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Base erosion and profit-shifting

Proposed Base Erosion and Profit-Shifting Related Changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries

Summary

This paper suggests changes that could be made to the text of the UN Model Tax Convention and its Commentaries to help address base erosion and profit shifting. It was prepared by the Coordinator of the Committee's Base Erosion and Profit Shifting Subcommittee, Carmel Peters, in consultation with that Subcommittee. Part A of this paper addresses possible changes relating to permanent establishments (Article 5) while Part B addresses possible changes to various articles and Commentaries to address the granting of treaty benefits in inappropriate circumstances. Issues relating to the revision of Article 1 and the Commentary to Article 1 and Article 29 and related commentary are dealt with in separate papers.

* E/C.18/2016/15

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PART A – ARTICLE 5 CHANGES

Interpretation of Article 5

Comment

At the 12th and 13th meetings the Committee discussed the fact that there are differences in views among countries regarding the interpretation of paragraph 4 of Article 5. In particular there is a question as to whether all items under the existing paragraph 4 are excluded from constituting a PE regardless of whether they have a preparatory or auxiliary character or not. However, the proposed changes to paragraph 4 of Article 5 will make it explicit that all the activities are subject to the condition of having a preparatory or auxiliary character regardless of particular country views on the interpretation of the previous provision.

This issue also arose in relation to the OECD Model. The solution for both Models is to add text to the Commentary on paragraph 1 of Article 5 to clarify that these changes to Article 5 do not affect the interpretation of those Articles prior to the changes.

Proposed change to the United Nations Model Convention

Article 5, paragraph 3

Anti-contract splitting rule

Comment

At the 12th and 13th meetings the Committee discussed two distinct but related problems with the splitting up of contracts which were brought to the attention of the Committee. They are related because they both address concerns that enterprises can artificially split up contracts, or projects or activities to circumvent the permanent establishment threshold.

[redacted]s also an issue addressed in the work on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). This is already a concern identified in the United Nations Model Convention. The general concern is the avoidance of time thresholds in the construction site rule in paragraph 3 or any other similar time thresholds for se

18.1 The [six] month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or subcontractors working on the continental shelf or engaged in activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period of less than [six] months and attributed to a different company which was, however, owned by the same group. Apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial anti-avoidance rules, ~~countries concerned with this issue can adopt solutions in the framework of bilateral negotiations.~~ ***these abuses could also be addressed through the application of the anti-abuse rule of paragraph 9 of Article 29, as shown by example J [and example K] in paragraph [17] of the Commentary on Article 29. Some States may nevertheless wish to deal expressly with such abuses. Moreover, States that do not include paragraph 9 of Article 29 in their treaties should include an additional provision to address contract splitting. Such a provision could, for example, be drafted along the following lines:***

> ***For the sole purpose of determining whether the [six] month period referred to in paragraph 3 has been exceeded,***
>
> ***a) where an enterprise of a Contracting State carries on activities in the other Contracting State at a place that constitutes a building site or construction or installation project and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without [six]***

- ***whether the nature of the work involved under the different contracts is the same or similar;***
- ***whether the same employees are performing the activities under the different contracts***

The Committee points out that measures to counteract abuses would apply equally in cases under Article 5, paragraph 3, subparagraph (*b*). ***The anti-contract splitting rule provided in paragraph 18.1 of the OECD Commentary can be amended to also counteract abuses under subparagraph (b). A further possibility is to include the following text immediately after subparagraph (b), which is based on a similar provision found in the 2016 treaty between Chile and Japan, but utilizes the closely related enterprise word10 (t)-21 (u)-14 (bpa)-1hf (t)-6***

The Commentary of the OECD Model Convention continues as follows:

