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REVISED COMMENTARY ON ARTICLE 12A FEES FOR TECHNICAL SERVICES

Summary
At its twelfth session the Committee was presented with the draft Commentary to the new Article 12A on taxation of fees for technical services. The text was discussed and amended before its final approval, notwithstanding necessary editorial changes.
Subsequently, the Subcommittee on Tax treatment of Services reviewed the text for its final form and made changes in the Article text and its Commentary. However, in the course of doing so, the Subcommittee made changes of substance to render the text clearer and easier for its application. The Subcommittee seeks a full discussion by the Committee and approval of the additions. All changes and additions are color-highlighted. The paragraph 6 of the Article is redrafted to eliminate reference to "a third state". As for the Commentary, most changes concern the following paragraphs:
1) An addition of paragraphs 28 to 31 to explain the closely related person concept;
2) An addition of a sentence to paragraph 41 explaining the addition of Article 12 A to

fixed place of business in that State and without being present in that State for any substantial period. The OECD/G20 Base Erosion and Profit Shifting Project, Action 1: Final Report "Addressing the Tax Challenges of the Digital Economy" (2015) illustrates the difficulties faced by tax policy makers and tax administrations in dealing with the new digital business models made available through the digital economy. The Report did not recommend, for the time being, a withholding tax on digital transactions (which include digital cross border services); nor did it recommend a new nexus for taxation in the form of a significant economic presence test. However, it was recognized that countries were free to include such provisions in their tax treaties, among other additional safeguards against BEPS.

3. Before the introduction of Article 12A, countries were faced with more restrictive rules of application when technical services were provided cross border. In general, the rules under Article 7, together with Article 5, and Article 14 of the United Nations Model Convention give limited scope for taxing income from such services, in particular without a fixed base or permanent establishment in the State of source. As noted in these Commentaries, countries have different interpretations of those rules, which can make their application difficult for all parties.

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phrase, and therefore payments for such services are in general taxable under Article 12. (See paragraphs 14 and 16 of the Commentary on Article 12.)

6. The uncertainty concerning the treatment of fees for technical and other similar services under the provisions of the United Nations Model Convention as it read before 2017 was undesirable for both taxpayers and tax authorities. It may also have resulted in difficult disputes, both for taxpayers and administrations, consuming scarce resources, as well as causing unrelieved double taxation or double non-taxation.

7. Fees for technical services may also result in the erosion of the tax base of countries that are prevented from taxing such fees by the provisions of the United Nations Model Convention. Fees for technical services are usually deductible against a country's tax base if the payer is a resident of the country or a non-resident with a permanent establishment or fixed base in the country. The reduction or erosion of a country's tax base by deductible fees for technical services is not generally objectionable. If the payer is an enterprise, the payments are legitimate expenses incurred by the payer for the purpose of earning income and should be deductible (assuming, of course, that the amount of the payments is reasonable). If the country is entitled to tax the non-resident service provider on the fees earned for the technical services, the reduction of the country's tax base by the deductible payments is offset by the country's tax on those fees.

8. Where technical services are provided by an enterprise of one Contracting State to an associated enterprise in the other Contracting State, there is the possibility that the payments may be more or less than the arm's length price of the services. Within a multinational group, fees for technical services may sometimes be used to shift profits from a profitable group company resident and operating in one country to another group

only if the services are provided in the first State. In particular, the majority rejected the argument that the residence of a payer of fees for technical services in a Contracting State and the deduction of those fees against that State´s tax base do not provide sufficient nexus to that State to justify that State taxing those fees. In the view of those members of the Committee, base erosion is a sufficient justification for the taxation of income from employment under Article 15 and directors' fees and remuneration of top-level managerial officials under Article 16. Although taxation of employment income under Article 15 is limited to employment exercised in a country, Article 16 allows a Contracting State to tax an individual resident in the other Contracting State on fees derived by the individual as a director or remuneration derived as a top-level managerial official of a company resident in the first State, irrespective of whether the services are rendered inside or outside the first State. Moreover, under Articles 7 and 14, a country is entitled to tax income derived outside the country as long as the income is attributable to a permanent establishment or fixed base in that country.

14. Article 12A may result in some non-resident service providers grossing up the cost of technical services provided to residents of a Contracting State. Countries should be aware of this possibility in the same way that they should be aware of the possibility of similar grossing up with respect to interest and royalties under Articles 11 and 12 respectively. The possibility that fees for technical services may be grossed up is a factor to be taken into account in this regard, along with many other factors. It is also a factor to be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for technical services under Article 12A, paragraph 2.

