geographically. Subject to this proviso, a building site forms a single unit even if the orders have been placed by several persons (e.g. for a row of houses). *[rest of the paragraph is moved to paragraph 18.1]*

18.1

the general contractor on the building project. The subcontractor himself has a

contractors on a project-by-project basis. However, requiring enterprises, even large enterprises with multiple projects, to keep records with regard to the countries in which their employees and independent contractors are working does not appear to be unduly onerous or unreasonable especially in light of technological advances. However, for countries that are concerned about the uncertainty involved in adding together unrelated

Changes to paragraph 4 of Article 5 of the United Nations Model Convention

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

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

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

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

(*d*) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(*e*) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity ~~of a preparatory or auxiliary character.~~***;***

(*f*) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (*a*) to (*e*), ~~provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.~~**,**

provided that such activity or, in the case of subparagraph (f), the overall activity of the fixed place of business, is of a preparatory of auxiliary character.

Proposed change to United Nations Model Convention Commentary

16. ***In 2017, the Committee agreed to include in the update to the United Nations Model Convention, an amended paragraph 4 of Article 5. The changes made were based on the recommendations of the OECD/G20 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). Paragraph 4 was modified so that all of the activities covered by in paragraph 4 are subject to the condition that they are preparatory and auxiliary.***

17. ~~This paragraph reproduces Article 5, paragraph 4 of the OECD Model Convention with one substantive amendment~~: ***The new paragraph 4 of Article 5 in the United Nations Model Tax Convention still omits the reference to*** ~~the deletion of~~ "delivery" in subparagraphs (*a*) and (*b*).

paragraph 1 are met, be a permanent establishment.

17.1 In view of the similarities to ***that recommended text***~~the OECD Model Convention~~ provision and the general relevance of its Commentary, the general principles of Article 5,

~~such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery~~. ***This subparagraph is irrelevant in cases where a stock of goods or merchandise belonging to an enterprise is maintained by another person in facilities operated by that other person and the enterprise does not have the facilities at its disposal as the place where the stock is maintained cannot therefore be a permanent establishment of that enterprise. Where, for example, an ~~independent~~ logistics company operates a warehouse in State S and continuously stores in that warehouse goods or merchandise belonging to an enterprise of State R to which the logistics company is not closely related, the warehouse does not constitute a fixed place of business at the disposal of the enterprise of State R and subparagraph b) is therefore irrelevant. Where, however, that enterprise is allowed unlimited access to a separate part of the warehouse for the purpose of inspecting and maintaining the goods or merchandise stored therein, subparagraph b) is applicable and the question***

State S. The employees who work at that office are experienced buyers who have special knowledge of this type of product and who visit producers in State S, determine the type/quality of the products according to international standards (which is a difficult process requiring special skills and knowledge) and enter into different types of contracts (spot or forward) for the acquisition of the products by RCO. In this example, although the only activity performed through the office is the purchasing of products for RCO, which is an activity covered by subparagraph d), paragraph 4 does not apply and the office therefore constitutes a permanent establishment because that purchasing function forms an essential and significant

.

Example 2: RCO, a company resident of State R which operates a number of large discount stores, maintains an office in State S during a two-year period for the purposes of researching the local market and lobbying the government for changes that would allow RCO to establish stores in State S. During that period, employees of RCO occasionally purchase supplies for their office. In this example, paragraph 4 applies because subparagraph f) applies to the activities performed through the office (since subparagraphs d) and e) would apply to the purchasing, researching and lobbying activities if each of these was the only activity performed at the office) and the overall activity of the office has a preparatory character.

