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Tax consequences of the digitalized economy

THE TAXATION OF FEES FOR TECHNICAL, MANAGERIAL AND CONSULTANCY SERVICES IN THE DIGITAL ECONOMY WITH RESPECT TO ART 12A OF THE 2017 UN MODEL[1]

Summary

This secretariat paper addresses the history of the Committee's work on fees for technical services and considers the extent to which:

- It sheds some light on possible approaches to the broader question of taxation rules for the digital economy that might prove to be effective or ineffective;
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Introduction

Evolution of Article 12A on fees for technical services

The UN Committee of Experts on International Cooperation in Tax Matters (the "Committee") has dealt with issues on the taxation of income from technical, managerial, consultancy and other similar services ("technical services") within the UN Model especially since 2008.[2] In its eight session in 2012 the majority of members agreed in principle (by majority vote) on the inclusion of a new article dealing with the taxation of fees for technical services. A draft proposal for an article on fees for technical services was presented at the ninth session of the Committee in 2013 by Ms. Kana, coordinator of the former Subcommittee on Tax Treatment of Services (the "Subcommittee").[3] Based on the draft article and commentary prepared by the consultant of the Subcommittee Mr. Arnold, a draft article and draft commentary on the

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scientific experience". While the definition of "royalties" includes the use of, or the right to use, property, "technical services" are performed independently of any transfer of (immaterial) property.

3. It is often hard to distinguish payments on royalties, on the one hand, from fees for technical, managerial and consultancy services on the other. Technical, consulting and

know-how as such.[10] From a practical perspective, no discernible difference may be found between technical assistance and technical services in a strict sense.[11]

5. The technical aspect of services and assistance generally includes consulting on "technical" issues. Consulting activities might relate to the training of technical personnel for a certain period of time to instruct the personnel on the operation of a plant, construction site or mine. In contrast hereto, the transmission of know-how, e.g. the documentation on the construction of a plant or a mine may not be regarded as an independent service but rather the transmission of know-how as such.

6. Some tax treaties also cover technical assistance connected to intellectual property under article 12 on the taxation of royalties. By applying the concept of article 12 of the UN Model 2011, managerial services cannot be understood as "technical" services in a strict sense. Traditionally, the term "technical" should be applied to "engineering sciences" or "applied and industrial science", excluding social sciences, commercial managerial activity and professional services, e.g. managers, lawyers and doctors.[12]

7. "Consulting" services have to be distinguished from the transmission of industrial, commercial or scientific experience, which would be qualified as royalties. The consultant does not "transmit" know-how, but rather uses industrial, commercial or scientific experience as a tool for giving advice to his customer. The consultant is liable for the service as such, which means for the use of "know-how" as a tool. In contrast to the consultant, the vendor of know-how sells the tool as such and not the solution.[13] Therefore, payments for opinions given by engineers, advocates or accountants shall be seen as payments given in consideration for the rendering of services, rather than the transmission of know-how.

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managerial and consultancy services is the extension of source country taxing rights, especially in cases in which no PE exists in the source state.

Challenges and opportunities on taxation of "technical" services in the digital economy

10. Organizational structures of MNEs have changed as means and speed of telecommunication have improved and have become more important as digitalization in general has increased. The rise of the digital economy raises fundamental issues about a balanced allocation of taxing rights between the source state and the residence state. The traditional concept of permanent establishment as a fixed place of business has arguably become redundant in a digitalized economy, as corporations do not need any workforce to generate very significant income in the source state very quickly. Additionally, MNEs do not necessarily establish a fixed place of business in the source state as digital means allow them to furnish cross-border services or distribute products without any physical facility in the source state. As a result, taxing rights may not be attributed appropriately under tax treaties, as many current tax treaties strongly preserve residence taxation. Business profits may only be taxed by the source state, if a PE of an enterprise is located in the source state.[16]

11. Under the current rules of the UN Model, source country taxation is limited to cases where a resident of the other contracting state has a PE or a fixed base in the source country or if a resident of the other contracting state stayed in the source state for a specific period of time. With the inclusion of article 12A into the UN Model 2017, the Committee of Experts decided to strengthen preservation of source country rights with the aims of a "fair" allocation of taxing rights between residence and source states and prevention of base erosion of the tax base in the source state originating from the deductibility of expenses for fees for technical services.[17]