15. The taxation of fees for technical services on a gross basis under Article 12A may result in excessive or double taxation. However, the possibility that fees for technical services

may be subject to excessive or double taxation is reduced or eliminated under Article 23 (Methods for the Elimination of Double Taxation)]. In addition, the possibility of excessive or double taxation can be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for technical services under Article 12A, paragraph 2, and depending on the negotiated rate, the risk of an excessive tax may be completely eliminated.

16. Despite the inclusion of Article 12A in the United Nations Model Convention, a significant minority of the members of the Committee did not agree with the policy justifications set forth above for the Article. Fundamentally, these members did not agree with the justification set forth in paragraph 2 above that rapid changes in modern economies, particularly with respect to cross-border services, enable non-resident service providers to be substantially involved in another State's economy without a physical presence. Rather, these members were of the view that in cases of payments for technical services that are not provided in the payer's State, there is no nexus to that State that warrants taxation by that State on the payment.

17. In the view of these members of the Committee, as a policy matter, taxation of fees for technical services is warranted only when the service provider has a sufficient nexus to the payer's State, which typically is in the form of a permanent establishment or fixed base. In other words, to justify taxation of technical services in a State, the services should be provided in that State with the degree of nexus required by Articles 5 (Permanent Establishment), 7 (Business Profits) and 14 (Independent Personal Services).

18. The other argument advanced for the inclusion of Article 12A is that payments for services are deductible and hence erode the tax base of the payer's State. However, in

the view of the members opposed to Article 12A, mere deductibility of a commercially justified payment cannot be equated to harmful base erosion, and is therefore not a sufficient reason for taxing that payment in the same State.

19. Those members of the Committee that did not agree with the inclusion of Article 12A in bilateral tax treaties were also concerned that the term "technical services" as used in the Article is not adequately defined. These members were therefore concerned that the application of the Article would result in increased uncertainty, inconsistent treatment, and lengthy disputes between taxpayers and tax authorities.

20. In the view of those members of the Committee that did not agree with the inclusion of Article 12A, a further problem with taxation of fees for technical services on a gross basis is that it can lead to double taxation. The imposition of a tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection with the provision of the services, which would be deductible if tax were imposed on a net basis. Thus, it is possible that the residence State's remedies for relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State.

21. As a matter of broader economic policy, those members that opposed the inclusion of Article 12A were concerned that, as a result of the Article, consumers of technical services in the source State may encounter higher prices for those services, because foreign service providers could pass added tax costs on to the consumer through means such as so-called "gross-up" clauses in contracts. Typically, a gross-up clause will specify a net amount that the provider will receive, effectively passing the burden of any withholding tax on to the consumer of the services. The use of gross-up clauses could result in the tax being shifted to the consumer and make it more expensive to

situations where an individual pays for services (other then services for the personal use of an individual) provided by another individual who is not carrying on an enterprise. For this purpose, the terms “blood relationship,” “marriage” and “adoption” take their meaning from the domestic law of the country applying the treaty in accordance with paragraph 2 of Article 3.

32. Article 12A allows fees for technical services to be taxed by a Contracting State on a gross basis. Many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents. A withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents. Such a method of taxation may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns.

33. Article 12A does not require any threshold, such as a permanent establishment, fixed base or minimum period of presence in a Contracting State as a condition for the taxation of fees for technical services. In this regard, Article 12A is significantly different from Article 7 and Article 14. However, in the case of technical services, modern methods for the delivery of services allow non-residents to perform substantial services for customers in the other country with little or no presence in that country. This ability to derive income from a country with little or no presence there, combined with concerns about the base-erosion and profit-shifting aspects of technical services, is considered by a majority of the members of the Committee to justify the absence of any threshold requirement as a condition for a country to tax fees for technical services.

34. Where fees for technical services are dealt with in both Article 12A and Article 7, paragraph 6 of Article 7 provides that the provisions of Article 12A prevail. However, this priority for Article 12A does not apply if the beneficial owner of the fees for technical services carries on business through a permanent establishment in the Contracting State in which the fees for technical services arise, and those services are effectively connected with the permanent establishment or business activities referred to in (c) of paragraph 1 of Article 7. In this situation, paragraph 4 of Article 12A provides that the provisions of Article 7 apply instead of Article 12A.

