United Nations Practical Portfolio

Protecting the Tax Base

of Developing Countries against Base Erosion: Income from Services

asdf

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Part 1
Introduction

1.1 Background

In 2012, the Organisation for Economic Co-operation and Development (OECD) began working on the problem of base erosion and profit shifting (BEPS). The work on BEPS was a natural outgrowth of the OECD work on exchange of information as a means of countering international tax avoidance and evasion. In their June 2012 meeting, the G20 finance ministers emphasized "the need to prevent base erosion and profit shifting". In February 2013, in response to the G20, the OECD issued a short report on Addressing Base Erosion and Profit Shifting[1] that identified several areas for action and deadlines for the An az /T1_68

Tax Matters established a Subcommittee on Base Erosion and Profit Shifting for Developing Countries with a mandate to consider the implications of BEPS for developing countries and to recommend changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations Model Convention)[3] to deal with BEPS. In addition, the Subcommittee on Transfer Pricing is engaged in work with respect to the effects of the transfer pricing aspects of BEPS on developing countries.

In early 2014, the Capacity Development Unit of the United Nations Financing for Development Office launched a project to assist

- A paper on tax policy considerations related to countermeasures to such base-eroding payments
- An analysis of the advantages and disadvantages of the various options to deal with base-eroding payments
- Model legislation and explanatory notes
- Administrative guidance and practical auditing techniques
- Training materials

In response to the recommendation of the DWG Report, the Capacity Development Unit of the Financing for Development O□ce

countermeasures may be difficult for tax officials in developing countries to administer and enforce.

It is worth emphasizing that any country concerned about BEPS should first review the provisions of its domestic tax system to determine whether it is imposing tax on non-residents earning income from services in all of the situations in which the country considers that it wants to impose tax and is able to do so effectively. Second, the country must review the operation of the rules of its tax system to determine whether those rules are operating as intended or are allowing or facilitating BEPS. Third, if the existing rules are allowing or facilitating BEPS in certain circumstances, the country must consider what types of action it might take to prevent it.

The present Portfolio contains four parts, including this introduction. Part 2 comprises a Tax Policy Assessment Manual consisting of:

Part 3 of the present

Part 2
Tax Policy Assessment Manual

Chapter 1

of the word “services” in the United Nations Model Double Taxation

commercial or scientific equipment and payments for know-how. These distinctions are especially difficult to make where services and other transfers are made under so-called mixed contracts and where services are provided as an ancillary and subsidiary aspect of a transfer of intellectual property, lease of equipment or supply of know-how.

Countries take different positions with respect to whether certain payments are treated as services, royalties or other income. Some countries take the position that services must involve activities performed by individuals; therefore, they consider automated activities, such as the provision of access to a database, online gaming or gambling and communications, not to be services. However, other countries do not consider intervention by individuals to be necessary in order for income to be characterized as income from services.

1.3 Residents earning foreign source income from services

The opportunities for base erosion with respect to residents of a country earning income from services performed outside the country depend on whether the country taxes on a worldwide or territorial basis. In general, worldwide taxation means that a country taxes all or most of the income earned by its residents irrespective of whether the income

opportunities for base erosion are more limited than if it taxes on a territorial basis. If a country does not tax its residents on income from services performed outside the country, those residents have an incentive to earn income outside the country if the foreign tax on such income is less than what the residence country's tax would be, assuming that the income was earned in the residence country. In these circumstances, the choice to exempt foreign source income generally from domestic taxation, either as a matter of tax policy or as a mechanism to relieve double taxation, results in signi□cant opportunities for base erosion.

□us, there are two basic patterns for taxing income from services earned by residents of a country:

(a) Worldwide taxation, under which residents are generally taxable on their income from services wherever those services are earned or performed; and

(b) Territorial taxation, under which a country taxes income from services generally only if the income is earned or derived from the country, so that residents are not taxable on income from services earned outside the country.

It is not necessary for a country to tax all income from services in accordance with one of these basic patterns. For example, a country that generally taxes on a worldwide basis may decide to exempt certain de0.9(d)2.2(e t)-11.1(a)-35.2(x)-11.6(a)10.1(t)-20.4(i)1 /Span #b.7(g1.68a

the obligation to eliminate the double taxation and must do so by providing a credit against its own tax for the tax paid to the foreign country, or by exempting the income earned in the foreign country. It should be noted that if a country provides relief from double taxation by exempting the foreign source income from tax, in e□ect, it is taxing that income on a territorial basis (see the discussion of20.1(t)-2.2(e)-7.1(s)0.5(r)10(
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many countries consider that income from services earned by residents is foreign source income if the person performing the services is physically present and performing the services outside the residence country.

 ird, even if a country taxes on a worldwide basis, it will not usually tax the income, including income from services, derived by a foreign corporation that is owned or controlled by residents of the country. us, residents of a country that provide services outside the country on which they are subject to tax by the country may form foreign corporations that they control to provide those services. is use of a controlled foreign corporation (CFC) is a relatively simple way for residents of a country to avoid paying tax on their worldwide income. Moreover, such CFCs can be used to provide services in the country in which the controlling shareholders of the CFCs are resident. In this situation, a country's ruolder5.7(i)]Tpntse

If a country also taxes income derived by non-residents from services consumed or used in the country, the basic patterns of taxation of those services are as follows:

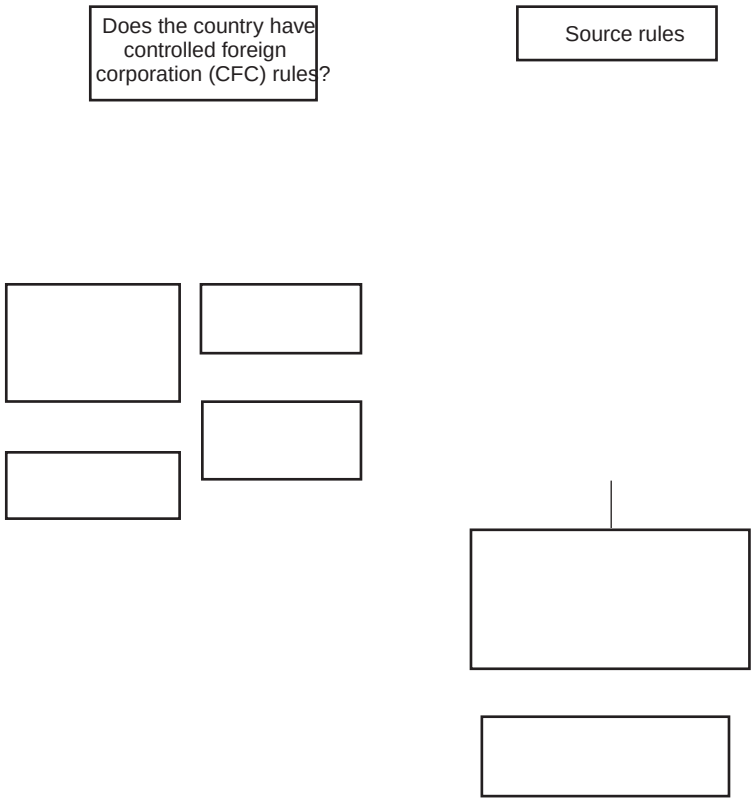
(a) All payments by residents of the country for services provided by non-residents are subject to a gross basis withholding tax; such a broad tax is difficult to enforce, especially where the payments are made by individuals;

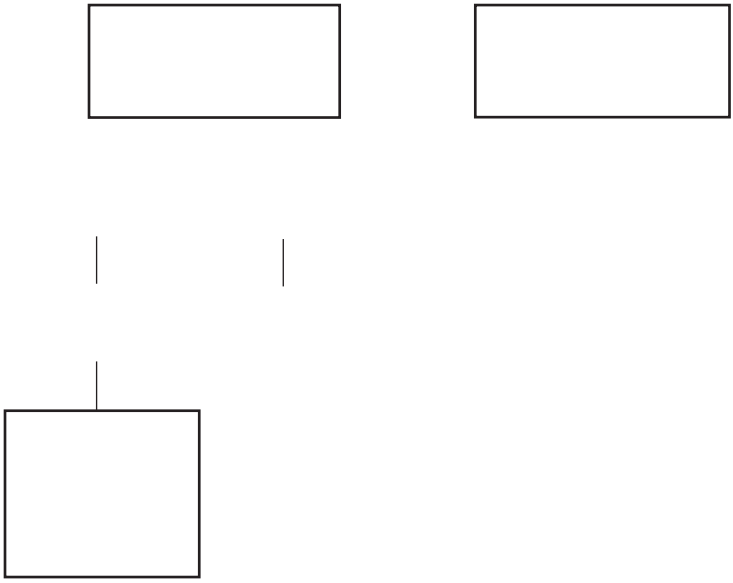
(b) Payments by residents of the country for services provided by non-residents are subject to a gross basis withholding tax if the payments are deductible by the residents in computing their income subject to tax;

(c) Payments by non-residents with a PE or fixed base in the country are subject to a gross basis withholding tax if the payments are deductible by the non-residents in computing their income subject to tax by that country (that is, their income attributable to the PE or fixed base).

Income from services provided by a non-resident outside the country and used or consumed outside the country would not be subject to tax by that country.

Some services performed by non-residents may be subject to tax by a country irrespective of where the services are performed or used or consumed if the payments for the services are made by a resident of the country or a non-resident with a PE or fixed base in the country. Alternatively, the country may deny the payer any deduction for the payments to the non-resident service provider. This form of taxation is usually restricted to payments for managerial, technical and consulting services. For example, assume that R Co, a resident of Country R, provides 2 TD [(R)-19(, p)14.8(r)7.1(.7(t)-199(a)(i)10s)-6.8(s)3.3(u)-20.4(m)8.9


Does the country have controlled foreign corporation (CFC) rules?
Source rules



of ships and aircra in international tra c and boats in inland waterways transport are taxable only in the country in which the enterprise has its place of e ective management; thus, neither the country in which the enterprise is resident nor the country

2.3.2.1 Employment income

In general, under Article 15 of both Models, the country in which employment is exercised is entitled to tax the income from such employment unless the employee is employed by a non-resident without a PE or □xed base in the country and is not present in the country for 183 days or more in any 12-month period beginning or ending in the relevant taxation year. (Since Article 14 dealing with professional and other independent services has been deleted from the OECD Model Convention, the reference to □xed base is relevant only for purposes of the United Nations Model Convention.) In other words, the provisions of Article 15 of both the United Nations and OECD Model Conventions prevent

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following specific types of employment income are subject to special rules:

(a) Under Article 16 of the United Nations and OECD Model Conventions, directors' fees are taxable by the country in which the company paying the fees is resident; Article 16 of the United Nations Model Convention also extends to remuneration of top-level managerial officials. Such fees and remuneration are taxable by the country in which the company paying the fees and remuneration is resident, irrespective of where the directors or managers perform their services (that is to say, inside or outside the country in which the company is resident).

