles to the development of enterprise. It has been argued that fiscal incentives undermine the tax base and can lead to the damaging effects of tax incentive competition which then takes place between neighbouring States, as they try to outdo each other's incentives and lend themselves to fiscal manipulation. Moreover, where "matching" credit provisions have been included in tax treaties, there have been examples of the artificial structuring of business transactions in order to take advantage of them, leading both to erosion of the tax base and to an unintended economic distortion in the process of investment decision-making.

12. That said, the reality is that, as a policy matter, countries remain free to adopt those investment incentives that seem to them to be useful or unavoidable, given the pressure resulting from the existence of preferential tax regimes, such as tax-free zones in the other jurisdictions, although, as a matter of observation, there is a tendency in more recent years for these to be more narrowly targeted than formerly. For example, they may be restricted to specific areas of economic activity, or to specific geographical regions; and, instead of being open-ended, they tend to be relatively tightly time-limited. Where developing countries choose to adopt such fiscal incentives, some experts from developing countries consider that they should continue to have, as a treaty negotiating aim, the inclusion of a "matching" or "tax-sparing" provision in treaties with capital exporting countries which have a foreign tax credit system. Studies of ~~recent~~ tax treaties concluded between developed and developing countries show that tax-sparing provisions are still features, although these provisions, in their turn, now show a tendency to be more strictly time-limited than previously. Sometimes, there is a "break" or "sunset" clause, providing for the provision to be terminated after, say, five years, unless the treaty partner States agree to an extension. Where such clauses are included, it is the view of some experts from developing countries that the capital-importing country should provide, both in its domestic tax laws and in its treaties, some protection against a future decision by the treaty partner to refuse to extend the life of

**each State at a time when he is a resident of that State and Article 4 does not deal with the issue as there is no concurrent residence in the two States.**

**4.2 The conflict in that situation will be reduced to that of case *b*) and solved accordingly to the extent that the employment services to which the option relates have been rendered in one of the Contracting States so as to be taxable by that State under Article 15 because it is the State where the relevant employment is exercised. Indeed, in such a case, the State in which the services have been rendered will be the State of source for purposes of elimination of double taxation by the other State. It does not matter that the first State does not levy tax at the same time (see paragraph 32.8). It also does not matter that that State considers that it levies tax as a State of residence as opposed to a State of source (see the last sentence of paragraph 8).**

**4.3 Where, however, the relevant employment services have not been rendered in either State, the conflict will not be one of source-residence double taxation. The mutual agreement procedure could be used to deal with such a case. One possible basis to solve the case would be for the competent authorities of the two States to agree that each State should provide relief as regards the residence-based tax that was levied by the other State on the part of the benefit that relates to services rendered during the period while the employee was a resident of that other State. Thus, in the above example, if the relevant services were rendered in a third State before the person became a resident of State R2, it would be logical for the competent authority of State R2 to agree to provide relief (either through the credit or exemption method) for the State R1 tax that has been levied on the part of the employment benefit that relates to services rendered in the thiriese Tw[J20.55 ee Itbe for(te at whentbe for(u)-7.8**

**14.**—“

| | | |
|---|---|---|
| Tax in State R, 30 % ~~per cent~~ of 80,000 . . . | 24,000 | 24,000 |
| Plus tax in State S | 4,000 | 8,000 |
| Total taxes | 28,000 | 32,000 |
| Relief has been given by State R in the amount of | 11,000 | 11,000 |

~~(~~b) Exemption with progression

261(b) / Or2dinary crA State RmputeAs tax on 2oPcoPme of 100,000 a 2hPe of 22etP 2 2lws 2eeducn 2f tP57.9hx1

**may be taxed by the State of source in accordance with the rovisions of the Convention, it follows that such relief must be provided regardless of when the tax is levied by the State of source. The State of residence must therefore provide relief of double taxation through the credit or exemption method with respect to such item of income or capital even though the State of source taxes it in an earlier or later year. Some States, however, do not follow the wording of Article 23 A or 23 B in their bilateral conventions and link the relief of double taxation that they give under tax conventions to what is provided under their domestic laws. These countries,**

**income and capital which in accordance with the Convention "may be taxed" in the other State E or S.**

**34. The State of residence must accordingly exempt income and capital which may be taxed by the other State in accordance with the Convention whether or not the right to**