~~25. A permanent establishment could also be constituted if an enterprise maintains a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers where, in addition, it maintains or repairs such machinery, as this goes beyond the pure delivery mentioned in subparagraph *a*) of paragraph 4. Since these after-sale organisations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones. Subparagraph *e*) applies only if the activity of the fixed place of business is limited to a preparatory or auxiliary one. This would not be the case where, for example, the fixed place of business does not only give information but also furnishes plans etc. specially developed for the purposes of the individual customer. Nor would it be the case if a research establishment were to concern itself with manufacture.~~

~~26. Moreover, subparagraph *e*) makes it clear that the activities of the fixed place of business must be carried on for the enterprise. A fixed place of business which renders services not only to its enterprise but also directly to other enterprises, for example to other companies of a group to which the company owning the fixed place belongs,~~ would not fall within the scope of subparagraph *e*

~~preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words "provided" to "character" in subparagraph *f).*~~

27.1 ***Unless the anti-fragmentation provisions of paragraph 4.1 are applicable (see below),*** ~~S~~***s***ubparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) ~~provided that they are separated from each other locally and organisationally,~~ as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. ~~Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.~~

28. The fixed places of business ~~mentioned in~~***to which*** paragraph 4 ***applies do not*** ~~cannot be deemed to~~ constitute permanent establishments so long as ~~their~~***the business*** activities ***performed through those fixed places of business*** are restricted to the ***activities referred to in that paragraph*** functions whi aux( )] aof to in th-18(y)20(21(inquisma)

(e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.

(f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

19.2. Under this alternative formulation as under paragraph 4 as it read before 2017, a fixed place of business is deemed not to constitute a permanent establishment if the only activities carried on at that place are activities to which one of the subparagraphs a) to d) apply.

20. As noted above, the United Nations Model Convention, in contrast to the OECD Model Convention, does not refer to "delivery" in subparagraphs (*a*) or (*b*). The question

Article 5, paragraph 4.1: new anti-fragmentation rule

Summary

At the twelfth meeting the Committee discussed a proposal to add an anti-fragmentation rule immediately following paragraph 4 of Article 5, paragraph 4 as a new paragraph 4. The main idea in paragraph 4.1 is to prevent fragmentation of activities by an enterprise or a closely related enterprise to come within the specific activity exemptions and thereby avoid the existence of a permanent establishment of the enterprise.

This new provision uses the concept of a "closely related enterprise" which is defined in a proposed amendment to paragraph 7 under the proposal relating to dependent agent permanent establishments in Article 5, paragraphs 5 and 7.

Proposed addition of Article 5, paragraph 4.1 to the United Nations Model Convention

4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and

(a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

(b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

Proposed change to United Nations Model Convention Commentary

Paragraph 4.1

21.1 In 2017 the Committee decided to adopt a new paragraph 4.1 in Article 5. The new paragraph 4.1 is an anti-fragmentation rule that was recommended for the OECD Model Tax Convention in the OECD/G20 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). The purpose of this new paragraph is to prevent an enterprise from fragmenting its activities either within the enterprise or between closely related enterprises in order to qualify for the specific activity exemptions in paragraph 4 of Article 5. The Final Report also includes new Commentary to provide guidance on the application of paragraph 4.1 to situations where an enterprise or a group of closely related enterprises attempt to circumvent the preparatory or auxiliary activity rule in paragraph 4 by fragmenting a cohesive business operation into several small operations. The new OECD Commentary states:

Article 5, paragraph 5

OPTION 1

Proposed change to Article 5, paragraph 5 of the United Nations Model Convention

5. Notwithstanding the provisions of paragraphs 1 and 2 ***but subject to the provisions of paragraph 7***, where a person ~~other than an agent of an independent status to whom paragraph 7 applies~~ is acting in a Contracting State on behalf of an enterprise ~~of the other Contracting State~~, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

~~Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise,~~ ***habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are***

(i) in the name of the enterprise, or
(ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
(iii) for the provision of services by that enterprise,

unless the activities of such g[illegible]t

enterprise, the offer made by a third party to enter into a standard contract with that enterprise. Also, a contract may, under the relevant law, be concluded in a State even if that contract is signed outside that State; where, for example, the conclusion of a contract results from the acceptance, by a person acting on behalf of an enterprise, of an offer to enter into a contract made by a third party, it does not matter that the contract is signed outside that State. In addition, a person who negotiates in a State all elements and details of a contract in a way binding on the enterprise can be said to conclude the contract in that State even if that contract is signed by another person outside that State.