(b) Under Article 19 of both Models, remuneration and pensions paid by the Government of one contracting State to an employee resident in the other contracting State are taxable by the Government paying the remuneration or pension. It does not matter for the purpose of this rule whether the employment services are performed inside or outside the country paying the amount. However, as noted above, this rule does not apply if the employee is a resident and national of the other State and the employment services are performed in the other State.

(c) Under Article 17 of both Models, income from entertainment and athletic activities performed in a country by an individual as an employee may be taxed by that country. The only condition for taxation is that the entertainment or athletic activities must take place in the country. There is no minimum threshold for taxation. Income from entertainment and athletic services are discussed in more detail in section 2.3.2.2 below.

(d) Under Article 18 of the OECD Model Convention, pensions (and other similar remuneration) are taxable only by the country in which the recipient is a resident. Under Article 18 of the United Nations Model Convention, however, pensions paid by the Government of a country as part of its social security system are taxable by that country. Also, under Article 18 (alternative B) a country is entitled to tax pension payments if the payer is a resident or a non-resident with a PE in that country.

2.3.2.2 Entertainment and athletic activities

Under Article 17 of both Models, a country is entitled to tax income from any entertainment or athletic activities that take place in the country. □ ere is no minimum threshold for tax by the source country. Article 17 also contains an anti-avoidance rule that allows the country in which the activities take place to tax the income from those activities even if they accrue to a person other than the entertainer or athlete.

2.3.2.3 Income from professional and other independent services

Under Article 14 of the United Nations Model Convention, income from professional and other independent services performed by a resident of one contracting State is taxable by the other contracting State if the resident has a □xed base regularly available in the other State or stays in the other State for 183 days or more in any 12-month period beginning or endosdo.182 TD [(s)-h(d)m74T-aMc37 ɛo)12.9(.)12.8(n)1.2u 183(99.
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completely clear under the United Nations Model Convention, a construction PE must be a fixed place of business and also meet the time threshold. Thus, taxpayers can avoid having a construction PE by carrying out projects that take less than 6 or 12 months or that take place in different locations, or by fragmenting projects among related parties.

Insurance

Under Article 5 (6) of the United Nations Model Convention, a resident of one contracting State is deemed to have a PE in the other contracting State if it collects insurance premiums or insures risks in the other State (other than through an independent agent). In contrast, under the OECD Model Convention, a resident of one contracting State carrying on an insurance business in the other contracting State is subject to tax in that State only if it has a PE in that other State. Thus, under the OECD Model Convention, it is relatively easy for an insurance company resident in one State to avoid tax on insurance profits derived from the other State by not establishing a fixed place of business in the other State and not doing business through agents with authority to regularly conclude contracts. However, it is difficult to avoid tax on insurance profits earned in another country under Article 5 (6) of the United Nations Model Convention.

2.3.2.5 Income from technical services

The United Nations Committee of Experts on International Cooperation in Tax Matters, at its eleventh session in October 2015, approved the addition of a new Article to the United Nations Model Convention dealing with fees for technical services. Under this new Article, a country will be entitled to tax fees for technical services paid by its residents or non-residents with a PE or fixed base in the country to residents of the other country for technical services on the gross amount of the fees. If, however, the recipient of the fees is a resident of the other country and the beneficial owner of the fees, the tax on the fees is limited to a rate agreed through the negotiations of the treaty partners. Under the new Article, it is not necessary for the technical services to be performed in the country; nor is it necessary for the non-resident service provider to have a PE or fixed base in the country. A country is entitled to impose a gross withholding tax on fees for technical services if the fees “arise” in the country and are paid to a

resident of the other country. For this purpose, technical fees would arise in a country if the fees are paid by a resident of the country or a non-resident with a PE or fixed base in the country. Fees for technical services are defined to be fees for services of a management, technical or consultancy nature and generally include services that require the exercise of specialized skills, knowledge or experience. Employment services and services for the personal use of an individual are expressly excluded from the provision.

Table 1
Summary of the provisions of the United Nations and OECD Model Conventions dealing with income from services

Type of income from services	Conditions for source country tax
Business profits (Arts. 5 and 7)	■ PE and income attributable to PE ■ United Nations Model Convention: à Services performed in the source country for 183 days or more for the same or a connected project ■ OECD Model Convention: à Alternative services PE rule
Construction and related services (Art. 5 (3))	■ Construction project in the source country that lasts more than 6 months (United Nations) or 12 months (OECD)
Insurance (Art. 5 (6))	■ United Nations Model Convention only: à Collection of premiums or insurance of risks in the source country other than through independent agents
Shipping and air transportation (Art. 8)	■ No source country tax except under United Nations Model Convention alternative B rule if international shipping activities in the source country are more than casual
Independent personal services (Art. 14)	■ If business profits, see "Business profits" above ■ United Nations Model Convention only: à Fixed base and income attributable to the fixed base à Services performed in the country if the person stays in the country for 183 days or longer

Table 1 (cont'd)

Type of income from services	Conditions for source country tax
Dependent personal services (Art. 15)	▪ Employment exercised in the source country if the individual stays for more than 183 days or is paid by a resident of the source country or a non-resident with a PE or fixed base (United Nations Model Convention only) in the source country
Remuneration of directors (Art. 16)	▪ Residence of the payT1.3 0 Td [(RqEMC /Span /Lan.9(h)42(ne

Chapter 3
Information gathering for tax policy analysis

3.1 Introduction

For purposes of applying tax policy analysis to a country's tax system

countries that do not have an extensive network of bilateral tax treaties may wish to consider ratifying the Multilateral Convention on Mutual Administrative Assistance.

3.3 Income derived by non-residents from services

3.3.1 Types of services

What are the major types of services performed by non-residents in a country, or for residents of a country, or for non-residents carrying on business in the country? This information is useful if the tax treatment is different for income from various types of services under a country's domestic law or under the provisions of its tax treaties. For example, many countries have special provisions for taxing non-resident entertainers and athletes; therefore, it would be useful to have a system to identify performances in a country by non-resident entertainers and athletes.

3.3.2 Total amounts paid by residents to non-residents for services

It would be important to know the total amounts paid by residents to non-residents for services:

- Performed in a country
- Performed through a permanent establishment (PE) or fixed base in a country
- Performed outside a country

This information is important to determine to what extent a country's tax base is reduced by payments for services to non-residents.

3.3.3 Total amount of net income from services performed by non-residents and total amount of tax collected on such income

3.3.4 Total amount of withholding tax collected on gross amounts paid to non-residents

Chapter 4

Still further, the risks of base erosion are greater with respect to certain types of services provided by related parties. For example, a multinational enterprise may incur large expenses with respect to services provided to it by third parties, such as telecommunications companies. These expenses represent legitimate expenses. The issue for the country is whether the amount of the enterprise's total expenses allocated to the subsidiary is reasonable. The amount charged to the enterprise by the telecommunications companies are expenses incurred at arm's length. In contrast, where the expenses are for services provided to the subsidiary in the country by another group company, such as technical or management services or head office services, the amounts charged must be checked to ensure that they do not exceed arm's length amounts.

Even if arm's length services are provided to persons carrying on business in a country, the country may have concerns where the service providers are resident in low-tax countries. In such circumstances, the non-resident service providers may have a competitive advantage over residents of the country providing the same or similar services.

One very important point to keep in mind in examining the question of base erosion is that any identification of the risks of the erosion of a country's tax base involves an assumption about what the country's tax base is or should be. For the purposes of this Tax Policy Assessment Manual, it is assumed that a country's tax base is comprehensive (that is to say, that all income from services derived by residents and all income derived by non-residents from services having its source in the country is subject to tax). Therefore, each country must assess the risks of tax base erosion from the perspective of its own tax system, as suggested in the introduction to the present Portfolio.

The major factors that should be considered in identifying and evaluating the risks of base erosion are as follows:

¾ What income from services does the country not tax?

¾

¾

Most countries impose tax on an employee's gross income from employment, permitting no or only limited deductions in computing income. Also, they collect tax on income from employment derived by non-residents by imposing an obligation on employers to withhold tax on account of the employees.

The major risks of base erosion with respect to income from employment derived by non-residents are discussed immediately below. For a detailed discussion of the issues involved in the secondment of employees by a non-resident company to a related resident company or to a PE of the non-resident company, see section 5.3 below.

If non-residents are employed by a non-resident employer that has a PE or fixed base in a country, is the employment income subject to tax under the country's domestic law?

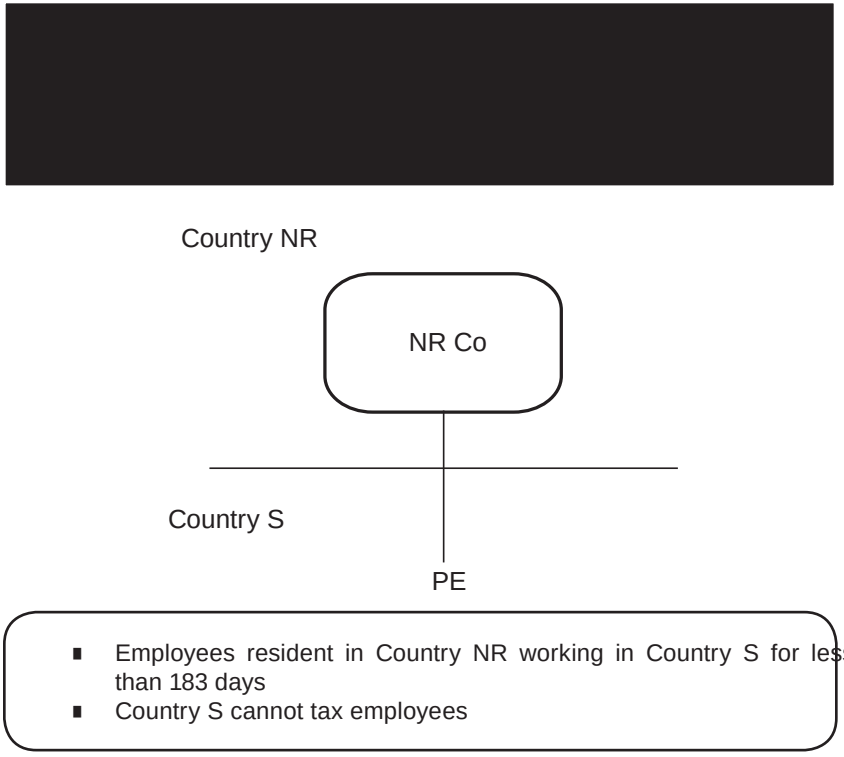
The remuneration paid by the non-resident employer to non-resident employees who are employed in connection with a PE or fixed base that the non-resident has in a country will usually be deductible in computing the income attributable to the PE or fixed base that is taxable by that country. Thus, if the employees' income is not taxable but the employer claims a deduction, the country's tax base will be eroded by the deduction.

