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United Nations

Model Tax Convention 2025



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INTRODUCTION

A. Origin of the United Nations Model Tax Convention

1. The *United Nations Model Tax Convention* (the UN Model) forms part of the continuing international efforts aimed at eliminating double taxation. These efforts were begun by the League of Nations and pursued in the Organisation for European Economic Co-operation (OEEC) (now known as the Organisation for Economic Co-operation and Development (OECD)) and in regional forums, as well as in the United Nations, and have in general found concrete expression in a series of model or draft model bilateral tax conventions.

2. These models, particularly the UN Model and the OECD *Model Tax Convention on Income and on Capital* (the OECD Model), have had a profound influence on international treaty practice, and have significant common provisions. The similarities between these two leading models reflect the importance of achieving consistency where possible. On the other hand, the important areas of divergence exemplify, and allow a close focus upon, some key differences in approach or emphasis as exemplified in country practice. Such differences relate, in particular, to the issue of how far one country or the other should forgo, under a bilateral tax treaty, taxing rights which would be available to it under domestic law, with a view to avoiding double taxation and encouraging investment.

3. The UN Model generally favours retention of greater so-called "source country" taxing rights under a tax treaty – the taxation rights of the host country of investment – as compared to those of the "residence country" of the investor. This has long been regarded as an issue of special significance to developing countries, although it is a position that some developed countries also seek in their bilateral treaties. To reflect this fact, the Committee decided in 2025 to delete "between developed and developing countries", which had previously been included in the name of the Model.

4. The desirability of promoting greater inflows of foreign investment to developing countries on conditions which are politically acceptable as

well as economically and socially beneficial has been frequently affirmed in resolutions of the General Assembly and the Economic and Social Council of the United Nations and the United Nations Conference on Trade and Development. The 2002 Monterrey Consensus on Financing for Development,[1] the follow-up Doha Declaration on Financing for Development of 2008,[2] the Addis Ababa Action Agenda[3] and the Sevilla Commitment[4] all recognize the special importance of international tax cooperation in encouraging investment for development and maximizing domestic resource mobilisation, including by combating tax evasion. They also recognize the importance of supporting national efforts in these areas by strengthening technical assistance (in which this Model will play a vital part) and enhancing international cooperation and participation in addressing international tax matters (of which the UN Model is one of the fruits).

5. The growth of investment flows between countries depends to a large extent on the prevailing investment climate. The prevention or elimination of international double taxation in respect of the same income – the effects of which are harmful to the exchange of goods and services and to the movement of capital and persons – constitutes a significant component of such a climate.

6. Broadly, the general objectives of bilateral tax treaties therefore include the protection of taxpayers against double taxation with a view to improving the flow of international trade and investment and the transfer of technology. They also aim to prevent certain types of discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can confidently be carried on. With this background, tax treaties should contribute to the furtherance of the development aims of developing countries. In addition, the treaties seek to improve cooperation between taxing authorities in carrying out their functions, including by the exchange of information with a view to preventing avoidance or evasion of taxes and by assistance in the collection of taxes.

1 United Nations 2002, A/CONF.198/11.

2 United Nations 2008, A/CONF.212/L.1/Rev.1.

3 United Nations 2015, A/RES/69/313.

4 United Nations 2025, A/RES/79/323.

7. Finally, it has become clear, as a result of international focus on base erosion and profit shifting, that treaties are not intended to facilitate treaty shopping and other treaty abuses.

8. The desirability of encouraging the conclusion of bilateral tax treaties between developed and developing countries, which might require different approaches than those set out in the OECD Model, was recognized by the Economic and Social Council (ECOSOC) of the United Nations, in its resolution 1273 (XLIII) adopted on 4 August 1967. This led to the Secretary-General setting up in 1968 the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries. The Group was composed of tax officials and experts from both developing and developed countries, appointed in their personal capacity.

9. In 1980, the United Nations published, as a result of the Ad Hoc Group of Experts' deliberations, the *United Nations Model Double Taxation Convention between Developed and Developing Countries*, which was preceded in 1979 by the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (the Manual). By its resolution 1980/13 of 28 April 1980, the Economic and Social Council renamed the Group of Experts as the "Ad Hoc Group of Experts on International Cooperation in Tax Matters" (the Ad Hoc Group of Experts), recognizing the importance of international tax cooperation issues not related to tax treaties.

10. In the 1990s, the Ad Hoc Group of Experts recognized that significant changes had taken place in the international economic, financial and fiscal environment. In addition, there was increasing focus on the tax impacts of new financial instruments, transfer pricing, the growth of tax havens and globalization affecting international economic relations, leading to increasingly frequent updates to the OECD Model. The Ad Hoc Group of Experts considered these factors in deciding to revise and update the UN Model and the Manual. This led to a new version of the Model (revised in 1999 and published in 2001[5]) and a new version of the Manual (published electronically in 2003).

11. In 2005, the Ad Hoc Group of Experts was converted into a Committee structure, which remains its current form. The 25 members

5 United Nations 2001, E.01. XVI.2.

of the Committee of Experts on International Cooperation in Tax Matters are nominated by countries and chosen by the Secretary-General of the United Nations to act in their personal capacities for a period of 4 years. The Committee reports directly to the ECOSOC.

12. At the time of completion of this updated version of the UN Model, the members of the Committee appointed in 2021 were:[6]

> Mathew Olusanya Gbonjubola (Nigeria), Co-Chair of the Committee; Liselott Kana (Chile), Co-Chair of the Committee; Rasmi Ranjan Das (India), Vice-Chair; Carlos Protto (Argentina), Vice-Chair; Elisângela Rita (Angola), Vice-Chair; Stephanie Smith (Canada), Vice-Chair; Muhammad Ashfaq Ahmed (Pakistan); YoungJoo Lee (Republic of Korea); Waziona Ligomeka (Malawi); Nana Akua Achiaa Amoako Mensah (Ghana); Enrique Bolado Muñoz (Mexico); Kapembwa Elizabeth Namuyemba-Sikombe (Zambia); Marlene Patricia Nembhard-Parker (Jamaica); Eamonn O'Dea (Ireland); Pande Putu Oka Kusumawardani (Indonesia); Mya Mya Oo (Myanmar); El Hadramy Oubeid (Mauritania); Aart Roelofsen (the Netherlands); Alexander Smirnov (Russia); Trude Steinnes Sønvisen (Norway); Titia Stolte-Detring (Germany); José Troya (Ecuador); Mario Visco (Italy); Ingela Willfors (Sweden) and Yan Xiong (China).

B. Special Characteristics of the United Nations Model Tax Convention

13. The UN Model represents a compromise between the source principle and the residence principle, although as noted above, it gives more weight to the source principle than does the OECD Model. The UN Model is not intended to be prescriptive, but to equip decision-makers in countries with the information they need to understand the consequences of these differing approaches for their country's specific situation. The provisions of the UN Model are not themselves enforceable. Its provisions are not binding and should not be construed as formal

6 The countries nominating the members are listed for information only, because, as noted above, the Members of the Committee act in their personal capacity, rather than as representatives of those countries.

recommendations of the United Nations. Rather, the UN Model is intended to facilitate the negotiation, interpretation and practical application of bilateral tax treaties based upon its provisions.

14. Over time, the UN Model has placed increasing emphasis on the taxing rights of source countries, particularly in the case of income from cross-border services. As a corollary to the principle of taxation at source, the Articles of the Model are based on a recognition by the source country that taxation of income from foreign capital (a) should take into account expenses allocable to the earnings of the income, (b) should not be so high as to discourage investment and (c) should take into account the appropriateness of the sharing of revenue with the country providing the capital. In addition, the UN Model embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption, as is also the case with the OECD Model.

15. In drawing upon this Model for guidance, a country should bear in mind the important relationship between treaties and domestic law, the nature of which may vary from country to country. In general, the provisions of tax treaties prevail over the provisions of domestic law in the event of a conflict between those provisions. More specifically, tax treaties establish which Contracting State shall have jurisdiction to tax a given item of income or capital and under what conditions and subject to which limitations it may do so. For that purpose, both the UN Model and the OECD Model identify various categories of income and indicate in which of the Contracting States such income "shall be taxable only" or "may be taxed". In this respect, it is important to note, as is done in paragraph 25.1 of the Introduction of the 2017 version of the OECD Model, that

> … throughout the Convention, the words "may be taxed in" a Contracting State mean that that State is granted the right to tax the income to which the relevant provision applies and that these words do not affect the right to tax of the other Contracting State, except through the application of Article 23 A or 23 B when that other State is the State of residence.

16. Countries wishing to enter into bilateral tax treaty negotiations should analyse carefully the applicable provisions of their domestic tax laws in order to assess the implications of applying the treaty.

They should also discuss the relevant domestic laws of potential treaty partners, as part of the preparation for and negotiation of a treaty.

17. Domestic tax laws in their turn exert a substantial influence on the content of bilateral tax treaties. They are an important reason for many of the differences between treaties, as countries seek to preserve domestic taxing rights in their treaty networks. Such domestic laws, and the treaty practice reflecting them, form the basis for the policy positions found in the various models. Conversely, if countries do not exert certain taxing rights in domestic law, and see no likelihood of that changing, they generally do not seek to retain the ability to exert that taxing right under their treaties. Should their policy change, the domestic law may later be introduced to exert the domestic taxing right, but it would only operate to the extent that it was consistent with the treaty relationships.

