Update of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Cou î M

Note by the Secretariat

1. The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (the "Manual") was originally published in 1979 with the main purpose of providing practical guidance to tax treaty negotiators in developing countries.

better respond to the needs of developing countries, the Committee, at its eighth session (Geneva, 15-19 October 2012), requested the Secretariat "to seek additional resources to advance the work" in this area.

3. As a follow-up to that request, the Capacity Development Unit (FfDO/DESA) organised an expert group meeting on "Tax Treaty Negotiation and Capacity Development" (New York, 13 and 14 December 2012) in order to analyse the existing tools available to developing countries and assess the most effective resources needed to strengthen their capacity to negotiate tax treaties. One of the proposals resulting from the meeting was to draft a series of practical papers on relevant issues in tax treaty negotiation from the perspective of developing countries.

adequate skills and experience to effectively negotiate and administer tax treaties that encourage international investments while protecting their tax base.

The present publication, entitled *United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries*, seeks to contribute to strengthening the technical expertise of tax officials in developing countries. It provides practical guidance to treaty negotiators in developing countries, in particular those who use the *United Nations Model Double Taxation Convention between Developed and Developing Countries.*[1] We see this *Manual* as an important contribution to the implementation of the AAAA and hope that it will serve as a useful and relevant tool in assisting developing countries to foster their sustainable development efforts.

Introduction

Mandate

Economic and Social Council resolution 2004/6[illegible]

unintended consequences, in particular where differences exist between the United Nations Model Convention and the OECD Model Tax Convention on Income and on Capital[13] (OECD Model Convention).

Chapter III (Taxation of income) deals with the distributive rules contained in Articles 6 to 21, which determine the allocation of the taxing rights between the treaty parties with respect to different categories of income. Special attention is devoted to some of

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the Subcommittee wrote: "To my estimation the structure should be kept. The manual is for absolute beginners and dealing with the improper use of tax treaties seems to overload the reader". Does the Subcommittee prefer to keep a separate section on Improper Use of treaties or to merge its contents into the explanations on the new provisions of Articles 1 and 29? If it is decided to keep the old Section IV, what should it include?]

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The electronic version of this *Manual* is available, free of charge, at http://www.un.org/esa/ffd/wp-content/uploads/2016/02/manual-btt.pdf. [Will be replaced]

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In the future, FfDO will continue working on capacity development activities in the area of tax treaties, including by making use of this *Manual* and other relevant publications, with a view to strengthening the capacity of developing countries and promoting South-South cooperation and sharing information in this area. More information about ongoing FfDO capacity development activities may be found at http://www.un.org/esa/ffd/topics/capacity-development.html.

Contents

treaties may assist in the elimination of double taxation and in addressing other tax barriers. Treaties may also assist in combating both international tax evasion and double non-taxation.

B. Concepts and issues

1. Concept of residence

Under the residence principle, a country's claim to tax income is based on the residential status of the person deriving that income. Where the person is regarded as a resident for tax purposes, the country may tax the income of that person, regardless of where the income has its source. Most countries tax their residents on their worldwide income, although a few countries will tax their income only if it is derived from sources in that jurisdiction (so-ealled' territorial taxation).

Domestic law rules for determining residence for tax purposes differ from country to country. With respect to individuals, physical presence in a country is an important indicator of residence. Other factors may include the existence of a place of abode in that country, or

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3. Source/source

[A new paragraph should be added to explain how the new transparent entity provision also addresses cases of economic double taxation]

5. Elimination of double taxation

When international juridical double taxation arises, many countries (though not all) provide at least some relief under their domestic law. Where such unilateral relief is granted, it usually applies in the same way in respect of income from all countries and may include limitations on the amount of relief that will be provided.

Two main methods are commonly used for this purpose. Under the exemption method, a country will exempt certain items of income derived by its residents in another country. Under the credit method, a country will give a credit against its normal tax claims on its residents for tax that those residents have already paid to the source State on income or profits derived from that State.[17]

Treaties can assist in eliminating juridical double taxation by ensuring that, where the treaty permits both countries to tax the income, the country of residence of the taxpayer is required to provide relief for that double taxation.

D. Other tax barriers to cross-border transactions

1. Excessive source taxation

Very high levels of source taxation can be a deterrent to international trade and, in particular, to investment. These can occur not only when the headline tax rate is high, but also where the effective rate is excessive, for example, where tax is imposed on a gross basis without allowance for deductions for costs incurred in deriving the income. Notwithstanding that the taxpayer's country of residence may provide double tax relief, whether by exemption or by credit, in cases where the source State tax exceeds the tax imposed in the country of residence, the overall tax burden on the taxpayer is likely to discourage foreign investment in the source State.

also contain rules to avoid profit shifting between jurisdictions in the case of multinational enterprises. Through the exchange of information and, in some cases, assistance in collection of taxes, tax administrations are able to assist each other in ensuring the proper application of tax treaties, as well as enforcement of domestic laws.

~~A recent focus of Governments has also been on~~Tax treaties should also adress

(d) Political reasons.

The importance of each of these reasons will be different in each situation. Motivations may vary depending on whether a country is a net exporter of capital (typically a developed country) or a net importer of capital (typically a developing country). It is important to understand all perspectives when considering a negotiation request from another country or designing a broader tax treaty strategy.

In a developing country, there may be little outbound investment by its residents. For such countries, the main reasons for entering into treaty negotiations are commonly:

(a) To attract foreign direct investment;

(b) To attract inbound transfers of technology or skills;

(c) To respond to political or other pressure from other countries.

The benefits of increased tax cooperation, such as exchange of information and assistance in collection, should also be taken into account by developing countries.

It should be noted that, even if one country has concluded that it would serve its interests to enter into a tax treaty with another country, that other country may not be willing or able to commence negotiations. Before treaty negotiations can commence, both countries must consider that a tax treaty would benefit them, and must be in a position to start them.

Section I of the present Manual outlines some of the common issues that arise as the result of the overlap of taxes imposed in different countries. It also discusses issues that may arise in connection with tax discrimination, complexity and uncertainty. The main benefit of tax treaties is that they remove or reduce these barriers to cross-border investment and the transfer of knowledge and skills.

For developing countries, however, there may be other benefits to be gained from tax treaties. For example, negotiation of treaties by a developing country may be seen by other countries as an expression of its willingness to conform to the international tax norms, such as non-discrimination, arm’s length principle and exchange of information. It may al}ӂ n

- Avoidance of fiscal evasion

***Costs*:**

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

While tax treaties can be beneficial to developing countries, there are also significant costs to entering into such treaties. By understanding what outcomes are desired, and how treaties can assist in achieving those outcomes, countries are better able to determine whether or o omes, countri ő ęs can aa nm l A ʒ ∫ qv

Other aspects of a tax treaty may be open to negotiation, such as coverage of capital taxes, and levels of source taxation permitted under the treaty. Departures from the international models will almost always increase the difficulty of negotiating a satisfactory

The relevant authority to give approval for negotiations will usually be the Minister of Finance, or an authority approved by the Minister of Finance. The Ministry of Foreign Affairs should be consulted before any decision is made.

2. Logistics

Both countries will need to agree on:

- The dates on which the negotiat]x˙soa M^{m}é made.

- Notification to its embassy in the country of the visit and its purpose

3. Defining the roles of each member of the team

In the preparations for the negotiations, as well as during them, it is important that all members of the team know which duties they are allocated, and what their roles will be:

(a) *Leader of the team*:

- The leader of the team should be a senior official with the authority to make important decisions during the negotiations.
- Preferably, the leader should have comprehensive knowledge of domestic tax legislation and its interaction with domestic legislation and tax treaties.
- It would be highly desirable for the leader to be experienced in tax treaty negotiations.
- He/she should lead the discussions and present the team's arguments.