32.5
contracts that are routinely concluded without material modification by the

from the actions that the person performs in a Contracting State on behalf of the enterprise even though, under the relevant law, the contract is not concluded by that

32.10
restrict the application of the subparagraph to contracts that are literally in the name of the enterprise; it may apply, for example, to certain situations where the name of the enterprise is undisclosed in a written contract.

32.11 The crucial condition for the application of subparagraphs b) and c) is that the person who habitually concludes the contracts, or habitually plays the principal role leading to the conclusion of the contracts that are routinely concluded without material modification by the enterprise, is acting on behalf of an enterprise in such a way that the parts of the contracts that relate to the transfer of the ownership or use of property, or the provision of services, will be performed by the enterprise as

32.12 For the purposes of subparagraph b), it does not matter whether or not the relevant property existed or was owned by the enterprise at the time of the conclusion of the contracts between the person who acts for the enterprise and the third parties. For example, a person acting on behalf of an enterprise might well sell property that the enterprise will subsequently produce before delivering it directly to

intangible property.

32.13 The cases to which paragraph 5 applies must be distinguished from situations where a person concludes contracts on its own behalf and, in order to perform the

determined on the basis of the commercial realities of the situation. A person who is

resident (whether or not by the enterprise itself or by its dependent agents) and have contributed to the sale of such goods or merchandise, a permanent establishment may exist.[2]

Article 5, paragraph 7

Both options for Article 5, paragraph 5 would require the same change to paragraph 7

Proposed change to Article 5, paragraph 7 of the United Nations Model Convention

7. ~~An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.~~

(a)

38.1 ***I***t should be noted that***, where the last sentence of subparagraph a) of***

aspects of the insurance business. The OECD Model Convention nevertheless discusses the possibility of such a provision in bilateral tax treaties in the following terms:

> 39. According to the definition of the term “permanent establishment” an insurance company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on

attribution of profits, some countries may instead prefer to include in Article 7 a provision which provides the source country with the right to tax insurance businesses without deeming a permanent establishment to exist. Some countries may prefer to include a maximum rate of taxation permitted in the source country, with the rate to be determined in bilateral negotiations.

> ***[]. Notwithstanding the other provisions of this Article, an enterprise of a Contracting State that derives profits from any form of insurance, in the form of collecting premiums or insuring risks in the other Contracting State, may be taxed on such profits in that other Contracting State. However, the tax in the other Contracting State may not exceed ___ percent of the premiums collected.***

operate without the need for tax treaties. Whilst these domestic provisions will likely address most forms of residence-source juridical double taxation, they will not cover all cases of double taxation, especially if there are significant differences in the source rules of the two States or if the domestic law of these States does not allow for unilateral relief of economic double taxation (e.g. in the case of a transfer pricing adjustment made in another State).

15.4 Another tax policy consideration that is relevant to the conclusion of a tax treaty is the risk of excessive taxation that may result from high withholding taxes in the source State. Whilst mechanisms for the relief of double taxation will normally ensure that such high withholding taxes do not result in double taxation, to the extent that such taxes levied in the State of source exceed the amount of tax normally levied on profits in the State of residence, they may have a detrimental effect on cross-border trade and investment.

15.5 Further tax considerations that should be taken into account when considering entering into a tax treaty include the various features of tax treaties that encourage and foster economic ties between countries, such as the protection from discriminatory tax treatment of foreign investment that is offered by the non-discrimination rules of Article 24, the greater certainty of tax treatment for taxpayers who are entitled to benefit from the treaty and the fact that tax treaties provide, through the mutual agreement procedure, together with the possibility for Contracting States of moving to arbitration, a mechanism for the resolution of cross-border tax disputes.

15.6 An important objective of tax treaties being the prevention of tax avoidance and evasion, States should also consider whether their prospective treaty partners are willing and able to implement effectively the provisions of tax treaties concerning administrative assistance, such as the ability to exchange tax information, this being a key aspect that should be taken into account when deciding whether y Tr-11(icM09(p161(tr)4(()-3(d)] TJ)-159(th

~~A new version of Article 26 that confirms and clarifies the importance of exchange of information under the United Nations Model Convention, along the lines of the~~

which is based on a similar provision included in the US model . The intent of the saving clause is to put at rest the argument that some provisions aimed at the taxation of non-

residents. While such interpretations have been rejected, the Committee considers that a saving clause in the United Nations Model Convention puts the matter beyond doubt.