C. Tax policy considerations that are relevant to the decision of whether to enter into a tax treaty or amend an existing treaty

18. In 2023, the Committee approved the most recent update to the *United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.*[7] The aim of the Manual is to provide a guide to all aspects of treaty negotiation, including a brief description of the Articles of the UN Model, to negotiators of tax treaties. While every country should form its own policy and define its objectives in relation to tax treaties, the Manual seeks to provide practical guidance on all aspects of treaty negotiations, including on how to prepare for and conduct negotiations. It examines in depth the most common reasons why a country would enter into a tax treaty with another, for example, the facilitation of inbound and outbound investment by removing or reducing double taxation or excessive source country taxation, the reduction of cross-border tax avoidance and evasion through the exchange of information and mutual assistance in collection of taxes, or for political reasons. Treaty negotiators in developing countries are encouraged to use the Manual in preparing for tax treaty negotiations, in the light of their country's policy framework and the intended outcomes they wish to achieve.

7 New York: United Nations, 2019, available at manual-bilateral-tax-treaties-update-2019.pdf (un.org), accessed on 10 May 2021.

19. The Manual served as the basis for the development, by the Platform for Collaboration on Tax,[8] of the *Toolkit on Tax Treaty Negotiations,* which includes a section that examines the purposes of tax treaties, their potential costs and benefits and whether there are alternative ways to achieve the same policy objectives.

20. Also, the Manual refers to the part of the Introduction of the OECD Model that discusses the tax policy considerations that are relevant to the decision of whether to enter into a tax treaty, amend an existing tax treaty, or, as a last resort, terminate a tax treaty.[9] The Committee took note of the considerations identified by the OECD and suggests considering them in addition to the guidance included in the Manual. The relevant part of the Introduction of the OECD Model reads as follows:

> 15.1 In 1997, the OECD Council adopted a recommendation that the Governments of member countries pursue their efforts to conclude bilateral tax treaties with those member countries, and where appropriate with non-member countries, with which they had not yet entered into such conventions. Whilst the question of whether or not to enter into a tax treaty with another country is for each State to decide on the basis of different factors, which include both tax and non-tax considerations, tax policy considerations will generally play

8 Platform for Collaboration on Tax, *Toolkit on Tax Treaty Negotiations (Online Version),* available as an online version at https://www.tax-platform.org/publications/PCT_Toolkit_Tax_Treaty_Negotiations_Online_Version, accessed on 10 May 2021. The Platform for Collaboration on Tax, which is a joint effort of the IMF, the OECD, the United Nations and the WBG, was set up with a major aim "to better frame technical advice to developing countries as they seek both more capacity support and greater influence in designing international rules". See https://www.worldbank.org/en/programs/platform-for-tax-collaboration, accessed on 12 March 2021.

9 That part of the Introduction of the OECD Model was added in 2017 as a result of the work on Action 6 of the G20/OECD Project on Base Erosion and Profit Shifting (BEPS). See OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD, 2015), available at http://www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm, accessed on 10 May 2021.

a key role in that decision. The following paragraphs describe some of these tax policy considerations, which are relevant not only to the question of whether a treaty should be concluded with a State but also to the question of whether a State should seek to modify or replace an existing treaty or even, as a last resort, terminate a treaty (taking into account the fact that termination of a treaty often has a negative impact on large number of taxpayers who are not concerned by the situations that result in the termination of the treaty).

15.2 Since a main objective of tax treaties is the avoidance of double taxation in order to reduce tax obstacles to cross-border services, trade and investment, the existence of risks of double taxation resulting from the interaction of the tax systems of the two States involved will be the primary tax policy concern. Such risks of double taxation will generally be more important where there is a significant level of existing or projected cross-border trade and investment between two States. Most of the provisions of tax treaties seek to alleviate double taxation by allocating taxing rights between the two States and it is assumed that where a State accepts treaty provisions that restrict its right to tax elements of income, it generally does so on the understanding that these elements of income are taxable in the other State. Where a State levies no or low income taxes, other States should consider whether there are risks of double taxation that would justify, by themselves, a tax treaty. States should also consider whether there are elements of another State's tax system that could increase the risk of non-taxation, which may include tax advantages that are ring-fenced from the domestic economy.

15.3 Accordingly, two States that consider entering into a tax treaty should evaluate the extent to which the risk of double taxation actually exists in cross-border situations involving their residents. A large number of cases of residence-source juridical double taxation can be eliminated through domestic provisions for the relief of double taxation (ordinarily in the form of either the exemption or credit method) which operate without the need for tax treaties. Whilst these domestic provisions will likely address most forms of residence-source juridical double taxation, they will not cover all cases of double taxation, especially if there are significant differences in the source rules of the two States or if the domestic law of these States does not allow for unilateral relief of economic double taxation (e.g. in the case of a transfer pricing adjustment made in another State).

15.4 Another tax policy consideration that is relevant to the conclusion of a tax treaty is the risk of excessive taxation that may result from high

withholding taxes in the source State. Whilst mechanisms for the relief of double taxation will normally ensure that such high withholding taxes do not result in double taxation, to the extent that such taxes levied in the State of source exceed the amount of tax normally levied on profits in the State of residence, they may have a detrimental effect on cross-border trade and investment.

15.5 Further tax considerations that should be taken into account when considering entering into a tax treaty include the various features of tax treaties that encourage and foster economic ties between countries, such as the protection from discriminatory tax treatment of foreign investment that is offered by the non-discrimination rules of Article 24, the greater certainty of tax treatment for taxpayers who are entitled to benefit from the treaty and the fact that tax treaties provide, through the mutual agreement procedure, together with the possibility for Contracting States of moving to arbitration, a mechanism for the resolution of cross-border tax disputes.

15.6 An important objective of tax treaties being the prevention of tax avoidance and evasion, States should also consider whether their prospective treaty partners are willing and able to implement effectively the provisions of tax treaties concerning administrative assistance, such as the ability to exchange tax information, this being a key aspect that should be taken into account when deciding whether or not to enter into a tax treaty. The ability and willingness of a State to provide assistance in the collection of taxes would also be a relevant factor to take into account. It should be noted, however, that in the absence of any actual risk of double taxation, these administrative provisions would not, by themselves, provide a sufficient tax policy basis for the existence of a tax treaty because such administrative assistance could be secured through more targeted alternative agreements, such as the conclusion of a tax information exchange agreement or the participation in the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*.

D. Main features of this revision of the United Nations Model Tax Convention

21. This latest revision of the UN Model continues an ongoing review process intended to ensure that the contents of the Model keep up with developments, including in country practice, new ways of doing business and new challenges.

22. This review process led the Committee to address concerns expressed by both developing and developed countries with respect to the tax treaty treatment of digitalized services. To do so, the Committee established a Subcommittee on the Digitalized and Globalized Economy, which drafted a new Article on Income from Services, together with its Commentary. That Article (Article 12AA), which, together with its Commentary, was adopted at the thirtieth session of the Committee (March 2025), replaces former Articles 12A (Fees for Technical Services) and 14 (Independent Personal Services). This change will eliminate questions regarding the scope of source States' taxing rights and simplify the application of the Model.

23. Another important part of these revisions consists of the new paragraph 3 of Article 1, which is intended to address cases of unintended double non-taxation. Under this paragraph, a source State is required to reduce its domestic tax on an item of income pursuant to the allocation rules of a bilateral tax treaty only if that income is subject to tax in the residence State (at a rate not less than a minimum rate to be agreed through bilateral negotiations). This "subject-to-tax rule" was added to the UN Model in order to address concerns expressed by developing countries that they were giving up taxing rights in cases where there is no double taxation because of the domestic rules in the other Contracting State.

24. The 2025 version of the Model also introduces two completely new articles, Article 5A (Income from the Exploration for, or Exploitation of, Natural Resources) and Article 12C (Insurance Premiums). New Article 5A lowers the threshold for finding a permanent establishment in the case of certain activities relating to resources naturally occurring in a Contracting State. This provision was developed in cooperation with the Subcommittee on Extractives Industries Taxation as it addresses a key aspect of developing countries' domestic tax priorities. New Article 12C allows a source State to tax insurance premiums on a gross basis rather than the former approach of deeming a permanent establishment to exist under Article 5(6) and taxing the profits of the deemed permanent establishment under Article 7. Developing countries viewed the Article 12C approach as simpler and easier for them to administer. Article 5(6) therefore has been deleted.

25. Other substantive changes made to the Articles of the Model through this latest revision are as follows:

- Changes to the definition of "royalties" in Article 12 to cover payments for the use of software even if such use does not constitute the use of copyright.
- A re-ordering of the alternative versions of Article 8 and a revision of the alternative (now Alternative A) that allows source State taxation of income from international transport so that it conforms more closely to actual treaty practice.
- Additions to Article 25 regarding the relationship between tax treaties and other agreements (i.e. trade or investment agreements) that might also apply to tax matters.

26. A number of changes were also made to the Commentaries on the Articles of the Model. These primarily include changes that reflect the above-mentioned additions and changes to the Articles. In addition, some small additions were made to the Commentary on Article 6 to clarify its operation.

E. The Commentaries

27. The Commentaries on the Articles are regarded as part of the UN Model along with the Articles themselves. The Commentaries frequently include quotations from the Commentaries on the Articles of the OECD Model, which appear in separate indented paragraphs in a smaller font in the case of long quotations. The quotations from the Commentary on the OECD Model are generally identified as quotations from the 2017 version of that Model. In some cases, however, the quotations are from previous versions of the OECD Model and the relevant version is also identified in such cases.