The solution for this type of base erosion is to subject the employ-

If non-residents are employed by a non-resident employer that does not have a PE or fixed base (or is not otherwise taxable) in a country, is the employment income subject to tax under the country's domestic law?

If a country does not impose tax under its domestic law on employment income earned by non-resident employees from employment services performed in the country for a non-resident employer unless the employer has a PE or fixed base in the country, non-resident employers may try to avoid having a PE or fixed base in the country in order to avoid paying tax to the country on any profits derived from that country and on any employment income derived from that country by their employees. Some of the common methods for avoiding a PE or fixed base include:

(a) Commissionaire arrangements (under the law of many civil law countries, the commissionaire has no legal authority to bind the principal on whose behalf the commissionaire



The solution for this risk of base erosion is to ensure that a country's domestic law contains anti-avoidance rules to prevent non-residents from avoiding having a PE or fixed base through artificial means. If the anti-avoidance rules are contained in domestic law, it is important that the provisions of the countries' tax treaties do not prevent the application of the anti-avoidance rules.

Even if non-resident employees are taxable under a country's domestic law where the non-resident employer does not have a PE or fixed base in the country, the employment income will escape tax to the extent that the country has entered into tax treaties with a provision similar to Article 15 (2) of the United Nations Model Convention

Article 15 (2) on dependent personal services prevents a source country from taxing employees resident in the other contracting State if they are employed by a non-resident employer without a PE or fixed

base in the country unless the employee is present in the country for 183 days or more.

The solution for this risk of base erosion is to ensure that a country's domestic law and tax treaties contain anti-avoidance rules to prevent non-residents from artificially avoiding having a PE or fixed base in the country.

If services are provided by a non-resident individual to a resident of a country or to a PE or fixed base that a non-resident has in a country and the individual is not an employee but an independent contractor, is the income derived from the country by the independent contractor subject to tax under the country's domestic law? Do the provisions of the country's tax treaties prevent the country from taxing a non-resident independent contractor on income from services earned in the country unless the independent contractor has a PE or fixed base in the country?

Under the domestic law and tax treaties of many countries, income earned by non-resident independent contractors is treated differently

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The solution to this type of base erosion is for each country to have domestic anti-avoidance rules to prevent this type of tax avoidance and to ensure that the provisions of its tax treaties are interpreted and applied to deny treaty benefits in these circumstances.

If a country does not tax the fees and remuneration earned by directors and top-level managers of companies resident in the country, the country's tax base will be eroded, since the fees and remuneration will be deductible by the resident companies

Directors and top-level managers can earn substantial amounts. The solution for this risk of base erosion is for a country to ensure that the provisions of its domestic law impose tax in these circumstances and that any tax treaties that it enters into contain a provision comparable to Article 16 of the United Nations Model Convention. Domestic tax imposed on directors' fees and the remuneration of top-level managers can be effectively collected by requiring the resident companies to withhold the tax from the fees and remuneration. Article 16 allows the country in which the paying company is resident to tax the fees and remuneration irrespective of where the services are performed by the directors or top-level managers. If a country imposes tax on directors' fees and remuneration of top-level managers that are derived

4.3 Income from entertainment and athletic services

Some entertainers and athletes can make large sums of money in a short period. They may be self-employed, employees of an entity such as a team or orchestra, or employees of an entity that they control or own. There is a possibility that the income derived by non-resident entertainers and athletes may not be taxable under a country's domestic law because, for example, the country taxes income of non-residents only if they have a PE or fixed base in the country or spend a minimum amount of time in the country.

The solution is for each country to ensure that it imposes tax on all income derived by entertainers and athletes from activities performed in the country, irrespective of whether the income is earned from employment or independent services. In addition, any tax treaties entered into by the country should not limit its right to tax income from entertainment and athletic activities performed in the country by non-residents (in other words, the tax treaties should contain provisions similar to Article 17 of the United Nations Model Convention).

Non-resident entertainers and athletes may attempt to avoid a country's tax by, for example, assigning some or all of their income earned in the country to another person (for example, a corporation controlled by the entertainer or athlete). Each country should ensure that the provisions of its domestic law allow it to tax any income derived from employment or athletic activities performed in the country, irrespective of whether the income is derived by the entertainer or athlete or by some other person, such as a related entity. In addition, any tax treaties entered into by the country should contain a provision comparable to Article 17 (2) of the United Nations Model Convention.

4.4 Income from professional and independent services

Non-resident professionals and other individuals performing services in a country may not be taxable under its domestic law unless they spend a minimum amount of time in the country or provide the services through a PE or fixed base in the country

If this type of base erosion is considered to be unacceptable, the solution is for the country to impose tax on all income from services performed in the country by non-resident individuals. Such a tax may be difficult to enforce, especially where an individual is in a country temporarily. The tax can be effectively enforced through a withholding obligation on residents of the country or non-residents carrying on business in the country. However, even these types of withholding tax may be difficult to enforce to the extent that they are imposed on individuals. A country may also consider denying a deduction by the person paying the non-resident for the services. This provision will be effective only for persons in the country that are otherwise entitled to claim a deduction for such service payments.

Even if a country taxes all income from services performed by non-resident individuals in the country, any tax treaties entered into by the country with provisions similar to Article 14 or 7 of the United Nations Model Convention will prevent the country

Even if a country taxes income from services performed by non-resident individuals outside the country, any tax treaties entered into by that country with provisions similar to those of the United Nations Model Convention will prevent the country from imposing such a tax

□ e solution here is for each country to negotiate the inclusion of spe-

4.5 Income from other business services

Non-resident entities and individuals performing services in a country may not be taxable under the country's domestic law unless they spend a minimum amount of time in the country or provide the services through a PE in the country

If this type of base erosion is considered to be unacceptable, the solution is for each country to impose tax on all income from services performed in the country by non-resident individuals or entities. Such a tax may be difficult to enforce, especially where the non-resident is in the country temporarily, and it may discourage non-residents from performing services in that country. The tax can be effectively enforced through a withholding obligation on payers resident in or carrying on business in the country. However, even such a withholding tax may be difficult to enforce to the extent that it is imposed on individuals. To the extent that the payments for the services provided by non-residents are deductible by payers in the country, the country may consider denying deductions for the payments or allowing deduc-

5 and 7 of the United Nations Model Convention will prevent the country from taxing the income unless the income is earned through a PE in the country

The above limitation on a country's taxing rights can be avoided if the country does not enter into tax treaties. Alternatively, a country might attempt to negotiate a shorter minimum time period for a services PE under Article 5 (3) (b) (Permanent establishment) than the 183-day minimum in the United Nations Model Convention.

Where non-resident service providers are taxable by a country only if (under its domestic law or tax treaties) they have a PE in the country, they may try through various artificial means to avoid having a PE in the country

The solution to this problem is for a country to have anti-avoidance rules in either its domestic law or its tax treaties, or both, to prevent artificial avoidance of PE status. The OECD BEPS Action 7 (Prevent the artificial avoidance of PE status) deals in detail with the artificial avoidance of PE status and makes several proposals for combating such avoidance. In addition, a country might consider attempting to negotiate tax treaties that do not contain the "same or connected project" requirement in Article 5 (3) (b).

Non-resident entities and individuals may perform services outside a country to clients resident in or carrying on business in the country; in these circumstances, the clients will likely deduct the payments for the services in computing their income for purposes of the country's tax—these deductions will reduce the country's tax base

The solution for this type of base erosion is for a country to impose a withholding tax on payments for services (or certain services) made to

Non-resident entities and individuals may perform services for related individuals or entities resident in or carrying on business in a country; as noted in subsection immediately above, the amounts paid for the services will likely be deductible against that country's tax base; in addition, because the payer and non-resident service provider are related, there is a risk that T267

Non-resident insurance companies may not be taxable by a country because they do not carry on business through a PE in the country; nevertheless, they may engage in substantial business in the country

 is type of base erosion can be countered if each country imposes tax on non-resident insurance companies that collect premiums in the country or insure risks located in the country.

Even if a country imposes tax on non-resident insurance companies that collect premiums or insure risks in the country, any tax treaties entered into by the country will prevent the country from imposing that tax unless theyt tcomb EMC /Span s.1(a)Spa.7(d 423i.3(y)(e i)84-20

Model Convention) will prevent that country from imposing that tax unless the construction project lasts for at least six months

A country can avoid the limitations imposed by tax treaties by not entering into tax treaties or by attempting to negotiate a shorter minimum time period for a construction site PE. In addition, a country might consider attempting to negotiate a provision in its tax treaties dealing with construction site PEs that does not require the construction activities to occur at a single fixed place of business.

Assuming that Country S has a tax treaty with Country R with a provision identical to Article 5 (3) (a) of the United Nations Model Convention, Country S will not be allowed to tax R Co on its profits from the construction project in Country S unless it lasts more than six months. However, arguably, each shopping centre will be considered to be a separate site for purposes of Article 5 (3) (a), so that neither site will be deemed to be a PE. In other words, the two construction sites cannot be aggregated for purposes of applying the six-month minimum time threshold, despite the fact that both shopping centres are owned by the same entity and both projects are covered by a single contract.

If Country S wants to be able to impose tax on non-resident construction companies in these circumstances, it should not enter into treaties with provisions similar to Article 5 (3) (a), or it should negotiate special provisions in its treaties that allow construction projects at different locations in Country S to be aggregated, especially if they are performed for the same owner.