107. The OECD Commentary on the issue reads as follows:

> ***26.17 Whilst some provisions of the Convention (e.g. Articles 23 A and 23 B) are clearly intended to affect how a Contracting State taxes its own residents, the object of the majority of the provisions of the Convention is to restrict the right of a Contracting State to tax the residents of the other Contracting State. In some limited cases, however, it has been argued that some provisions could be interpreted***
>
> ***was not intended (see, for example, paragraph 23 above, which addresses the case of controlled foreign companies provisions).***
>
> ***26.18 Paragraph 3 confirms the general principle that the Convention does not***
>
> ***intended and lists the provisions with respect to w***

ect how a Contracting State taxes an individual who is resident of that State if that individual derives income in respect of services rendered to the other Contracting State or a political subdivision or local authority thereof.

ffect how a Contracting State taxes an individual who is resident of that State if that individual is also a student who meets the conditions of that Article.

relief of double taxation to its residents with respect to the income that the other State may tax in accordance with the Convention (including profits that are attributable to a permanent establishment situated in the other Contracting State in accordance with paragraph 2 of Article 7).

certain discriminatory taxation practices by that State (such as rules that discriminate between two persons based on their nationality).

s 25 A and 25 B, which allows residents of a Contracting State to request that the competent authority of that State consider cases of taxation not in accordance with the Convention.

individual who is resident of that State when that individual is a

26.20 The list of exceptions included in paragraph 3 should include any other provision that the Contracting States may agree to include in their bilateral convention where it is intended that this provision should affect the taxation, by a Contracting State, of its own residents. For instance, if the Contracting States agree, in accordance with paragraph 27 of the Commentary on Article 18, to include in their bilateral convention a provision according to which pensions and other payments made under the social security legislation of a Contracting State shall be taxable only in that State, they should include a reference to that provision in the list of exceptions included in paragraph 3.

is defined in Article 4. Where, under paragraph 1 of Article 4, a person is considered to be a resident of both Contracting States based on the domestic laws of these States, paragraphs 2 and 3 of that Article determine a single State of residence for the purposes of the Convention. Thus, paragraph 3 does not apply to an individual or legal person who is a resident of one of the Contracting States under the laws of that State but who, for the purposes of the Convention, is deemed to be a resident only of the other Contracting State.

Article 23: saving clause

Comment

Proposed change to Article 23 B, paragraph 1 of the United Nations Model Convention

1. Where a resident of a Contracting State derives income or owns capital which ***may be taxed in the other Contracting State***, in accordance with the provisions of this Convention ***(except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State)***, ~~may be taxed in the other Contracting State,~~ the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State; and as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State. Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

Proposed change to United Nations Model Convention Commentary

14. The following extracts from the Commentary on Article 23 A and 23 B of the OECD Model Convention are applicable to Articles 23 A and 23 B (the additional comments that appear 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 and those of this Model and also to specify the applicable paragraph/subparagraph of this Model):

[…]

11.1 In some cases, the same income or capital may be taxed by each Contracting State as income or capital of one of its residents. This may happen where, for example, one of the Contracting States taxes the worldwide income of an entity that is a resident of that State whereas the other State views that entity as fiscally transparent and taxes the members of that entity who are residents of that ***(except to the extent that these provisions allow taxation by that other State solely because the levied exclusively on the basis of the residence of the taxpayer and that each State is therefore only obliged to provide relief of double taxation to the extent that taxation by the other State is in accordance with provisions of the Convention that allow taxation of the relevant income as the State of source or as a State where there is a permanent establishment to which that income is attributable, thereby excluding taxation that would solely be the result of the residence of a person in that other State. Whilst this result would logically follow from the wording of Articles 23 A and 23 B even in the absence of that phrase, the addition of the phrase removes any doubt in this respect.***