(b) *Adviser(s)*:

- Most negotiating teams include at least one or two members of the team who advise the leader on technical issues.
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- All differences between the two drafts should be identified beforehand because all differences, whether on major or on minor items, have to be agreed upon during the following negotiations.
- It is advisable to decide which differences are important and which are of less importance.
- Important issues should be discussed internally to find arguments to be used, and to determine what tactics should be followed in the process of trying to convince the treaty partner to accept a proposal.

Identifying provisions proposed in the two model drafts that deviate from provisions agreed in treaties with third countries

- A team should be aware of treaties its country has entered into with third countries because if provisions in such treaties are more beneficial than those in the draft model, the treaty partner country is likely to ask for similar treatment.
- It is advisable to be prepared either to accept the same solution or to explain why it was acceptable when negotiating with the third country but not in the present situation.
- Treaties entered into by the other country with countries which are comparable (economically or regionally) with one's own should be studied, as these will give an indication of what the other team may be willing to accept. They may also indicate how strongly the other team is likely to argue in favour of its own position.
- If the proposed treaty partner is a developed country, a comparison with treaties it has entered into with other developing countries will be of more value than a treaty entered into with another developed country.
- Recent treaties entered into by the other country are more valuable than older treaties and may also help the team to develop drafting that is likely to be acceptable to that other country.

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11. Studying the culture and customs of the other country

It is advisable to have some knowledge about the country with which one is going to negotiate:

- Consideration should be given to that country's economic situation, its gross national product (GNP), important industries and its relations with other countries.
- There should be an awareness of local customs and sensitive issues, for example,

More guidance on how to prepare for treaty negotiations may be found in *Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries*.[24] ***[Should we keep that reference or simply add the relevant information in the Manual?]***

D. Conduct of negotiations

The way in which treaty negotiations are conducted is vital to achieve a treaty that is beneficial to both countries and meets the interests of each side as far as possible. In particular, it is important that the negotiations be conducted in a cooperative atmosphere that is conducive to reaching agreement on balanced outcomes that are expressed in well-drafted, effective provisions that will stand the test of time.

1. Working draft

The two teams will first need to decide which model draft should be used as the working document:

- It is an advantage to have one's own model draft accepted as the working document.
- The host team will usually ask for its draft to be the working document. In many cases, this request will be accepted by the visiting team. Both drafts will be on the table, however, and should be taken into consideration during the discussi× or afts mψĂ

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6. Arguments

Teams should be prepared to present relevant arguments to explain the proposal put forward in the different articles of the draft presented:

- This is true of all articles, but is essential where the wording of an article deviates from what is common wording in international models.

Alternative provisions found in the Commentaries are easier to explain. There are different kinds of arguments commonly used:

- The policy argument plays on reason and sound policy. It is often based on economic arguments and is closely linked to a revenue argument.
- A reason often used in support of a proposal is the precedent argument, where a team shows that other countries have accepted the wording of an article. For a developing country negotiating with a developed country, such an argument will be of greater value if they can show that other developed countries have accepted the wording. It may also be the other way around. The team of one country may be asking for a wording the other country has accepted in treaties with third countries. It may point to those treaties and ask the other team why such wording is no longer acceptable.
- A further argument along the same lines is that by accepting a certain provision with a country to which one would prefer to be compared, business in one's country will be disadvantaged unless the same benefits are obtained.
- In several cases, a provision may be asked for to prevent abuse, for example, to introduce specific anti-abuse provisions in these treaties. Examples should be used to illustrate why the proposal is necessary.
- An argument may be that a proposal is based on firm policy**.** Some countries have non-negotiable provisions in their model. It is, however, important to distinguish between provisions that are genuinely non-negotiable and those which are only strongly preferred.
- Two arguments are of little or no value unless they are substantiated, namely: "We need this wording because we are a developing country" and "We need this wording because we have such a provision in our domestic legislation." In both cases it is important to explain clearly why special wording is needed.

7. Record of discussions

- During the discussions, the working draft should be projected on a screen that is visible to both teams, if possible.
- When going through the working draft article by article, all wording that is not agreed upon should be put in brackets:
  - To be on the safe side, the other team should be asked for an explicit agreement and only then should the brackets be deleted.
- If there is no screen, the text should be read before moving on to the next issue.
- Highlight colours may be used to identify each country's proposals.

3. Signing of the treaty

When any necessary translations have been completed and agreed upon by the two countries, the next step will be to seek the approval of each Government to sign the treaty:

- To get approval, the (translated) treaty and a technical explanation will generally have to be brought before the Minister of Finance and other relevant ministers. The procedures for approval, however, vary from one country to the other.

Once approved, the text would generally be transmitted to the Ministry of Foreign Affairs, which is usually the government agency responsible for arranging the signing ceremony and for deciding who will sign the treaty on behalf of the State:

- In most cases, only the Head of State, Head of Government and the Minister of Foreign Affairs have full powers to bind a country by signing a treaty. If the Minister of Finance, or any other minister or person is the one signing the treaty, that person will need to produce a written authorization that they have been given the appropriate full powers to sign.
- If the tax authority is in charge of the signing procedure — as may be the case — and there is doubt about the authority of the person of the other country who is going to sign the treaty, the Ministry of Foreign Affairs should be consulted in advance.
- There are always at least two originals of the treaty to be signed, one of which will be retained by each State. Where the official text is in more than one language, there will be two originals of the treaty in each official language to be signed. Each country should have a signed version of the treaty in all official languages.
- There are no set rules about where the signing ceremony should take place. It should be signed where it is most convenient the two countries.

To avoid delays in the entry into force of a treaty, it should be signed as soon as possible.

4. Post-signing activities

In almost all countries, the signed treaty has to be presented to the parliament for final approval:

- The Ministry of Finance or the authorized agency which negotiated the tax treaty will usually prepare a technical explanation of the treaty.
- The signed treaty,toften together with an accompanying domestic law and the explanation, will then be sent to the pamMmo t b Â y ¢p x and the

- The competent authority should inform its counterpart in the other country of important new legislation; some countries might inform its treaty partners also about significant judicial decisions, administrative rulings, and so forth.

More information on these activities may be found in the section on post-negotiation activities in *Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries.*[28] ***[Should we keep that reference or simply add the relevant information in the Manual?]***

28

Section III - Treaty provisions

A.

B. Chapter II – Definitions

Articles 3 to 5 include definitions of certain key terms used in the treaty. Other definitions of terms used in treaties are found in the articles to which they are relevant. For example, “immovable property” is defined in Article 6, which deals with income from such property, while dividends, interest and royalties are defined in their relevant Articles (10 to 12, respectively). These other definitions have a direct impact on the taxing rights granted by the respective Articles and care should be taken when deciding on their scope.

1. Article 3 – General definitions

Article 3 provides a definition for a number of terms used in the treatyct on the ant "

Paragraph 2

It is necessary, for example, for purposes of avoiding residence/residence double taxation described in section I, to assign residence for treaty purposes to only one of the Contracting States.

Paragraph 2 sets out a number of rules (known as “tie-breaker rules”) for determining in which State a dual resident individual will be deemed to be a resident for purposes of the treaty. It should be noted that these tie-breaker rules apply only for the purposes of the treaty and do not af ŭ

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where the person's visit is primarily for the purpose of vacation), taxing rights will not arise in that country. There is no equivalent to the second condition in either Article 14 or in subparagraph (c) of paragraph 3 of the alternative provision on services of Article 5 of the United Nations Model Convention.

The second situation dealt with under the OECD alternative provision is where an enterprise provides services in a country through one or more individuals (generally employees, but it may also refer to partners or dependent agents). Like subparagraph (b) of Article 5 of the United Nations Model Convention, the services must be provided for "the same or connected projects" during at least 183 days in any 12-month period, though they may be provided by different employees or other personnel on behalf of the enterprise. This condition ("for the same or a connected project") is included because, as paragraph 12 of the Commentary on Article 5 of the United Nations Model Convention mentions, "it is not appropriate to add together unrelated projects in view of the uncertainty which that step involves".