28. In quoting the OECD Commentaries, sometimes parts of a paragraph or entire paragraphs have been omitted as not being applicable, for whatever reason, to the interpretation of this Model. In such cases, the omission is indicated by ellipsis in italics (*[…]*). It cannot necessarily be assumed that non-inclusion, of itself, represents any disagreement with the content of the omitted part of the quotation, and the context of the omission should be considered in determining whether the omitted words were seen as irrelevant to interpretation of this Model, on the one

hand, or were instead left for future consideration. In some cases, the OECD Commentary is quoted with changes or additions that appear in italics between square brackets *([changes/additions]*). These changes and additions have been inserted in order to provide additional explanations or to reflect the differences between the provisions of this Model and those of the OECD Model. Footnotes contained within quoted passages from the OECD Commentaries have been omitted except where the meaning or purpose of the quotation would be incomplete or obscure without the footnote; in such cases, the footnote has been retained with its original footnote number and placed directly below the quoted passage, separated by a short line.

29. In quoting the Articles and Commentaries of the OECD Model it is noted that various OECD Member States have expressed "reservations" on certain Articles and have made "observations" on particular aspects of the Commentaries and that some non-OECD Member States have expressed "positions" in relation to certain Articles and Commentaries. Such formal expressions of differences of view to those taken in the OECD Model are contained in the Commentaries on the Articles of the OECD Model , as revised from time to time. The Committee has recognized in preparing this update to the UN Model that such expressions of country views are a useful aspect of the OECD Model in terms of understanding how it is interpreted and applied by the specific countries expressing those views, even though they have not been repeated in the text of the UN Model for practical reasons.

30. This 2025 version of the UN Model reflects an approach to minority views that was adopted by the Committee at its twenty-first session in October 2020. The Committee considers that a broad expression of views and approaches may assist in the interpretation and application of bilateral tax treaties. It follows, however, that it should not be assumed that any individual member of the Committee took a particular view in respect of any particular issue addressed in this Model. Additionally, in some cases, the views reflected in the Commentaries relate to discussions held by the former Group of Experts, or held by the Committee before or after particular individuals were members. To increase the transparency and consistency of minority views, the Committee decided in 2020 to introduce a process for the recording of minority views, develop consistent terminology to reflect

the differing levels of support for a particular minority view and date stamp minority views. Any member can have a minority view recorded. Any member proposing a minority view must advise the Subcommittee on the Update to the United Nations Model Tax Convention (and/or other relevant subcommittee) of his/her intention to include a minority view and provide a draft of the proposed minority view. This allows the relevant subcommittee to discuss the minority view and, as appropriate, make drafting suggestions to promote consistency in the drafting of minority views and to ensure the clarity of the position expressed before the minority view is discussed by the Committee. The process increases the transparency and consistency of minority views but does not restrict the right of any member to record a minority view. The minority view is date stamped by identifying the session of the Committee and the month and year during which the minority view was included. Further, the following terminology is used to reflect differing levels of support for a minority view (reference to numbers is based on 25 members of the Committee):

— A single member (when the view is held by only one member);
— A small minority of members (when the view is held by two to four members or by more than one member but less than 15 per cent of the members present and voting);
— A medium-sized minority of members (when the view is held by five to nine members or by 15 per cent or more but less than 35 per cent of the members present and voting); and
— A large minority of members (when the view is held by 10 to 12 members or by 35 per cent or more but less than 50 per cent of the members present and voting).

31. We wish to acknowledge the contribution of the Secretariat of the Financing for Sustainable Development Office in preparing this new version of the Model, including the contribution of Irving Ojeda Alvarez, Patricia Brown, Michael Lennard, Eduardo Diaz Huaman and Silvia Yiu. The technical assistance given by Brian Arnold and the editorial assistance of Leah McDavid are also recognized.

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Article 12B	Income from automated digital services
Article 12C	Insurance premiums
Article 13	Capital gains
Article 14	Independent personal services [Deleted]
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TITLE OF THE CONVENTION

Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and capital and the prevention of tax avoidance and evasion

PREAMBLE OF THE CONVENTION[10]

(State A) and (State B),

Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States),

Have agreed as follows:

10 The Preamble of the Convention shall be drafted in accordance with the constitutional procedures of the Contracting States.

Chapter I

SCOPE OF THE CONVENTION

Article 1

PERSONS COVERED

1. This Convention shall apply to persons who are residents of one or both of the Contracting States.

2. For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

3. (*a*) This Convention shall not affect the taxation by a Contracting State of any income arising in that State and derived by a resident of the other Contracting State if that income is subject to a low level of taxation in that other State within the meaning of subparagraph (b).

(*b*) Income is subject to a low level of taxation in that other State if:

(i) it is subject to a statutory tax rate of ___ per cent *[the percentage is to be established through bilateral negotiations]* or less; or

(ii) it is subject to a statutory tax rate higher than the rate set out in subdivision (i) but the beneficial owner of the income is entitled to a special exemption, exclusion or reduction that is linked directly to the income or the entity receiving it so that the amount of tax paid in that other State with respect to such income is less than the amount of tax that would be imposed if the tax rate set out in (i) were applied to such income without regard to such exemption, exclusion or reduction.

(*c*) Subparagraph (a) will not apply to income that: [*exemptions, if any, appropriate in the context of the bilateral relationship between the Contracting States*].

4. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 2 of Article 9, [paragraph 2 of Article 18 (Alternative A) or paragraph 3 of Article 18 (Alternative B)] and Articles 19, 20, [23 A or 23 B], 24, [25 (Alternative A) or 25 (Alternative B)] and 28.

5. *[Provision dealing with the application of the Convention to collective investment vehicles]*[11]

Article 2

TAXES COVERED

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are in particular:

(*a*) (in State A): .....

(*b*) (in State B): .....

11 Various forms that such a provision could take are discussed in the section "Collective Investment" in the Commentary on Article 1. As discussed in that section, the domestic tax rules applicable to various forms of collective investment vehicles in the Contracting States, disparities in the importance of investment by such vehicles in each of these States as well as other policy or administrative considerations may not justify the inclusion of a provision on collective investment vehicles in a bilateral tax treaty or may require different provisions aimed at different categories of such vehicles.

4. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.

Chapter II

DEFINITIONS

Article 3

GENERAL DEFINITIONS

1. For the purposes of this Convention, unless the context otherwise requires:

(*a*) the term "person" includes an individual, a company and any other body of persons;

(*b*) the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;

(*c*) the term "enterprise" applies to the carrying on of any business;

(*d*) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(*e*) the term "international traffic" means any transport by a ship or aircraft, except when the ship or aircraft is operated solely between places in a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State;

(*f*) the term "competent authority" means:

(i) (in State A): .....

(ii) (in State B): .....

(*g*) the term "national" means:

(i) any individual possessing the nationality of a Contracting State; and

(ii) any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State;

(*h*) the term "business" includes the performance of professional services and of other activities of an independent character;

(*i*) the term "recognized pension fund" of a Contracting State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:

(i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities, or

(ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements to which subdivision (i) applies.

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 4

RESIDENT

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of that person's domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognized pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

(*a*) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

(*b*) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

(*c*) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

(*d*) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

Article 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

(*a*) a place of management;

(*b*) a branch;

(*c*) an office;

(*d*) a factory;

(*e*) a workshop;

(*f*) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term "permanent establishment" also encompasses:

(*a*) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;

(*b*) the furnishing of services by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

(*a*) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

(*b*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(*c*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(*d*) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(*e*) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity;

(*f*) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (*a*) to (*e*),

provided that such activity or, in the case of subparagraph (*f*), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and

(*a*) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

(*b*) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, if such a person

(*a*) habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

(i) in the name of the enterprise, or

(ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

(iii) for the provision of services by that enterprise,

unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business

(other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(*b*) does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but habitually maintains in that State a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise.

6. Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

8. For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

Article 5A

INCOME FROM THE EXPLORATION FOR, OR EXPLOITATION OF, NATURAL RESOURCES

1. The provisions of this Article shall apply notwithstanding the provisions of Articles 5 and 8 of this Convention.

2. (*a*) For purposes of this Convention, a resident of a Contracting State which carries on activities in the other Contracting State which consist of, or are connected with, the exploration for, or exploitation of, natural resources that are present in that other State due to natural conditions (the "relevant activities") shall be deemed in relation to those activities to be carrying on business in that other State through a permanent establishment, unless such activities are carried on in that other State for a period or periods not exceeding in the aggregate 30 days in any twelve-month period commencing or ending in the fiscal year concerned.

b) Article 8 shall apply to income from the operation of ships or aircraft in international traffic constituting relevant activities as defined in subparagraph (a) only if any part of the transport by ships or aircraft constituting such operation is carried out in the other Contracting State for a period or periods not exceeding in the aggregate 30 days in any twelve-month period commencing or ending in the fiscal year concerned.

3. For the sole purpose of determining whether the 30-day threshold in paragraph 2 has been exceeded, where an enterprise of a Contracting State carries on relevant activities in the other Contracting State and substantially the same such activities are carried on in that other Contracting State during different periods of time by one or more enterprises closely related to the first-mentioned enterprise within the meaning of paragraph 8 of Article 5, these different periods of time shall be added to the period of time during which each of the enterprises has carried on such activities.

4. For the purposes of this Article,

(*a*) the term "natural resources" means natural assets that can be used for economic production or consumption, whether non-renewable

or renewable, including fish, hydrocarbons, minerals and pearls, as well as solar power, wind power, hydropower, geothermal power and similar sources of renewable energy; and

(*b*) the term "exploration for, or exploitation of, natural resources" means any activities carried on in connection with:

(i) the exploration for, or exploitation of, the natural resources described in subparagraph (*a*), including the extraction, development, production, processing, transport or storage of such natural resources;

(ii) the decommissioning and abandonment of facilities used in connection with the activities described in subdivision (i); and

(iii) the restoration and rehabilitation of the land or other site used in connection with the activities described in subdivision (i).