11.2 The principles put forward in the preceding paragraph are illustrated by the following examples:

Example A: An entity established in State R constitutes a resident of State R and is therefore taxed on its worldwide income in that State. State S treats that entity as fiscally transparent and taxes the members of the entity on their respective share of the income derived through the entity. All the members of the entity are residents of State S. All the income of the entity constitutes business profits attributable to a permanent establishment situated in State R. In that case, in determining the tax payable by the entity, State R will not be obliged to provide relief under Articles 23 A or 23 B with respect to the income of the entity as the only reason why State S may tax that income in accordance with the provisions of the Convention is because of the residence of the members of the entity. State S, on the other hand, will be required to provide relief under Articles 23 A or 23 B with respect to the entire income of the entity as that income may be taxed in State R in accordance with the provisions of Article 7 regardless of the fact that State R considers that the income is derived by an entity resident of State R. In determining the amount of income tax paid in State R for the purposes of providing relief from double taxation to the members of the entity under Article 23 B, State S will need to take account of the tax paid by the entity in State R.

Example B: Same facts as in example A except that 30 per cent of the income derived through the entity is interest arising in State S that is attributable to a permanent establishment in State R, the rest of the income being business profits attributable to the same permanent establishment. In that case, relief of double taxation with respect to the business profits other than the interest will be provided as described in example A. In the case of the interest, however, State R will be required to provide a credit to the entity under paragraph 2 of Article 23 A or paragraph 1 of Article 23 B for the amount of tax on the interest paid in State S by all the members of the entity without exceeding the lower of 10% of the gross amount of interest (which is the maximum amount of tax that may be paid in State S in accordance with paragraph 2 of Article 11) or the tax payable in State R on that interest (last part of paragraph 2 of Article 23 A and of paragraph 1 of Article 23 B). State S, on the other hand, will also be required to provide relief under Articles 23 A or 23 B to the members of the entity that are residents in State S because that income may be taxed by State R in accordance with the provisions of paragraph 1 of Article 7. If State S applies the exemption method of Article 23 A, that suggests that State S will need to exempt the share of the interest attributable to the members that are residents of State S (see paragraph 5 of the Commentary on Article 21 and paragraph 9 of the Commentary on Article 23 A and 23 B). If State S applies the credit method of Article 23 B, the credit should only be applicable against the part of the tax payable in State S that exceeds the amount of tax that State S would be entitled to levy under paragraph 2 of Article 11 and that credit should be given for the amount of tax paid in State R after deduction of the credit that State R itself must grant for the tax payable in State S under paragraph 2 of Article 11.

Example C: Same facts as in example A except that all the income of the entity is derived from immovable property situated in State S. In that case,

Example F: Same facts as in example D except that all the income of the entity is interest arising in a third State. In that case, in determining the tax payable by the entity, State R will not be obliged to provide relief under Articles 23 A or 23 B with respect to the income of the entity as the only reason why State S may tax that income in accordance with the provisions of the Convention is because of the residence of the members of the entity. State S, on the other hand, will also not be obliged to provide relief under Article 23 A with respect to the income of the entity since there is no permanent establishment to which the interest is attributable in State D in State R and the only reason why State R may tax the income is because the income is also income derived by a resident of State R. Paragraph 1 of right of the interest as income derived by an entity resident of State R. Paragraph 1 of Article 21 also confirm members resident of State S.

Article 1, paragraph 4: third-state PEs

Comment

At the 12

5. Where the conditions of subparagraphs a) and b) are met, the paragraph denies the benefits that otherwise would apply under the other provisions of the Convention if the relevant item of income is treated as being part of the profits of the permanent establishment situated in the third jurisdiction and the effective rate of tax levied on these profits in that third jurisdiction is less than the lower of the following two rates: a) the minimum rate that the Contracting States have determined bilaterally for the purposes of the paragraph, and b) 60 per cent of the effective rate of tax that would be imposed on the profits of the permanent establishment in the State of the enterprise if that permanent establishment were situated in that State.