~~Some countries do not wish to limit source taxation of services income to the extent provided under the United Nations Model Convention, however, and seek to remove the "same or a connected project" requirement or reduce the time threshold in subparagraph (b) and alternative subparagraph (c) of paragraph 3. Negotiators encountering these proposals are advised to read the relevant parts of the Commentary on Article 5 of the United Nations~~ Model Convention.[58] **[A new paragraph sh t]ᵐdˌvvemMᵐ x**

country. This paragraph does not apply, however, if the person is an independent agent to whom paragraph 7 of the Article applies.[63]

This paragraph is effectively the same as paragraph 5 of Article 5 of the OECD Model Convention, excepm ξ ϰ ʊ ᴶ tively the samst ˢ Conventi= ĮMϵ vή ConventiD ĮMϰv] nd!

1. Article 6 – Income from immovable property

(many common law countries), immovable property may be defined for treaty purposes by reference to the meaning of "real property" in the law of that country.

A number of assets and rights are specifically included in the treaty definition of "immovable property". These are items that are widely regarded as immovable property, such as property accessory to immovable property, mining rights or other rights relating to the exploitation of natural resources. Income from such assets and rights is covered by Article 6, even if the assets or rights are not encompassed by the domestic law definition of immovable property in the country in which the property is situated. **[This paragraph should be expanded given the importance of resource royalties in developing countries]**

Some countries specifically include in the definition of "immovable property" rights to the use or enjoyment of immovable property situated in their jurisdiction, where those rights derive from the holding of shares or other corporate rights in the company that owns the property (often time-share rights).[76]

Ships~~, boats~~ and aircraft are excluded from the treaty definition of "immovable property" in paragraph 2, regardless of whether they are covered by any domestic law definition. Interest from a debt secured by immovable property is not covered by Article 6.[77]

Paragraph 3

Paragraph 3 makes it clear that paragraph 1 applies to income from immovable property, irrespective of how that property has been used to produce that income, for example, for rental purposes, for the conduct of agricultural or forestry activities or mining, or for the granting of rights to others to use the property or exploit natural resources.

Paragraph 4

Paragraph 4 ensures that the provisions of paragraphs 1 and 3 apply to profits derived from the use or exploitation of immovable property of an enterprise and to immovable property used for the performance of independent personal services. Accordingly, the country in which the immovable property is situated may impose tax on the income derived from the use of that property by a resident of the other country, irrespective of whether or not that property is ~~part of~~ effectively connected with a permanent establishment or fixed base situated in the country in which the immovable property is situated.

s If the treaty does not include Article 14 (Independent personal services) then para

(b) Sales in the PE country by the enterprise of goods or merchandise that are of the same or a similar kind as those sold through the permanent establishment; or

(c) Other business activities carried on in the PE country that are the same or of a similar kind as those carried on through the permanent establishment.

The equivalent paragraph in both the former OECD Article 7 and the new OECD

another part of the enterprise or a separate enterprise or entity. **[This paragraph should be clarified]**

Paragraph 2 of the new OECD Article 7 also embodies the separate entity and arm’s length principles. In addition, it clarifies that the attribution of profits also applies for purposes of Article 23 (Methods for the e

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The second and third sentences of paragraph 3 in Article 7 of the United Nations Model Convention provide that deductions are not allowed in respect of any expenses paid between the permanent establishment and any other part of the enterprise by way of intra-enterprise royalties, commissions, management or other services or interest (except in the case of banks), unless the payments were made as reimbursement to the other part of the enterprise for actual expenses incurred. Thus, for example, where an enterprise owns a patent or copyright, no deduction will be allowed, in calculating the profits attributable to the permanent establishment for purposes of Article 7, in respect of any "royalties" charged by the head office or another part of the enterprise to a permanent establishment of the same enterprise. These sentences in paragraph 3 have no equivalent in the former OECD Article 7, although the United Nations Model Convention provision largely reflects the interpretation found in the Commentary on paragraph 3 of the former OECD Article 7.[89] The new OECD Article 7, which has no provision equivalent to paragraph 3, does not limit deductions to actual expenses, and requires the recognition and arm's length pricing of all dealings where one part of the enterprise performs functions for the benefit of the permanent establishment.[90]

Paragraph 3 of the new OECD Article 7 performs a completely differeetation

Paragraph 5

Paragraph 5, which mirrors paragraph 6 of the former OECD Article 7, is intended to give an assurance of continuous and consistent tax treatment by providing that, unless there is good reason to change, the same method of attributing profits to the permanent establishment is to be used each year. This refers generally to the ongoing use of direct or indirect methods, or of formulary apportionment methods. In most countries, it would be expected that the same method would be used each year even in the absence of this provi”x

be found in paragraph 10 of the Commentary on Article 8 of the United Nations Model Convention.[97]

The profits to which the Article applies are discussed in the Commentaries.[98] The application of the Article to profits from bareboat charters or from container leasing can be controversial and should be discussed during negotiations. If necessary, the application of the Article to these profits should be clarified.

Under alternative B, the words "ships or" are deleted from paragraph 1, with the result that this paragraph applies only to profits from international aircraft operations. Paragraph 2 of alternative B provides for source-country taxation of profits from the operation of ships in international traffic if the operations in that country are "more than casual".[99] If the operations are more than casual, an "appropriate allocation of the overall net profits" may be taxed in the source country. The United Nations Model Convention provides for a reduction in the source tax, but does not specify a percentage. A reduction of 50 or 60 per cent is typically provided for in the very small number of treaties that include this provision.[100] Even fewer countries extend the operation of paragraph 2 of alternative B to international aircraft operations.

Countries that are considering using alternative B should ensure that they can effectively administer this provision, that is to say, that they can identify the relevant operations, determine the appropriate allocation of overall net profits, and collect the tax while providing the necessary reductions.

Paragraph 2 (alternative A), paragraph 3 (alternative B)

Paragraph 2 of alternative A and paragraph 3 of alternative B allocate sole taxing rights over profits from the transport operation of boats on inland waterways to the country in which the place of effective management of the enterprise is situated.

In practice, few countries include this provision in their treaties. The Commentary notes that countries are "free to settle any specific tax problems which may occur with regard to inland waterways transport, particularly between adjacent countries, through bilateral negotiations".[101]

If the paragraph is included in a treaty which allocates exclusive taxing rights under paragraph 1 to the country of residence of the enterprise (rather than the country in which the

97

does not result in economic double taxation, the treaty partner country is generally required to make any necessary corresponding adjustment to the profits of the related enterprise.

The United Nations Model Convention and the OECD Model Convention embody the arm's length principle that forms the basis for allocating profits resulting from transactions between associated enterprises. The *United Nations Practical Manual on Transfer Pricing for Developing Countries* and the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*[103] explain in great detail the application of Article 9.

Paragraph 1

Paragraph 1 of Article 9 applies to associated enterprises. Enterprises are "associated" if:

- One of the enterprises of a Contracting State participates directly or indirectly in the management, control, or capital of an enterprise of the other State, or
- The same persons participate directly or indirectly in the management, control, or capital of both enterprises

In cases of associated enterprises, the tax authorities of the Contracting States may for the purpose of calculating tax liabilities rewrite the accounts of the enterprises if as a result of the special relationship between the enterprises the accounts do not show the true taxable profits arising in those States, that is to say, the internal pricing differs from arm's length pricing, the pricing that would have been agreed between enterprises that were wholly independent of each other and affected only by market forces.