**42.** ~~“~~A comparison of the laws and practices of the OECD ~~M~~**m**ember countries shows that the amount to be exempted varies considerably from country to country. The solution adopted by a State will depend on the policy followed by that State and its tax structure. It may be the intention of a State that its residents always enjoy the full benefit of their personal and family allowances and other deductions. In other States these tax free amounts are apportioned. In many States personal or family allowances form part of the progressive scale, are granted as a deduction from tax, or are even unknown, the family status being taken into account by separate tax scales.~~” [para. 42]~~

**43.** ~~“~~In view of the wide variety of fiscal policies and techniques in the different States regarding the determination of tax, especially deductions, allowances and similar benefits, it is preferable not to propose an express and uniform solution in the Convention, but to leave each State free to apply its own legislation and technique. Contracting States which prefer to have special problems solved in their convention are, of course, free to do so in bilateral negotiations. Finally, attention is drawn to the fact that the problem is also of importance for States applying the credit method . . .~~” [para. 43]~~

~~“~~2. Treatment of losses

**44.** Several States in applying Article 23 A treat losses incurred in the other State in the company but

from the diverse opinions of States and the variety of possible solutions. Some States, fearing tax evasion, preferred to maintain their freedom of action and to settle the question only in their domestic laws.~~" [para. 51]~~

**52.** "

~~C. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 23 B~~

## III. Commentary on the provisions of Article 23 B (credit method)

~~18. Since article 23 B of the United Nations Model Convention reproduces Article 23 B of the OECD Model Convention, the Commentary on that Article, quoted below, is fully relevant:~~

~~"~~**Paragraph 1**

A. Methods

**57.** Article 23 B, based on the credit principle, follows the ordinary credit method: the State of residence (R) allows, as a deduction from its own tax on the income or capital of its resident, an amount equal to the tax paid in the other State E (or S) on the income derived from, or capital owned in, that other State E (or S), but the deduction is restricted to the appropriate proportion of its own tax..~~" [para. 57]~~

**58** ~~"~~The ordinary credit method is intended to apply also for a State which follows the exemption method but has to give credit, under paragraph 2 of Article 23 A, for the tax levied at limited rates in the other State on dividends and interest **(see paragraph 47 above)**. The possibility of some modification **as mentioned in paragraphs 47 and 48 above (full credit)** could, of course, also be of relevance in the case of dividends and interest paid to a resident of a State which adopted the ordinary credit method (**see also paragraph 63 below)**." [pah2002 "It is to be noted [6 o) 58ed that Article 23 B applies in a State R only E which is appropriate to the income derived from the State S, or E (so-called 'maximum deduction'). Such maximum deduction may be computed either by apportioning the total tax on total income according to the ratio between the income for which credit is to be given and the total income, or by applying the tax rate for total income to the income for which credit is to be given. In the borrower company, under certain conditions, to treat an interest payment as a distribution of dividends in accordance with its domestic legislation; the essential condition is that the contributor of the loan should effectively share the risks run by the borrower company. This gives rise to two consequences:

— the taxing at source of such ‘interest’ at the rate for dividends (paragraph 2 of Article 10);

— the inclusion of such ‘interest’ in the taxable profits of the lender company.~~” [para. 67]~~

**68.** ~~“~~If the relevant conditions are met, the State of residence of the lender would be obliged to give relief for any juridical or economic double taxation of the interest as if the payment was in fact a dividend. It should then give credit for tax effectively withheld on this interest in the State of residence of the borrower at the rate applicable to dividends and, in addition, if the lender is the parent company of the borrower company, apply to such ‘interest’ any additional relief under its parent/subsidiary regime. This obligation may result:

~~(~~a) from the actual wording of Article 23 of the Convention, when it grants relief in respect of income defined as dividends in Article 10 or of items of income dealt with in Article 10;

~~(~~b) from the context of the Convention, i.e.~~,~~ from a combination of Articles 9, 10, 11, and 23 and~~,~~ if need be, by way of the mutual agreement procedure:

— where the interest has been treated in the country of residence of the borrower company as a dividend under rules which are in accordance with paragraph 1 of Article 9 or paragraph 6 of Article 11 and where the State of residence of the lender agrees that it has been properly so treated and is prepared to apply a corresponding adjustment;