64. Instead of adopting the wording of paragraph 4, some States may prefer a more comprehensive solution that would not be restricted to situations where an enterprise of a Contracting State is exempt from tax, in that State, on the profits attributable to a permanent establishment situated in a third jurisdiction, that would not include the exception applicable to income derived in connection with or incidental to the active conduct of a business and that would not require an evaluation of the tax that would have been paid in the State of the enterprise if the permanent establishment had been situated in that State. In such a case, the rule would be applicable in any case where income derived from one Contracting State that is attributable to a permanent establishment situated in a third jurisdictions is subject to combined taxation, in the State of the enterprise and the jurisdiction of the permanent establishment, at an effective rate that is less than the lower of a rate to be determined bilaterally and 60 per cent of the general rate of corporate tax in the State of the enterprise. The following is an example of a rule that could b

It was also noted that if there is a mandatory arbitration provision, this provision would not

~~Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavour to settle the question and to determine the mode of application of the Agreement to such person. In the absence of such agreement, such person shall be considered to be outside the scope of this Agreement, except for the Article "Exchange of information".~~

Article 4

8. Paragraph 3, which reproduces Article 4, paragraph 3, of the OECD Model Convention, deals with companies and other bodies of persons, irrespective of whether they are legal persons. The OECD Commentary indicates in paragraph 21 that "~~[i]t may be rare in practice for a company, etc. to be subject to tax as a resident in more than one State, but it is, of course, possible if,~~ ***Cases where a company, etc. is subject to tax as a resident in more than one State may occur if,*** for instance, one State attaches importance to the registration and the other State to the place of effective management. So, in the case of companies, etc. also, special rules as to the preference must be established". According to paragraph 22 of the OECD Commentary, "~~[i]t would not be an adequate solution to attach importance to a purely formal criterion like registration. Therefore paragraph 3 attaches importance to the place where the company, etc. is actually managed~~ ***When paragraph 3 was first drafted, it was considered that it would not be an adequate solution to attach importance to a purely formal criterion like registration. and preference was given to a rule based on the place of effective management, which was intended to be based on the place where the company, etc. was actually managed.***". ~~It may be mentioned that, as in the case of the OECD Model Convention, the word "only" was added in 1999 to the tie-breaker test for determining the residence of dual residents, other than individuals.~~

9. ***However, the OECD/G20 recommendation in the Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) resulted in changes to sole reliance on place of effective management to resolve cases of dual***

24. As a result of these considerations, ~~the "place of effective management" has been adopted as the preference criterion for persons other than individuals […].~~ ***the current version of paragraph 3 provides that the competent authorities of the Contracting States shall endeavour to resolve by mutual agreement cases of dual residence of a person other than an individual.***

~~10. It is understood that when establishing the "place of effective management", circumstances which may, inter alia, be taken into account are the place where a company is actually managed and controlled, the place where the decision-making at the highest level on the important policies essential for the management of the company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the place where the most important accounting books are kept. In this respect the OECD Commentary refers to some relevant country practices:~~

24.1 ~~Some countries, however, consider that cases of dual residence of persons who are not individuals are relatively rare and should be dealt with on a case-by-case basis. Some countries also consider that such a case-by-case approach is the best way to deal with the difficulties in determining the place of effective management of a legal person that may arise from the use of new communication technologies. These countries are free to leave the question of the residence of these persons to be settled by the competent authorities, which can be done by replacing the paragraph by the following provision:~~

~~3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.~~

Competent authorities having to apply ***paragraph 3*** ~~such a provision to determine the residence of a legal person for purposes of the Convention~~ would be expected to take account of various factors, such as where the meetings of ~~its~~ board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc. Countries that consider that the competent authorities should not be given the discretion to solve such cases of dual residence without an indication of the factors to be used for that purpose may want to supplement the provision to refer to these or other factors that they consider relevant. ~~Also, since the application of the provision would normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25, the request should be made within three years from the first notification to that person that its taxation is not in accordance with the Convention~~

~~since it is considered to be a resident of both Contracting States. Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.~~ [*the next sentence has been moved to new paragraph 24.2; the last sentence of the paragraph has been moved to new paragraph 24.3*]