Paragraph 2

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This paragraph is not widely adopted; one has to keep in mind that it leads to double penalties.[104] Treaty practice shows that a few countries include a variation of this provision that excludes the application of paragraph 2 in cases of fraud, wilful default or negligence even without the link to penalties or legal proceedings.**[This paragraph could be expanded to discuss the alternative provision that provides a time limit for an initial adjustment]** ***[Concerning this suggestion, one member of the Subcommittee indicated "agree we should update to refer to alternative provisions for time limit on initial adjustment" while another member indicated "It could be expanded by an explanation that this paragraph causes difficulties for countries that do not have a common law system". What are the Subcommittee's views on these comments?]***

5. Article 10 – Dividends

Article 10 deals with distributions of corporate profits in the form of dividends from a company in one country to its shareholders in a treaty partner country. The dividends may be taxed in both the country of residence of the shareholder (residence State) and the country of which the paying company is a resident (source State). Taxam≠ one forc℘ɪ ᵐtate) v

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The United Nations Model Convention does not provide for specific percentages for limits on dividend withholding tax rates, leaving them for countries to resolve in bilateral negotiations. A rate limit of 5 per cent of the gross amount of the direct investment dividends and 15 per cent for all other dividends is provided for in the OECD Model Convention. Rates in treaties with developing countries commonly vary; a careful design of a country model as described in section II.B and preparation of treaty negotiations as mentioned in

[A new paragraph should be added to explain the changes that have been made to the 2017 OECD Model to deal with the application of Art. 10(2)a) to transparent entities]
[Concerning this suggestion, one member of the Subcommittee indicated "Too detailed for a basic manual?" Does the Subcommittee agree that this issue is too detailed for inclusion in the Manual?]

Some countries seek exemption from source-country taxation in respect of certain categories of dividends, in particular where the dividend recipient is exempt from tax on tegor ヽ

Paragraph 3

Paragraph 3 specifies the meaning of the term “dividends” for purposes of the treaty. The definitions in the United Nations and OECD Model Conventions are identical and cover income from all kinds of shares or other rights that participate in profits, as well as income from other corporate rights that are taxed in the same way as dividends in the source State.

In some countries, excessive interest payments between related enterprises may be treated under domestic law as dividend distributions under domestic thin capitalization rules. While the Commentary provides guidance on when the payments may be considered to be dividends for purposes of the treaty, it may be desirable to clarify that the provisions of Article 10 (Dividends) have priority over Article 11 (Interest) in these cases. This is normally achieved by extending the definition of “interest” in paragraph 3 of Article 11 to ensure that this result is obtained, for example, by adding: “The term "interest" shall not include any item of income which is considered as a dividend under the provisions of paragraph 3 of Article 10.”**[The last two sentences should be reviewed to take account of the existing wording of the definitions of “dividends” and “interest” in Art. 10-11 UN and OECD Models and of the alternatives used by some countries, such as the US]**

Paragraph 4

Paragraph 4, like paragraph 4 of Article 10 of the OECD Model Convention, describes a situation where the rules for allocation of taxing rights over income provided in paragraphs 1 and 2 do not apply. Where the dividends form part of the profits of a permanent establishment situated in the country of which the paying company is a resident (source State), the source State is not required to limit its tax on those dividends. Instead, the source State may tax the income as business profits attributable to the permanent establishment in accordance with the provisions of Article 7 (Business profits). For treaties that include Article 14 (Independent personal services), paragraph 4 also provides that source-State tax is unlimited if the dividends are attributable to a fixed base in that State.

Paragraph 4 requires that the holding in respect of which the dividends are paid be “effectively connected” with the permanent establishment or fixed base. The meaning of the term effectively connected is discussed in paragraphs 32.1 and 32.2 of the Commentary on Article 10 of the OECD Model Convention. Broadly speaking, paragraph 4 applies only where the holding in respect of which the dividends are paid is a business asset of the permanent establishment or fixed base. Paragraph 4 does not operate as a “force of attraction” rule, that is, the paragraph does not apply where, for example, the shareholder has a permanent establishment or fixed base in the source State but the holding is not a business asset of that permanent establishment or fixed base. An example of an effective connection is the case of an insurance company which is engaged in business operations in the source State through a br ce se.

Convention. Rates in treaties with developing countries vary from full exemption to 25 per cent. Most treaties, however, limit withholding tax on interest to 10 or 15 per cent. Some regional models, such as the Association of Southeast Asian Nations (ASEAN) Model, specify 15 per cent.

Source-country rate limits are often one of the most controversial aspects of a treaty negotiation, especially in treaties between developed and developing countries. It is most important, particularly for developing countries, to achieve a balance between collecting revenue and attracting foreign investment. Interest to which the treaty applies will mostly arise in the developing country, since the flow of capital is almost exclusively from developed to developing country. Accordingly, the immediate impact of revenue reductions as a consequence of treaty rate limits will fall on the developing country (although there may be long-term revenue gains as a result of increased capital flows). Developing countries will need to decide what rate they can accept in their treaties, bearing in mind that high rates of withholding may deter investment or may result in the tax cost being passed on to resident payers through increased interest rates.

A careful design of a country model as described in section II.B and preparation of treaty negotiations as mentioned in section II.C of the present Manual are necessary for each country. In designing its treaty model and in its treaty negotiations, a country should aim to have a reasonably consistent treaty practice with respect to interest withholding tax rate limits. If,ŧ " otisᵂ d ʊg ᵐ˺

projects. Also, discussion of the application to tax of the sovereign immunity doctrine might be helpful.] ***[Concerning this comment, one member of the Subcommittee indicated "To my understanding 'may facilitate' is a neutral wording and can be kept". What are the Subcommittee's views on this comment?]***Reducing or eliminating the withholding tax rate on interest derived by financial institutions may also be beneficial to developing countries (which are generally recipients of foreign capital). Given the cost of funds to financial institutions, and the narrow margins of profit obtained on funds lent by those institutions, even a low rate of withholding on the gross amount of the interest will frequently absorb (or even exceed) the whole amount of the profit on the lending activities. As noted above, this is likely to deter lending by the financial institutions to residents of the other country, or result in a higher rate of interest on the debt claim or in the tax burden being pushed back onto borrowers from the developing country. This, of course, increases the cost of borrowing to residents of the developing country. Similar considerations apply to sales on credit. **[The arguments against such exemption (such as the risk of back-to-back lending) should also be highlighted.]** ***[Concerning this comment, one member of the Subcommittee indicated "? and too complex for a basic manual" an***

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from the transaction, Z Bank is likely to require X Ltd. to bear the cost of the State X tax, either directly, or by increasing the interest rate payable on the loan.

The rate limits provided in paragraph 2 apply only where the beneficial owner of the interest is a resident of the treaty partner country. If the interest is paid to a resident of the other country, but that person is not the beneficial owner of that income, the source country is not obliged to reduce its tax, and may apply the rates provided under its domestic law. Thus, for example, if interest arising in State A is paid to a resident of State B, who receives it as agent or nominee for a resident of State C, then State A is not obliged to limit its source taxation under the treaty between State A and State B.

On the other hand, if the resident of State B receives the interest as agent for another resident of State B, and the latter person is the beneficial owner of the interest, then the limits under the treaty between State A and State B do apply, since the beneficial owner is a resident of State B. Where the immediate recipient of the interest (as agent or nominee) is a resident of a third State, the Commentary states that the rate limitation in the source State remains available if the beneficial owner of the interest is a resident of the treaty partner country.[121] This can be made explicit in the treaty if the Contracting States so wish. **[A reference to the wording of the OECD Model, which avoids the issue, should be added]**

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applies where the debt

Some difficulties can arise in determining whether a sufficient economic connection exists between the interest and a permanent establishment or fixed base for the application of the exception to the general rule. These difficulties frequently occur, for example, where a loan is contracted by one part of an enterprise (for example, the head office) for funds that are for the use o! ! Ů ξ ɤ l se ĕ eral rule.

reference to the new PPT rule in Art. 29. A reference could also be added to the report on BEPS Action 4]

7. Article 12 – Royalties

Article 12 allocates taxing rights over roy Action 4]

The United Nations Model Convention does not specify a withholding rate limit on royalties that are beneficially owned by residents of the other country, leaving this for negotiation between treaty partners.