4.6 Summary: key risks of base erosion

This chapter contains a comprehensive list of the potential risks for the erosion of a country's tax system as a result of non-residents performing services. Many of the risks described in this chapter are relatively

insigni□cant and it may not be worthwhile for a country to take any action to eliminate these risks. From a risk management perspective, each country will wish to target the base-erosion risks that pose the greatest threat to its tax base. Each country must identify the most serious risks of tax base erosion based on its particular situation. However, in general, the following situations are likely to present the most serious risks of base erosion:

(a) Income from employment:

- Non-resident employees working for a PE or □xed base of a non-resident
- Non-resident employees who are in substance employees of a resident employer but who are legally employed by a non-resident employer (international hiring-out of labour)
- Non-residents who are in substance employees of a resident employer but are legally independent contractors

(b) Income from entertainment and sports activities:

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- Non-residents performing substantial services outside a country to clients who are resident or carrying on business in the country, especially where the clients claim deductions for the payments to the non-resident service provider

Chart
Risks of base erosion with respect to income from services and the options for dealing with such risks

Risks of base erosion	Options for dealing with the risks of base erosion
Employment income—residents	
▪ Services performed by residents outside a country if the country taxes on a territorial basis ▪ Exemption of income from services performed through a foreign PE ▪ Use of a controlled foreign cor-	

Risks of base erosion	Options for dealing with the risks of base erosion
	■ Deny a deduction if there is no withholding (Tax treaties may prevent a country from taxing)
■ Services performed by non-resident employees of a non-resident employer without a PE or fixed base in a country (no deduction against the country's tax base) à If taxable in the country, provisions similar to Art. 15 (2) of the United Nations Model Convention in the country's treaties will prevent that country from taxing employees	■ Ensure in domestic law or tax treaties that non-residents cannot artificially avoid having a PE or fixed base
■ Remuneration of non-resident directors and top-level managers of companies resident in a country	■ Ensure that tax on such income is imposed under domestic law and there is an obligation on the resident company to withhold tax ■ Ensure that any tax treaties contain provisions similar to Art. 16 of the United Nations Model Convention
■ Non-resident individual's legal status as independent contractor rather than employee may prevent a country from taxing, either because of domestic law or tax treaties (including international hiring-out of labour—formal employer is non-resident but resident is employer in substance)	■ Ensure that domestic law contains anti-abuse rules to prevent artificial manipulation of legal relationships, including international hiring-out of labour
■ Non-resident employers providing employment services to the Government of a country	■ Impose tax on amounts paid by the Government to non-resident employers and ensure that any tax treaties contain provisions similar to Art. 19 of the United Nations Model Convention

Risks of base erosion	Options for dealing with the risks of base erosion
■ Pensions paid to non-residents	■ Impose tax on pensions paid to non-residents by resident employers, non-resident employers with a PE or fixed base, or the Government, and ensure that any tax treaties contain provisions similar to Art. 18 (alternative B) of the United Nations Model Convention
Income from entertainment and athletic activities	
■ Income derived by a non-resident entertainer or athlete from activities in a country for a short time may not be taxable	■ Impose tax on any income from entertainment or athletic activities performed in the country irrespective of whether the non-resident has a PE or fixed base in the country or spends a minimum period of time in the country ■ Ensure that any tax treaties contain provisions similar to Art. 17 of the United Nations Model Convention
■ Non-resident entertainers and athletes may assign income to another person who is not taxable by a country	■ Ensure that domestic law contains anti-avoidance rules to prevent non-resident entertainers and athletes from assigning income to another person ■ Ensure that any tax treaties contain provisions similar to Art. 17 (2) of the United Nations Model Convention
Business, professional and other independent services	
■ If a country taxes income from business services only if a non-resident has a PE or fixed base in the country, the non-resident may structure its affairs to avoid PE or fixed base by:	■ Ensure in domestic law and/or tax treaties that non-residents cannot artificially avoid having a PE or fixed base

Risks of base erosion	Options for dealing with the risks of base erosion
à Providing services at various locations à Fragmenting services among related entities à Using related entities to carry on connected projects	
▪ Amounts paid to non-residents by residents of a country or non-residents with a PE or fixed base in the country for services performed outside the country, that is to say, services provided outside the country but consumed or used in the country (deductible against the country's tax base)	▪ Ensure that payments for such services are subject to tax under domestic law ▪ Impose a withholding obligation on resident payers and non-resident payers with PE or fixed in the country ▪ Deny a deduction if there is no withholding ▪ Ensure that tax treaties do not prevent the country from taxing
Construction	
▪ If construction activities are taxable only if they last for a minimum period, non-residents can avoid tax by fragmenting a construction project into multiple projects with shorter time periods ▪ Tax treaties may provide that income from construction is taxable by a country only if the non-resident has a PE	▪ Adopt a shorter minimum time period for construction projects in domestic law and in tax treaties ▪ Adopt anti-avoidance rules in domestic law and/or tax treaties ▪ Ensure that non-residents cannot avoid PE status artificially
Insurance	

Risks of base erosion	Options for dealing with the risks of base erosion
International shipping and air transportation	
▪ If payments for shipping and air transportation services are deductible against a country's tax base and payments are not taxable, the country's tax base will be eroded	▪ Impose a domestic withholding tax on payments for shipping and air transport of goods or persons taken on board in the country
▪ Difficult to tax to the extent that activities occur outside any country's territory	▪ Ensure that tax treaties do not contain provisions similar to Art. 8 (alternative A or B) of United Nations Model Convention
▪ Art. 8 (alternative A) prevents any tax on such services ▪ Art. 8 (alternative B) prevents any tax except on more than casual shipping activities in the country	
Fees for technical services	
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their VAT on supplies of services to resident consumers; non-resident suppliers must register for VAT purposes and collect tax on supplies of services. Some countries use a "reverse charge" mechanism to collect VAT on supplies of services by non-resident suppliers. Instead of the non-resident service supplier collecting the tax, business consumers who are registered for VAT are required to collect the tax. In most cases

If the employees of the non-resident parent company become residents of the country in which the subsidiary is resident, they will be taxable as residents under the domestic law of that country. However, if that country has entered into a tax treaty with the country in which the parent company is resident with a provision similar to the tie-breaker rule in Article 4 (Resident) of the United Nations Model Convention,[12] the employees will likely be considered to be residents of the country in which the parent company is resident for purposes of the treaty (because the employees have their permanent homes or their centre of vital interests in that country). Even if the tie-breaker rule applies to make employees resident in the country in which their employer is resident, the country in which the subsidiary is resident is entitled to tax the income from employment derived by the employees under Article 15 (Dependent personal services) of the treaty to the extent that they are employed by a resident of that country and the employment activities are exercised in that country.

Whether or not employees of the parent company or related company become residents of the country in which the subsidiary is resident, they may become employees of the subsidiary or remain employees of the parent company.

If the employees cease to be employees of the non-resident parent company or other related company and become employees of the subsidiary, their employment income will usually be taxable by the country in which the subsidiary is resident and deductible in computing the profits of the subsidiary under the domestic law of that country. In addition, if that country has any tax treaties with a provision similar to Article 15 of the United Nations Model Convention, those treaties will not prevent that country from taxing the income of the non-resident employees from employment exercised in that country in accordance with its domestic law.

If the employees remain employees of the parent or related company, which will often be the case because of complications with respect to their continuing participation in pension and other deferred

[12] United Nations, Department of Economic and Social Affairs, United Nations Model Double Taxation Convention between Developed and Developing Countries (New York: United Nations, 2011).

compensation plans, the subsidiary should be expected to compensate the parent or other related company for providing the services of their employees. The amount paid by the subsidiary will be deductible in computing its profits subject to tax by its country of residence; however, that country will not be entitled to tax the income derived by the employees unless they are present in that country for more than 183 days in any 12-month period or the non-resident parent or related company has a PE or fixed base in the country and the remuneration of the employees is borne by that PE or fixed base.

The provision of services by one company to a related company through the secondment of employees of the first company to the related company is a transaction between non-arm's length parties that should be subject to transfer pricing rules (see United Nations Practical Manual on Transfer Pricing for Developing Countries).[13] The country in which the subsidiary is resident should ensure that it does not allow the subsidiary to deduct an amount in excess of the arm's length price of the employment services provided by the parent or related company. The issue that often arises in this regard is whether the arm's length price for the provision of employees by a related enterprise is simply the salaries and other remuneration of the employees for the period during which they provide services for the subsidiary, or that amount plus a markup. Where the subsidiary can obtain the services by hiring its own employees for an amount equal to or less than the remuneration paid to the seconded employees by their employer, the country in which the subsidiary is resident should not allow the deduction of any markup on the remuneration; only reimbursement of the actual expenses incurred by the parent or related company with respect to the seconded employees should be deductible.

Where employees of a non-resident enterprise work on behalf of a PE or fixed base located in the source country, the source country will be entitled to tax the employment income derived by those employees under Article 15 of any applicable tax treaty. In addition, the source country will usually be required by Article 7 (Business profits) or 14

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(Independent personal services) of any applicable tax treaty to allow a deduction in computing the profits of the PE or fixed base for the remuneration of those employees to the extent that their employment activities are attributable to the PE or fixed base. The question that often arises in this regard is whether the source country must allow a deduction for the actual costs incurred in remunerating those employees or the actual costs plus a markup. The allowance of a markup is based on the proposition that a PE is deemed to be a separate entity dealing at arm's length with the other parts of the enterprise, and that such a separate enterprise would expect to make a profit from providing services through its employees to other enterprises.

The Commentary on Article 7 of the United Nations Model Convention[14] indicates that a markup should be allowed only if part of the business of the enterprise involves providing services to arm's length third parties. Therefore, if an enterprise provides services through employees to a PE, but does not provide similar services to third parties, only the actual costs incurred by the enterprise in providing the employees to the PE should be deductible in computing the profits of the PE.

See section 4.2 above for a discussion of the risks of base erosion with respect to employment income.

5.4 Intra-group services

In multinational groups, it is common for a wide range of services to be provided by one member of the group to another member or members of the group. For example, the parent company of a multinational

Intra-group services raise difficult transfer pricing issues. The country in which the payer is resident must ensure that the amount paid for services provided by a related non-resident service provider does not exceed the arm's length price of those services.[15] Before a country applies its domestic transfer pricing rules or the provisions of Article 9 (Associated enterprises) of an applicable tax treaty, it must determine whether, as a question of fact, intra-group services have been rendered to or by a resident member of a multinational group. This factual question may be relatively easy to determine where one member of the group provides services for the benefit of another member of the group because if the service recipient is an independent enterprise, it would be required to contract with a third party for those services or perform them in-house itself. The question is more difficult where one member of the group provides services for several members of the group or for the group as a whole.

In some situations, it may be appropriate to consider that no services have been provided to a group company. For example, activities performed by one group company, say the parent, that relate to its

to the fees for the services actually performed) with respect to services to be provided by another group company. Such fees should be allowed only if it would be reasonable for an independent enterprise in similar circumstances to incur similar standby fees.

It is important with respect to all intra-group services for the tax authorities to carefully examine the terms and conditions of the contractual arrangements between the group members, and also the actual services performed.

5.5 Mixed contracts

In some circumstances, goods or intangible property may be sold or licensed together with services. For example, goods or equipment may be sold with the seller agreeing to provide after-sales services, which could include training of the employees of the buyer with respect to the operation of the goods or equipment or repair services under a limited warranty. Another frequently encountered example is the licensing of intangible property together with technical assistance. Such mixed contracts present difficulties for tax administrations.

