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Committee of Experts on International Cooperation in Tax Matters
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Modification to Article 13 (Capital gains) of the UN Model

Summary

This note is presented for discussion and guidance (not for final approval of text) at the meeting of the Committee to be held in New York on 23-26 April 2019.

The Subcommittee responsible for the update of the United Nations Model Double Taxation Convention between Developed and Developing Countries (Model) was tasked with carrying out a general review of the Model to identify and amend inconsistences, improve the clarity, and update or remove historic passages that no longer hold relevance.

A list of possible topics that could be addressed as part of the next update of the UN Model was prepared by the Coordinator of the Subcommittee, with inputs from the Subcommittee members and the Secretariat, and circulated among Committee members for comments and was presented during the 17th session of the Committee.

Committee member Mr. Rajat Bansal prepared the attached paper outlining the key issues related to a proposal by a previous member of the Committee to amend Article 13(5) of the UN Model in respect of gains on offshore indirect transfers of assets other than immovable property situated in source country. It is y

TAXATION OF CAPITAL GAINS ON OFFSHORE INDIRECT TRANSFERS UNDER DOMESTIC LAWS

1. Tax treatment of offshore indirect transfers in essence, the sale of an entity owning an asset located in one country by a resident of another has emerged as a significant issue in many developing countries. Pros and cons of allocating taxing rights over indirect transfers have been analyzed by policy makers around the world. The concern often expressed is that by using the principle of separate legal personality, and tax planning through residence of companies and similar entities, multinational enterprises (MNEs) may, in substance, change the ownership of an asset located in a developing country without triggering the corresponding taxation of the economic profits from the ownership change in that developing country. The issue has been found to arise in respect of extractive industries[1], real estate holdings as well as telecommunication assets amongst others.

2.

country (which may otherwise attract tax on the profits) is therefore transformed into an offshore sale of a foreign holding company (which may hold the developing-country asset directly or through other foreign companies) usually to an offshore buyer. The claim is then usually made that the developing country lacks the jurisdiction under the domestic law to tax

assets in that country. A further claim is often made that even if domestic law allowed taxation on indirect transfer of assets, a tax treaty between the developing country and the country of the transferor company overrides any domestic taxing right the developing country might otherwise have had.

3. Some countries take positions that judicial or legislative anti-abuse rules, such as a general anti-

application of their GAAR in 2015 to re-characterize an indirect transfer of certain properties as a direct transfer of the same. The anti-abuse rule would, however, reach the gain on offshore indirect transfer, only if intentional tax avoidance regarding the transaction could be shown. Moreover, such rules are limited in scope as they would not provide that the gain in question should be taxed as a 1 0 0aniesentiof c 0 0008871 0 595.32 841.4(l)-7S0(a)4(s)-v(g)10(a)4(in Cu7(nsa)-6(c)4

NEED FOR A SPECIFIC PROVISION UNDER TAX TREATIES/ MODEL TAX CONVENTIONS TO GRANT TAXING RIGHTS TO SOURCE COUNTRY OVER OITS

9. Provisions of both the UN and OECD Model Tax Conventions suggest[3] wide acceptance that capital gains taxation of indirect transfer of immovable assets can be imposed by the location country. The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument" or "MLI") has increased the number of tax treaties that effectively include Article 13(4) of the OECD MTC. However, at present, there is no provision to address the capital gains on indirect transfer of assets other than immovable property in source country under the two Model Conventions.

10. Developing countries that have chosen to exercise right to tax capital gains arising on indirect transfers of assets other than immovable property under their domestic laws would therefore fail to tax gains on such transfers in cases where the