19.2 In the case of fiscally transparent partnerships, the *[six]* month test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the partners and the employees of the partnership exceeds twelve month***s***, the enterprise carried on ~~by~~ ***through*** the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site. ***Assume for instance that a resident of State A and a resident of State B are partners in a partnership established in State B which carries on its construction activities on a construction site situated in State C that lasts 10 months. Whilst the tax treaty between States A and C is identical to the OECD Model, paragraph 3 of Article 5 of the treaty between State B and State C provides that a construction site constitutes a permanent establishment only if it lasts more than 8 months. In that case, the time threshold of each treaty would be applied at the level of the partnership but only with respect to each partner's share of the profits covered by that treaty; s~~S~~ince the treaties provide for different time-thresholds, State C will have the right to tax the share of the profits of the partnership attributable to the partner who is a resident of State B but will not have the right to tax the share attributable to the partner who is a resident of State A. This results from the fact that whilst the provisions of paragraph 3 of each treaty are applied at the level of the same enterprise (i.e. the partnership), the outcome differs with respect to the different shares of the profits of the partnership depending on the time-threshold of the treaty that applies to each share.***

20. The very nature of a construction or installation project may be such that the contractor's activity has to be relocated continuously or at least from time to time, as the project progresses. This would be the case for instance where roads or canals were being constructed, waterways dredged, or pipelines laid. Similarly, where parts of a substantial structure such as an offshore platform are assembled at various locations within a country and moved to another location within the country for final assembly, this is part of a single project. In such cases the fact that the work force is not present for [six] months in one particular location is immaterial. The activities performed at each particular spot are part of a single project, and that project must be regarded as a permanent establishment if, as a whole, it lasts for more than [six] months.

12. [new paragraph 12 commentary discussed in the next section]

[paragraphs 13 – 17 are not amended]

consistency with the approach taken in Article 14, paragraph 1, subparagraph (*b*). ***In the 2017 revision the Committee made a further change to subparagraph (b) to remove the words in parenthesis "(for the same or a connected project)" altogether. This change is discussed in more detail in paragraph 12 below.***

Replace paragraph 12 of the Commentary with new paragraphs 12 and 12.1:

12. Until the 2017 update the UN Model contained the words "(for the same or a connected project)" in subparagraph (b). This wording was removed as the "project" limitation was easy to manipulate and created difficult interpretive issues and factual determinations for tax authorities, which in particular for developing countries is an undesired administrative burden. Moreover, from a policy perspective, if a non-resident provides services in a country for more than 183 days, the non-resident's involvement in the commercial life of that country clearly justifies the country taxing the income from those services whether the services are provided for one project or multiple projects. The degree of the non-resident's involvementhr r.004 Tc 0.03sts (ou)-4 (n)-8 (t)-16 (r)18 (.)-4 ((j)-16 y')-4

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 or 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 paragraph 4 are subject to the condition that they are preparatory or 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*). ***The deletion of the word "delivery" reflects the majority view of the Committee that a "warehouse" used for that purpose should, if the requirements of paragraph 1 are met, be a permanent establishment.***

22.3 Subparagraph *b)* relates to the ***maintenance of a stock of goods or merchandise belonging to the enterprise*** ~~stock of merchandise itself and provides that the stock, as 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 S-1 (t)-2 (i).06 t4 ((n)-4 (t)-2422.4 g16,(of)3 (t)8 (hr)3 (2 (ap9)1 (t)-2 (at))42 (4 44 (o(o (h)-3T (a)5***
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constitutes an essential part of the business operations of the enterprise and therefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of ~~subparagraph *e)* of~~ paragraph 4.

25. ***Also, where an enterprise that sells goods worldwide establishes an office in a State and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State without habitually concluding contracts or playing the principal role leading to the conclusion of contracts (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts), such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment.***

~~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~~

27. As already mentioned in paragraph 21 above, paragraph

~~also to engage in advertising for other enterprises, it would be regarded as a permanent establishment of the enterprise by which it is maintained.~~

29. If, ***under p***

the inappropriate use of these exceptions are addressed through the provisions of paragraph 4.1. States that share this view are free to amend paragraph 4 as follows (and may also agree to delete some of the activities listed in subparagraphs a) to d) below if they consider that these activities should be subject to the preparatory or auxiliary condition in subparagraph e)):

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 displ4 (l)-6 (eo14 (f)-1)-10 (c)6 (

reference to “delivery” is absent from the United Nations Model Convention, countries may wish to consider both points of view when entering into bilateral tax treaties, for the purpose of determining the practical results of utilizing either approach.