— when the State of residence of the lender applies similar thin capitali~~z~~sation rules and would treat the payment as a dividend in a reciprocal situation, i.e.~~,~~ if the payment were made by a company established in its territory to a resident in the other Contracting State;

— in all other cases where the State of residence of the lender recogni~~z~~ses that it was proper

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~~a State may exempt from tax certain kinds of income, e.g., pensions to war-wounded soldiers.” [para. 72]~~

*c)* the State of residence exempts the income which has benefited from tax incentives in the **State of source** ~~developing country~~. ~~Contracting States are free to devise other formulae in the course of bilateral negotiations." [para 75]~~

**17. Contracting States are free to devise other formulae in the course of bilateral negotiations. The following paragraphs of the OECD Commentary before the 2000 update of that Commentary, are still relevant:**

**17.1** "If a Contracting State agrees to stimulate especially investments in the other State being a developing country, the above provisions will generally be accompanied by guarantees for the investors, that is to say, the convention will limit the rate of tax which can be imposed in the State of source on dividends, interest and royalties." [para. 76]

**17.2** "Moreover, time restrictions or time limits can be provided for the application of the

**Commentary on chapter VI**

## SPECIAL PROVISIONS

*Article 24*

NON-DISCRIMINATION

1. Article 24 of the United Nations Model Convention**, except for reference to a different paragraph of Article 12 in paragraph,** reproduces Article 24 of the OECD Model Convention. **The Committee considers that the following extracts from the Commentary on paragraphs 1 to 4 of Article 24 of the OECD Model Convention ~~(as it read on 22nd July 2010)~~ are applicable to corresponding paragraphs of Article 24 (the additional comments that appear in italics between square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to reflect the differences between the provisions of the OECD Model Convention**

fact. The expression 'in particular with respect to residence' makes clear that the residence of the taxpayer is one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances. The expression 'in the same circumstances' would be sufficient by itself to establish that a taxpayer who is a resident of a Contracting State and one who is not a resident of that State are not in the same circumstances. In fact, whilst the expression 'in particular with respect to residence' did not appear in the 1963 Draft Convention or in the 1977 Model Convention, the Member countries have consistently held, in applying and interpreting the expression 'in the same circumstances', that the residence of the taxpayer must be taken into account. However, in revising the Model Convention, the Committee on Fiscal Affairs felt that a specific reference to the residence of the taxpayers would be a useful clarification as it would benefit which that State and its nationals will derive from those activities.~~" [para. 8]~~

**14.** ~~"~~Furthermore, paragraph 1 has been deliberately framed in a negative form. By providing that the nationals of a Contracting State may not be subjected in the other Contracting

**19. The following examples illustrate these principles.**

**20. Example 1: Under the domestic income tax law of State A, companies incorporated in that State or having their place of effective management in that State are residents thereof. The State A - State B tax convention is identical to this Model Tax Convention. The domestic tax law of State A provides that dividends paid to a company incorporated in that country by another company incorporated in that country are exempt from tax. Since a company incorporated in State B that would have its place of effective management in State A would be a res**

**incorporated in that State are residents of State A and companies incorporated abroad are non-residents. The State A - State B tax convention is identical to this Model Tax Convention except that paragraph 3 of Article 4 provides that if a legal person is a resident of both States under paragraph 1 of that Article, that legal person shall be deemed to be a resident of the State in which it has been incorporated. Under State A's payroll tax law, all companies that employ resident employees are subject to a payroll tax that does not make any distinction based on the residence of the employer but that provides that only companies incorporated in State A shall benefit from a lower rate of payroll tax. In that case, the fact that a company incorporated in State B will not have the same residence as a company incorporated in State A for the purposes of the A-B convention has no relevance at all with respect to the different tax treatment under the payroll tax and that different treatment would therefore be in violation of paragraph 1 absent other relevant different circumstances.**

**24. Example 5: Under the domestic income tax law of State A, companies incorporated in that State or which have their place of effective management in that State are residents of the State and companies that do not meet one of these two conditions are non-residents. Under the domestic income tax law of State B, companies incorporated in that State are residents of that State. The State A - State B tax convention is identical to this Model Tax Convention except that paragraph 3 of Article 4 provides that if a legal person is a resident of both States under paragraph 1 of that Article, that legal person shall be deemed to be a resident only of the State in which it has been incorporated. The domestic tax law of State A further provides that companies that have been incorporated and that have their place of effective management in that State are entitled to consolidate their income for tax purposes if they are part of a group of companies that have common shareholders. Company X, which was incorporated in State B, belongs to the same group as two companies incorporated in State A and all these companies are effectively managed in State A. Since it was not incorporated in State A, company X is not allowed to consolidate its income with that of the two other companies.**