12. The concept of "permanent establishment" was first establishe baecp 0 Tc 0 Tj 16.7 (sw -2

The Austro-Hungarian Empire and Prussia tax treaty also included several examples of what types of establishments may constitute a permanent establishment for tax treaty purposes.[22]

13. The concept of a PE is a means to attribute business profits between the residence and the source state. Discussions on the attribution of business profits are based on the economic allegiance (link) of a taxable person to the residence and the source state. The concept of economic allegiance has first been established in 1922. It is based on factors intending to measure the existence and extend of economic relationship between the income of a person or the person and a particular state.[23] Based on the 1923 proposal of the League of Nations Committee of Experts, economic allegiance should be based on the following four factors: 1) origin of wealth (source), 2) location of wealth (situs), 3) the place of enforcement of rights of wealth, 4) residence or domicile (place of consumption).[24]

14. It was the League of Nations which started to work on a model provision on the taxation of business profits borne by a permanent establishment in its draft bilateral treaty in 1927.[25] The draft business profits article defined the term “permanent establishment” in a very broad sense, as not only “*real centres of management,* […] *branches, factories, agencies, warehouses, offices, depots*” but also “*affiliated companies*” were regarded as permanent establishments.[26] The notion of “affiliated companies” was deleted from the PE definition in article 5 of the 1928 General Meeting´s draft convention.

15. The draft article on business profits was at that time a success for source states as it was a deviation from the general principle of residence state taxation established by the Committee of Experts.[27] The source state should have been allowed to tax profits attributable to a permanent establishment carrying on business within its territory. At the end of the 1920s international trade was mainly focused on trade of tangible goods. As a consequence enterprises operating at that time were required to have business operations in the source state. In order to conduct business in the source state, offices, sales facilities and storage facilities were needed which provide the source state´s tax authori 0. [(en)-4 (t)-6 (er)9 (ce)]TJ 0d trryi6 bd twe

Mexico City were mainly attended by representatives of least developed countries, the result of a more source based draft model was not a surprise.[29]

16. The PE principle was reintroduced by the Fiscal Committee in London in 1946. According to the 1943 Mexico Model an enterprise is liable to tax in the source state if it carries out not only "isolated or occasional transactions" in that state.[30] In comparison to the 1943 Mexico Model, the 1946 London Model required the existence of a PE, in the sense of a fixed place of business, to tax business profits generated in the source state.[31] The general nature of a PE had to been drawn from the list of PE examples in the Mexico and London draft Models as the 1946 London Model lacked a general definition of a PE.[32] However, article 5 para 1 of the Protocol to the 1946 London Model gives a definition of the term "permanent establishment". Two conditions must be met for an establishment to be regarded as "permanent establishment": Firstly, it must be a" fixed place" of business and secondly that fixed place needs to contribute to business earnings.[33]

17. The Fiscal Committee of the League of Nations stated the view that taxing profits generated by an enterprise in the source state was extremely difficult without the existence of a PE.[34] This is especially true in the light of the view that a PE should have been regarded as an independent enterprise with the same or similar activities functioning at least on similar conditions.[35] Books and accounts are kept separately for each establishment as it were an independent enterprise. The obligation to hold and report accounts on the profits of the enterprise and its assets generated in the source state helped the source state´s tax administration to tax the income generated within their territory. As regards the digital economy enterprises do not need any assets or personnel in the souras sout2 (a)4 (l)-2 (e)-64 trondit ai in thg pt

which the director exercises his activity, in the second half of the 1950s.[39] Especially considering modern information and telecommunication technologies enabling conferences,

concepts and might lead to further discussions on renovated concepts leading to an appropriate attribution of taxing rights in the digital economy.