35. Similarly, where fees for technical services are dealt with in both Article 12A and Article 14, Article 12A, paragraph 2 indicates expressly that Article 12A applies notwithstanding the application of Article 14. However, this priority for Article 12A over Article 14 does not apply if the beneficial owner of the fees performs independent personal services in the Contracting State in which the fees for technical services arise through a fixed base situated in that State and the technical services are effectively connected with the fixed base. In this situation, Article 12A, paragraph 4 provides that the provisions of Article 14 apply instead of Article 12A.

36. There is no overlap between Article 12A and Articles 15, 18 and 19 dealing with income from employment, pensions and government services respectively because the

(Shipping, Inland Waterways Transport and Air Transport), 16 (Directors' Fees and Remuneration of Top-Level Managerial Officials) and 17 (Artistes and Sportspersons), Article 12A does not apply to fees for technical services to which the provisions of those Articles apply. In general, the taxing rights of a country under Article 8, 17 or 18 are unlimited, whereas the taxing rights under Article 12A, paragraph 2 are limited to the maximum percentage of the gross fees for technical services agreed to in that provision. The relationship between Article 12A, paragraph 2 and Articles 8, 17 and 18 is discussed further in the Commentary on paragraph 2.

B. Commentary on the Paragraphs of Article 12A

Paragraph 1

38. This paragraph establishes that fees for technical services arising in one Contracting State and paid to a resident of the other Contracting State may be taxed in the other Contracting State. It does not, however, provide that such fees are taxable exclusively by the State of residence.

39. In most cases, the person who provides technical services will receive fees for those services. If the person who receives the fees for technical services is not the person who provides those services, it is a matter of domestic law as to who is the proper taxpayer with respect to those fees. If fees for technical services are paid to a person, other than the person who provides the services, Article 12A applies to the fees as long as the recipient is a resident of the other Contracting State.

40. The expression "fees for technical services" is defined in paragraph 3 to mean any "payment" for managerial, technical or consulting services. The term "payment" has a

broad meaning consistent with the meaning of the related term “paid” in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the OECD Model Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the OECD Model Convention), the concept of payment means the fulfillment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

41. Article 12A deals only with fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to fees for technical services arising in a third State. Paragraph 5 and paragraph 6 specify when fees for technical services are deemed to arise in a Contracting State and deemed not to arise in a Contracting State, respectively. However, unlike Articles 10 and 11, which do not apply to dividends paid by a company resident in a third State or interest arising in a third State, Article 12A applies to fees for technical services paid by a resident of a Contracting State or a third State that are borne by a permanent establishment or fixed base that the resident has in the other Contracting State.

Paragraph 2

42. This paragraph lays down the principle that the Contracting State in which fees for technical services arise may tax those payments in accordance with the provisions of its

43. When considered in conjunction with Article 23 (Methods for the Elimination of Double

country, which would mean that the country would increase its revenue at the expense of its own residents rather than the non-resident service providers;

- the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment;

- the possibility that some non-resident service providers may incur high costs in providing technical services, so that a high rate of withholding tax on the gross fees may result in an excessive effective tax rate on the net income derived from the services;

the potential benefit of applying the same rate of withholding tax to both royalties under Article 12And fees for technical services under Article 12A (see Example 6, paragraphs [-3(e)4(6,)] TETBTTBT1 (de)4(r A)5(rticle)5(12)-9(A x 0 1 103.1 5(100)4(r(A x 103.7(

47. Under paragraph 4, if a resident of one Contracting State performs independent personal services (that are technical services) in the other Contracting State through a fixed base that is regularly available to the resident and receives fees for technical

closely connected to the direct operation of ships and aircraft, as discussed in paragraph 11 of the Commentary on Article 8. To eliminate any uncertainty in this regard, paragraph 2 explicitly provides that in any situation in which both Article 12A and Article 8 apply to the same services, the provisions of Article 8 prevail. Thus, any fees for technical services that result from the operation of ships or aircraft in international traffic, or the operation of boats in inland waterways, in accordance with the terms of Article 8 are taxable exclusively in accordance with that Article.

If, however, an artiste or sportsperson resident in one Contracting State receives fees for technical services from a person resident in the other Contracting State and those fees are outside the scope of Article 17 (because, for example, although the fees are in

an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the fees by the direct recipient such as an obligation that is not dependent on the receipt of the fees and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of fees for technical services does have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person, the recipient is the "beneficial owner" of those fees.