**25. In that case, even if company X is a resident of State A under the domestic law of that State, it is not a resident of State A for purposes of the Convention by virtue of paragraph 3 of Article 4. It will therefore not be in the same circumstances as the other companies of the group as regards residence and paragraph 1 will not allow it to obtain the benefits of consolidation even if the different treatment results from the fact that**

are in one of the situations enumerated in paragraph 2 of ~~a~~**A**rticle 1 of the above-mentioned Convention of 28~~ th~~ September~~,~~ 1954, are not covered by that Convention. This is mainly the case, on the one hand, of persons receiving at the time of signature of that Convention, protection or assistance from organs or agencies of the United Nations other than the United Nations High persons differently, for practical reasons, from resident persons, as long as this does not result in more burdensome taxation for the former than for the latter. In the negative form in which the provision concerned has been framed, it is the result alone which counts, it being permissible to adapt the mode of taxation to the particular circumstances in which the taxation is levied.

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advantages attaching to activities the exercise of which is strictly reserved, on grounds of national interest, defence, protection of the national economy, etc., to domestic enterprises, since non-resident enterprises are not allowed to engage in such activities.~~” [para. 28]~~

**47. Finally, the provisions of paragraph 3 should not be construed as obliging a State which accords special taxation privileges to non-profit institutions whose activities are performed for purposes of public benefit that are specific to that State, to extend the same privileges to permanent establishments of similar institutions of the other State whose activities are not exclusively for the first-mentioned State’s public benefit.**

“B. Special treatment of dividends received in respect of holdings owned by permanent establishments

**48.** In many countries special rules exist for the taxation of dividends distributed between companies (parent company subsidiary treatment, the ‘*Schachtelprivileg*’, the rule ‘*non bis in idem*’). The question arises whether such treatment, should by effect of the provisions of paragraph 3, also be enjoyed by permanent establishments in respect of dividends on holdings

~~to permanent establishments urge that as the essential feature of this system is a special technique of taxing profits which enterprises in a corporate form derive from their activities, and is designed to afford immediate relief from the double taxation levied on the profits distributed, it should be applied to permanent establishments in bilateral conventions against double taxation. It is generally recognizsed that, by the effects of their provisions, such conventions necessarily result in some integration of the taxation systems of the Contracting States. On this account, it is perfectly conceivable that profits made in a State (A) by a permanent establishment of a company resident in another State (B) should be taxed in State A according to the split rate system. As a practical rule, the tax could in such case be calculated at~~

~~paragraph 35 of the Commentary on Article 7.).” [para. 44]~~

**63.** According to the respective Commentaries on the above-mentioned provisions of Articles 10, 11 and 12 **[...]** these provisions dispense the State of source of the dividends, interest or royalties received by the permanent establishment from applying any limitation provided for in those Articles, which means—and this is the generally accepted interpretation—that they leave completely unaffected the right of the State of source, where the permanent establishment is situated, to apply its withholding tax at the full rate.”

**70.**

~~paragraph 4 (referring to paragraph 1 of Article 9 and paragraph 6 of Article 11) takes precedence over this paragraph in relation to the deduction of interest." [para. 58]~~

**77. Since the paragraph relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital, it follows that it cannot be interpreted to extend the benefits of rules that take account of the relationship between a resident enterprise and other resident enterprises (*e.g.* rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership). For example, if the domestic tax law of one State allows a resident company to consolidate its income with that of a resident parent company, paragraph 5 cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company. This would require comparing the combined treatment of a resident enterprise and the non-resident that owns its capital with that of a resident enterprise of the same State and the resident that owns its capital, something that clearly goes beyond the taxation of the resident enterprise alone.**