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issued an Interpretative Declaratory Act in 2014[46] for the interpretation of technical services and technical assistance, with or without technology transfer, based on Brazil´s tax treaty protocols. According to Brazil´s tax legislation, the term “technical services” shall be defined in a broad sense, which means that not only technical services in a strict sense are covered by this definition but any service requiring specialized skills.[47] According to the Federal Revenue Service, technical services means the execution of services requiring a specialized technical knowledge or administrative assistance or consultancy, performed by independent professionals or with employment relationship or, also, automated with clear technological content. Fees for technical services, technical assistance, administrative and similar services derived by a non-resident are subject to a 15 % or, if the payment is made to a person resident in a “tax haven”, 25 % withholding tax in Brazil.[48]

Chile

29. Payments for services provided by non-resident service providers in Chile are generally taxed with a tax rate of 35 %.[49] However, payments for engineering or technical work are as well as payments for professional or technical services exempt from tax in Chile, if they are similar as the services named by the Customs export list and therefore qualified as exports from Chile. In case that the services are not included in the list, the gross amount paid for those services is subject to a withholding tax rate of 15 % or 20 %, if the payment is made to a payee or beneficiary, resident of a state named in the list of tax havens.[50]

30. The application of most of Chile´s tax treaties would result in source taxation only if a physical presence in the form of a permanent establishment is given in Chile, as article 7 on business profits, which is construed after the UN (e07Tj 09 (e)4 (of)3 (15)-10 ( )-10 (%)3 ((i)-16 (7(n)2

2012 fees for technical, consultancy and managerial services were not specifically subject to tax in Chile´s tax treaties, except the tax treaty concluded with Malaysia.[52]

India

31. Fees for technical services are treated differently among India´s tax treaties. Most of the tax treaties concluded by India include a provision on the taxation of fees for technical services with a very broad scope.[53] This scope includes fees paid in consideration of services of managerial, technical or consultancy nature, except services provided by an employee to its employer.[54] Not only payments made by the employer to the employee for services provided by the employee but also payments made for independent services of technical, managerial or consultancy nature are not included in some "fees for technical services provisions" of India´s tax treaties.[55] Some of India´s tax treaties also include a "make-available" clause. According to the "make-

34. Service fees paid to non-resident companies are generally taxed as business profits under Indonesian tax treaties. Therefore, the source state may only have a taxation right on service fees, if a permanent establishment is established in the source state. However, Indonesia negotiated provisions on the taxation of service fees in a few tax treaties. Such provisions are found in the tax treaties with Germany, Luxembourg, Papua New Guinea, Pakistan, Switzerland, Venezuela and Zimbabwe.[59] Indonesia agreed with Germany and Luxembourg to tax fees for technical services the same way as royalties.[60] The technical services definition in these treaties includes any service of managerial, technical or consultancy nature rendered in the payer´s resident state.

35. Indonesia´s tax treaties with Pakistan, Papua New Guinea, Switzerland and Zimbabwe include an autonomous article on the taxation of services. The wording and scope of the article used in the tax treaties differ from each other. Article 13 (3) of the tax treaty with Zimbabwe also includes services of administrative nature to the definition of "technical fees" paid for services. Whereas "technical fees" should be taxed under the tax treaties with Papua New Guinea and Zimbabwe, the terms "fees for technical services" in the tax treaty with Pakistan and "payments for services" for services of any kind shall be taxed under the tax treaty with Switzerland.[61]

36. Indonesia imposes a 20 % withholding tax on service fees paid to non-residents.[62] Up to 2009 no withholding tax was applied on service fees according to DGT Circular Letter SE-03/PJ.101/1996,[63] if the non-resident taxpayer did not have a permanent establishment in Indonesia. However, in 2009 the before mentioned regulation has been revoked and no respective law has been put in place instead.

Japan

37. Under Japan´s tax treaties fees for technical services are generally taxed by the application of the article on the taxation of business profits. However, Japan included a provision on the taxation of fees for technical services in two of their tax treaties, i.e. India and Pakistan. Fees for technical services are taxed as passive income under these treaties. Whereas a provision on the taxation of fees for technical services may be found in the article on the taxation of royalties under the Japan-India tax treaty[64], Japan´s tax treaty with Pakistan[65] includes a separate article on the taxation of fees for technical services which by their definition also include managerial and consultancy services. Those provisions were most probably

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[59] P.L. de Ridder, *Taxar, J proba7.8a1d fo4. (th.004 Tc 0.192 7.36(l)19 (n)-4 (ar)bt)-6 1.4 B b13130.0068 fdeT49.IaJ7i9.J7*

included in those treaties on the request of India and Pakistan, as taxation of fees for technical services is a key issue of both countries tax policy.