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:

> ***30.2 […] Under paragraph 4.1, the exceptions provided for by paragraph 4 do not apply to a pl/hot***
> ***upoTted O9 en(o5 (p(t -27.51dr)-1 (t)8 (e)4 (.) [(op)6 (0)64 5(s)-1,***

- ***SCO and RCO are closely related enterprises;***
- ***SCO's store constitutes a permanent establishment of SCO (the definition of permanent establishment is not limited to situations where a resident of one Contracting State uses or maintains a fixed place of business in the other State; it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State); and***

The business activities carried on by RCO at its warehouse and by SCO at its store constitute complementary functions that are part of a cohesive business operation (i.e. storing goods in one place for the purpose of delivering these goods as part of the obligations resulting from the sale of these goods through another place in the same State).

Article 5, paragraphs 5 and 7: dependent agents

Comment

Article 5, paragraph 5

At the 12th and 13th meetings the Committee discussed proposals to amend Article 5, paragraphs 5 and 7 to broaden the scope of the dependent agent PE rule to counter structures aimed at the avoidance of a PE (including commissionaire arrangements).

Two options for an amended paragraph 5 were discussed at the 13th meeting. Option 1 was based on the OECD/G20 proposal in the Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). Option 2 was also based on the OECD/G20 recommendations except it proposed to remove the words "that are routinely concluded without material modification s1

Article 5, paragraph 5

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:

(a) ~~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 person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) ~~Has no such authority, but~~ ***the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but*** habitually maintains in the first

enterprise should be treated as having a permanent establishment in that State—even if it does not have a fixed place of business in that State under paragraph 1. Paragraph 5 achieves

obligations that will effectively be performed by such enterprise rather than by the person contractually obliged to do so.

32.9 A typical case covered by these subparagraphs is where contracts are concluded with clients by an agent, a partner or an employee of an enterprise sorpw 2h ant algu
t)-12 (e)4 (r)-11 (pr)-1 (i)-12 (s)-1 (e)4 ( )-10 d(o)-6 (r(n)-4 o(t)-2 lt)-12 (e)4 gollybitn(t)-2 (h)-14
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other enterprises. Where, for example, a company acts as a distributor of products in

frequency test. Nonetheless, the same sorts of factors considered in paragraph 6 would be relevant in making that determination

~~24. The Committee's view is that where paragraph 33 of the OECD Commentary above refers to "[a] person who is authorised to negotiate all elements and details of a contract", this should be taken to include a person who has negotiated all the essential elements of the contract, whether or not that person's involvement in the negotiation also extends to other~~ non-essential aspects. *[the OECD is removing the sentence to w BT (.)-14 6.2 e O7ss 9e 0e 9*

~~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) Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. ~~However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.~~ ***Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.***

(b) For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person

37. The exception of paragraph 6 only applies where a person acts on behalf of an enterprise in the course of carrying on a business as an independent agent. It would therefore not apply where a person acts on behalf of an enterprise in a different capacity, such as where an employee acts on behalf of her employer or a partner acts on behalf of a partnership. As explained in paragraph 8.1 of the Commentary on Article 15, it is sometimes difficult to determine whether the services rendered by an individual constitute employment services or services rendered by a separate enterprise and the guidance in paragraphs 8.2 to 8.28 of the Commentary on Article 15 will be relevant for that purpose. Where an individual acts on behalf of an enterprise in the course of carrying on his own business and not as an employee, however, the application of paragraph 6 will still require that the individual do so as an independent agent; as explained in paragraph 38.7 below, this independent status is less likely if the activities of that individual are performed exclusively or almost exclusively on behalf of one enterprise or closely related enterprises.