57. The fact that the recipient of fees for technical services is considered to be the beneficial owner of those fees does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "b_ o _ t o b_ c

58. The above explanations concerning the meaning of “beneficial owner” make it clear that the mean

59. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State. The text of the United Nations Model Convention was amended in 2001 and 2017 (following amendments to the OECD Model Convention in 1995 and 2014) to clarify this point.

60. The paragraph lays down nothing about the mode of taxation in the State in which fees for technical services arise. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or individual assessment. As with other provisions of the United Nations Model Convention, procedural questions are not dealt with in the Article. Each State is able to apply the procedure provided in domestic law.

Paragraph 361. This paragraph specifies the meaning of the phrase “fees for technical

or the transfer of knowledge, skill or expertise to the client, other than a transfer of information covered by the definition of “royalties” in Article 12, paragraph 3. Services of a routine nature that do not involve the application of such specialized knowledge, skill or expertise are not within the scope of Article 12A.

65. Technical services are not limited to the professional services referred to in Article 14, paragraph 2. Services performed by other professionals, such as pharmacists, and other occupations, such as scientists, academics, etc., may also constitute technical services if those services involve the provision of specialized knowledge, skill and expertise.

66. The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature. Professionals usually provide advice or services that fit within the general meaning of consultancy services although, as noted in paragraphs [63] and [64], they may also constitute management or technical services.

67. The terms “management,” “technical” and “consultancy” do not have preech !

not be fees for technical services subject to Article 16 because of the specific exclusion in subparagraph 3(b). There is no definition of the term “educational institution” for purposes of subparagraph 3(b). Consequently, in accordance with Article 3, paragraph 2 of the Convention, the term would have its meaning under the law of the State applying the Convention. The meaning of the term would generally include universities, colleges and other post-

enforce and might cause serious compliance problems for individuals utilizing technical services supplied remotely by non-residents.

73. The definition of “fees for technical services” in paragraph 3 does not exclude profits from international shipping, inland waterways transport and international air transport, income from entertainment and sports activities, and pensions and social security payments. However, such income (even if it is within the definition of “fees for technical services”) is not subject to tax by a country under paragraph 2 if it is taxable under Article 8 , 17 (Artistes and Sportspersons), or 18 (Pensions and Social Security Payments) as the case might be, because paragraph 2 is expressly subject to the provisions of Article 8, 17 and 18.

74. The treatment of reimbursements of expenses for purposes of the definition of “fees for technical services” in paragraph 3 poses special difficulties. As an initial matter, it is important to distinguish between an allowance for expenses and the reimbursement of expenses. An allowance is an amount usually established in advance for which the recipient of the allowance is not obligated to account; a *per diem* allowance for meals and accommodation is an example of a typical allowance. Since the recipient of an allowance does not have to account for the actual expenses incurred, any allowance received by a person for technical services is included within the meaning of “fees for technical services” under paragraph 3.

75. The reimbursement of expenses is different from an allowance because the person must account for the actual expenses incurred, and only those actual expenses qualify for reimbursement. The issue is whether payments received in reimbursement of actual expenses incurred in connection with the provision of technical services should be included in the definition of “fees for technical services”.

reimbursed. Preventing these types of abuses would impose a significant administrative burden on the tax authorities.

78. Third, a non-resident service provider might not be reimbursed for any of the expenses incurred in providing the services. In this case, the amount of the payment received by the non-resident service provider will be greater than the amount of the service provider's net profit. The maximum rate of withholding tax in paragraph 2 may have been agreed to on the assumption that some of a non-resident's expenses would be reimbursed. On this assumption, the maximum rate of withholding tax may be established at a higher rate than it otherwise would be in order to approximate tax on-6(x).-86(a)4(t)-1

82. As a result of the difficulties described in the foregoing paragraphs, the solution that has been adopted is to omit any reference to the reimbursement of expenses in the definition of “fees for technical services” in Article 12A, paragraph 3. However, countries are encouraged to deal with the problem in their domestic laws and to take the issue into account in establishing the maximum rate of tax under Article 12A, paragraph 2.

83. Although paragraph 3 defines the phrase “fees for technical services,” it does not provide a definition of the term “services.” Similarly, other articles of the United Nations Model Convention dealing with various types of services do not contain any definition of the term “services.” Neither Article 14, which deals with professional and other independent personal services, nor Article 19, which deals with services rendered to the government of a Contracting State, provides a definition of the term “services.” Similarly, the General Agreement on Trade in Services does not contain any definition of the term “services.”