Malaysia

38. Malaysia introduced a withholding tax on payments for technical, management and other services. Those payments are, if made to a non-resident, subject to a 10 % withholding tax on the gross amount paid.[66] The Finance Act 2017 enables Malaysia`s tax authorities to impose a withholding tax on service fees even if the services are performed outside of Malaysia.

Saudi Arabia

41. The Saudi-Arabian Income Tax Law provides for a withholding tax on service fees for

- The profits attributed to the permanent establishment are expected to be earned as it were a separate legal entity engaged in the same or similar activities under the same or similar conditions,
- dealing wholly independently with the enterprise of which it is a part of.

51. Any expenses incurred for business purposes of the permanent establishment are deductible expenses to determine the profits of a permanent establishment in the source state, whether they are incurred in the source state or a third state.[90] Article 7 (3) of the UN Model 2011 also explicitly excludes certain payments (royalties, fees for services or other similar payments) made by the permanent establishment to its head office or any other part of the enterprise from the calculation of attributable profits to the permanent establishment. As a result, article 7 of the UN Model 2011 attributes net profits to a permanent establishment, computed in accordance with the arm´s length principle.[91]

52. As already mentioned, the source state will only be granted a taxing right on business services, if a permanent establishment of the non-resident taxpayer is located in the source state and profits are attributable to the permanent establishment. According to article 5 (1) of the UN Model 2011

Income from independent personal services – Article 14

54. Article 14 of the UN Model 2011 constitutes rules on the taxation of professional services and other activities of independent character. Aforementioned activities are subject to tax in the source state, if the following conditions are met:

- The individual established a fixed base, which is regularly available to him in the source state, or
- the individual is present in the source state for a period of at least 183 days within a period of 12 months.

55. The term "professional services" is defined in article 14 (2) and especially includes independent scientific, literary, artistic, educational or teaching activities. Additionally, independent activities of physicians, lawyers, engineers, architects, dentist and accountants are covered by the definition of "professional services".

56. In case that the individual established a fixed base in the source country, only the income attributable to the fixed base is subject to tax in the source state. The attributable income may also include income from services performed outside the source state.[96] In contrast hereto, if the individual resident does not have a fixed base in the source country, but is present therein for at least 183 days within 12 months, only the part of the income earned in the source state through rendering independent services therein, is taxable in the source state.[97]

57. Basically, the term "fixed base" in article 14 (1) (a) of the UN Model 2011 is regarded as having the same meaning as "fixed place of business" in article 5 (1) of the UN Model 2011.[98] However, some states take the view that differences in meaning exist between those two terms.

58. In order to establish a fixed base in the sense of article 14 (1) (a) of the UN Model 2011, the threshold requirements constituted in article 5 of the UN Model have to be met. A threshold requirement for a fixed place of business is insufficient in today's digital economy. The concept underlying the existence of a threshold requirement was developed at a time, where the manufacturing, production and sale of goods were of crucial importance. In today´s digital economy cross-border services through digital means become increasingly important. As already mentioned in this paper, those kinds of services can be rendered without the need of a fixed place of business in the source state. The source stateshould have a right to tax an appropriate amount of the service fees paid to the resident of the other contracting state.

59. Article 14 (1) (b) of the UN Model 2011 constitutes a 183 days threshold in which the individual has to be present in the source state in order for a taxing right to exist for the source state. Contracting states are free to deviate from this threshold and

often not be needed, especially as the individual might render professional services through digital means,[99] it will be in the interest of the source state to (re)negotiate the physical presence threshold to retain certain taxing rights.

Other Income – Article 21

60. Article 21 (1) of the UN Model 2011 attributes an exclusive taxing right to the residence state on items of income not covered by other distributive rules of the UN Model. However, paragraph 1 shall not apply in cases where business is carried out through a permanent establishment or independent personal services are rendered through a fixed base in the source state by a resident of the other contracting state.[100] In those cases, article 7 or 14 shall apply. Article 21 (3) of the UN Model 2011 grants a taxing right to the source state for items of income not mentioned in the other distributive rules, but arising in that state.