**78. Also, because paragraph 5 is aimed at ensuring that all resident companies are treated equally regardless of who owns or control their capital and does not seek to ensure that distributions to residents and non-residents are treated in the same way (see paragraph 76 above), it follows that withholding tax obligations that are imposed on a resident company with respect to dividends paid to non-resident shareholders but not with respect to dividends paid to resident shareholders cannot be considered to violate paragraph 5. In that case, the different treatment is not dependent on the fact that the capital of the company is owned or controlled by non-residents but, rather, on the fact that dividends paid to non-residents are taxed differently. A similar example would be that of a State that levies a tax on resident companies that make distributions to their shareholders regardless of whether or not they are residents or non-residents, but which, in order to avoid a multiple application of that tax, would not apply it to distributions made to related resident companies that are themselves subject to the tax upon their own distributions. The fact that the latter exemption would not apply to distributions to non-resident companies should not be considered to violate paragraph 5. In that case, it is not because the capital of the resident company is owned or controlled by non-residents that it is treated differently; it is because it makes distributions to companies that, under the provisions of the treaty, cannot be subjected to the same tax when they re-distribute the**

**enterprise, provided that the treatment would be the same if the interest had been paid to a non-resident associated enterprise that did not itself own or control any of the capital of the payer. Clearly, however, such a domestic law rule could be in violation of paragraph 4 to the extent that different conditions would apply for the deduction of interest paid to residents and non-residents and it will therefore be important to determine, for purposes of that paragraph, whether the application of the rule is compatible with the provisions of**

certain paragraphs of that ~~a~~**A**rticle in bilateral negotiations. It was suggested for example that, because of

**provision of information by one Contracting State whether or not information is also being provided at that time by the other Contracting State.**

**5.1. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State should provide information under ~~a~~Article 26 in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts or writings), to the extent feasible. Under paragraph 3, the requested State may decline to provide the information in the specific form requested if, for instance, the requested form is not known or permitted under its law or administrative practice. A refusal to provide the information in the form requested does not affect the obligation to provide the information.**

**5.2. Contracting States may wish to use electronic or other communication and information technologies, including appropriate security systems, to improve the timeliness and quality of exchanges of information. Indeed, the Contracting States may be obligated to provide requested information in electronic form if such action is necessary for an effective exchange of information. Contracting States which are required, according to their law, to observe data protection laws may wish to include provisions in their bilateral conventions concerning the protection of personal data exchanged. Data protection concerns the rights and fundamental freedoms of an individual, and in particular, the right to privacy, with regard to automatic processing of personal data. In no event is a Contracting State relieved of its obligation to exchange information simply because its domestic laws do not allow it to provide the information in the form requested.**

**5.3. The scope of exchange of information covers all tax matters without prejudice to the general rules and legal provisions governing the rights of defendants and witnesses in judicial proceedings. Exchange of information for criminal tax matters can also be based on bilateral or multilateral treaties on mutual legal assistance (to the extent that they also apply to tax crimes).**

**5.4. Article 26 provides in paragraph 6 that "the competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made". This language authorizes the competent authorities to exchange information in at least three modes: exchange by specific request, automatic exchange, and other exchanges, understood to include spontaneous exchanges.**

**5.5. Nothing in the United Nations Model Convention prevents the application of the provisions of ~~a~~Article 26 to the exchange of information that existed prior to the entry into force of the Convention, as long as the assistance with respect to this information is provided after the Convention has entered into force and the provisions of the article have become effective. Contracting States may find it useful, however, to clarify the extent to which the provisions of the article are applicable to such information, in particular when the provisions of that Convention will have effect with respect to taxes arising or levied from a certain time.**

**6. The Committee of Experts has suggested some guidelines for arrangements regarding the implementation of appropriate exchanges of information. (See E/C.18/2008/3/Add.1, sect. C.) Those guidelines are in the form of an inventory of options available to the competent authorities. The inventory is not intended to be exhaustive or to impose any procedural obligations on a Contracting State. Instead, the inventory is a listing of suggestions to be**

**information might be limited to taxes covered by the Convention, plus one or two important taxes, such as the value added tax (VAT). To accomplish that outcome, the following language might be substituted for paragraph 1:**

> **"1. The competent authorities of the Contracting States shall exchange such information Sta '9trac.(36.3(p)3-7./-945((h)-7.8(e )6.4(obliga9trac(ies o)on(e )6.Cthe Coo)5.7(isi6.9deBTqu7( )J(h)-2.3(es 2.7d9(n)56.2(ge**