Negotiators may find it useful to discuss with their counterparts their understanding of the concept of beneficial ownership.**[A cross-reference to the explanation of the concept of "beneficial owner" added to the explanations on Article 11 should be included here]**

The treaty does not prescribe how the rate limit is to be applied. The second sentence in paragraph 2 authorizes the competent authorities to settle by mutual agreement the mode of application of the limitation. As with source tax limits imposed under Articles 10 and 11, each country is free to apply the procedures applicable under its domestic law, for example, taxation by withholding or by assessment.[140] The source State may either limit the tax withheld to the treaty rate, or it can impose tax at the domestic law rate and subsequently refund the portion that exceeds the tr

4 of Article 11 will, however, apply. Broadly speaking, paragraph 4 applies only where the right or property in respect of which the royalties are paid is a business asset of the permanent establishment or fixed base. Paragraph 4 does not operate as a "force of attraction" rule, that is to say, the paragraph does not apply where, for example, a copyright owner has a permanent establishment or fixed base in the source State but the copyright giving rise to the royalties is not a business asset of that permanent establishment or fixed base.

Paragraph 5

Paragraph 5 provides a deeming rule for determining, for treaty purposes, the jurisdiction in which the royalties arise. Regardless of any domestic law source rule for royalties, the general rule under this paragraph is that for purposes of the treaty, royalties are deemed to arise in the country of which the payer is a resident. Where, however, the royalties are, in effect, an expense of a permanent establishment or fixed base, those royalties are deemed to arise in the country where the permanent establishment or fixed base[147] is located. This approach will generally ensure that, if the royalties are a deductible expense of the payer, the source of the royalties is allocated to the country in which a deduction is allowed and, consequently, gives it a taxing right.

Article 12 of the OECD Model Convention does not include a provision equivalent to paragraph 5. In treaties that follow paragraph 1 of Article 12 of the OECD Model Convention, most countries do not consider it necessary to include paragraph 5, since the source of the royalties will not be relevant where all taxing rights are allocated exclusively to the residence State.

Paragraph 6

Treaty benefits such as the reduction of source taxation on royalties may lead to attempts by taxpayers to artificially structure their dealings in ways intended to attract such benefits. Treaties may assist developing countries in dealing with tax avoidance of this kind, even where the domestic law of that country does not have comprehensive transfer pricing rules.

Paragraph 6 deals with profit shifting by persons that seek to reduce ~~their~~ source-country tax ~~burden~~ by inflating royalty payments from ~~associates~~ related parties in a treaty partner country. Where royalties exceeding an arm's length amount are paid as a result of a special relationship between the two parties (or between both of them and a third party), paragraph 6 provides that the treaty limits on source taxation apply only to the arm's length amount, that is, the royalties that would have been payable between independent parties.

"Special relationship" commonly refers to the relationship between associated enterprises such as that described in Article 9 (Associated enterprises). It may, however, also

147

refer to relationships between individuals, such as marriage or family, or between individuals and companies, such as a managing director or significant shareholding.

Other approaches to deal with tax avoidance in relation to royalties are also available. ~~Countries may find it helpful to include in their treaties a general anti-avoidance provision (a main purpose test) in Article 12 to combat artificial devices designed to obtain the benefits of the Article through the creation or assignment of the rights in respect of which the royalties are paid.[148]~~ **[This last sentence should be replaced by a reference to the new PPT rule in Art. 29. A reference could also be added to the report on BEPS Action 4]**

8. Article 12A – Fees for technical services

[Explanation of the new Article 12A will be added]

9~~8~~. Article 13 – Capital gains

Article 13 allocates taxing rights over capital gains from the alienation of property. In general, the country that has primary taxing rights over the income from immovable property, assets of a permanent establishment and ships and aircraft used in international traffic is allocated taxing rights over capital gains from the alienation of that property. For other gains, treaty practice varies, as d!

Paragraph 1

Under both the United Nations and OECD Model Conventions, the country in which immovable property is situated may tax capital gains from alienation of that property. The gains may also be taxed in the country of which the person alienating the immovable property is a resident (although that country must provide relief for any double taxation in accordance with Article 23).

The term "immovable property" has the same meaning in this Article as it has in Article 6 (Income from immovable property). It may therefore differ from domestic law definitions.[152]

Paragraph 1 applies only to gains derived by a resident of one treaty partner country from immovable property situated in the other country. Gains from alienation of immovable property situated in the alienator's country of residence or in a third State are dealt with under paragraph 6 of this Article of the United Nations Model Convention.[153]

Paragraph 2

Capital gains from the alienation of business assets (other than immovable property) of a permanent establishment or, in treaties that include Article 14 (Independent personal services), a fixed base, may be taxed in the country in which the permanent establishment or fixed base is situated. Gains from the alienation of immovable property of a permanent establishment or fixed base are dealt with under paragraph 1 of this Article.

It should be noted that paragraph 2 does not operate as a "force of attraction" rule. Accordingly, gains from other movable property, including assets used for the purposes of activities described in subparagraphs (b) and (c) of Article 7 (1) of the United Nations Model Convention, are dealt with under paragraph 6[154] of Article 13 and not under this paragraph.

Paragraph 3

Paragraph 3 provides that capital gains arising from the disposal of ships or aircraft used in international traffic~~, and boats used in inland waterways transport,~~ are generally taxable only in the ~~country in which the place of effective management~~ State of residence.~~of the enterprise is situated.~~ This rule applies irrespective of whether Article 8 (alternative A) or Article 8 (alternative B) of the United Nations Model Convention is adopted.

In treaties that allocate taxing rights in Article 8 on the basis of ~~where the~~the place of effective management of the enterprise ~~is a resident~~ (rather than the State of residence~~where its~~

place of effective management is situated), paragraph 3 should be amended to reflect this

an anti-avoidance provision designed to ensure that a taxpayer cannot escape source taxation by selling off multiple small parcels of shares that together form a substantial holding.

Treaty practice varies with respect to this provision. Some treaties do not include a minimum participation, although it should be recognized that there are significant administrative and compliance difficulties in enforcing taxation in respect of gains from small shareholdings. Some countries specifically exclude gains from the alienation of quoted

Others provide for a concessional rate of tax on gains from the alienation of shares. Still others limit taxing rights over gains from disposal of shares to gains by individuals who are former residents of that State.

Many countries do not include paragraph 5 at all in their treaties. There is no equivalent to paragraph 5 in the OECD Model Convention.

In deciding their position on this paragraph, countries should take into account their ability to identify, and collect tax on, sales of shares by non-residents.

[A discussion of treaty issues related to indirect transfer of shares should be added to this section] ***[Concerning this suggestion, one member of the Subcommittee indicated "Would be too complex for a basic manual". Does the Subcommittee agree with this view?]***

Paragraph 6

Paragraph 6 is a "sweep-up" provision allocating taxing rights over all capital gains that are not dealt with in paragraphs 1 to 5. In both the United Nations and OECD Model Conventions, these gains may be taxed only in the country of residence of the alienator.[161]

Some countries, however, including many developin h n M1 mMa

some countries seek to preserve ~~taxing rights over~~ the right to impose an “exit” or “departure” tax ~~that is intended to prevent avoidance of capital gains tax through a change of residence~~.[163]

10~~9~~. Article 14 – Independent personal services

Article 14 (which is no longer found in the OECD Model Convention)[164] deals with income from professional services and other independent services such as those of contractors. It does not deal with income from industrial or commercial activiti iviti ivMʌɹpl om

exemption from source taxation for a limited period to this category of employment. This is discussed further in the section on the limited period of employment (

should discuss this issue during negotiations and, if necessary, provide specifically for this outcome.