61. The only requirement for source taxation that article 21 (3) of the UN Model 2011 sets, is that the income must have its "source" in the source state. Domestic law determines the issue, whether income is "sourced" in a state.[101]

Taxation of "technical services" under Art 12A of the UN Model 2017

Object and Purpose

62. Developed countries usually take an export-oriented view. Income should be attributed to the state in which the production factors for income generation are located. This approach does not consider the consumer market, in which the goods are sold or the services are rendered (demand side). The right to tax a certain type of income would only be attributed to the source state, if a sufficient economic nexus between the taxpayer or the income as such and the source state can be demonstrated.[102] In this context the concept of a permanent establishment with a minimum time threshold was developed in order to get a sufficient nexus.

63. On the basis of the discussion on the allocation of taxing rights between source and residence state, the question on the erosion of the tax base of the source state plays a key role. Even without the existence of a permanent establishment in the source state, taxation in the source state might be justified by the application of the base-erosion principle. Fees for technical, managerial and consultancy services paid to non-resident taxpayers might be deductible against the tax base of the source state. To counter base erosion in the source state some developing countries are of the opinion that payments made in connection to the

66. The inclusion of article 12A in the UN Model 2017 will lead to a significant change in the allocation of taxing rights of income from technical, managerial and consultancy services. As already noted, current rules of tax treaty law only allow for source taxation in case of business services, if a company establishes a permanent establishment or a fixed base in the source state. The UN and the OECD Models establish high (time) thresholds that must be met for

skill or expertise on behalf of a client or transfers knowledge, skill or expertise to the client

cause any tax base erosion in the state in which the fees for technical, managerial and consultancy services arise, as they are usually not deductible for tax purposes.[115] Therefore, the aforementioned payments are excluded from the scope of article 12A.

Relationship to other distributive rules

76. As service fees (in general) may fall within the scope of other distributive rules of the

- Many developing countries[121] take the view that remuneration derived from technical services or technical assistance should be included in article 12 (royalties) to safeguard taxation at source. Some states also take the view that "information concerning industrial, commercial or scientific experience" includes certain services covered by the scope of article 12 and also that the provision of brain-work and technical services is covered by this wording, and therefore payments related to such services are generally taxable under article 12.[122] However, according to article 12 (3) of the UN Models, royalties are payments for the use of, or the right to use, intellectual property, equipment or know-how (information concerning industrial, commercial or scientific experience). Royalties involve the use of, or the right to use, intellectual property, equipment or know-how. The rendering of services does not necessarily include the transfer of intellectual property or know-how or experience to the customer. In case of so called "mixed-contracts", an enterprise is transferring intellectual property or know-how together with the furnishing of services. In those cases, the remuneration has to be split up and taxed separately on the one hand by the application of article 12 on the transfer of intellectual property or know-how and on the other hand by the application of article 12A for the furnishing of services to the customer.

Article 12A and the digital economy

77. New business models create a digital presence in the market jurisdiction, where economic value is created. Creating a digital without a physical presence gives opportunities of base erosion and profit shifting (BEPS) as current rules of (inter)national tax law require physical presence in the market jurisdiction. BEPS may occur by fragmenting physical operations in a way to avoid taxes. It is common that companies conduct services through a remote location at a distance far from the market jurisdiction with minimal use of personnel. Economic value is effectively arising in the market jurisdiction to which the services are addressed but may only be taxed by the residence state as no permanent establishment is established in the market jurisdiction and therefore no required nexus under current (inter)national taxation rules. Although the consideration paid for the services rendered by a non-resident of the market jurisdiction may not be taxed in that state, they may be conducted as business expenses by the payer of the consideration, resident in the market jurisdiction. In those situations the tax base of the payer of the consideration will be lowered resulting in (tax) base erosion in the market jurisdiction.

78. States[123] have started to introduce certain unilateral and bilateral measures to tax fees for technical services originating in the source state. Those unilateral measures also include provisions affecting the taxation of fees for managerial, technical and consultancy services, which are covered by article 12A of the UN Model 2017.

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121 E.g. Argentina, Brazil, Gabon, Ivory Coast, Philippines, Thailand, Tunisia, Vietnam.
122 UN, *supra* n. 8, at A 5.
123 E.g. Australia, China, India, Israel, Italy and the UK.