If property and services are sold together in a mixed contract between associated enterprises, the tax authorities must determine for the purpose of transfer pricing rules whether the rules should be applied to the combined transaction, or whether the combined transaction should be disaggregated into its separate components and the

by a country only if the income is earned by a resident of the other contracting State through a PE or fixed base located in the country and only to the extent that the income is attributable to the PE or fixed base. Moreover, the income covered by Article 7 or 14 will usually be taxed on a net basis. Under the new Article on fees for technical services (see section 2.3.2.5 above), a contracting State will be entitled to tax fees for technical services derived by a resident of the other contracting State on a gross basis at a rate to be negotiated.

In contrast to the treatment of income from services, under Article 12 (Royalties), a contracting State in which royalties arise is entitled to tax the gross amount of the royalty payments at a rate to be negotiated between the contracting States. Royalties are defined in Article 12 (3) to mean payments for the use of, or the right to use, any copyright, patent, trademark, design, plan, secret formula or process, any industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience. In general, royalties mean payments for the use of, or the right to use, intellectual property, equipment or know-how (information concerning industrial, commercial or scientific experience). Thus, royalties involve the transfer of the use of or the right to use property or know-how. In contrast, typically when an enterprise provides services to a customer, the enterprise does not transfer its property or know-how or experience; instead, the enterprise simply performs work for the customer.

Where an enterprise provides both services and the right to use property or know-how to a customer, the Commentary on the United Nations Model Convention provides that the payments under the contract must be disaggregated into separate elements of payments for services and royalties, unless one element is only ancillary and largely unimportant.[17] If a developing country includes the new Article on technical services in its treaties, the negotiation of a rate of tax for fees for technif payes and t.1(y a)-22.9(n)10.(, u)-19.5(n)-20.9(l)9.9(e)-7.1(s)N2(g)0.4(e)·

As with intra-group services, it is important with respect to mixed contracts for the tax authorities to carefully examine the terms and conditions of the contractual arrangements between the parties, as well as the actual facts concerning the use of property and services provided. □ is is especially important where the parties are not dealing at arm's length.

2. How much tax revenue, if any, does the country raise from taxing income from services earned by non-residents?
3. Consider whether the country's rules for taxing non-residents on income from services discourages non-residents from rendering services in the country or to residents of the country.
4. Consider whether the country discriminates against non-residents compared to residents or vice versa.

Part 3

treaties may suggest possible changes that might be made. Further, the sample provisions should not be treated as recommendations for the inclusion of such provisions, even in modified form, in a country's tax system or its tax treaties. Each country must decide for itself whether, and to what extent, it is concerned about the risks of base erosion with respect to income from services identified in chapter 4 of part 2 and, if so, how best to deal with those risks. This Portfolio is intended to provide the tax officials of developing countries with guidance in this regard.

Chapter 2

e major design elements in dra ing domestic legislation to counter base erosion with respect to income from services

2.1 Introduction

 is chapter analyses the major design elements or structural features of domestic legislation for taxing income from services to eliminate the risks of base erosion that were identi ed in chapter 4 of part 2. e

net-basis taxation and which amounts are subject to withholding tax.[1] It analyses the design features of net-basis taxation and withholding taxes in general, rather than as they might apply to particular types of income from services.

2.2 Taxation of residents on income from services

2.2.1 Introduction

As discussed in chapter 1 of part 2, the risks of base erosion with respect to income from services earned by residents of a country are dependent upon how that country taxes its residents. If it taxes its residents on their worldwide income, including their income from services performed outside the country, the risks of base erosion will be less than they would be if the country taxes residents only on their income earned in the country. The extent of base erosion is greatest where residents of a country earn income in low-tax or no-tax countries.

2.2.2 Risks of base erosion

exempt from tax, rather than domestic source income, which is taxable, can be dealt with by:

(a) Taxing all foreign source income and providing a credit for any foreign taxes on the income (as discussed in section 2.2.2.2 below); or

(b) Limiting the scope of the exemption for income from foreign services.

The scope of the exemption for income from services earned outside a country could be limited to income from foreign services that is subject to foreign tax or subject to foreign tax in the source country (not in other countries) at a rate comparable to the tax rate imposed by the residence country. For example, if a country imposes tax at a rate of 40 per cent, it might limit the exemption from tax for income from foreign services to such income that is taxed at a foreign rate equal to some minimum percentage (for example, 50 or 75 per cent) of the country's domestic tax rate. If the income is subject to a foreign tax rate that is less than the minimum, the foreign source income would be subject to tax by the country, with a credit for the foreign tax on the income (as discussed in section 2.2.2.2 below). This approach would require a comparison of a country's tax on the income in question and the foreign tax on that income. To be meaningful, such a comparison requires the foreign source income to be computed in accordance with the residence country's tax rules for the computation of income. This comparison will impose compliance burdens on taxpayers and administrative burdens on the tax administration.

A possible alternative to minimize the compliance burden on taxpayers would be to provide a list of either high-tax countries (income earned in such countries would be exempt) or low-tax

substantial. For example, the exemption could be limited to income from services performed in a foreign country if the services are performed through a permanent establishment (PE) or □xed base in that country, or if the resident taxpayer spends a substantial amount of time (presence or time spent performing services) in the other country. □ is approach requires a de□nition of a PE and □xed base (which may already exist as part of domestic law) and a decision on the amount of time that must be spent in another country in order to obtain the exemption. It might also be necessary to have anti-avoidance rules to prevent resident taxpayers from arti□cially creating a PE or □xed base in another country in order to obtain the exemption. (□ is problem of avoidance—discussed in section 2.3.2.2 below—is the converse of the problem where a non-resident avoids tax in a source country by arti-□cially not having a PE or □xed base in that country.) It would also be di□cult for the tax authorities to verify whether a taxpayer has a PE or □xed base in another country or spends the requisite amount of time there. If the residence country has a tax treaty with that country that provides for the exchange of information, it may request the tax authorities of that country to provide the necessary information.

Another risk of base erosion with respect to an exemption for services provided outside a country is that taxpayers may attempt to change the source of income from domestic to foreign in order to obtain the exemption. □ is problem is similar to the problem discussed in section 2.3.2.1 beloourc Ae2-3.7(c)-17(t)

country or an overall limitation on the foreign tax credit, it may allow foreign taxes to be credited on income from services that are greater than the country's tax on the income. If the country uses an overall limitation on the foreign tax credit, under which the credit is limited to the country's tax on the taxpayer's total foreign source income, high foreign taxes on income from services paid to one country can be

2.2.2.2.2 Allocating expenses to foreign source income for purposes of the limitation on the foreign tax credit

If income from services provided by residents of a country outside that country is taxable by the residence country (that is to say, the country taxes its residents on their worldwide income from services), the residence country will likely provide a credit against its tax for the foreign tax imposed on that income in order to eliminate double taxation. In principle, this foreign tax credit should be limited to the amount of the residence country's tax on the foreign source income; otherwise, the credit will reduce the residence country's tax on domestic source income. □erefore, in computing the limitation on the foreign tax credit, it is important for any expenses incurred by residents in

earning the income from foreign services to be deducted. □ is point is shown in the following example.

2.3 Taxation of non-residents on income from services

2.3.1 Introduction

As discussed in chapter 4 of part 2, the risks of base erosion with respect to non-residents performing services in a country or to residents of a country depends on whether the country taxes such non-residents on their income and, if so, whether the country taxes the income on a net or gross basis. If the country does not tax the income from services

derived by non-residents, it may be because it has determined that the tax is too difficult to collect or that it would discourage non-residents from providing services to residents of the country. These are legitimate concerns for a country. The discussion that follows assumes that a country has decided that, at least in certain circumstances, non-resi-

2.3.2.2 Avoidance of threshold requirements

If a country taxes certain non-residents on their income from services only if they meet a minimum threshold requirement, such as having a PE or fixed base in the country or spending a minimum amount of time in the country, there is a risk of base erosion where non-residents avoid that country's tax by artificially avoiding the threshold under its domestic law. A country can minimize the risks of base erosion by eliminating any threshold requirement or by designing the threshold requirement so that it is not easy to avoid. Some of the common ways of avoiding threshold requirements are as follows:

- If the threshold is a fixed place of business or a fixed base that must be carried on for a minimum period of time, it is relatively easy for some non-residents to arrange their affairs so that the services are provided at different

short-term services. On the other hand, if the time threshold is too

service providers represent legitimate expenses incurred by the payers

on the tax authorities will be greater than if a uniform rate is applicable to all services. From a compliance and administrative perspective, the simplest and most e□cient system is to require withholding on all payments for services irrespective of whether the payments are made to residents or non-residents, the type of services involved, and whether the services are performed inside or outside the country. Under such a system, withholding agents would not be required to determine:

the services, the withholding tax paid will be more than it should be, although the amount of the deduction claimed for the services will also be more than it should be. If a country's transfer pricing rules apply to adjust the amount paid for the services, both the deduction and the amount of the withholding tax should be reduced.

Second, if withholding taxes are imposed only on actual payments, there may be a mismatch between the timing of the deduction of the expenses incurred in respect of the services and the withholding tax. If expenses are deductible under a country's domestic law when they are incurred, rather than when they are paid, the expenses in respect of the services will ordinarily be deductible on an accrual basis (generally when the liability to pay is incurred). However, withholding tax is not usually imposed until the payment is made. □erefore, where a taxpayer claims a deduction for payments for services to a non-resident service provider, but does not actually pay for the services so there is no withholding tax, the result is inappropriate. □is can be prevented if the country deems the payment to be made when the expense is incurred or makes the deduction of the expense conditional upon the payment of withholding tax by the payer.

2.3.3.2 Which payments for services should be subject to withholding tax?

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impose tax on the non-resident on a net basis in the ordinary manner applied to residents. However, where a non-resident does not have a substantial and continuing presence in a country, it is often difficult to impose tax effectively by requiring the non-resident to file a return. In these circumstances, the country may impose a withholding tax on payments made to the non-resident.

Even where a non-resident has a substantial presence in a country, provisional withholding on payments to non-residents for services is an effective method of collecting tax. The provisional withholding is remitted to the tax authorities on account of the non-resident's tax liability as ultimately determined by the assessment of the non-resident's tax return. To the extent that the tax assessed is greater than the amount withheld on behalf of the non-resident, the non-resident is liable to pay the excess. Conversely, to the extent that the amount withheld exceeds the tax assessed, the non-resident is entitled to a refund of the excess.

The domestic legislation imposing withholding tax on payments to non-residents should clearly describe the payments for services that are covered so that the withholding agents can meet their obligations, as discussed below. In general, based on the withholding taxes levied in many developed and developing countries, withholding taxes are imposed on payments to non-resident entertainers and athletes and remuneration paid to non-resident employees, including directors and officers of resident companies. Several developing countries also impose withholding taxes on payments to non-residents for technical services. As mentioned above in section 2.3.3.1, the compliance burden on withholding agents may be significantly increased if only certain types of services are subject to withholding, and therefore they

justi□ed in imposing tax. However, where the services are provided outside the country but are consumed or used in the country (for

Every country should carefully consider whether it wants to impose a gross-based withholding tax on payments for technical services to non-residents where the services are performed outside the country. In this regard, every country should carefully consider whether such a withholding tax would constitute a violation of its obligations under the General Agreement on Trade in Services (GATS).