**company located in State C. State B may request that State A provide it with information about the profits and expenses of the company located in State C. Domestic law of State A obliges the parent company to keep records of transactions of its foreign subsidiaries.**

***Paragraph* 2**

**11. A Contracting State cannot be expected to provide confidential financial information to another Contracting State unless it has confidence that the information will not be disclosed to unauthorized persons. To provide the assurance of secrecy required for effective information exchange, paragraph 2 provides that information communicated under the provisions of the Convention shall be treated as secret in the receiving State in the same manner as information obtained under the domestic laws of that State. Sanctions for the violation of such secrecy in that State will be governed by the administrative and penal laws of that State.**

**12. Of course, the information received under ~~a~~Article 26 would be useless, or nearly so, to**

**Paragraph 3 (a) does not remove the obligation to provide information relating to taxes that the requested State does not impose. For instance, a requested State cannot avoid its obligation to provide information helpful to the requesting State in the enforcement of its value added tax merely because the requested State does not have a value added tax. Of course, the requested State may avoid the obligation to supply such information if it cannot obtain that information under its normal administrative procedures, within the meaning of paragraph 3 (b).**

**16.3. The purpose of paragraph 3 (a) is to avoid traps for the unwary, not to create such traps. A Contracting State that believes that it is not required to obtain certain types of information on behalf of the other Contracting State because of its own laws or administrative practice (including the laws and administrative practice of its subnational governments) should disclose that position in writing prior to entering into a convention containing ~~a~~Article 26. It should also disclose the likely effects of that position on its ability to provide an effective exchange of information. For instance, if a Contracting State believes that one of its laws prevents it from providing the other Contracting State with information as to the beneficial owners of its resident companies or other juridical persons, it should give written notice of that position during the negotiation of the convention, with an explanation of the impact of that law on its obligations in relation to mutual assistance. Depending on the facts and circumstances of the particular case, a failure to disclose may eliminate the right of a Contracting State to invoke paragraph 3 (a) to avoid its obligations under paragraph 1.**

**16.4. A Contracting State that changes its laws or administrative practice after entering into a convention containing paragraph 3 (a) must disclose that change to the other Contracting State in timely fashion. Depending on the facts and circumstances of the case, such a change may constitute a material breach of the convention. In any event, a failure to provide timely notice of**

**17.1. A Contracting State that under its domestic law is required to notify the person who provided the information and/or the taxpayer that an exchange of information is proposed should inform its treaty partners in writing that it has this requirement and what the consequences are for its obligations in relation to mutual assistance. Such information should be provided to the other Contracting State before a convention is concluded and thereafter whenever the relevant rules are modified. Depending on the facts and circumstances of the particular case, a failure to disclose may eliminate the right of a Contracting State to invoke paragraph 3 (a) to avoid its obligations under paragraph 1.**

**18. In general, the requested State is not obligated to carry out administrative measures on behalf of the requesting State that are not permitted under the laws or administrative practice of the requesting State. The purpose of this rule is to prevent a requesting State from using the administrative measures of the requested State to avoid limitations imposed on the requesting**

**procedure of tax determination, which may include special investigations or special examination of the business accounts kept by the taxpayer or other persons. For instance, if the requested State, as part of its audit policies, obtains information about the appropriateness of the transfer prices used by its taxpayers in dealings with associated companies, it is deemed to be able to**

**afforded under domestic law to confidential communications may differ among States, the protection provided under paragraph 3 (c) does not extend so broadly so as to hamper the effective exchange of information.**

**21.2. Notwithstanding the provisions of domestic law in the requested State, that State may decline to supply requested communications between attorneys, solicitors or other admitted legal representatives and their clients only if, and to the extent that, such representatives act in their capacity as attorneys, solicitors or other admitted legal representatives and not in a different capacity, such as nominee shareholders, trustees, settlors, company directors, or accountants, or under a power of attorney to represent a company in its business affairs. More specifically, the communication must have been produced in good faith for the purpose of seeking or providing legal advice or for use in existing or contemplated legal proceedings.**

**21.3. In no event may a requested State decline to disclose communications between attorneys, solicitors or other admitted legal representati**