79. The OECD recognized that base erosion may occur by the use of modern information and communication technologies and released a report on "Addressing the Tax Challenges of the Digital Economy" (BEPS Action 1) in 2015.[124] BEPS Action 1 addresses the new tax challenges in terms of value creation in the market jurisdiction through a marketable location established by the use of digital products and services, application of related source taxation rules and VAT/GST aspects in relation to cross-border supply of digital goods and services.[125] One of the measures recommended by the OECD was, countering BEPS issues arising in the digital economy by the introduction of a withholding tax on digital transactions.[126]

80. The OECD did not consider that base erosion and profit shifting might occur in the source state, through the deductibility of service fees paid to non-residents. The UN on the other hand will introduce article 12A on the taxation of fees for technical services in the UN

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established by deeming a PE to exist in the digital economy, based on a monthly user base, revenue earned throug Td t Td t

transactions and also enhances the collectability and enforceability of a tax on “digital” transactions of goods or services.

85. *Baez/Brauner* proposed how a withholding tax might be incorporated in the OECD Model. In the authors opinion, a new article

be taxed in the state of residence of the payer if the recipient of the fee is a resident of the other contracting state. The before mentioned fees are deemed to arise in the residence state of the payer. Therefore, no physical presence needs to be established, neither by the use of workforce nor by a fixed place of business. Services conducted with digital means, are covered by the scope of article 12A if they involve the application of specialized knowledge, skill or expertise by the non-resident service provider and do not include routine, standardized services.

88. Article 12A does not provide for any definition of the term "services". However, the omission of a definition does not need to result in a disadvantage for the application of article 12A in the digital economy. It gives financial authorities more leeway to cover new emerging business models and instruments used by companies in the digital economy. New types of technologies might be developed and classified as services in the future. A "narrow" definition in the tax treaty might result in non-coverage of new types of technologies by article 12A. As a result, omitting the inclusion of a definition of the term "services" creates uncertainty but leaves room for interpretation of future technologies, which might be classified as "services" in the sense of article 12A.[141]

Alternatives to the taxation of "technical services" in the digital economy

89. Instead of including article 12A in their tax treaties, states may alternatively choose to opt for example for one of the following options:[142]

- Reduction of the 183 days´ time threshold in article 5 (3) (b) and article 14 (1) (b) of the UN Models and application of the new time threshold to either only technical services or all kind of services.

90. The period of physical presence constituted in article 5 (3) (b) and article 14 (1) (b) of the UN Models could be reduced to a number which fits both contracting states most. From the perspective of developing countries, a low time threshold should be negotiated in order to increase their taxing right over the services rendered by the non-resident taxpayer. The same applies in respect of professional services of independent character provided in the source state. Modern digital means allow companies to still generate a substantive amount of profits by the furnishing of services in the source state without the use or with shorter presence of personnel therein. Administrative costs and compliance issues remain unchanged, irrespectively of the time threshold negotiated in the tax treaty. However, the major argument to not reduce the 183 days´ time threshold is, to stay consistent with the 6-month time threshold for a fixed place of business established in the commentaries to article 5 of the UN Model.[143] In negotiating a time threshold, the developing country should also be aware of not to insist on a time threshold which is as low as to discourage inbound investments.

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[141] See F. Sixdorf & S. Leitsch, *Taxation of Technical Services under the New Article 12A of the UN Model – Improved Taxation or a Step in the Wrong Direction, European Taxation*, at 241 (2017).

[142] See also UN, *Committee of Experts on International Cooperation in Tax Matters, Note on the taxation of services under the United Nations Model Tax Convention*, E/C.18/2010/CRP.7 (2010).

[143] B.J. Arnold, *The Taxation of Income from Services under Tax Treaties: Cleaning up the Mess – Expanded Version*, Bulletin for International Taxation, at 63 et seq. (2011).

- Inclusion of the base erosion conditions of article 15 (2) in article 14. Payments for professional and independent services would be taxed by the source state if they were made by a resident of the source state or borne by a permanent establishment or fixed base of a non-resident in the source state. Negotiating states may decide to apply the revised version of article 14 of the UN Models on either technical or all kind of services.

91. According to article 15 (2) of the UN Models, an exclusive taxing right of the residence state in respect of employment income is dependent from the exercise of the employment in the source state, the days of presence of the employee in the source state and the question of who bears the cost for the remuneration of the employee. Applying those principles to article 14 of the UN Models, would require the independent individual to render services in the source state, being present for 183 days in the source state and the remuneration does not have to be borne by a corporation or PE in the source state to attribute an exclusive taxing right to the residence state. Those criteria have to be cumulatively met; otherwise the source state should have a taxing right if the individual renders services in the source state. However, such a revised provision would still require physical presence of the individual in the source state for a shared taxing right to apply between both contracting states. This alternative is not suitable for the taxation of technical, managerial or consultancy services rendered without any physical presence in the source state.