84. Although the term “services” in the phrase “fees for technical services” is undefined in the context of Article 12A, the term “services” should be understood to have a broad meaning in accordance with ordinary usage to generally include activities carried on by one person for the benefit of another person in consideration for a fee. Such activities can be carried out in a wide variety of ways and the manner in which such services are provided does not alter their character for the purpose of Article 12A, to the extent that such services fall within the definition of “fees for technical services” in paragraph 3.

85. It is often necessary to distinguish between fees for services, including fees for technical services, and royalties in order to determine whether Article 12 or another Article of the Convention (Article 12A in the case of “fees for technical services”) is applicable. The distinction between fees for services and royalties is clear in principle.

Under Article 12, paragraph 3, royalties are payments for the use, or the right to use,

89. Example 2: X is a resident of State R and a heart surgeon. X's practice is carried on primarily in State R, although X occasionally travels to other countries to provide heart surgery. X enters into a contract with a health services corporation resident in State S under which X agrees to provide heart surgery on patients referred to him by the health services corporation. X is not an employee of the health services corporation. The surgeries are provided both in State S and in State R. The tax treaty between State R and State S contains a provision identical to Ar4( )] TJET7R

91. If, however, S Company entered into a contract with R Company under which R Company created a specialized database customized for S Company's use from information supplied by S Company or collected by R Company, the payments by S Company to R Company would be "fees for technical services" under paragraph 3. In this situation, R Company would be applying its knowledge, skill and expertise for the benefit of S Company. As a result, the payments would be taxable by State S in accordance with paragraph 2. It would not matter whether R Company performed all or any part of the services of creating the database in State S.

92. Example 4: R Company, a resident of State R, is engaged in the insurance business in both State R and State S. R Company provides insurance against a wide variety of risks through standard form insurance contracts. State R and State S have a tax treaty that is the same as the United Nations Model Convention, including Articles 5, 7 and 12A. Article 12A would not apply because the insurance premiums received by R Company cannot be considered to be fees for technical services within the meaning of paragraph 3. Although R Company uses its knowledge, skill and expertise to develop its various insurance products that are sold to its clients, R Company is not applying its knowledge, skill and expertise directly for the benefit of each particular client.

93. In Example 4, if R Company writes customized insurance contracts dealing with special risks for some clients in State S, the insurance premiums derived by R Company may be considered to be fees for technical services within the meaning of paragraph 3. However, R Company would be deemed to have a permanent establishment in State S under Article 5, paragraph 6 to the extent that it collects premiums or insures risks in State S other than through an agent of independent status. Therefore, by virtue of paragraph 4, the income derived from R Company's insurance activities in State S

would be taxable by State S in accordance with Article 7, and Article 12A would not apply.

94. Example 5: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, credit and debit cards, payment and transmission services, bankers drafts, guarantees, foreign exchange, negotiable instruments, derivative products, investment research and advisory services. R Company’s business is

resident in State S, with respect to a potential merger or acquisition involving S Company. As a result, the payments for such advice would be fees for technical services taxable by State S in accordance with paragraph 2. If, however, R Company provides the services through a permanent establishment located in State S, the fees received for those services would be taxable by State S in accordance with Article 7 rather than Article 12A by virtue of paragraph 4 (see paragraph 93).

97. Example 6: S Company, an enterprise resident in State S, enters into a contractual arrangement with R Company, an enterprise resident in State R, for the right to use a patented chemical formula owned by R Company for the production of an industrial substance. The contract also requires R Company to use its specialized knowledge and expertise to assist S Company to produce the industrial substance in accordance with specifications set out in the contract. In particular, R Company will provide the following services for S Company:

> provide the production procedures and assist S Company in carrying out those procedures; and
>
> provide specifications concerning the necessary materials, tools, and containers used in the production process.

R Company also agrees to use its best efforts to ensure that S Company is able to produce the industrial substance in the quantities and with the characteristics that S Company expects. State S and State R have entered into a tax t

paragraph 2 of Article 12A are the same. If these rates of tax are the same, it will not matter whether payments under mixed contracts are considered to be royalties for the transfer of know-how or fees for technical services. However, if the maximum rates of tax in the two articles are different, it will be important to determine if a particular payment is a royalty taxable in accordance with Article 12, fees for technical services under Article 12A, or some other type of payment.

101.The following example illustrates the distinction between payments for the transfer of know-how and fees for technical services. The considerations to be taken into account in making this distinction are discussed in paragraph 12 of the Commentary on Article 12.