**disclosure because it contains protected secret information may be disclosed if the secret information is removed.**

**22.3. Financial information, including books and records, does not by its nature constitute a trade, business or other secret. In certain limited cases, however, the disclosure of financial information might reveal a trade, business or other secret. For instance, a request for information on certain purchase records may raise such an issue if the disclosure of such information would reveal the proprietary formula used in the manufacture of a product. The protection of such information may also extend to information in the possession of third persons. For instance, a bank might hold a pending patent application for safe keeping, or a secret trade process or formula might be described in a loan application or in a contract held by a bank. In such circumstances, details of the trade, business or other secret should be excised from the**

*Paragraph 4*

**26. Paragraph 4 was added to the United Nations Model Convention in 20~~08~~11. It is taken directly from the comparable provision ~~added to~~ in the OECD Model Convention~~ in 2005~~. As a result, the OECD commentary to paragraph 4 is fully applicable in interpreting paragraph 4 of ~~a~~Article 26. The position taken in the OECD commentary is that the addition of this paragraph was intended to assist in the interpretation of ~~a~~Article 26 and does not result in a substantive change in the obligations implicit in the prior version of ~~a~~Aticle 26.**

**used to prevent the exchange of information held by banks, other financial institutions, nominees, agents and fiduciaries, as well as ownership information.**

**27.2. Paragraph 5 states that a requested State shall not decline to supply information to a requesting State solely because the information requested is held by a bank or other financial institution. Thus, paragraph 5 overrides paragraph 3 to the extent that paragraph 3 would otherwise permit a requested Contracting State to decline to supply information on grounds of domestic bank secrecy laws. Access to information held by banks or other financial institutions may be by direct means or indirectly through a judicial or administrative process. The procedure for indirect access should not be so burdensome and time-consuming as to act as an impediment to access to bank information.**

**27.7. Contracting States wishing to refer expressly to the protection afforded to confidential communications between a client and an attorney, solicitor or other admitted legal representative may do so by adding the following text at the end of paragraph 5: "Nothing in the above sentence shall prevent a Contracting State from declining to obtain or provide information which would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative where such communications are protected from disclosure under paragraph 3 (b) and when the claim for protection under that paragraph is unrelated to the status of the legal representative as an agent, fiduciary, or nominee."**

**28. The following examples illustrate the application of paragraph 5:**

**(a) Company X owns a majority of the stock in a subsidiary company Y, and both companies are incorporated under the laws of State A. State B is conducting a tax examination of business operations of company Y in State B. In the course of this examination the question of both direct and indirect ownership in company Y becomes relevant, and State B makes a request to State A for ownership information of any person in company Y's chain of ownership. In its**

7. *Regular sources of income*. The items covered under a routine transmittal or exchange of information may extend to regular sources of income flowing between countries, such as dividends, interest, compensation (including wages, salaries, fees and commissions), royalties, rents and other possible items whose regular flow between the two countries is significant. It should be recognized that at present a few countries are not in a position to supply routine information of this type because their tax collection procedures do not provide the needed data.

*Transactions involving taxpayer activity*. A routine exchange of information may cover certain significant transactions involving taxpayer activity**:**

*(a)* Transactions relevant to the treaty itself:

**(i)** Claims for refund of transmitting country tax made by residents of receiving country;

**(ii)** Claims for exemption or particular relief from transmitting country tax made by residents of receiving country;

*(b)* Transactions relevant to special aspects of the legislation of the transmitting country: ~~I~~items of income derived by residents of the receiving country that receive exemption or partial relief under special provisions of the national law of the transmitting country;

*(c)* Transactions relating to activities in the transmitting country of residents of the receiving country:

**(i)** Opening and closing by receiving country residents of a branch, office**,** etc. in the transmitting country;

**(ii)** Creation or termination by receiving country residents of a corporation in the transmitting country;

**(iii)** Creation or termination by receiving country residents of a trust in the transmitting country;

**(iv)** Opening and closing by receiving country residents of bank accounts in the transmitting country;

**(v)** Property in the transmitting country acquired by residents of the receiving country by inheritance, bequest or gift;

**(vi)** Ancillary probate proceedings in the transmitting country concerning receiving country residents;

*(d)* General information:

**(i)** Tax laws, administrative procedures**,** etc. of the transmitting country;

**(ii)**

associate such information with its own taxpayers, either routinely or on a sufficient scale to justify the routine receipt of the information.