- Defining income from technical services as "other income" in the sense of article 21 (3) of the UN Models. It would also be possible to add a limitation on source country taxation in article 21 (3).

92. Article 21 (3) of the UN Models constitutes the application of the article on other income that has not been dealt with in the foregoing articles of the UN Model. Usually, fees for technical services would be taxed under articles 7, 12 (if negotiated) or 14 of the respective tax treaty. If by means of interpretation fees for technical, managerial or consultancy services cannot be subsumed under one of these provisions, such fees will be taxed in conformity with national law on the basis of article 21 of the UN Model. The source state is not limited in source taxation on the basis of article 21 (3) of the UN Model.[144] Article 21 (3) of the UN Model does not constitute any threshold requirement. The only requirement that has to be met is that income must arise in the source state. This result cannot be justified in cases where services are rendered for the purpose of carrying on business in the source state. Current rules in the OECD and UN Model require that a PE or fixed base is established in the source state to tax business services. Unlimited taxation of fees for technical, managerial and consultancy services would therefore be inconsistent with the pattern of the OECD and UN Models.

- Taxation of intra-group services by the source state by deeming a subsidiary of a non-resident parent company as a permanent-establishment. Services rendered to and payments made by the subsidiary would be attributable to the permanent establishment and taxable in the source state. Services which are "arm´s length" should be excluded from taxation.

[144] B.J. Arnold, *supra* n. 143, at 65.

93. This measure will counter B2B transactions within a group of companies and covers a great number of cases of BEPS originating in the deductibility of fees for technical, managerial and consultancy services in the source state. However, as this measure only applies to intra-

which are crucial for the business model as such, e.g. supply of energy or infrastructure and enforcement of payments.[145]

- Amendments could be made in respect of article 5 (4) of the current UN Model. Service provider with auxiliary or preparatory activities in the source state would be addressed through this action.

96. Changes in the provision of article 5 (4) of the current UN Model might lead to a taxing right for the source state, as auxiliary activities or other activities of preparatory nature will not be deemed to be excluded from the qualification as a PE in the tax treaty anymore. However, changes of article 5 (4) of the UN Model only affects business models requiring at least some kind of physical presence to support the company's core activities in the source state. A deletion of article

- An efficient withholding system with an option to register and file for net taxation should be established.

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for a successful information exchange with other states and also to identify non-resident taxpayers who are potentially subject to the withholding tax.[151]

Relief from double taxation

105. The state in which fees for technical, managerial and consultancy services arise has the primary right to tax those payments.[152] In the case of article 12A of the UN Model 2017, fees for such services arise in the residence state of the payer of the fees. Therefore, the residence state of the payee is obliged to eliminate double taxation of those fees. Articles 23 A and 23 B of the OECD and the UN Models establish rules on the elimination of double taxation in cases in which the application of a distributive rule results in a shared taxing right. In order to avoid double taxation, either a credit or an exemption must be granted by the residence state for taxes paid on before mentioned service fees in the source state. In cases in which the residence state applies the exemption method constituted in article 23 A of the UN Model 2017, it is, according to the switchover provision in article 23 A (2), entitled to apply the credit method on article 12A income. [153]

Conclusion

106. Organizational structures of MNEs have changed as digitalization in general increased. The rise of the digital economy fundamentally challenges a balanced allocation of taxing rights between the source state and the residence state. The traditional concept of permanent establishment as a fixed place of business has become redundant in a digitalized economy, as corporations don´t need any workforce to generate income in the source state. Additionally, MNEs do not necessarily establish a fixed place of business in the source state as digital means allow them to furnish cross-border services or distribution of products without any physical facility in the source state. As a result, taxing rights may not be attributed appropriately, as current taxation rules strongly rely on residence taxation.

107. Business profits may generally only be taxed in the source state under tax treaties if a PE of an enterprise is located in the source state.

jurisdiction. In those situations the tax base of the payer of the consideration will be lowered