24.2 ~~Also, since the~~ *A determination under paragraph 3* ~~application of the provision would~~ *will* normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25~~, the~~. *Such a* request *may be made as soon as it is probable that the person will be considered a resident of each Contracting State under paragraph 1. Due to the notification requirement in paragraph 1 of Article 25, it* should *in any event* be made within three years from the first notification to that person *of taxation measures taken by one or both States that indicate that reliefs or exemptions have been denied to that person because of its dual-residence status without the competent authorities having previously endeavoured to determine a single State of residence under paragraph 3. The competent authorities to which a request for determination of residence is made under paragraph 3 should deal with it expeditiously and should communicate their response to the taxpayer as soon as possible.*

24.3 Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.

*24.4 The last sentence of paragraph 3 provides that i****n the absence of a determination by the competent authorities, the dual-resident person shall not be entitled to any relief or exemption under the Convention except to the extent and in such manner as may be agreed upon by the competent authorities. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person. This will mean, for example, that the condition in subparagraph b) of paragraph 2 of Article 15 will not be met with respect to an employee of that person who is a resident of either Contracting State exercising employment activities in the other State. Similarly, if the person is a company, it will be considered to be a resident of each State for the purposes of the application of Article 10 to dividends that it will pay.***

10. While the place of effective management test was removed from Article 4, paragraph 3 in the 2017 update, some States may consider it to be preferable to deal with cases of dual residence of entities using such a test. These States may consider that this rule can be interpreted in such a way to prevent it from being abused and may wish to include the following version of paragraph 3, which appeared in the United Nations Model Convention prior to the 2017 update:

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

~~11. A particular issue, as regards a bilateral treaty between State A and State B, can arise in relation to a company which is under paragraph 1 of Article 4, a resident of State A, and which is in receipt of, say, interest income, not directly, but instead, through a permanent establishment which it has in a third country, State C. Applying the Model Convention has the effect that such a company can claim the benefit of the terms on, say, withholding tax on interest in the treaty between State A and State B, in respect of interest that is paid to its permanent establishment in State C. This is one example of what is known as a "triangular case". Some concern has been expressed that treaties can be open to abuse where, in the example given, State C is a tax haven and State A exempts the profits of permanent establishments of its resident enterprises. The situation is discussed in depth in the OECD study on the subject.[16] States which wish to protect themselves against potential abuse can take advantage of the possible solutions suggested there, by adopting additional treaty provisions.~~ *[this should be removed as triangular cases are now dealt with in Article 1]*

Article 10, paragraph 2

Comment

At the 12th

E/C.18/2016/CRP.

9. Both the source country and the country of residence should be able to tax dividends on portfolio investment shares, although the relatively small amount of portfolio investment and its distinctly lesser importance compared with direct investment might make the issues concerning its tax treatment less intense in some cases. The former Group of Experts decided not to recommend a maximum rate because source countries may have varying views on the importance of portfolio investment and on the figures to be inserted.

10. In 1999, it was noted that recent developed/developing country treaty practice indicates a range of direct investment and portfolio investment withholding tax rates. Traditionally, dividend withholding rates in the developed/developing country treaties have been higher than those in treaties between developed countries. Thus, while the OECD direct and portfolio investment rates are 5 per cent and 15 per cent, developed/developing country treaty rates have traditionally ranged between 5 per cent and 15 per cent for direct investment dividends and 15 per cent and 25 per cent for portfolio dividends. Some developing countries have taken the position that short-term loss of revenue occasioned by low withholding rates is justified by the increased foreign investment

gains from the alienation of quoted shares. Countries that wish to do so may include in their bilateral tax treaties the following:

> Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, excluding shares in which there is substantial and regular trading on a recognized stock exchange, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.

The treaty text itself or associated documents could expand on the meaning of the phrases "substantial and regular trading" and "recognized stock exchange".

14. Some countries might consider that the Contracting State in which a company is resident 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.

16. If countries choose not to tax the gains derived in the course of corporate reorganizations, they are of course also free to do so.