2.3.3.3 Which rates of withholding tax should be applied?

As noted above in section 2.3.3.1, in principle a withholding tax is a proxy for a tax on the net income derived by a non-resident. Where a non-resident incurs substantial expenses in earning income from services, which might be the case with respect to certain services, a high rate of withholding tax may be excessive and result in double taxation because the non-resident cannot claim the full amount of the withholding tax against the tax payable by the non-resident in its country of residence.

Therefore, it is important for each country to carefully consider the rate of withholding tax imposed on services provided by non-residents, especially where the non-resident service provider is likely to incur significant expenses. It may be appropriate to consider imposing different rates of withholding depending on the services involved. Alternatively, some countries impose withholding tax not on the gross amount of the payments for services, but on a portion of that amount that reflects an allowance for the expenses incurred by the non-resident.

□e allowance may vary depending on the type of services involved. However, as noted in section 2.3.3.1 above, the compliance burden on withholding agents may be increased if there are di□erent rates of

Since employees do not usually incur signi□cant expenses in earning their income, the rate of withholding tax can be similar to the tax rate imposed on resident employees (which is usually higher than the rate of withholding tax applied to payments of dividends, interest and royalties).

Withholding tax should also be applied to payments by non-resident employers who have a PE or □xed base in a country, since that country's tax base is eroded to the extent that they claim deductions for the salary and wages paid to any resident or non-resident employees. □ is withholding should apply irrespective of whether the employment is exercised inside or outside the country. As discussed in section 2.3.2.2 above, countries should consider adopting rules to prevent non-resident employers from arti□cially avoiding having a PE or □xed base in their country.

If withholding agents fail to withhold, a country could consider denying a deduction for the amounts paid to non-resident employees o2(b)-3.7(o)129(f 41 Tw 4.4c2T.7.21s)If 41 Tw 4.4c2T.7.21sh

□e withholding taxes on non-resident directors and managerial o□cials of companies resident in a country can be imposed on the fees and remuneration from services performed in the country or on the total amounts that are paid irrespective of where the services are rendered. If a country taxes fees for services rendered outside the country (for example, in the country in which the directors or o□cials are resident), there is a substantial risk of double taxation, since the country in which the services are rendered is also likely to tax the income. Nevertheless, if a country has entered into tax treaties based on the United Nations Model Convention, Article 16 will allow that coun

2.3.3.6.6l

Chapter 3

Sample legislative provisions with explanatory notes

3.1 Introduction

 is section provides some sample legislative provisions dealing with the taxation of income from services that are designed to reduce the risks of base erosion. e sample provisions presented here deal exclusively with non-residents earning income from services performed in a country or for persons in the country, and deal only with situations in which the risks of base erosion are considered to be most serious. In addition, this section presents sample provisions only with respect to those provisions that deal exclusively with services, rather than to provisions that deal with income generally (including services).

3.2 Sample withholding tax provisionJ EMCTMC /Span <</Lang (en

person if the payments are deductible in computing the income of the resident payer;]

(b) F

to limit the tax under paragraph 1 to fees for consulting, technical or

contracting State is not entitled to impose tax on fees for business, professional and other independent services derived by a resident of the other contracting State unless the resident of the other contracting State has a PE or fixed base or stays in the first State for more than 183 days. Thus, if a country enters into tax treaties with provisions similar to those of the United Nations or OECD Model Conventions, the country will be prevented from imposing withholding tax on payments for services by its residents to non-residents. See section 4.2.7 below for a discussion of treaty provisions dealing with fees for business, professional and other independent services. As discussed in section 4.2.7.5 below, the United Nations Committee of Experts on International Cooperation in Tax Matters, at its eleventh session in October 2015, agreed on a new Article to be included in the United Nations Model Convention to allow a contracting State to impose a withholding tax on fees for consulting, technical and management services paid to a resident of the other contracting State.

Paragraph 2 imposes an obligation on any resident person that pays an amount described in paragraph 1 to a non-resident person to withhold the amount of the tax from such payments and remit it to the tax authorities on behalf of the non-resident. The amount withheld pursuant to paragraph 2 is considered to be tax paid by the non-resident person and to satisfy the non-resident's obligation to pay tax under paragraph 1.

If a resident person fails to withhold as required by paragraph 2, that person is liable for the tax payable by the non-resident person under paragraph 1 to the extent that the amount of that tax is not withheld. Thus, both the non-resident person and the resident payer are liable for the same amount and the tax authorities may take collection action against either the non-resident person or the resident person, or both. Any amount collected by the tax authorities from one of the parties is considered to satisfy the liability of both parties. The tax authorities shall not collect in total more than the amount of tax payable under paragraph 1. To the extent that a resident person pays an amount under paragraph 3, that person shall have the right

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ing Countries (New York: United Nations, 2011); and Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital (Paris: OECD, 2014).

to recover that amount from the non-resident person. [□ ese ancillary issues should probably be dealt with explicitly in the legislation.]

A failure to withhold under paragraph 2 should also be subject to interest and penalties. However, such interest and penalties should apply generally to all withholding taxes, not just withholding taxes in respect of fees for services.

As an alternative or additional mechanism to enforce the obligation to withhold under paragraph 2, paragraph 4 provides that to the extent that a resident person fails to withhold as required by paragraph 2, that person will not be entitled to deduct the amounts paid to a non-resident person.

Paragraph 5 extends the tax under paragraph 1 and the obligation to withhold under paragraph 2 to non-residents of Country X who make payments for services to other non-resident persons by deeming such non-resident payers to be residents of Country X. However, non-resident payers are deemed to be residents for this purpose only to the extent that the payments are deductible in computing their income subject to tax under the tax law of Country X. In general, payments by non-residents for services described in paragraph 1 will be deductible in computing income under the tax law of Country X only if non-

resident partner. By deeming the partnership to be a resident of the country, paragraph 6 has the e□ect of making the partnership liable to withhold under paragraph 2.

Similarly, if a partnership in which a non-resident person is a partner receives an amount from a person resident in the country for services described in paragraph 1, the non-resident partner may not be considered to have received the partner's pro rata share of the amount received by the partnership. □ us, if the partnership is not considered to be a non-resident person for purposes of the country's taTe13(p i)-5.7(s)0.5(n)10

3.3.1 Explanatory notes

moreover, as independent businesses they bear the risks and rewards of their work.

Paragraph 1 is intended to apply for purposes of domestic law and any tax treaties entered into by Country X. With respect to the application of tax treaties of Country X, this provision is intended to be consistent with paragraph 1 of the Commentary on Article 15 (Dependent personal services) of the United Nations Model Convention.[7] □ at Commentary provides additional explanation andis intendul.1(

3.4.1 Explanatory notes

If directors and officers of companies resident in Country X are treated as independent contractors, they may be subject to tax on their remuneration from those companies only if they have a PE or fixed base in

payments and remit it to the tax authorities on behalf of the non-resident. Any amount withheld pursuant to paragraph 2 is considered to be tax paid by the non-resident director or managerial official and to satisfy the non-resident's obligation to pay tax under paragraph 1.

2. Paragraph 1 above shall apply notwithstanding any provisions of an agreement for the elimination of double taxation and scal evasion entered into between Country X and another country. [is provision may not be possible under the laws of some countries because of constitutional considerations.]

3.5.1 Explanatory notes

Paragraph 1 is a general anti-abuse rule that is intended to prevent the

[□ is general anti-abuse rule is based on the assumption that a country's domestic law does not contain such a rule. If a country does have a general anti-abuse rule, that rule should be reviewed to ensure that it deals with abusive transactions that erode the country's tax base, including transactions that involve the abuse of the country's tax treaties.]

Chapter 4

Negotiation of tax treaties to prevent base erosion with respect to income from services

4.1 Introduction

Tax treaties are bilateral agreements that are the result of negotiations between the contracting States. They reflect not only the relative negotiating power of the contracting States, but also the international consensus about the provisions of tax treaties, as shown in the provisions of the United Nations and Organisation for Economic Co-operation and Development (OECD) Model Conventions.[8] Any attempt by a country to deviate significantly from the provisions of these model treaties is likely to be resisted by other countries. Therefore, although the following discussion makes several suggestions for provisions in tax treaties to limit the risks of base erosion, these provisions may not be acceptable to all countries. If a country decides that it wishes to include some of these provisions in its tax treaties, it must realize that the other contracting State may not agree, or may agree only if the country makes concessions with respect to other provisions of the treaty.

The OECD/G20 and the United Nations Committee of Experts on International Cooperation in Tax Matters are currently engaged in a project to limit base erosion and profit shifting (BEPS). This project is likely to result in changes to the United Nations and OECD Model Conventions. Therefore, a country may find that other countries are

[8] United Nations, Department of Economic and Social Affairs, United Nations Model Double Taxation Convention between Developed and Developing Countries (New York: United Nations, 2011); and Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital (Paris: OECD, 2014).

more willing to agree to anti-base erosion provisions if these provisions have been included in one or both of the model treaties.

Tax treaties have the effect of limiting the taxes imposed under the domestic laws of the contracting States. When a country is negotiating a tax treaty, it should be aware that the treaty may prevent it from applying the provisions of its domestic law to prevent base erosion if those provisions conflict with the provisions of the tax treaty. Therefore, in general, if a country decides to enter into tax treaties, it should carefully consider including a specific provision in its tax treaties to allow it to apply the provisions of its domestic law designed to prevent base erosion, as suggested in section 3.5 of chapter 3 above.

The following discussion examines provisions that might be included in a country's tax treaties to prevent base erosion. The discussion is organized on the basis of the various types of services dealt with in the United Nations Model Convention. It assumes that a country's tax treaties will be based on the United Nations Model Convention and that the relevant income is taxable under the country's domestic law.

4.2 Types of income from services

4.2.1 Income from employment

If a country imposes tax on non-resident employees with respect to amounts paid to them by resident employers or by non-resident employers with a permanent establishment (PE) or fixed base in the country, any treaties with a provision similar to Article 15 (Dependent personal services) of the United Nations Model Convention will prevent that country from imposing the tax on employment services provided by such employees outside the country. Therefore, if a country wishes to prevent this type of base erosion, it must get agreement on revised wording for the second sentence of Article 15 (1) and the exemption in Article 15 (2). Since almost all bilateral tax treaties contain provisions similar to Article 15 of the United Nations Model Convention, it is likely to be difficult for a country to get other countries to agree to any significant revisions to that Article.