*Transmittal on specific request*

12. A method of exchange of information that is in current use is that of a request for specific information made by one treaty country to another. The specific information may relate to a particular taxpayer and certain facets of his situation, or to particular types of transactions or activities, or to information of a more general character. The following are various aspects of the question that the competent authorities should focus on in developing a structure for such exchange of information pursuant to specific requests.

*Items covered*

13. *Particular taxpayers.* The information that may be desired from a transmitting country with respect to a receiving country taxpayer is essentially open-ended and depends on the factors involved in the situation of the taxpayer under the tax system of the receiving country and the relationship of the taxpayer and his activities to the transmitting country. A specific enumeration in advance of the type of information that may be within the scope of an exchange pursuant to specific request does not seem to be a fruitful or necessary task. The agreement to provide information pursuant to specific request may, thus, be open-ended as to the range, scope and type of information, subject to the overall constraints to be discussed herein.

14. The request for specific information may arise in a variety of ways. For example:

(*a*) Information needed to complete the determination of a taxpayer's liability in the receiving country when that liability depends on the taxpayer's worldwide income or assets; the nature of the stock ownership in the transmitting country of the receiving country corporation; the amount or type of expense incurred in the transmitting country; and the fiscal domicile of an individual or corporation;

(*b*) Information needed to determine the accuracy of a taxpayer's tax return to the tax

15. *Economic relationships between the countries.* The specific request may extend to requests for information regarding certain economic relationships between the countries which may be useful to a country as a check on the effectiveness of its tax administration activities, for example:

(*a*) The volume of exports from the transmitting country to the receiving country;

(*b*) The volume of imports into the transmitting country from the receiving country;

(*c*) Names of banks dealing in the transmitting country with branches, subsidiaries etc. of residents of the receiving country.

It should be noted that since items in this category, such as the volume of exports between the countries, are presumably not regarded as secret to thein.9(s)9.3( )-60005 x a.3(tri6.1(e)-5..3(io).7 )-66.1(e)-tetrae7t.7(s)9.nivuty0001 -T*[()9 provisions.

18. The competent authorities will have to determine, under the standards governing the exchange of information developed pursuant to the treaty, whether it is the duty of a transmitting country affirmatively to develop a procedure and guidelines governing when such information is to be transmitted, whether such transmittal is to be considered by the transmitting country but is fully discretionary, or

authorities will have to consider how to provide for a transmittal that meets this need. (See also the comment on documents in the section above dealing with rules applicable to the specific request.)

*Consultation among several competent authorities*

22. Countries may wish to give consideration to procedures developed by the competent authorities for consultations covering more than the two competent authorities under a particular treaty. Thus, if countries A, B and C are joined in a network of treaties, the competent authorities of A, B and C might desire to hold a joint consultation. **A joint meeting** ~~This~~ could be desired whether **or not** all three countries are directly intertwined **by their treaty network. For** ~~for~~

such coordination is otherwise appropriate;

(*c*) Some countries may decide it is appropriate to have a tax official of one country participate

consultation between the competent authorities. Such consultation should extend both to particular situations and problems and to periodic review of the operations under the exchange of information provision. The periodic review should ensure that the process of exchange of information is working with the requisite promptness and efficiency, that it is meeting the basic requirements of treaty implementation and that it is promoting adequate compliance with treaty provisions and the national laws of the two countries.

NOTE BY THE SECRETARIAT: THE NEW COMMENTARY ON ARTICLE 27

**whether, for constitutional or other reasons, the taxes to which the Article applies should be limited.**

**whether there should be a limit of time after which a request for assistance could no longer be made as regards a particular revenue claim;**

**what should be the applicable exchange rate when a revenue claim is collected in a currency that differs from the one which is used in the requesting State;**

**how should any amount collected pursuant to a request under paragraph 3 be remitted to the requesting State; or**

**whether there should be minimum threshold below which assistance will not be provided.**

***Paragraph 2***

**10. Paragraph 2 defines the term "revenue claim" for the purposes of the Article. The definition applies to any amount owed in respect of all taxes that are imposed on behalf of the Contracting States, or of their political subdivisions or local a**

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**Article ~~27~~28**

**MEMBERS OF DIPLOMATIC MISSIONS AND CONSULAR POSTS**

Article ~~27~~**28**

State if they are only subject to a limited taxation in that State . . . This consideration also holds true of the international organi~~z~~sations established in a Contracting State and their officials as current year, others on