Chapter III

TAXATION OF INCOME

Article 6

INCOME FROM IMMOVABLE PROPERTY

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall also apply to income derived from the direct use, letting or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

Article 7

BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(*a*) that permanent establishment;

(*b*) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or

(*c*) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment

on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

5. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8

INTERNATIONAL SHIPPING AND AIR TRANSPORT

Article 8 (Alternative A)

1. Income arising in a Contracting State from the operation by a resident of the other Contracting State of ships or aircraft in international traffic may be taxed in that other State.

2. However, income from the operation of ships or aircraft in international traffic arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged in the State in which the income arises shall not exceed:

(*a*) if the taxation law of that State imposes tax on such income on a net basis, 50 per cent of the tax that would be imposed by that State on that income in the absence of this Convention; or

(*b*) ___ per cent [*the percentage is to be established through bilateral negotiations*] of the gross amount of the payments underlying such income;

whichever is lower.

3. For the purposes of this Article, "income from the operation of ships or aircraft in international traffic" means the total gross amount received in consideration for the carriage of passengers, mail, livestock or goods in international traffic.

4. For the purposes of this Article, income from the operation of ships or aircraft in international traffic shall be deemed to arise in a Contracting State if that income is received for the carriage of passengers, livestock, mail or goods, where such carriage:

(*a*) starts from a location in that Contracting State and ends at a location outside that Contracting State; or

(*b*) ends at a location in that Contracting State and starts from a location outside that State.

5. The provisions of paragraphs 1 and 2 shall also apply to income from the participation in a pool, a joint business or an international operating agency engaged in the operation of ships or aircraft.

Article 8 (Alternative B)

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

2. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 9

ASSOCIATED ENTERPRISES

1. Where:

(*a*) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(*b*) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of the Convention and the competent authorities of the Contracting States shall, if necessary, consult each other.

3. The provisions of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that by actions giving rise to an adjustment of profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or wilful default.

Article 10

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(*a*) ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the dividends if the beneficial

owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365-day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

(*b*) ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or

the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, interest arising in a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein and the debt claim in respect of which the interest is paid is effectively connected with

(*a*) such permanent establishment, or with

(*b*) business activities referred to in (*c*) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with

which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12

ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, royalties arising in a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "royalties" as used in this Article means payments of any kind:

(*a*) received as a consideration for the use of, or the right to use:

i) any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting;

ii) any patent, trademark, design or model, plan, or secret formula or process; or

iii) industrial, commercial or scientific equipment; or

(*b*) received as a consideration for information concerning industrial, commercial or scientific experience; or

(*c*) received as a consideration for the use of, or the right to use, any software, or paid as a consideration for the acquisition of any copy of software for the purposes of using it.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with:

(*a*) such permanent establishment, or

(*b*) business activities referred to in (*c*) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 shall apply.

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment, then such royalties shall be deemed to arise in the State in which the permanent establishment is situated.

6. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12A

FEES FOR TECHNICAL SERVICES

[Deleted 2025]

Article 12AA

FEES FOR SERVICES

1. Fees for services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, subject to the provisions of Articles 8, 12B, 12C, 15, 16, 17, 18 and 19, fees for services arising in a Contracting State may also be taxed in that Contracting State and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent [*the percentage is to be established through bilateral negotiations*] of the gross amount of the fees.

3. The term "fees for services" as used in this Article means any payment in consideration for any service.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for services arise through a permanent establishment situated in that other State, and the fees for services are effectively connected with:

(*a*) such permanent establishment, or

(*b* business activities referred to in (*c*) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 shall apply.

5. For the purposes of this Article, subject to paragraph 6, fees for services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment.

6. For the purposes of this Article, fees for services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State and such fees are borne by that permanent establishment.

7. Where, by reason of a special relationship between the payer and the beneficial owner of the fees for services or between both of them and some other person, the amount of the fees, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12B

INCOME FROM AUTOMATED DIGITAL SERVICES

1. Income from automated digital services arising in a Contracting State, underlying payments for which are made to a resident of the other Contracting State, may be taxed in that other State.

2. However, subject to the provisions of Article 8, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the payments underlying the income from automated digital services.

3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests,

subject to the provisions of Article 8, the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be 30 per cent of the amount resulting from applying the profitability ratio of that beneficial owner's automated digital services business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits. However, where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be that of the business segment of the group relating to the income covered by this Article, or of the group as a whole in case segmental accounts are not maintained by the group, provided such profitability ratio of the multinational enterprise group is higher than the aforesaid profitability ratio of the beneficial owner. Where the segmental profitability ratio or, as the case may be, the overall profitability ratio of the multinational enterprise group to which the beneficial owner belongs is not available to the Contracting State in which the income from automated digital services arises, the provisions of this paragraph shall not apply; in such a case, the provisions of paragraph 2 shall apply.

4. For the purposes of paragraph 3, "multinational enterprise group" means any "group" that includes two or more enterprises, the tax residence for which is in different jurisdictions. Further, for the purposes of paragraph 3, the term "group" means a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public stock exchange.

5. The term "automated digital services" as used in this Article means any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.

6. The term "automated digital services" includes especially:

(*a*) online advertising services;

(*b*) supply of user data;

(*c*) online search engines;

(*d*) online intermediation platform services;

(*e*) social media platforms;

(*f*) digital content services;

(*g*) online gaming;

(*h*) cloud computing services; and

(*i*) standardized online teaching services.

7. The provisions of this Article shall not apply if the payments underlying the income from automated digital services qualify as "royalties" or "insurance premiums" under Article 12 or Article 12C as the case may be.

8. The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, carries on business in the other Contracting State in which the income from automated digital services arises through a permanent establishment situated in that other State and the income from automated digital services is effectively connected with:

(*a*) such permanent establishment, or

(*b*) business activities referred to in subparagraph (*c*) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 shall apply.

9. For the purposes of this Article and subject to paragraph 10, income from automated digital services shall be deemed to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State or if the person making the underlying payments for the automated digital services, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment.

10. For the purposes of this Article, income from automated digital services shall be deemed not to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State which carries on business in the other Contracting State through a permanent establishment situated

in that other State and such underlying payments towards automated digital services are borne by that permanent establishment.

11. Where, by reason of a special relationship between the payer and the beneficial owner of the income from automated digital services or between both of them and some other person, the amount of the payments underlying such income, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments underlying such income from automated digital services shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12C

INSURANCE PREMIUMS

1. Insurance premiums arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, insurance premiums arising in a Contracting State may also be taxed in that State and according to the laws of that State, but if the beneficial owner of the insurance premium is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent [*the percentage is to be established through bilateral negotiations*] of the gross amount of the insurance premiums. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. As used in this Article:

(*a*) the term "insurance premiums" means amounts paid to an insurer pursuant to a contract (policy) in which the insurer indemnifies another person against losses from specific contingencies, perils or risks; the term includes amounts paid to secure reinsurance but does not include amounts paid to acquire or maintain an annuity contract or an insurance contract that includes a substantial investment component; and

(*b*) the term "insurer" means a person or arrangement, the majority of the income of which consists of premiums and other amounts received in consideration for the issuance of insurance, reinsurance and annuity contracts and investment income related thereto.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the insurance premiums, being a resident of a Contracting State, carries on business in the other Contracting State in which the insurance premiums arise, through a permanent establishment situated therein, and the policy in respect of which the insurance premium is paid is effectively connected with:

(*a*) such permanent establishment, or

(*b*) business activities referred to in (*c*) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 shall apply.

5. For the purposes of this Article, subject to paragraph 6, insurance premiums shall be deemed to arise in a Contracting State if the payer is a resident of that State or, if the person paying the insurance premiums, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the premiums was incurred, and such premiums are borne by such permanent establishment.

6. For the purposes of this Article, insurance premiums shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State and such insurance premiums are borne by that permanent establishment.

7. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the insurance premium, having regard to the policy for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13

CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

3. Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or of movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

5. Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests, such as interests in a partnership or trust, which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ per cent *[the percentage is to be established through bilateral negotiations]* of the capital of that company or entity.

6. Gains derived by a resident of a Contracting State from the alienation of a right granted under the law of the other Contracting State which allows the use of resources that are naturally present in that other State and that are under the jurisdiction of that other State, may be taxed in that other State.

7. Subject to paragraphs 4 and 5, gains derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests of an entity, such as interests in a partnership or trust, may be taxed in the other Contracting State if

(*a*) the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ per cent *[the percentage is to be established through bilateral negotiations]* of the capital of that company or entity; and

(*b*) at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from

(i) a property any gain from which would have been taxable in that other State in accordance with the preceding provisions of this Article if that gain had been derived by a resident of the first-mentioned State from the alienation of that property at that time, or

(ii) any combination of property referred to in subdivision (i).

8. Gains from the alienation of any property other than that referred to in paragraphs 1 to 7 shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14

INDEPENDENT PERSONAL SERVICES

[Deleted 2025]

Article 15

DEPENDENT PERSONAL SERVICES

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(*a*) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(*b*) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(*c*) the remuneration is not borne by a permanent establishment which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the other Contracting State, shall be taxable only in the first-mentioned State.