102. Example 7: S Company, an enterprise resident in Country S, enters into a contractual arrangement with R Company, an enterprise resident in Country R, to acquire the use of a secret formula or process developed by R Company. The contract requires R Company to provide the information to S Company subject to strict confidentiality conditions and to use its specialized knowledge and expertise to train employees of S Company with respect to the use of the secret formula or process. State R and State S have entered into a tax treaty with provisions identical to those of the United Nations Model Convention, including Articles 12And 12A.

103. In Example 7 the payments made by S Company to R Company for the right to use the secret formula or process would be payments for “information concerning industrial, commercial or scientific experience” within the meaning of the definition of “royalty” in paragraph 3 of Article 12. This would be the case even if the information represents know-how that is not patented or otherwise protected by intellectual property laws. Similarly, the payments made by S Company to R Company for the training of S Company’s employees would also be payments for “information concerning industrial,

105. Since Article 7 of the United Nations Model Convention adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 4 also makes paragraphs 1 and 2 inapplicable if the fees for technical services are effectively connected with business activities in the State in which the fees arise that are of the same or similar kind as those effected through the permanent establishment.

106.The paragraph does not define the meaning of the expression “effectively connected.”

residence of the owner of the permanent establishment or fixed base, even where the owner resides in a third State.

110. Where there is no economic link between the technical services and the permanent establishment or fixed base, the payments for technical services are considered to arise in the Contracting State in which the payer is resident. If the payer of fees for technical services is not a resident of a Contracting State, Article 12A does not apply to the fees for technical services unless the payer has a permanent establishment or fixed base in the Contracting State and there is a clear economic link between the technical services and the permanent establishment or fixed base. Otherwise there would be, in effect, a force-of-attraction principle for fees for technical services, which would be inconsistent with other provisions of the United Nations Model Convention.

111. Paragraph 5 is subject to paragraph 6, which provides an exception to the source rule in paragraph 5. Paragraph 6 deems fees for technical services made by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in the other Contracting State or in a

deductible for some reason other than the fact that the fees for technical services should not be allocated to the permanent establishment or fixed base.

115.The application of paragraphs 5 and 6 can be illustrated by the following examples.

116.Example 8: R Enterprise is carried on by a resident of State R. R Enterprise provides technical services to S Company, a resident of State S. The tax treaty between State R and State S is identical to the United Nations Model Convention, including Article 12A. S Company carries on business in State S and in State R (or a third State) through a permanent establishment situated there. However, the technical services provided by R Enterprise to S Company are related to S Company's business carried on in State S, not to the business carried on through the permanent establishment in State R (or a third State).

120. In Example 9, Article 12A of the Convention denies State S the right to tax the fees for technical services despite the fact that the fees are paid by a resident of State S. This

State S. Thus, the fees are deemed to arise in State S in accordance with paragraph 5 and State S is entitled to tax the payments in accordance with paragraph 2.

123. In the case of interest and royalties, paragraph 21 of the Commentary on Article 11 and paragraph 19 of the Commentary on Article 12 of the United Nations Model Convention indicate that countries might substitute a rule that would identify the source of interest or royalties as the State in which the loan giving rise to the interest or the property or right giving rise to the royalties was used. A similar source rule might be substituted for purposes of Article 12A. Similarly, as suggested in the Commentary on Articles 11 and 12, where, in bilateral negotiations, the parties differ on the appropriate rule, a possible solution would be a rule that, in general, would accept the payer's place of residence as the source of fees for technical services, but where the technical services are used or consumed in a State having a place-of-use rule, the payment would be deemed to arise in that State.

124. Various other alternative source rules for fees for technical services are possible. Such alternatives include the following:

- The Contracting States might decide not to include paragraph 6. If paragraph 6 were omitted from Article 12A, fees for technical services would b//-3(e)4(d fr)6(om 9( )-29(when1S)-3(tat

permanent establishment or fixed base is situated. Thus, the fees for technical services will be taxed both in the Contracting State of which the payer is a resident and in the Contracting State of which the beneficiary is a resident. Although double taxation will be avoided between these two States, it will not be avoided between them and the third State if the third State taxes the fees for technical services because they are borne by the permanent

having common interest with the individual. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

130. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationships giving rise to the fees for technical services.

131. With regard to the taxation treatment to be au9au9atmegarof7rlaf7boo3( )10231gnCrda7t20BT1 0 0 1 10

fees for technical services, it will be necessary to resort to the mutual agreement