38. Whether a person ***acting as an agent is*** independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vivito/-2.36 -1.15 1(ac)4 4M(s)]T

38.*4*~~5~~It may be a feature of the operation of an agreement that an agent will provide

~~agent rather than the other business activities carried out by that agent. Whilst the comparison normally should be made with the activities customary to the agent's trade, other complementary tests may in certain circumstances be used concurrently or alternatively, for example where the agent's activities do not relate to a common trade.~~

38.7 The last sentence of subparagraph a) provides that a person is not considered to be an independent agent where the person acts exclusively or almost exclusively for one or more enterprises to which it is closely related. That last sentence does not mean, however, that paragraph 6 will apply automatically where a person acts for one or more enterprises to which that person is not closely related. Paragraph 6 requires that the person must be carrying on a business as an independent agent and be acting in the ordinary course of that business. Independent status is less likely if the activities of the person are performed wholly or almost wholly on behalf of only one enterprise (or a group of enterprises that are closely related to each other) over the lifetime of that person's business or over a long period of time. Where, however, a person is acting exclusively for one enterprise, to which it is not closely related, for a short period of time (e.g. at the beginning of that person's business operations), it is possible that paragraph 6 could apply. As indicated in paragraph 38.5, all the facts and circumstances would need to be taken into account to determine whether the person's activities constitute the carrying on of a business as an independent agent.

38.8 The last sentence of subparagraph a) applies only where the person acts "exclusively or almost exclusively" on behalf of closely related enterprises. This means that where the person's activities on behalf of enterprises to which it is not closely related do not represent a significant part of that person's business, that person will not qualify as an independent agent. Where, for example, the sales that an agent concludes for enterprises to which it is not closely related represent less than 10 per cent of all the sales that it concludes as an agent acting for other enterprises, that agent should be viewed as acting "exclusively or almost exclusively" on behalf of closely related enterprises.

38.9 Subparagraph b) explains the meaning of the concept of a "person closely related to an enterprise" for the purpose of the Article. That concept is to be distinguished from the concept of "associated enterprises" which is used for the purposes of Article 9; although the two concepts overlap to a certain extent, they are not intended to be equivalent.

38.10 The first part of subparagraph b) includes the general definition of "a person closely related to an enterprise". It provides that a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. This general rule would cover, for example, situations where a person or enterprise controls an enterprise by virtue of a special arrangement that allows that person to exercise rights that are similar to those that it would hold if it possessed directly or indirectly more than 50 per cent of the beneficial interests in the enterprise. As in most cases where the plural form is used, the reference to the "same persons or enterprises" at the end of the first sentence of subparagraph b) covers cases where there is only one such person or enterprise.

a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. ***Also, the changes to paragraphs 5 and 6 made in [next update] have addressed some of the concerns that such a provision is intended to address.*** Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

28. Paragraph 6 of the United Nations Model Convention, which achieves the aim quoted above, is necessary because insurance agents generally have no authority to conclude contracts; thus, the conditions of paragrahusim m

negotiations, in the light of their countries policy framework and the intended outcomes they wish to achieve.

17.2 In particular, the Committee noted that the Manual provides the following useful checklist of the benefits and costs commonly associated with tax treaties:

Benefits:

- ***Increased foreign investment as a result of removal or reduction of tax barriers***
- ***Greater access to foreign technology and skills***
- ***Flow-on benefits to the local economy from increased foreign investment***
- ***Increased certainty for both taxpayers and tax administrations***
- ***Improved consistency for tax treatment***
- ***Protection for investment abroad***
- ***Avoidance of fiscal evasion***

Costs:

- ***Immediate revenue costs***
- ***Affect or limit on the operation of certain domestic tax laws***
- ***Risk of treaty-shopping and treaty abuse***
- ***Risk of double non-taxation***
- ***Need for changes and/or clarifications to domestic law to conform with tax treaties***
- ***Challenges to tax administration capacity to negotiate and administer tax treaties, including obligations under the mutual agreement procedure, exchange of information and, in some treaties, assistance in the collection of taxes***

17.3 Following the work by the OECD and G20 on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), the OECD will insert a section into the Introduction to the OECD Model Convention on the tax policy considerations that are relevant to the decision of whether to enter into a tax treaty, amend an existing tax treaty, or, as a last resort, terminate a tax treaty. The Committee took note of the considerations identified by the OECD and suggests to consider them additionally beside the United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries The relevant section of the Commentary to the OECD Model Convention is as follows:

15.1 In 1997, the OECD Council adopted a recommendation that the Governments of member countries pursue their efforts to conclude bilateral tax treaties with those member countries, and where appropriate with non-member countries, with which they had not yet entered into such conventions. Whilst the question of whether or not to enter into a tax treaty with another country is for each State to decide on

considerations, tax policy considerations will generally play a key role in that decision. The following paragraphs describe some of these tax policy considerations, which are relevant not only to the question of whether a treaty should be concluded with a State but also to the question of whether a State should seek to modify or replace an existing treaty or even, as a last resort, terminate a treaty (taking into account the fact that termination of a treaty often has a negative impact on large number of taxpayers who are not concerned by the situations that result in the termination of the treaty).

15.2 Since a main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross-border services, trade and investment, the existence of risks of double taxation resulting from the interaction of the tax systems of the two States involved will be the primary tax policy concern. Such risks of double taxation will generally be more important where there is a significant level of existing or projected cross-border trade and investment between two States. Most of the provisions of tax treaties seek to alleviate double taxation by allocating taxing rights between the two States and it is assumed that where a State accepts treaty provisions that restrict its right to tax elements of income, it generally does so on the understanding that these elements of income are taxable in the other State. Where a State levies no or low income taxes, other States should consider whether there are risks of double taxation that would justify, by themselves, a tax treaty. States should also consider whether there are elements of another State's tax system that could increase the risk of non-taxation, w(d i)-274 (as)-17-2 (h)-]TJ 3 t

15.5 Further tax considerations that should be taken into account when considering entering into a tax treaty include the various features of tax 0 Tw 2.59 0 Td.8 6

Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)

Have agreed as follows:

Proposed change to United Nations Model Convention Commentary

Introduction

4. The desirability of promoting greater inflows of foreign investment to developing countries on conditions which are politically acceptable as well as economically and socially beneficial has been frequently affirmed in resolutions of the General Assembly and the Economic and Social Council of the United Nations and the United Nations Conference on Trade and Development. The 2002 Monterrey Consensus on Financing for Development[8] and the follow up Doha Declaration on Financing for Development of 2008[9] together recognize the special importance of international tax cooperation in encouraging investment for development and maximizing domestic resource mobilisation, including by combating tax evasion. They also recognize the importance of supporting national efforts in these areas

discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can confidently be carried on. With this background, tax treaties should contribute to the furtherance of the development aims of developing countries. In addition, the treaties seek to improve cooperation between taxing authorities in carrying out their functions, including by the exchange of information with a view to preventing avoidance or evasion of taxes and by assistance in the collection of taxes.

6.1 Finally, it has become clear as a result of international focus on base erosion and profit shifting that treaties are not intended to facilitate treaty shopping and other treaty abuses.

10. In 2005 the Ad Hoc Group of Experts was upgraded by conversion into a Committee structure, which remains its current form. The 25 members of the Committee of Experts on

Committee identified a number of issues that require further work***. In particular*** ~~and~~ it mandated one Subcommittee to address the issue of the taxation treatment of services in general and in a broad way including all related aspects and issues ***but*** ~~. Furthermore,~~ the issue of taxation of fees for technical services should ~~also~~ be addressed ***in particular. The Subcommittee therefore focused its work on the drafting of the new article with its commentary which is now included in the 2017 update of the Model.***

- ***A modified version of Article 13, paragraph 5 for consistency with Article 13, paragraph 4;***
- ***Changes to Articles 23A and 23B to clarify that there is no obligation to provide relief for tax imposed on a solely residence basis;***
- ***A new Article 29 that contains provisions relating to entitlement to treaty benefits. These include a limitation on benefits rule, a third state permanent establishment rule and a principal purpose test.***

~~A modified version of Article 13, paragraph 5 to address possible abuses;~~

~~An optional version of Article 25 that provides for mandatory binding arbitration when a dispute cannot be solved under the usual Mutual Agreement Procedure;~~

~~A new version of Article 26 that confirms and clarifies the importance of exchange of~~ information under the United Nations Model Convention, alonghe(e)4 (r)3 e-2 (Cai)-12ta2 (o

~~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***

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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

5. The OECD Model Convention restricts the tax in the source country to 5 per cent in subparagraph *a)* for direct investment dividends and 15 per cent in subparagraph *b)* for portfolio investment dividends, but the United Nations Model Convention leaves these percentages to be established through bilateral negotiations.