Article 16

DIRECTORS' FEES AND REMUNERATION OF TOP-LEVEL MANAGERIAL OFFICIALS

1. Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the Board of Directors of a company which is a resident of the other Contracting State may be taxed in that other State.

2. Salaries, wages and other similar remuneration derived by a resident of a Contracting State in his capacity as an official in a top-level managerial position of a company which is a resident of the other Contracting State may be taxed in that other State.

Article 17

ARTISTES AND SPORTSPERSONS

1. Notwithstanding the provisions of Article 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of Articles 7 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

Article 18

PENSIONS AND SOCIAL SECURITY PAYMENTS

Article 18 (Alternative A)

1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

2. Notwithstanding the provisions of paragraph 1, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Article 18 (Alternative B)

1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment may be taxed in that State.

2. However, such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by

a resident of that other State or if the person paying the pensions or similar remuneration, whether he is a resident of a Contracting State or not, has in that other State a permanent establishment in connection with which the obligation to pay the pensions or similar remuneration was incurred, and such pensions or similar remuneration are borne by such permanent establishment.

3. Notwithstanding the provisions of paragraphs 1 and 2, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Article 19

GOVERNMENT SERVICE

1. (*a*) Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

   (*b*) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the individual is a resident of that State who:

      (i) is a national of that State; or

      (ii) did not become a resident of that State solely for the purpose of rendering the services.

2. (*a*) Notwithstanding the provisions of paragraph 1, pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

   (*b*) However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that other State.

3. The provisions of Articles 15, 16, 17 and 18 shall apply to salaries, wages, pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 20

STUDENTS

Payments which a student or business trainee or apprentice, who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training, receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.

Article 21

OTHER INCOME

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

3. Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Convention and arising in the other Contracting State may also be taxed in that other State.

Chapter IV

TAXATION OF CAPITAL

Article 22

CAPITAL

1. Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State may be taxed in that other State.

3. Capital of an enterprise of a Contracting State that operates ships or aircraft in international traffic represented by such ships or aircraft, and by movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

[4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.]

[The question of the taxation of all other elements of capital of a resident of a Contracting State is left to bilateral negotiations. Should the negotiating parties decide to include in the Convention an Article on the taxation of capital, they will have to determine whether to use the wording of paragraph 4 as shown or wording that leaves taxation to the State in which the capital is located.]

Chapter V

METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

Article 23 A

EXEMPTION METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10, 11, 12, 12AA, 12B and 12C may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income which may be taxed in that other State.

3. Where in accordance with any provision of this Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10, 11, 12, 12AA or 12C, or the provisions of Article 12B,

to such income; in the case where the other Contracting State does not exempt the income, the first-mentioned State shall allow the deduction of tax provided for by paragraph 2.

Article 23 B

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

(*a*) as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State;

(*b*) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where, in accordance with any provision of this Convention, income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Chapter VI

SPECIAL PROVISIONS

Article 24

NON-DISCRIMINATION

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, paragraph 6 of Article 12, paragraph 7 of Article 12AA, paragraph 11 of Article 12B or paragraph 7 of Article 12C apply, interest, royalties, fees for services, payments underlying income from automated digital services, insurance premiums and other disbursements paid by an enterprise of a Contracting State to a resident

of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

Article 25

MUTUAL AGREEMENT PROCEDURE

Article 25 (Alternative A)

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent

authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article.

5. Notwithstanding paragraph 6, for the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph 3, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

6. A taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties, and any dispute over whether a taxation measure taken by a Contracting State is in accordance with this Convention, or whether the measure falls within the scope of the Convention, shall be settled only by reference to the provisions of the Convention and without recourse to dispute resolution arrangements under any other treaty of which the Contracting States are parties. As respects any other dispute over a taxation measure, or as to

whether a measure is a taxation measure, the settlement of such dispute shall, unless the competent authorities of the Contracting States agree otherwise, be undertaken without recourse to any dispute resolution arrangements under [*such treaties as are agreed to be covered*].

Article 25 (Alternative B)

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article.

5. Where,

(*a*) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

(*b*) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within three years from the presentation of the case to the competent authority of the other Contracting State,

any unresolved issues arising from the case shall be submitted to arbitration if either competent authority so requests. The person who has presented the case shall be notified of the request. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

6. Notwithstanding paragraph 7, for the purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph 3, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of this Article or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

7. A taxation measure, taken by a Contracting State, that is in accordance with this Convention shall be deemed not to breach any other treaty of which the Contracting States are parties, and any dispute over whether a taxation measure taken by a Contracting State is in

accordance with this Convention, or whether the measure falls within the scope of the Convention, shall be settled only by reference to the provisions of the Convention and without regard to dispute resolution arrangements under any other treaty of which the Contracting States are parties. As respects any other dispute over a taxation measure, or as to whether a measure is a taxation measure, the settlement of such dispute shall, unless the competent authorities of the Contracting States agree otherwise, be undertaken without regard to any dispute resolution arrangements under [*such treaties as are agreed to be covered*].

Article 26

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws of the Contracting States concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. In particular, information shall be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorizes such use.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

(*a*) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(*b*) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(*c*) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (*ordre public*).

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

6. The competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made.

Article 27

ASSISTANCE IN THE COLLECTION OF TAXES[12]

1. The Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Articles 1 and 2. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.

2. The term "revenue claim" as used in this Article means an amount owed in respect of taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to this Convention or any other instrument to which the Contracting States are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amount.

3. When a revenue claim of a Contracting State is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of collection by the competent authority of the other Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State.

4. When a revenue claim of a Contracting State is a claim in respect of which that State may, under its law, take measures of conservancy with a view to ensure its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of

12 In some countries, national law, policy or administrative considerations may not allow or justify the type of assistance envisaged under this Article or may require that this type of assistance be restricted, for example, to countries that have similar tax systems or tax administrations or as to the taxes covered. For that reason, the Article should only be included in the Convention where each State concludes that, based on the factors described in paragraph 1 of the Commentary on the Article, they can agree to provide assistance in the collection of taxes levied by the other State.

taking measures of conservancy by the competent authority of the other Contracting State. That other State shall take measures of conservancy in respect of that revenue claim in accordance with the provisions of its laws as if the revenue claim were a revenue claim of that other State even if, at the time when such measures are applied, the revenue claim is not enforceable in the first-mentioned State or is owed by a person who has a right to prevent its collection.

5. Notwithstanding the provisions of paragraphs 3 and 4, a revenue claim accepted by a Contracting State for purposes of paragraph 3 or 4 shall not, in that State, be subject to the time limits or accorded any priority applicable to a revenue claim under the laws of that State by reason of its nature as such. In addition, a revenue claim accepted by a Contracting State for the purposes of paragraph 3 or 4 shall not, in that State, have any priority applicable to that revenue claim under the laws of the other Contracting State.

6. Proceedings with respect to the existence, validity or the amount of a revenue claim of a Contracting State shall not be brought before the courts or administrative bodies of the other Contracting State.

7. Where, at any time after a request has been made by a Contracting State under paragraph 3 or 4 and before the other Contracting State has collected and remitted the relevant revenue claim to the first-mentioned State, the relevant revenue claim ceases to be

(*a*) in the case of a request under paragraph 3, a revenue claim of the first-mentioned State that is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, or

(*b*) in the case of a request under paragraph 4, a revenue claim of the first-mentioned State in respect of which that State may, under its laws, take measures of conservancy with a view to ensure its collection

the competent authority of the first-mentioned State shall promptly notify the competent authority of the other State of that fact and, at the option of the other State, the first-mentioned State shall either suspend or withdraw its request.

8. In no case shall the provisions of this Article be construed so as to impose on a Contracting State the obligation:

(*a*) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(*b*) to carry out measures which would be contrary to public policy (*ordre public*);

(*c*) to provide assistance if the other Contracting State has not pursued all reasonable measures of collection or conservancy, as the case may be, available under its laws or administrative practice;

(*d*) to provide assistance in those cases where the administrative burden for that State is clearly disproportionate to the benefit to be derived by the other Contracting State.

Article 28

MEMBERS OF DIPLOMATIC MISSIONS AND CONSULAR POSTS

Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.

Article 29

ENTITLEMENT TO BENEFITS[13]

1. Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25) unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.

13 The drafting of this Article will depend on how the Contracting States decide to implement their common intention, reflected in the preamble of the Convention and incorporated in the minimum standard agreed to as part of the OECD-G20 Base Erosion and Profit Shifting project by particular countries, to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is:

(*a*) an individual;

(*b*) that Contracting State, or a political subdivision or local authority thereof, or an agency or instrumentality of that State, political subdivision or local authority;

(*c*) a company or other entity, if, throughout the taxable period that includes that time, the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognised stock exchanges, and either:

(i) its principal class of shares is primarily traded on one or more recognised stock exchanges located in the Contracting State of which the company or entity is a resident; or

(ii) the company's or entity's primary place of management and control is in the Contracting State of which it is a resident;

(*d*) a company, if:

(i) throughout the taxable period that includes that time, at least 50 per cent of the aggregate vote and value of the shares (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares) in the company is owned directly or indirectly by five or fewer companies or entities entitled to benefits under subparagraph (*c*) of this paragraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of the Contracting State from which a benefit under this Convention is being sought or is a qualifying intermediate owner; and

(ii) with respect to benefits under this Convention other than under Article 10, less than 50 per cent of the company's gross income, and less than 50 per cent of the tested group's gross income, for the taxable period that includes that time, is paid or accrued, directly or indirectly, in the form of payments that are deductible in that taxable period for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested

group, not including intra-group transactions) to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph (*a*), (*b*), (*c*) or (*e*);

(*e*) a person, other than an individual, that

(i) is a *[agreed description of the relevant non-profit organisations found in each Contracting State]*,

(ii) is a recognised pension fund;

(*f*) a person other than an individual, if

(i) at that time and on at least half the days of a twelve-month period that includes that time, persons who are residents of that Contracting State and that are entitled to the benefits of this Convention under subparagraph (*a*), (*b*), (*c*) or (*e*) own, directly or indirectly, shares representing at least 50 per cent of the aggregate vote and value (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares) of the shares in the person, provided that, in the case of indirect ownership, each intermediate owner is a qualifying intermediate owner, and

(ii) less than 50 per cent of the person's gross income, and less than 50 per cent of the tested group's gross income, for the taxable period that includes that time, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions), to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph (*a*), (*b*), (*c*) or (*e*) of this paragraph; or

(*g*) *[a collective investment vehicle to which paragraph 5 of Article 1 applies]*;[14]

14 Subparagraph (*g*) should only be inserted if a provision on collective investment vehicles is included in the Convention; see the footnote to paragraph 5 of Article 1.