Some countries consider that the exemption from source taxation should be available only where the employer is a resident of the treaty partner country. Countries that take this view should adapt

The provision is ~~rarely included in~~not found in many tax treaties,[177] but it is favoured by a few developing countries whose domestic law provides for taxation of such remuneration on the basis that it is paid by a domestic company and is therefore allowed as a deduction to the company.

Countries that cannot exercise the taxing right provided under paragraph 2 of Article 16 (for example, where they can tax only if the activities are exercised in their jurisdiction) should omit this paragraph. In the absence of this provision, the income of these ~~managers~~ individuals would fall within the scope of Article 15 (Dependent personal services). Under that Article, the remuneration is taxable in the country in which the individual~~manager~~'s activities are exercised (the exemption provided in paragraph 2 of Article 15 does not apply where the employer company is a resident of that State).

13~~12~~. Article 17 – Artistes and sportspersons

Article 17 allows source taxation of income relating to performances by entertainers and sportspersons in that country. Unlike other Articles dealing with the provision of cross-border dependent or independent services, the only threshold condition for source taxÐ D Ṭ

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The Commentary suggests that some countries may wish to apply the rules of Article 17 only in respect of independent services, so that Article 15 applies to income of employed entertainers and sportspersons.[179] This, however,

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other State and the income is not attributable to a permanent establishment in the source State. Paragraph 2 ensures that the country in which the entertainment or sporting activities are performed may tax the income from such activities, regardless of who derives that income.[184]

1413. Article 18 – Pensions and social security payments

Arti

discussed in the Commentary, should be considered by negotiators prior to commencement of negotiations.[193]

Paragraph 2 of alternative A, paragraph 3 of alternative B

Paragraph 2 of alternative A and paragraph 3 of alternative B give to the source State sole taxing rights over pensions and other payments made under that country's social security system. The rationale for this is described in the Commentary as being that "the payments involved are wholly or largely financed out of the tax revenues of the State of source".[194]

There is no equivalent to this paragraph in the OECD Model Convention, although the Commentary on Article 18 of that Convention proposes an alternative provision which providen m Thb Þhts over[a]

The Commentary notes that “allowing recognition of cross-border pension contributions and facilitating cross-border transfer of pension rights from a pension scheme to another will also stimulate the movement of personnel to foreign countries”.[199]

1514. Article 19 – Government service ¾ " d ‘

Article 19 generally reserves the sole right to tax remuneration from, and pensions paid in respect of, government service to the p]− s t Ãŧ5v

Where the conditions of the exception are met, exclusive taxing rights over the remuneration are allocated to the receiving State. This exception commonly applies to “locally engaged” staff such as secretarial staff, drivers or security personnel who are employed in the receiving

It should be noted that the same benefit for visiting educators could be achieved with more precision through domestic law, unless the intention is to achieve a reciprocal treatment in both States ʃ

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The paragraph ~~primarily~~ addresses the case of income that does not constitute business profits but is ~~arising in a third State that is~~ paid with respect of assets effectively connected with ~~attributable to~~ a permanent establishment or fixed base. It ~~also deals~~covers such income even where ~~, however, with the case where~~ the payer and the person deriving the income ~~recipient (or beneficial owner) of the income~~ are ~~both~~ residents of ~~i~~n the same State, but the income is paid in respect of right or property that is effectively connected with a permanent establishment or fixed base ~~attributable to a permanent establishment or fixed base~~ of the recipient in the treaty partner country. For example, interest paid by a resident of State A may be beneficially owned by another resident of State A but paid in respect of right or property that is effectively connected with ~~attributable to~~ a fixed base of that person situated in State B. In this case, paragraph 2, in combination with Article 7, will allow State B to tax the income, and Article 23 will require State A to relieve double taxation. If State A relieves by the exemption method, however, this will result in that State not being able to tax the income at all, notwithstanding that the interest arises in State A.

Some countries do not agree with this outcome, and seek to include a provision that ensures that State A may impose tax as the source country (limited, where appropriate, in accordance with treaty provisions such as Articles 10, 11 or 12). The country in which the permanent establishment or fixed base is situated must give relief from any double taxation.[214]

The Commentary suggests possi

~~If the treaty partners agree to provide for exclusive residence country taxation, paragraph 3 should be omitted~~**[This is simply under way to represent the difference between the OECD and UN models]**.

Additional paragraphs

The Commentary includes three alternative provisions whic

Paragraph 2

Paragraph 2 provides that the country in which a permanent establishment or fixed base of a non-resident is situated may tax capital represented by movable business property of the permanent establishment or fixed base.

This corresponds to the rules for taxing income attributable to a permanent establishment or fixed base. If Article 14o ɔ ɣ ʌ ıᴰpeȘ nt ncohe r m he rulb Art

If the treaty does not cover capital taxes, the references to capital and to capital taxes should be omitted from Article 23.

1.1 Article 23 A – Exemption method

~~the source country to tax.~~[228] **[The last sentence has been made obsolete by the inclusion of paragraph 4 of Art. 23 A in the UN Model]**

Since the amount of a taxpayer's taxable income or capital may be relevant for non-tax purposes, for example, for social benefits, the Commentary provides an alternative formulation of paragraph 1. Under this alternative provision, instead of reducing the taxpayer's income or capital by the amount of the foreign income or capital, the taxpayer's tax liability is reduced by the amount of tax applicable to that foreign income or capital.[229] **[This paragraph seems to belong more logically to the discussion of Art. 23A(**

Paragraph 2

Paragraph 2 provides for exemption with progression where income is exempted by the provisions of the treaty from taxation in the residence State. In effect, this paragraph allows the country of residence to take the exempt income into account in determining the tax liability in respect of other income of the taxpayer.[239]

Exemption with progression is discussed above in relation to paragraph 3 of Article 23 A.

Special issues

Capital taxes

As noted in the Commentary,

Tax sparing

The benefit of special tax concessions offered by the source State to foreign investors may be lost if the investor is a resident of a country that uses the credit method. In these cases, the reduction in source taxation merely results in an increase in the amount of tax collected by the country of residence of the taxpayer.

By contrast, the exemption method ensures that no further tax will be imposed in the country of residence on the income that has benefited from the tax incentive in the source country. However, if the treaty partner is not prepared to use the exemption method, developing countries often seek to include tax-sparing provisions in their treaties. For some developing countries, preservation of the benefit of their tax incentives through relief of double taxation by the exemption method or by the inclusion of tax-sparing provisions "is a basic and fundamental aim in the negotiation of tax treaties".[242]

Tax sparing is an arrangement under which the developed country will agree to provide a credit for the source tax of the developing country, notwithstanding that the tax has not actually been imposed because of tax incentives provided by the developing country. The purpose of tax sparing is to ensure that the benefit of the incentive is not lost to the taxpayer as a result of taxation of the income by the country of residence.[243]

While some developed countries are prepared to agree to such provisions with their least developed treaty partners, many are resistant to a tax-sparing provision, especially after the publication of the OECD report entitled *Tax Sparing: a Reconsideration* recommending caution in agreeing to tax-sparing provisions in treaties.[244] In particular, the report noted that tax sparing was vulnerable to taxpayer abuse, and was not necessarily an effective tool for promoting economic development.[245] The report did not say that tax sparing should never be granted, but suggested that it should be considered only in regard to States whose economic level was considerably below that of OECD member States. It also recommended the use of "best practices", such as the limitations mentioned below, to minimize potential for abuse.