Under Article 15 (2), non-resident employees employed by employers resident in a country or non-resident employers with a PE or

fixed base in the country are taxable by that country on their income from employment exercised in the country. However, individuals that are independent contractors performing services in a country for residents of that country, or for non-residents with a PE or fixed base in that country, are taxable by the country only if they carry on business through a PE or fixed base in the country and the income is attributable to that PE or fixed base. Therefore, countries should consider protecting their domestic tax base through the following actions:

1. Adopting provisions in their domestic law that ignore the formal contracts and determine an individual's status on the basis of the nature of the services rendered and the extent to which those services are integrated into the employer's business.[9]
2. Denying the benefits of Article 15 (2) of the treaty in abusive cases.[10]
3. Including a provision in their tax treaties dealing with the international hiring-out of labour similar to the alternative provision in paragraph 1 of the Commentary on Article 15 of the United Nations Model Convention.[11]

4.2.2 Directors' fees and remuneration of top-level managerial officials

If a country wishes to prevent base erosion with respect to fees paid to non-resident directors and remuneration paid to non-resident managerial officials of companies resident in the country—since such amounts are usually deductible in computing the income of such resident companies—it should ensure that its tax treaties contain provisions similar

[9] See chapter 3, section 3.5, above and paragraph 1 of the Commentary on Article 15 of the United Nations Model Convention, quoting paragraphs

to Article 16 (Directors' fees and remuneration of top-level managerial o□cials) of the United Nations Model Convention, which will allow the country to tax such amounts.

4.2.3 Income from government service

If a country wishes to prevent base erosion with respect to amounts paid by its Government to non-resident employees, it should ensure that its tax treaties contain provisions similar to Article 19 (Government service) of the United Nations Model Convention, which will allow the

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Article 17 (Artistes and sportspersons) of the United Nations Model Convention in its tax treaties.

4.2.7 B

allows enterprises resident in one contracting State to carry on substantial preparatory and auxiliary activities in the other State without having a PE. As part of the BEPS project, the OECD/G20 is considering narrowing the scope of the activities exempted under Article 5 (4). If a country is concerned that the scope of the exemptions under Article 5 (4) is too broad, it should consider trying to negotiate a narrower version of the provision. In this regard, it should be noted that, even if some activities are excluded from the exemption under Article 5 (4) so that there is a PE in a country, there may not be any signi□cant pro□ts attributable to the PE. □ erefore, any narrowing of the scope of the exemptions in Article 5 (4) should take into account the impact on the attribution of pro□ts under Article 7 (Business pro□ts).

4.2.7.3 Commissionaire and other similar arrangements

Commissionaire arrangements may be used to avoid an agency PE under Article 5 (5). As part of the BEPS project, the OECD/G20 is considering revisions to Article 5 (5) of the OECD Model Convention to ensure that commissionaire arrangements and other similar arrangements give rise to a PE. Once the OECD/G20 recommendations have been □nalized, developing countries should consider including the revised version of Article 5 (5) in their tax treaties.

4.2.7.4 Insurance

If a country wishes to tax non-resident insurance companies earning income from the insurance of risks in the country, it should include provisions in its tax treaties similar to Article 5 (6) of the United Nations Model Convention, which allows taxation of non-residents that collect insurance premiums or insure risks in the country. Article 5 (6) excludes reinsurance, which allows non-resident insurance companies a relatively easy way to avoid the e□ect of Article 5 (6). □ erefore, countries should attempt to negotiate a provision similar to Article 5 (6) of the United Nations Model Convention but excluding the words "except in regard to re-insurance".

4.2.7.5 Fees for technical services

If a country wishes to prevent base erosion through payments by residents of the country or non-residents with a PE or □xed base in the

Part 4
Tax Administration Manual

Chapter 1
Introduction

Part 4 of the present Portfoliodeals with issues of tax administration with respect to the taxation of income from services and focuses on the prevention of base erosion and pro□t shi□ing (BEPS). Chapter 2 deals with disclosure and information reporting requirements. Chapter 3 deals with audit and veri□cation activities by tax o□cials to detect and counter BEPS. Chapter 4 examines the issues involved in the administration of the provisions of a country's tax treaties with respect to the taxation of income from services.

As with the other parts of this Portfolio, part 4 is concentrated on the risks of BEPS with respect to income from services. Each coun-

face the difficult task of identifying non-resident service providers that it considers to be subject to tax as a preliminary step to ensuring that such non-residents comply with their tax obligations under domestic law. These difficulties can be minimized if non-resident service providers are subject to interim or final withholding. To the extent that non-resident service providers are subject to withholding, the obligations to identify non-residents subject to tax and the amount of the tax are effectively shifted to the withholding agents.

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If residents of a country are taxable on their worldwide income, including income from foreign services, they will usually be required by the laws of that country to provide information in their tax returns or supporting schedules with respect to the amount of such income, the country or countries in which the income is earned and the amount of foreign tax on the income. □ is information is necessary to determine a resident's worldwide income subject to tax and also the possible entitlement of the resident to a foreign tax credit for foreign taxes on the foreign income. Perhaps the best evidence of the amount of the income earned in another country and the amount of tax paid to that country is the taxpayer's foreign tax return.

Even if a resident is not subject to tax on foreign income from services, a country may require the resident to provide information about that income. □ is information can be used to verify that the resident is not claiming an exemption for foreign income from services in excess of the amount of such income. Also, for countries that exempt a resident's foreign source income but take that income into account to determine the rate of tax (exemption with progression), such information is important to verify that the tax rate applied is correct.

2.3 Disclosure and information reporting requirements for non-residents

2.3.1 Introduction

In general, the information necessary to tax non-residents on income from services properly is available from five main sources:

- The non-resident service provider
- A local agent or representative of the non-resident
- Persons, usually residents of the country, making payments to the non-resident service provider
- The tax authorities of another country with which the country has a tax treaty providing for exchange of information
- Public information

The following sections of this chapter are organized on the basis of the type of information that a country needs to tax non-residents on income from services. The sources for the information are discussed in each section.

It is assumed for the purposes of the following discussion that the tax authorities of a country have the authority under domestic law to obtain the necessary information from the taxpayer, the person making payments to a non-resident or other persons.

2.3.2 Identification of non-resident service providers

In order to impose tax on non-residents earning income from services, it is necessary, at a minimum, to know the names and addresses of the non-residents. Sometimes this information will be provided by non-residents pursuant to business registration requirements, in applications for taxpayer identification numbers or in tax returns. In other situations, if the payments to a non-resident service provider are subject to withholding tax, the withholding agent will be required to obtain and supply this information in order to comply with its withholding obligations.

With respect to income from services, some countries require persons visiting the country for the purpose of carrying on business

activities to obtain a visa. If the information obtained pursuant to
the visa process is availabis (t)-11.1visinnitte4(o)12.8(n o).1(o o)5(b)1(o6(, .4(e)- v

a country, the only effective way to identify such non-residents may be to require persons resident in the country that pay for the services to provide information concerning the identity of the non-resident as part of an obligation to withhold tax from the payment. The administrative aspects of withholding taxes on payments for services are dealt with below in section 4.7.2.

Where a non-resident is not subject to withholding and does not voluntarily file a tax return, the tax authorities of a country may sometimes use public information to identify non-residents earning income from services in the country. For example, if big-name entertainers or athletes visit a country to make appearances or participate in events, these visits will usually be a matter of public knowledge and often be aggressively promoted. Similarly, if non-resident shipping companies or airlines take on passengers or cargo in a country, this information will usually be made public. It may be useful for the tax authorities to monitor Tw -0.025 -1.18.(h)8.9(e)0.5(t)-.9(l)-24.4(l uWc)-6.2

□is type of form should be required to be □led for each payment to a non-resident for services. A copy of the form should also be provided by the payer to the recipient. In addition, it would be useful for payers to be required to □le an annual form showing all of the payments made to non-residents for services, the amount of tax deducted, the amount of tax remitted to the tax authorities and the total number of forms □led for payments to non-residents for service.

Chapter 3

law with respect to the taxation of residents and non-residents on income from services. In particular, it is worth noting that if a country's domestic law treats income from services derived by non-residents differently, depending on the nature of the services and whether the services are provided by a related party, the compliance burden imposed on withholding agents and the administrative burden imposed on the tax authorities will be significantly greater than if all payments for services to non-residents are treated similarly. For e88(r)7.6(l)856s3(a)18.9(w t)-19.9.1(t)-26(l8(u)-1 0.a.9(i,f a)-294a)18.9(w t g)-

2. If foreign services income is exempt:
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included in their income. □is assumes that the withholding agents are required to provide useful information, as discussed in section 3.4 below, and that the tax authorities have the necessary resources to use the information e□ectively.

3.4 Provisional or □nal withholding taxes

If certain persons—usually residents and non-residents with a PE or □xed base in a country—are required to withhold tax from payments for services provided by non-residents, the tax authorities need to audit the withholding agents to ensure that they have withheld the proper amounts. Where non-residents are subject to provisional withholding and are entitled to □le tax returns and pay tax on a net basis, the tax authorities have access to both the information provided by the non-residents in their tax return and the information provided by the withholding agents. □ese two sources of information can be cross-checked to determine whether the non-residents have reported the correct amount of income and tax payable and the withholding agents have withheld the correct amounts.

Where non-resident service providers are subject only to a □nal withholding tax, the only issue for the tax authorities to verify is whether the withholding agent withheld the proper amount from any payments to non-residents for services. In addition, the only source of information for this purpose is information provided by or in the hands of the withholding agents. As discussed in chapter 2 above, withholding agents should be required to provide certain information with respect to the amounts withheld and remitted to the tax authorities. □is information can be checked against the withholding agent's books and records and its banking records. For example, if a resident payer claims a deduction for amounts paid to a non-resident service provider, the payer's books and records and the information provided in its tax returns or information reporting forms can be cross-checked against the information provided with respect to the amounts withheld.

If withholding agents are subject to serious penalties for failure to withhold properly, they will be more likely to withhold properly in order to avoid the penalties. Such penalties may reduce the need for the tax authorities to audit withholding agents with respect to payments to non-residents for services. For example, if persons paying

non-residents for services fail to withhold, they may be made liable for the tax payable by the non-residents and/or they might not be allowed to claim a deduction for the amount paid for the services.

Each country must carefully consider the compliance burden imposed on payers to withhold from payments to non-resident service providers and to provide information about such payments. Where the payers are individuals resident in a country and the services represent personal consumption, it may be di□culiT.6(f).9(e f)13.4(o)119(ri)-11(y)16.1(o

2. If non-residents are taxable on a withholding basis:
   - Verify that payers are withholding tax properly on the basis of withholding information returns, payers' tax returns, books and records and other information
   - Check the deduction of amounts paid to non-residents for services

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and provides guidance for the tax officials of developing countries in applying the provisions of their tax treaties dealing with income from services.