3. (*a*) A resident of a Contracting State shall be entitled to benefits under this Convention with respect to an item of income derived from the other Contracting State, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the first-mentioned State and the income derived from the other State emanates from, or is incidental to, that business. For purposes of this Article, the term "active conduct of a business" shall not include the following activities or any combination thereof:

(i) operating as a holding company;

(ii) providing overall supervision or administration of a group of companies;

(iii) providing group financing (including cash pooling); or

(iv) making or managing investments, unless these activities are carried on by a bank [*list financial institutions similar to banks that the Contracting States agree to treat as such*], insurance enterprise or registered securities dealer in the ordinary course of its business as such.

(*b*) If a resident of a Contracting State derives an item of income from a business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other State from a connected person, the conditions described in subparagraph *a*) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned State to which the item is related is substantial in relation to the same or complementary business activity carried on by the resident or such connected person in the other Contracting State. Whether a business activity is substantial for the purposes of this paragraph shall be determined based on all the facts and circumstances.

(*c*) For purposes of applying this paragraph, activities conducted by connected persons with respect to a resident of a Contracting State shall be deemed to be conducted by such resident.

4. *[A rule providing so-called derivative benefits. The question of how the derivative benefits paragraph should be drafted is discussed in the Commentary.]*

5. A company that is a resident of a Contracting State that functions as a headquarters company for a multinational corporate group consisting of such company and its direct and indirect subsidiaries shall be entitled to benefits under this Convention with respect to dividends and interest paid by members of its multinational corporate group, regardless of whether the resident is a qualified person. A company shall be considered a headquarters company for this purpose only if:

(*a*) such company's primary place of management and control is in the Contracting State of which it is a resident;

(*b*) the multinational corporate group consists of companies resident of, and engaged in the active conduct of a business in, at least four States, and the businesses carried on in each of the four States (or four groupings of States) generate at least 10 per cent of the gross income of the group;

(*c*) the businesses of the multinational corporate group that are carried on in any one State other than the Contracting State of residence of such company generate less than 50 per cent of the gross income of the group;

(*d*) no more than 25 per cent of such company's gross income is derived from the other Contracting State;

(*e*) such company is subject to the same income taxation rules in its Contracting State of residence as persons described in paragraph 3 of this Article; and

(*f*) less than 50 per cent of such company's gross income, and less than 50 per cent of the tested group's gross income, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property or payments in respect of financial obligations to a bank that is not a connected person with respect to such company, and in the case of a tested group, not including intra-group transactions) to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph (*a*), (*b*), (*c*) or (*e*) of paragraph 2.

If the requirements of subparagraph (*b*), (*c*) or (*d*) of this paragraph are not fulfilled for the relevant taxable period, they shall be deemed to be

fulfilled if the required ratios are met when averaging the gross income of the preceding four taxable periods.

6. If a resident of a Contracting State is neither a qualified person pursuant to the provisions of paragraph 2 of this Article, nor entitled to benefits under paragraph 3, 4 or 5, the competent authority of the Contracting State in which benefits are denied under the previous provisions of this Article may, nevertheless, grant the benefits of this Convention, or benefits with respect to a specific item of income or capital, taking into account the object and purpose of this Convention, but only if such resident demonstrates to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the Contracting State to which a request has been made, under this paragraph, by a resident of the other State, shall consult with the competent authority of that other State before either granting or denying the request.

7. For the purposes of this and the previous paragraphs of this Article:

(*a*) the term "recognised stock exchange" means:

(i) [*list of stock exchanges agreed to at the time of signature]*; and

(ii) any other stock exchange agreed upon by the competent authorities of the Contracting States;

(*b*) with respect to entities that are not companies, the term "shares" means interests that are comparable to shares;

(*c*) the term "principal class of shares" means the ordinary or common shares of the company or entity, provided that such class of shares represents the majority of the aggregate vote and value of the company or entity. If no single class of ordinary or common shares represents the majority of the aggregate vote and value of the company or entity, the "principal class of shares" are those classes that in the aggregate represent a majority of the aggregate vote and value;

(*d*) two persons shall be "connected persons" if one owns, directly or indirectly, at least 50 per cent of the beneficial interest in the other (or, in the case of a company, at least 50 per cent of the aggregate

vote and value of the company's shares) or another person owns, directly or indirectly, at least 50 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares) in each person. In any case, a person shall be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

(*e*) the term "equivalent beneficiary" means:

(i) a resident of any State, provided that:

(A) the resident is entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that State and the Contracting State from which the benefits of this Convention are sought, under provisions substantially similar to subparagraph (*a*), (*b*), (*c*) or (*e*) of paragraph 2 or, when the benefit being sought is with respect to interest or dividends paid by a member of the resident's multinational corporate group, the resident is entitled to benefits under provisions substantially similar to paragraph 5 of this Article in such convention, provided that, if such convention does not contain a detailed limitation on benefits article, such convention shall be applied as if the provisions of subparagraphs (*a*), (*b*), (*c*) and (*e*) of paragraph 2 (including the definitions relevant to the application of the tests in such subparagraphs) were contained in such convention; and

(B) (1) with respect to income referred to in Article 8. 10, 11, 12, 12AA, 12B or 12C if the resident had received such income directly, the resident would be entitled under such convention, a provision of domestic law or any international agreement, to a rate of tax with respect to such income for which benefits are being sought under this Convention that is less than or equal to the rate applicable under this Convention. Regarding a company seeking, under paragraph 4, the benefits of Article 10 with respect to dividends, for purposes of this subclause:

(I) if the resident is an individual, and the company is engaged in the active conduct of a business in its Contracting State of residence that is substantial in relation, and similar or complementary, to the business that generated the earnings from which the dividend is paid, such individual shall be treated as if he or she were a company. Activities conducted by a person that is a connected person with respect to the company seeking benefits shall be deemed to be conducted by such company. Whether a business activity is substantial shall be determined based on all the facts and circumstances; and

(II) if the resident is a company (including an individual treated as a company), to determine whether the resident is entitled to a rate of tax that is less than or equal to the rate applicable under this Convention, the resident's indirect holding of the capital of the company paying the dividends shall be treated as a direct holding; or

(2) with respect to an item of income referred to in Article 7, 13 or 21 of this Convention, the resident is entitled to benefits under such convention that are at least as favourable as the benefits that are being sought under this Convention; and

(C) notwithstanding that a resident may satisfy the requirements of clauses (A) and (B) of this subdivision, where the item of income has been derived through an entity that is treated as fiscally transparent under the laws of the Contracting State of residence of the company seeking benefits, if the item of income would not be treated as the income of the resident under a provision analogous to paragraph 2 of Article 1 had the resident, and not the company seeking benefits under paragraph 4 of this Article, itself owned the entity through which the income was derived by the company, such resident shall not be considered an equivalent beneficiary with respect to the item of income;

(ii) a resident of the same Contracting State as the company seeking benefits under paragraph 4 of this Article that is entitled to all the benefits of this Convention by reason of subparagraph (*a*), (*b*), (*c*) or (*e*) of paragraph 2 or, when the benefit being sought is with respect to interest or dividends paid by a member of the resident's multinational corporate group, the resident is entitled to benefits under paragraph 5, provided that, in the case of a resident described in paragraph 5, if the resident had received such interest or dividends directly, the resident would be entitled to a rate of tax with respect to such income that is less than or equal to the rate applicable under this Convention to the company seeking benefits under paragraph 4; or

(iii) a resident of the Contracting State from which the benefits of this Convention are sought that is entitled to all the benefits of this Convention by reason of subparagraph (*a*), (*b*), (*c*) or (*e*) of paragraph 2, provided that all such residents' ownership of the aggregate vote and value of the shares (and any disproportionate class of shares) of the company seeking benefits under paragraph 4 does not exceed 25 per cent of the total vote and value of the shares (and any disproportionate class of shares) of the company;

(*f*) the term "disproportionate class of shares" means any class of shares of a company or entity resident in one of the Contracting States that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments or otherwise, in the earnings generated in the other Contracting State by particular assets or activities of the company;

(*g*) a company's or entity's "primary place of management and control" is in the Contracting State of which it is a resident only if:

(i) the executive officers and senior management employees of the company or entity exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company or entity and its direct and indirect subsidiaries, and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions, in that Contracting State than in any other State; and

(ii) such executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision-making for the company or entity and its direct and indirect subsidiaries, and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions, than the officers or employees of any other company or entity;