The Commentary suggests three different forms that tax-sparing provisions may take, namely, a deduction for the tax that the source State could have imposed, a deduction for a fixed rate of tax or an exemption of the income.[246]

Countries that are prepared to include tax-sparing provisions should ensure that the incentives for which tax sparing is sought are described with sufficient precision so that the other country knows exactly which measures are covered. This may involve a reference to legislation that sets out which income or projects are eligible for the incentive. Increasingly, tax-sparing provisions include certain limitations, for example:

- The eligible incentives may be limited to certain types of investment or activities, for instance, genuine investments aimed at developing the domestic infrastructure of the developing country
- Tax sparing may apply only to active business income (not passive income such as interest, royalties or leasing payments)
- Tax sparing may not apply to financial activities such as banking and insurance
- A "sunset" clause may apply, for instance, a provision that states that tax sparing will apply only for a limited period (such as 10 years), unless further extended by agreement between the two countries[247]

The Commentary discusses other approaches that may be adopted by countries seeking to preserve the benefit of their tax incentives, namely:

- Making the granting of the tax incentive under domestic law of the source country conditional upon the income being exempted (or the tax forgone credited) in the investor's country of residence
- Providing in a treaty that income benefiting from a tax incentive will be exempt from

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maintained, negotiators for that country should be prepared to explain fully the operation of those laws during negotiations and, if the other country agrees, specify precisely in the Article any laws that are to be excluded from the operation of the treaty rules in this Article.

Paragraph 1

Paragraph 1 stipulates that a Contracting State may not tax nationals of the other State more harshly than its own nationals.

The term "national" is defined in Article 3,[250] and includes legal persons, partnerships and associations that derive their status as such in the country, as well as individuals who are nationals of that country. For legal persons, partnerships and associations, this generally means that the entity is incorporated or established in that country.

Nationals of a treaty partner country cannot be taxed at a higher rate, or subjected to more onerous administrative or compliance obligations than those applicable to a State's own nationals who are, for tax purposes, in the same circumstances. The text of paragraph 1 makes it clear that the comparison must be made between nationals of the two countries that have the same residential status, that is to say, a national of State A who is a resident of State B is not "in the same circumstances" as a national of State A who is a resident of State A. Issues relating to the meaning of "in the same circumstances" should be resolved by reference to the Commentaries and the examples provided therein.[251]

The second sentence of paragraph 1 provides that tax discrimination against nationals of the treaty partner country who are residents of a third State must also be eliminated.

Paragraph 2

Paragraph 2 precludes tax discrimination against stateless persons who are resident in one or other of the States. In the absence of this provision, stateless persons would not be protected against discrimination on the basis of nationality.

Many treaties omit this paragraph~~Treaty practice with respect to this paragraph varies~~. ***[Concerning this suggested change, one member of the Subcommittee indicated "I prefer the old wording which is more neutral". Which version does the Subcommittee prefer?]***

Paragraph 3

Paragraph 3 ensures that a permanent establishment in a treaty partner country is not less favourably taxed than a local enterprise, where they are both carrying on the same activities.

Difficult issues can arise with respect to the application of this provision, and negotiators are strongly advised to read the Commentaries for guidance on the implications of the equal treatment requirement for:

- Assessment of tax
- Treatment of dividends received in respect of holdings owned by permanent establishments
- Structure and rate of tax
-

~~resident companies in similar circumstances~~. It is aimed at ensuring that local enterprises ~~resident companies~~ are taxed in the same way ~~equally,~~ irrespective of who owns or controls their capital.

This paragraph is concerned only with taxation of the ~~income of the resident company~~enterprise itself, and not with taxation of the owners or of the distributions made by the enterprise~~company to them~~, or with rules that depend on the relationship between the ~~company~~ enterprise and other enterprises, for example, consolidation ~~rules~~ or loss transfers rules.

Countries that have special rules relating to foreign-owned companies that they consider important to maintain should raise these matters during negotiations and, if necessary, make specific provision for them.

Paragraph 6

In accordance with paragraph 6, the operation of Article 24 is not limited to taxes covered by the treaty as specified in Article 2. The non-discrimination rules in the United Nations and OECD Model Conventions apply to all taxes, including national- and subnational-level taxes, income tax, value added tax (VAT), property taxes, petroleum taxes, and so forth.

However, in some countries, there may be constitutional or other barriers preventing the application ~~to applying~~ of the non-discrimination rules to all taxes. While it is desirable that the rules apply as widely as possible, these countries may need to limit the application of these rules in their treaties to taxes covered by the treaty, or to those taxes and other major taxes imposed in the two countries.

2. Article 25 – Mutual agreement procedure

[This section should be entirely revised to take account of the Commentary changes made in the 2017 UN and OECD Models as well as the most recent work of the Committee on dispute resolution and the G20-OECD work on BEPS Action 14] Tax treaties provide a mechanism by which taxpayers and tax administrations can resolve issues and uncertainties relating to the application or interpretation of the tax treaty and the elimination of double taxation. Article 25 of the United Nations and OECD Model Conventions also put forward provisions for mandatory arbitration in cases that are not resolved within a specified time by the two competent authorities (as defined in Article 3).

Countries that enter into tax treaties must b א ъo m l del

taxpayer's ability to obtain relief under the mutual agreement procedure, for example, if a late adjustment is made in one country and domestic law time limits prevent a corresponding adjustment in the other country. It should also be recognized that mutual agreement cases may take longer to resolve than domestic law cases, particularly where two or more competent authorities are required to consider the case and consult each other on possible solutions.

Paragraph 3

Paragraph 3 authorizes and requires the competent authorities to try to resolve issues relating to interpretation or application of the treaty, as well as double taxation issues that are not dealt with under the treaty, for example, where a resident of a third State has a permanent establishment in both Contracting States.

The laws of some countries do not permit the elimination of double taxation in cases not dealt with under the treaty. These countries will generally not agree to include the second sentence of paragraph 3 in their treaties.

Paragraph 4

Paragraph 4 authorizes the competent authorities to consult with each other directly for purposes of the mutual agreement procedure. They may consult, without the need for diplomatic formalities, through any means, for example, by letter, e-mail, telephone or face-to-face meetings; or the competent authorities may establish a formal joint commission for dealing with the case.

Some countries prefer to address cases solely through direct, informal means, and not through a joint commission. These countries omit the words "including through a joint commission consisting of themselves or their representatives".

The second sentence in paragraph 4 of the United Nations Model Convention[261] allows the competent authorities to develop, through consultation, bilateral procedures for the implementation of the mutual agreement procedure. Procedural issues, and suggestions for possible procedures that could be adopted by the competent authorities, are discussed in paragraphs 20 to 46 of the Commentary on Article 25 of the United Nations Model Convention. These paragraphs cover:

- Aspects of the mutual agreement procedure that should be dealt with
- Necessary cooperation of the person who makes the request

certain range of cases, for example, issues of fact such as those found in transfer pricing matters or whether a permanent establishment exists.[266]

The Annex to the Commentary on paragraph 5 of Article 25 (alternative B) addresses a number of the procedural issues by providing a sample agreement that could be used as a basis for a mutual agreement to implement the arbitration process.

Interaction with the General Agreement on Trade in Services

A number of countries include in their treaties a provision that deals with a potential overlap of the mutual agreement provision in the tax treaty and the dispute resolution mechanism of the General Agreement on Trade in Services (GATS).

The dispute resolution mechanisms of the GATS do not apply to disputes relating to the application of the GATS national treatment rule if the disputed measure is a tax covered by a tax treaty. Countries that wish to ensure that any dispute as to whether a tax is covered by a tax treaty and is dealt with through the mutual agreement procedure, rather than the GATS dispute resolution procedures, should include the provision set out in paragraph 93 of the Commentary on Article 25 of the OECD Model Convention.[267]

* * *

Administrative assistance (Articles 26 and 27)

As the economy becomes increasingly globalized, cooperation between tax authorities has become a vital part of international tax systems.