This chapter focuses primarily on the risks of base erosion with respect to the provisions of tax treaties dealing with income from services. For this reason, it deals only with the application of tax treaty provisions that affect the taxation of non-residents earning income from services. It does not deal with treaty provisions affecting residents of a country, such as provisions that require the country to provide relief from international double taxation. Similarly, the chapter does not deal with the administration and application of tax treaties generally. For information and guidance concerning the administration of tax treaties generally, including the organizational structure of the tax administration and the relationship between tax treaties and a country's domestic law and between its tax treaties and its trade and investment treaties, see United Nations Handbook on Selected Issues in the Administration of Double Tax Treaties for Developing Countries

imposition of domestic tax as well as the application of the provisions of an applicable tax treaty. If a country cannot identify the non-residents deriving income from the country, the issue of whether such non-residents are entitled to treaty bene□ts is irrelevant. □erefore, every country should have strategies in place to identify non-residents doing business in or deriving income from the country, as discussed in chapter 2 above.

For the purposes of this chapter dealing with the application of tax treaties, it is assumed that a country has identi□ed the non-residents earning income from services that are subject to tax under that country's domestic tax law. □erefore, the issues in this chapter are: is a non-resident entitled to a reduction or exemption from a country's tax under a tax treaty and, if so, how are the provisions of the treaty applied by the tax authorities of the country?

4.3 Determining the country of residence of the non-resident service provider in order to establish the relevant treaty

4.3.1 Treaty residence

Assuming that a non-resident is entitled to a reduction or exemption from a country's tax under a tax treaty, the next issue is how the provisions of the treaty are applied by the tax authorities of the country. The first step in this process is to determine the country of residence of the non-resident service provider in order to establish the relevant treaty.

be determined under the law of the treaty partner, not under the source country's law. Article 4 (Resident) states that a person is a resident of a country if the person is liable to tax "under the laws of that State". A country's tax authorities may not be knowledgeable about the laws of its treaty partners as to the residence of taxpayers. Therefore, where a taxpayer claims the benefits of a tax treaty, it is customary for the tax authorities to verify that the taxpayer is a resident of the other country by requesting the taxpayer to provide a certificate from the tax authorities of the other country verifying that the taxpayer is a resident.

seem overly onerous if it is simply an annual requirement. If, however, a separate certificate is required for each payment, the burden could be significant. Another problem is the potential delay in obtaining the benefits of the treaty caused by the necessity to obtain residence or other certifications from the foreign tax authorities. The delay is

treaty bene□ts to “real” residents of a country.[5] For example, a resident of one country may wish to make an investment in another country. If there is no treaty between those two countries, the investor may establish a shell company in a country that does have a treaty with the country in which the investment will be made. However, that company may have little or 77(r)-13(v)13(e l)-16(i)12(t)-22.4 /Sp(i)12(t1)o cishan /La i5 cu1

must give up its taxing rights. Consequently, the application of the tie-breaker rules should be carefully considered. For individuals, the tie-breaker rules are inherently factual and should be applied on a balanced basis to give residence to the country to which the individual is more closely connected. In addition, dual-resident entities are often used for tax avoidance purposes. Therefore, when the tax authorities of a country encounter dual-resident entities, they should consider whether the entities have been used for tax avoidance purposes, and if so, whether such tax avoidance can be countered by anti-abuse rules in the country's domestic law or tax treaties.

4.4 Determining the applicable provision of the treaty

4.4.1 Introduction

Once the tax authorities of a country have determined that a non-resident taxpayer is a resident of a country with which its country has a tax treaty, they must decide which provision of that treaty applies to the income from services earned by the non-resident. As discussed in part 2 of this Portfolio, the United Nations and OECD Model Conventions treaties contain several provisions potentially applica-

cases, especially those involving royalties for the use of or the right to use property, it may be difficult to differentiate between income from services and other income. In general, the performance of services does not involve any transfer of property or the right to use property by the service provider to the client. Where there is a transfer of property or the right to use property, there should be payments (rents or royalties) in consideration for the use of the property.[8]

4.4.3 Types of services

As discussed in part 2, under the provisions of the United Nations and OECD Model Conventions, income from services is treated differently depending on the nature of the services. The risks of base erosion also vary depending on the nature of the services. Under the provisions of the United Nations Model Convention, the following types of services

the United Nations and OECD Model Conventions depends on the legal capacity in which the services are provided. □us,h tis dhe lonveveS2(e)7roi7.9(i)t4.8033i9 ub27s o4.b2(y)Tww20 d2.9(s)-4.7(e)4.1()01neABDC

¾ □e services must be performed in the source country

¾ □e payer must be a resident of the source country

¾

For this purpose, the tax authorities will likely start with the information provided by the taxpayer and then use standard audit techniques to verify that information.

If a country has imposed withholding on amounts paid to non-residents that are taxable on a net basis under the terms of the treaty, the country must allow the non-residents to apply for a refund on any tax withheld in excess of the tax payable in accordance with the provisions of the treaty. Issues with respect to withholding taxes are discussed below in section 4.7.2.

4.6 Computation of income

Although the amount subject to tax by a country in accordance with the provisions of an applicable tax treaty may be limited, the rules for the computation of the income are the rules for that purpose under the country's domestic law. For example, a country's tax rules will determine what amounts are included in income, what amounts are deductible in computing income and the timing of those inclusions and deductions. Where the income from services derived by a non-resident is subject to tax on a net basis under Article 7 or 14 of a treaty based on the United Nations Model Convention, the treaty provides some basic rules for computing the amount of income that is attributable to a PE or □xed base. □e rules in Article 7 of the United Nations Model Convention may be summarized as follows:

- ¾ □e deduction of expenses is a matter of the domestic law of the country in which the PE is located; however, the deduction of

¾ □e pro□ts of a PE must be determined consistently from year to year unless there is a good reason to make a change

Although Article 14 of the United Nations Model Convention does not provide similar rules for the computation of the pro□ts attributable to a □xed base, it is generally considered that similar rules apply.

In addition, where the income is derived from transactions between an enterprise that is resident in a country and a related or associated enterprise resident in the other country, the transfer pricing provisions of the treaty will apply. Similarly, under the new Article of the United Nations Model Convention dealing with fees for technical services, payments that are excessive because of a special relation-

residents. □erefore, for example, some countries may require residents and non-residents carrying on business in the country to pay instalments of tax on a periodic basis and then to pay any balance owing when

withhold an amount from the payments for the services and remit that amount to the tax authorities as tax on behalf of the non-resident. The obligation to withhold is usually imposed on residents of a country and non-residents carrying on business in the country through a PE or fixed base. Some countries do not impose an obligation to withhold on individuals making payments to non-resident service providers, or impose an obligation to withhold only on payments that are deductible. Unlike a non-resident service provider who may have little connection with a country, residents and non-residents with fixed places of business in the country have substantial connections to the country, and that country can take enforcement action against them if they fail to withhold. Various penalties can be imposed on withholding agents to ensure that they withhold properly. These penalties include interest and financial penalties, liability (with the non-resident) for any tax that should have been withheld, and the denial of any deduction for the payments to the non-resident if tax is not withheld.

An exception to this general pattern is made by the new Article to the United Nations Model Convention dealing with fees for technical services, which provides that the source country will be allowed to tax such fees, but not in excess of the rate agreed to by the contracting States. Even in cases where the treaty specifies a maximum rate of tax, it does not prevent a country from requiring payers to withhold at a higher rate; however, if it does so, the country would be required to refund any tax withheld in excess of the maximum rate provided in the treaty.

Since tax treaties do not deal with how a country imposes tax, the method of taxation is a matter of domestic law. Therefore, countries have flexibility in determining how to apply their withholding taxes. First, withholding can be imposed on an interim basis or as a final tax. If withholding is imposed on an interim basis, the taxpayer is entitled or obligated to file a tax return and determine the amount

Second, countries have flexibility to establish the rate of withholding in their domestic law at a rate that is more than, less than or equal to the rate specified in the treaty. If the domestic rate is less than or equal to the treaty rate, the country will meet its treaty obligations simply by applying its domestic law. The rate may be less than the treaty rate in order to attract investment from non-residents. If the domestic

treaty partner to collect tax owing to the country by a resident of the country. Article 27 requires the requested country to collect the taxes owing as if they were taxes owed to that country. However, Article 27 is a relatively recent addition to the United Nations and OECD Model Conventions and countries may not have that Article in any of their tax treaties.

In the absence of a provision similar to Article 27 of the United Nations and OECD Model Conventions, a country will be unable to enforce a judgment that it obtains from its own courts for the recovery of unpaid tax owing by a non-resident in the courts of the country in 4.8

- Are the activities performed at the PE purely preparatory and auxiliary activities?
- Is the income derived by the non-resident service provider attributable to the PE in the country?
- Is the income derived from services performed in the country or outside the country?

h Article 8:

- Where is the place of effective management of the enterprise located?
- If the place of effective management is located outside the country, are the profits of the enterprise derived from the operation of ships or aircraft in international traffic or boats in inland waterways transport?
- If Article 8 (alternative B) is included in a country's treaties, are the shipping activities of the enterprise in the country more than casual?

h Article 14:

- Is the non-resident a resident of the other country?
- Does the non-resident have a fixed base in the country that is regularly available?
- Does the non-resident perform professional services or other personal services of an independent character?
- Are those services performed through the fixed base?
- What is the income derived by the non-resident attributable to the fixed base in the country?
- Does the non-resident stay in the country for 183 days or more in any 12-month period beginning or ending in the relevant fiscal period?
- In this case, what is the income from the services performed in the country?

h Article 15:

- Is the non-resident a resident of the other country?
- Is the non-resident an employee?

- Does the non-resident exercise the employment in the country?
  - à As an employee of an employer resident in the country? Or
  - à As an employee of an employer that has a PE in the country? Or
  - à Is the employee present in the country for more than 183 days in any 12-month period beginning or ending in the relevant fiscal year?

  If any one of the above conditions is met, the country is entitled to tax the employee's income from employment exercised in the country.
- Does the country have anti-avoidance rules to prevent employees from artificially avoiding employment status?

h Article 16:

- Is the non-resident a resident of the other country?
- Is the non-resident a director or managerial official of a company resident in the country?
- Is the managerial official a top-level managerial official?
- Are the payments received by the non-resident director in his or her capacity as a director of the company?
- Are the salary, wages or other remuneration received by the managerial official in his or her capacity as a top-level managerial official of the company?

h Article 17:

- Is the non-resident a resident of the other country?
- Does the non-resident perform personal activities as an entertainer or athlete?
- Are the activities performed in the country?
- Does the income in respect of the entertainment or sports activities accrue to the entertainer or athlete or to another person?