(*h*) the term "qualifying intermediate owner" means an intermediate owner that is either:

(i) a resident of a State that has in effect with the Contracting State from which a benefit under this Convention is being sought a comprehensive convention for the avoidance of double taxation; or

(ii) a resident of the same Contracting State as the company applying the test under subparagraph (*d*) or (*f*) of paragraph 2 or paragraph 4 to determine whether it is eligible for benefits under the Convention;

(*i*) the term "tested group" means the resident of a Contracting State that is applying the test under subparagraph (*d*) or (*f*) of paragraph 2 or under paragraph 4 or 5 to determine whether it is eligible for benefits under the Convention (the "tested resident"), and any company or permanent establishment that:

(i) participates as a member with the tested resident in a tax consolidation, fiscal unity or similar regime that requires members of the group to share profits or losses; or

(ii) shares losses with the tested resident pursuant to a group relief or other loss sharing regime in the relevant taxable period; and

(*j*) the term "gross income" means gross receipts as determined in the person's Contracting State of residence for the taxable period that includes the time when the benefit would be accorded, except that where a person is engaged in a business that includes the manufacture, production or sale of goods, "gross income" means such gross receipts reduced by the cost of goods sold, and where a person is engaged in a business of providing non-financial services, "gross income" means such gross receipts reduced by the direct costs of generating such receipts, provided that:

(i) except when relevant for determining benefits under Article 10 of this Convention, gross income shall not include the portion of any dividends that are effectively exempt from tax in the person's Contracting State of residence, whether through deductions or otherwise; and

(ii) except with respect to the portion of any dividend that is taxable, a tested group's gross income shall not take into account transactions between companies within the tested group.

8. (*a*) Where

(i) an enterprise of a Contracting State derives income from the other Contracting State and the first-mentioned State treats such income as attributable to a permanent establishment of the enterprise situated in a third jurisdiction, and

(ii) the profits attributable to that permanent establishment are exempt from tax in the first-mentioned State,

the benefits of this Convention shall not apply to any item of income on which the tax in the third jurisdiction is less than the lower of *[rate to be determined bilaterally]* of the amount of that item of income and 60 per cent of the tax that would be imposed in the first-mentioned State on that item of income if that permanent establishment were situated in the first-mentioned State. In such a case any income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other State, notwithstanding any other provisions of the Convention.

(*b*) The preceding provisions of this paragraph shall not apply if the income derived from the other State emanates from, or is incidental to, the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).

(*c*) If benefits under this Convention are denied pursuant to the preceding provisions of this paragraph with respect to an item of

income derived by a resident of a Contracting State, the competent authority of the other Contracting State may, nevertheless, grant these benefits with respect to that item of income if, in response to a request by such resident, such competent authority determines that granting such benefits is justified in light of the reasons such resident did not satisfy the requirements of this paragraph (such as the existence of losses). The competent authority of the Contracting State to which a request has been made under the preceding sentence shall consult with the competent authority of the other Contracting State before either granting or denying the request.

9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

Chapter VII

FINAL PROVISIONS

Article 30

ENTRY INTO FORCE

1. This Convention shall be ratified and the instruments of ratification shall be exchanged at _____ as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

(*a*) (in State A): .....

(*b*) (in State B): .....

Article 31

TERMINATION

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year _____ . In such event, the Convention shall cease to have effect:

(*a*) (in State A): .....

(*b*) (in State B): .....

TERMINAL CLAUSE

[NOTE: The provisions relating to the entry into force and termination and the terminal clause concerning the signing of the Convention shall be drafted in accordance with the constitutional procedure of both Contracting States.]

Part Two

COMMENTARIES ON THE ARTICLES OF THE UNITED NATIONS MODEL TAX CONVENTION

Commentary on chapter I

SCOPE OF THE CONVENTION

Article 1

PERSONS COVERED

A. General considerations

1. Article 1 of the UN Model is similar to Article 1 of the OECD Model. However, in 2021, the Committee added paragraph 4, a place-holder paragraph for a provision dealing with the application of the Convention to collective investment vehicles. Since 2025, Article 1 of this Model also includes a subject-to-tax rule (STTR) in paragraph 3.

2. The title of Article 1 was changed in 1999 from "Personal scope" to "Persons covered". The first Article of the Convention should specify the types of persons or taxpayers to whom the Convention applies. The title "Personal scope" did not convey the scope of application of the Convention. Hence, the title of Article 1 was appropriately changed to "Persons covered" to convey the correct scope of the Convention.

B. Commentary on the paragraphs of Article 1

Paragraph 1

3. Like the OECD Model, the UN Model applies to persons who are "residents of one or both of the Contracting States". The personal scope of most of the earliest conventions was more restrictive, in that it encompassed "citizens" of the Contracting States. However, in some early conventions that scope was wider, covering "taxpayers" of the Contracting States, that is persons who, although not residing in either State, are nevertheless liable to tax on part of their income or capital in each of them. In some Articles there are exceptions to this rule, for example in paragraph 1 of Articles 24, 25 and 26.

Paragraph 2

4. Paragraph 2 addresses special issues presented by payments to entities that are either wholly or partly fiscally transparent, such as partnerships and trusts. In 1999, The OECD Committee on Fiscal Affairs adopted the report entitled *The Application of the OECD Model Tax Convention to Partnerships*.[15] The report deals with the application of the provisions of the OECD Model, and indirectly of bilateral tax conventions based on that Model, to partnerships. The OECD Committee on Fiscal Affairs recognizes, however, that many of the principles discussed in that report may also apply, mutatis mutandis, to other non-corporate entities. In that report, references to "partnerships" cover entities which qualify as such under civil or commercial law as opposed to tax law. The wide differences in the views of the OECD member countries stem from the fact that their domestic laws treat partnerships in different ways. In some OECD countries, partnerships are treated as taxable units and sometimes even as companies, while other OECD countries do not tax the partnership as such and only tax individual partners on their shares of partnership income. Similar differences in the tax treatment of partnerships exist in the developing countries. The intent of paragraph 2 is to realise the principles set forth in the report.

5. An important question is whether a partnership should itself be allowed the benefits of the Convention. If, under the laws of a Contracting State, partnerships are taxable entities, a partnership may qualify as a resident of that Contracting State under paragraph 1 of Article 4 and therefore be entitled to benefits of the Convention. However, if a partnership is treated as fiscally transparent under the laws of the residence State, and accordingly, the partners are taxed on the partnership's income, paragraph 2 provides that the provisions of the Convention should be applied at the level of the partners.

6. As the first step in applying the benefits of the Convention, paragraph 2 identifies the resident of a Contracting State that derives an item of income for which treaty benefits are sought. In order to be

15 Reproduced at page R(15)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page2099, accessed on 10 May 2021.

entitled to such benefits, such resident must also satisfy any additional requirements that are set forth in the applicable treaty, such as beneficially owning the item of income under the tax principles of the source State, any applicable requisite ownership thresholds (such as those found in paragraph 2(*a*) of Article 10 (Dividends)), and either a principal purpose test or a limitation on benefits provision, or both.

7. These general principles are expanded upon in the following paragraphs 2 through 16 of the Commentary on Article 1 of the 2017 OECD Model, which the Committee considers to be applicable to paragraph 2 of Article 1 of this Model subject to paragraphs 8 and 9 below (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 2. This paragraph addresses the situation of the income of entities or arrangements that one or both Contracting States treat as wholly or partly fiscally transparent for tax purposes. The provisions of the paragraph ensure that income of such entities or arrangements is treated, for the purposes of the Convention, in accordance with the principles reflected in the 1999 report of the *[OECD]* Committee on Fiscal Affairs entitled "The Application of the OECD Model Tax Convention to Partnerships". That report therefore, provides guidance and examples on how the provision should be interpreted and applied in various situations.
>
> 3. The report, however, dealt exclusively with partnerships and whilst the Committee recognised that many of the principles included in the report could also apply with respect to other non-corporate entities, it expressed the intention to examine the application of the Model Tax Convention to these other entities at a later stage. As indicated in paragraph 37 of the report, the Committee was particularly concerned with "cases where domestic tax laws create intermediary situations where a partnership is partly treated as a taxable unit and partly disregarded for tax purposes." According to the report:
>
> > Whilst this may create practical difficulties with respect to a very limited number of partnerships, it is a more important problem in the case of other entities such as trusts. For this reason, the Committee decided to deal with this issue in the context of follow-up work to this report.

4. Paragraph 2 addresses this particular situation by referring to entities that are "wholly or partly" treated as fiscally transparent. Thus, the paragraph not only serves to confirm the conclusions of the Partnership Report but also extends the application of these conclusions to situations that were not directly covered by the report *[…]*.

5. The paragraph not only ensures that the benefits of the Convention are granted in appropriate cases but also ensures that these benefits are not granted where neither Contracting State treats, under its domestic law, the income of an entity or arrangement as the income of one of its residents. The paragraph therefore confirms the conclusions of the report in such a case (see, for example, example 3 of the report). Also, as recognised in the report, States should not be expected to grant the benefits of a bilateral tax convention in cases where they cannot verify whether a person is truly entitled to these benefits. Thus, if an entity is established in a jurisdiction from which a Contracting State cannot obtain tax information, that State would need to be provided with all the necessary information in order to be able to grant the benefits of the Convention. In such a case, the Contracting State might well decide to use the refund mechanism for the purposes of applying the benefits of the Convention even though it normally applies these benefits at the time of the payment of the relevant income. In most cases, however, it will be possible to obtain the relevant information and to apply the benefits of the Convention at the time the income is taxed *[…]*.