6. ***Prior to the 2017 update, the*** ~~Also, the~~ minimum ownership necessary for direct investment dividends ***was***~~is~~ reduced in subparagraph (*a*) from 25 per cent to 10 per cent. However, the 10 per cent threshold which determines the level of shareholding r ate r.(

[The United Nations Model Convention Commentary then quotes OECD commentary paras 11-22 - it will need to be checked if these are changing. The Commentary omits part of 12.2 , and 12.3-12.7]

Article 13, paragraphs 4 and 5

Comment

At its 12th and 13th meetings the Committee discussed a proposal to replace paragraph 4 of the current United Nations Model Convention with the provision recommended in the Action 6 Final Report (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances).

There are two significant changes to paragraph 4 in adopting this new provision.

First, the proposal arising out of the Action 6 Final Report (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) amends Article 13, paragraph 4 to address the concern that there might be cases where assets are contributed to an entity shortly before

Proposed change to Article 13, paragraphs 4 and 5 of the United Nations Model Convention

~~4. Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:~~

~~(*a*) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.~~

~~(*b*) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.~~

4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

5. 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***, or comparable interests, such as interests in a partnership or trust,*** which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the ~~12-month period~~ ***365 days*** 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.

Proposed Change to the United Nations Model Convention Commentary

Paragraph 4

8. This paragraph ***corresponds with paragraph 4 of the OECD Model Convention. Until the 2017 update, paragraph 4 of the United Nations Model Convention read as follows:***

4.

principally of immovable property used by such company, partnership, trust or estate in its business activities.

(b) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.

Both formulations are ~~, which broadly corresponds to paragraph 4 of the OECD Model Convention, allows a Contracting State to tax a gain on an alienation of shares of a company or on an alienation of interests in other entities the property of which consists principally of immovable property situated in that State. It is~~ designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the incorporation of a company to hold such property, it is necessary to tax the sale of shares in such a company. This is especially so where ownership of the shares carries the right to occupy the property. In order to 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 partnerships, trusts and estates which own immovable property. ~~It also decided to exclude from its scope such entities whose property consists directly or indirectly principally of immovable property used by them in their business activities. However, this exclusion will not apply to an immovable property management company, partnership,~~

Article 23: Proposed changes to paragraph 1 of Article 23 A and paragraph 1 of Article 23 B

Comment

At the 12th and 13th meetings, the Committee also agreed to consider a proposal to clarify that Article 23 A and Article 23 B do not require relief to be provided in respect of tax imposed exclusively because of the residence of an entity. The following proposal is based on the OECD provision recommended as a result of the follow up work undertaken following the release of the OECD/G20 Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances). These changes are also related to the Committee's decision to adopt a new paragraph 2 of Article 1 regarding fiscally transparent entities.

At paragraph 14 of the Commentary extracts of OECD Commentary are inserted because they are applicable to Articles 23 A and 23 B. This Commentary is now being amended and includes:

- Changes to paragraph 9 and the addition of paragraph 9.1
- Insertion of two new paragraphs 11.1 and 11.2

Note that further consequential amendments will need to be made to the Commentary on Articles 10, 11 and 21.

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

1. Where a resident of a Contracting State derives income or owns capital which ***may be***

a) as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State;

b)

exemption method. The State where the permanent establishment is situated would give a credit for such tax along the lines of the provisions of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B; of course, this credit would not be given in cases where the State in which the permanent establishment is situated does not tax the dividends or interest attributed to the permanent establishment, in accordance with its domestic laws.

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 other State on their respective share of the income. The phrase "(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)" clarifies that in such cases, both States are not reciprocally obliged to provide relief for each other's tax 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 Article 23 A or 23 B with respect to the income of the entity as the only reason why Staup .mSsohe-0.004***