All treaties provide for exchange of tax information between competent authorities, while ensuring that confidentiality with respect to taxpayer information is maintained. Some countries also seek to include an article in their treaties that provides for reciprocal assistance between the two tax administrations in collecting outstanding tax liabilities.

3. Article 26 – Exchange of information

A tax treaty authori

Exchange of information has been a key focus of tax administrations over the past decade or more.[269] Comparable (though not identical) standards for exchange of tax information are now found in the United Nations and OECD Model Tax Conventions, the model Agreement on Exchange of Information on Tax Matters[270] and the Council of Europe-OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters.[271]

Any country wishing to enter into a tax treaty must be prepared to commit to the current international standards for exchange of information as reflected in Article 26 of the United Nations Model Convention.**[It would seem important to refer to the monitoring work of the GFTEoI to make negotiators aware of the importance of not departing from the wording of Art. 26 that is provided in the UN and OECD models]**

Countries will need to ensure that their tax administrations have the legal and administrative ability to obtain and exchange tax information. Some developing countries may have concerns about the administrative burden placed on their revenue agencies by the obligation to exchange tax information, but should always take account of the benefits of access to tax information in addressing these concerns. These countries may wish to include in their model a provision requiring extraordinary costs incurred in providing information to

- Factors affecting the implementation of exchange of information and the structure of exchange of information processes

The OECD 2006 Manual on the implementation of exchange of information provisions for tax purposes[275] also provides practical assistance to officials dealing with exchange of information, and may be helpful in designing or revising national manuals. It covers:

- General and legal aspects of exchange of information
- Exchange of information upon request
- Spontaneous information exchange
- Automatic ~~(or routine)~~ exchange of information
- Industry-wide exchange of information
- Simultaneous tax examinations
- Tax examinations abroad
- Country profits regarding information exchange
- Information exchange instruments and models

A detailed discussion of administrative issues relating to exchange of information may also be found in chapter IX of the *United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries*.[276]

Information relating to tax years prior to the entry into force of a treaty may also be exchanged. Some countries, however, prefer to limit the period for which such information may be requested.[277]

[The Subcommittee considers that additional explanations on developments related to AEoI would be helpful]

Paragraph 1

Paragraph 1 authorizes and requires the exchange of relevant information on all taxes, whether or not they are taxes covered by the treaty. Information must be obtained and exchanged by the competent authorities if it is "foreseeably relevant"[278] to the administration of either the treaty provisions or domestic law provisions (provided that the tax treatment under the domestic law is not contrary to the treaty).

The only difference between p~~P~~aragraph 1 of Article 26 of the United Nations Model ~~Convention differs from~~ and the equivalent paragraph in the OECD Model Convention in that the paragraph of the UN Model Convention ~~it~~ specifies that "[i]n particular, information shall

be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes". This statement of purpose is intended to provide explicit guidance to Contracting States on the interpretation of the Article.[279]

necessary to do so, provided the persons involved in the oversight activities are also subject to confidentiality requirements.[282]

Paragraph 3

Paragraph 3 sets out the limits to the obligation to exchange information (subject to the provisions of paragraphs 4 and 5).

A country generally has to provide information to the other country only if that type of information would be obtainable under the law and normal practices of both countries. This should not, however, be interpreted in a way that would prevent effective exchange of information.[283]

owed to a Contracting State, provided that the conditions of the Article are met. The Commentary on Article 27 of the United Nations Model Convention, however, provides drafting suggestions for more limited assistance for countries for which comprehensive assistance is not possible or is not appropriate.[290]

Paragraph 1 of the Article allows the competent authorities to settle how the Article is to be applied in practice. Before including an article providing for assistance in collection in a treaty, countries should have a clear view on the issues raised in paragraphs 6 to 9 of the Commentary M Ar 9 ogᵑKudiÑo tl` ŭ nt authM

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such taxes and persons, as well as the extent to which administrative assistance can be requested for information or liabilities relating to periods prior to entry into force of the treaty, should be discussed during negotiations. Some countries prefer to specify the date from which these provisions apply, in particular with respect to taxes other than treaty taxes, or liabilities arising or income derived in earlier years. **[This paragraph could be usefully clarified]**

If the treaty is replacing an existing treaty, the existing treaty should be terminated by a provision to this effect in the new treaty. The paragraph should also specify that the provisions of the existing treaty will cease to have effect from the date or dates that the provisions of the new treaty have effect. In some cases, for example, where the provisions of the earlier treaty are more beneficial to the taxpayer, the new treaty may provide for an extension of that treatment for a specified period.

~~Rarely~~In some cases, countries may wish to delay giving effect to certain provisions, such as an article dealing with assistancfle d" ʻ a

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3. Terminal clause (Note)

Tax treaties often include a terminal clause concerning the signing of the treaty and the official language or languages in which it is made. While the United Nations Model Convention states merely that this clause will be drafted in accordance with the constitutional procedure of both Contracting States, in practice such clauses commonly are formulated along the following lines if two official languages are used:

> Done at [place] on [date], in duplicate in [language] and [language], both texts being equally authoritative.

In the case of three official languages, the clause may be formulated as follows:

> Done at [place] on [date] in duplicate, in the [one country's] language, the [other country's] language and [a third] language, each text being authentic. In case of divergent interpretations of the [own country's] language and the [other country's] language texts, the [third] language text shall prevail.

Section IV – Improper use of treaties

[As already metioned, it would be more consistent with the structure of the Model to include the contents of this short section in the explanations on Articles 1 and 29] ***[Concerning this suggested change, one member of the Subcommittee indicated "I find it preferable to have a separate chapter on this. The reader of the manual who has made his way through the other chapters has now the basic knowledge to understand. And the explanations given in this chapter seem to be more broad than the ones that could be given to Article 29." Another member indicated "I found this section is useful for beginners". What are the views of the Subcommittee on the issue of whether Improper use of treaties should be treated in a separate section of the Manual or in the explanations on Article 1 and 29.]***

A. Introduction

Taxpayers may, from time to time, seek to obtain benefits from treaties in ways that were not intended by the two countries. For example, a resident of State A may seek to take advantage of lower withholding rates on royalties provided by State B under its treaty with State C, by structuring contracts through an intermediary in State C.

The Commentary on Article 1 of the United Nations Model Convention discusses a number of approaches that can be applied to prevent improper use of tax treaties,[294] including specific or general legislative anti-abuse rules or judicial doctrines found in domestic law, specific and general anti-abuse rules found in tax treaties, and interpretation of tax treaty provisions. The OECD/G20 Base Erosion and Profit Shifting (BEPS) Project also identifies treaty abuse as a major source of concern. Action 6 of that project examines how to prevent the granting of treaty benefits in inappropriate circumstances and makes some recommendations on possible actions to limit this form of treaty abuse.[295]

To minimize the risk of treaty abuse, developing countries should consider the extent to which they can or should adopt any of these approaches. As a guiding principle, "the benefits of a double tax convention should not be available where the main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions".[296] As noted in the Commentary, however, "it is important to maintain a balance between the need for tax administrations to protect their tax revenues from the misuse of tax treaty provisions and the need to provide legal certainty and to protect the legitimate expectations of taxpayers".[297]

2. Specific anti-abuse rules found in tax treaties

Hiring-out-of-labour arrangements designed to obtain exemption of employment income in the country where employment activities are exercised[311]

Use of so-called star companies by artistes or sportspersons to avoid taxation in the country where their activities are performed[312]

Arrangements that seek to change the classification of income for treaty purposes in order to obtain unintended treaty benefits;[313] such arrangements include conversion of dividends into interest, allocation of price under a mixed contract, conversion of royalties into capital gains and use of derivative transactions

Arrangements that are intended to circumvent thresholds found in treaties, such as [illegible] permanent establishments (for example, furnishing of services) or holdinc[illegible]