6. The following example illustrates the application of the paragraph:

> *Example:* State A and State B have concluded a treaty identical to the Model Tax Convention. State A considers that an entity established in State B is a company, and taxes that entity on interest that it receives from a debtor resident in State A. Under the domestic law of State B, however, the entity is treated as a partnership, and the two members in that entity, who share equally all its income, are each taxed on half of the interest. One of the members is a resident of State B and the other one is a resident of a country with which States A and B do not have a treaty. The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B.

7. The reference to "income derived by or through an entity or arrangement" has a broad meaning and covers any income that is earned by or through an entity or arrangement regardless of the view taken by each Contracting State as to who derives that income for

domestic tax purposes and regardless of whether or not that entity or arrangement has legal personality or constitutes a person as defined in subparagraph *a*) of paragraph 1 of Article 3. It would cover, for example, income of any partnership or trust that one or both of the Contracting States treats as wholly or partly fiscally transparent. Also, as illustrated in example 2 of the report, it does not matter where the entity or arrangement is established: the paragraph applies to an entity established in a third State to the extent that, under the domestic tax law of one of the Contracting States, the entity is treated as wholly or partly fiscally transparent and income of that entity is attributed to a resident of that State.

8. The word "income" must be given the wide meaning that it has for the purposes of the Convention and therefore applies to the various items of income that are covered by Chapter III of the Convention (Taxation of Income), including, for example, profits of an enterprise and capital gains.

9. The concept of "fiscally transparent" used in the paragraph refers to situations where, under the domestic law of a Contracting State, the income (or part thereof) of the entity or arrangement is not taxed at the level of the entity or the arrangement but at the level of the persons who have an interest in that entity or arrangement. This will normally be the case where the amount of tax payable on a share of the income of an entity or arrangement is determined separately in relation to the personal characteristics of the person who is entitled to that share, so that the tax will depend on whether that person is taxable or not, on the other income that the person has, on the personal allowances to which the person is entitled and on the tax rate applicable to that person; also, the character and source, as well as the timing of the realisation, of the income for tax purposes will not be affected by the fact that it has been earned through the entity or arrangement. The fact that the income is computed at the level of the entity or arrangement before the share is allocated to the person will not affect that result.[1] States wishing to clarify the definition of "fiscally transparent" in their bilateral conventions are free to include a definition of that term based on the above explanations.

1 See paragraphs 37 – 40 of the report *[…]*.

10. In the case of an entity or arrangement which is treated as partly fiscally transparent under the domestic law of one of the Contracting States, only part of the income of the entity or arrangement might be taxed at the level of the persons who have an interest in that entity or arrangement as described in the preceding paragraph, whilst the rest

would remain taxable at the level of the entity or arrangement. This, for example, is how some trusts and limited liability partnerships are treated in some countries (i.e. in some countries, the part of the income derived through a trust that is distributed to beneficiaries is taxed in the hands of these beneficiaries whilst the part of that income that is accumulated is taxed in the hands of the trust or trustees; similarly, in some countries, income derived through a limited partnership is taxed in the hands of the general partner as regards that partner's share of that income but is considered to be the income of the limited partnership as regards the limited partners' share of the income). To the extent that the entity or arrangement qualifies as a resident of a Contracting State, the paragraph will ensure that the benefits of the treaty also apply to the share of the income that is attributed to the entity or arrangement under the domestic law of that State (subject to any anti-abuse provision such as a limitation-on-benefits rule).

11. As with other provisions of the Convention, the provision applies separately to each item of income of the entity or arrangement. Assume, for example, that the document that establishes a trust provides that all dividends received by the trust must be distributed to a beneficiary during the lifetime of that beneficiary, but must be accumulated afterwards. If one of the Contracting States considers that, in such a case, the beneficiary is taxable on the dividends distributed to that beneficiary, but that the trustees are taxable on the dividends that will be accumulated, the paragraph will apply differently to these two categories of dividends, even if both types of dividends are received within the same month.

12. By providing that the income to which it applies will be considered to be income of a resident of a Contracting State for the purposes of the Convention, the paragraph ensures that the relevant income is attributed to that resident for the purposes of the application of the various allocative rules of the Convention. Depending on the nature of the income, this will, therefore, allow the income to be considered, for example, as "income derived by" for the purposes of Articles 6, 13 and 17, "profits of an enterprise" for the purposes of Articles 7, 8 and 9 (see also paragraph *[7]* of the Commentary on Article 3) or dividends or interest "paid to" for the purposes of Articles 10 and 11. The fact that the income is considered to be derived by a resident of a Contracting State for the purposes of the Convention also means that, where the income constitutes a share of the income of an enterprise in which that resident holds a participation, such income shall be considered to be the income of an enterprise carried on by that resident (e.g. for

the purposes of the definition of enterprise of a Contracting State in Article 3 and paragraph 2 of Article 21).

13. Whilst the paragraph ensures that the various allocative rules of the Convention are applied to the extent that income of fiscally transparent entities is treated, under domestic law, as income of a resident of a Contracting State, the paragraph does not prejudge the issue of whether the recipient is the beneficial owner of the relevant income. Where, for example, a fiscally transparent partnership receives dividends as an agent or nominee for a person who is not a partner, the fact that the dividend may be considered as income of a resident of a Contracting State under the domestic law of that State will not preclude the State of source from considering that neither the partnership nor the partners are the beneficial owners of the dividend.

14. The paragraph only applies for the purposes of the Convention and does not, therefore, require a Contracting State to change the way in which it attributes income or characterises entities for the purposes of its domestic law. In the example in paragraph 6 *[of the Commentary on Article 1 of the 2017 OECD Model, as quoted above]*, whilst paragraph 2 provides that half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B, this will only affect the maximum amount of tax that State A will be able to collect on the interest and will not change the fact that State A's tax will be payable by the entity. Thus, assuming that the domestic law of State A provides for a 30 per cent withholding tax on the interest, the effect of paragraph 2 will simply be to reduce the amount of tax that State A will collect on the interest (so that half of the interest would be taxed at 30 per cent and half at 10 per cent under the treaty between States A and B) and will not change the fact that the entity is the relevant taxpayer for the purposes of State A's domestic law. Also, the provision does not deal exhaustively with all treaty issues that may arise from the legal nature of certain entities and arrangements and may therefore need to be supplemented by other provisions to address such issues (such as a provision confirming that a trust may qualify as a resident of a Contracting State despite the fact that, under the trust law of many countries, a trust does not constitute a "person").

15. As confirmed by paragraph *[4]*, paragraph 2 does not restrict in any way a State's right to tax its own residents. This conclusion is consistent with the way in which tax treaties have been interpreted with respect to partnerships (see paragraph 6.1 *[of the Commentary on Article 1 of the OECD Model]* as it read after 2000 and before the inclusion of paragraph 3 *[of the OECD Model]* in 2017).

> 16. Paragraphs 2 and *[4]* do not, however, restrict the Contracting States' obligation to provide relief of double taxation under Articles 23 A and 23 B where income of a resident of that State may be taxed by the other State in accordance with the Convention. There may be cases however, where the same income is taxed by each Contracting State as income of one of its residents and where relief of double taxation will be necessary with respect to tax paid by a different person. Where, for example, one of the Contracting States taxes the worldwide income of an entity that is a resident of that State whereas the other State views that entity as fiscally transparent and taxes the members of that entity who are residents of that other State on their respective share of the income, relief of double taxation will need to take into account the tax that is paid by different taxpayers in the two States. In such a case, however, it will be important to determine, under Articles 23 A and 23 B, to what extent the income of a resident of one Contracting State "may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State […]". In general, this requirement will result in one State having to provide relief of double taxation only to the extent that the provisions of the Convention authorise the other State to tax the relevant income as the State of source or as a State where there is a permanent establishment to which that income is attributable (see paragraphs 11.1 and 11.2 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*).

8. While, as a general matter, the Committee is in agreement with paragraphs 2 to 16 of the Commentary to Article 1 of the OECD Model quoted in paragraph 7 above, some Committee members have expressed concerns regarding the application of the paragraph when income is derived by or through an entity or arrangement resident in a third state and that has interest holders resident in a Contracting State under whose tax laws the entity is treated as fiscally transparent with respect to the income. In such case, the tax treaties of both the country of residence of the entity or arrangement and the country of residence of the interest holders could be applicable, creating the risk of duplicative claims of benefits under different tax treaties on a single item of income. However, such risks are mitigated by the fact that while in such case, more than one person may be viewed as deriving an item of income, the fact remains that only one payment is being made from the country of source, affording

that country only one opportunity to grant benefits with respect to the item of income. Moreover, the issue of duplicative claims of treaty benefits have not been problematic in the practice of countries that include provisions similar to paragraph 2. In the experience of those countries, the entity and its interest holders typically consult and provide to the withholding agent a single claim for treaty benefits on the payment. Additionally, the requirement that a person deriving an item of income under paragraph 2 must also satisfy all applicable requirements set forth in the treaty should reduce instances of duplicative claims of benefits. If a Contracting State is confronted with a situation of duplicative claims for benefits, it may engage in the mutual agreement procedure to obtain additional information as necessary to make the proper determination of which claim for treaty benefits to honour.

9. Contracting States wishing to provide clarity for both their treaty partners and taxpayers are free to enter into and publish competent authority agreements of general applicability pursuant to paragraph 3 of Article 25 (Mutual agreement procedure) regarding the application of paragraph 2.

Paragraph 3

10. In 2025, the Committee introduced paragraph 3, which is intended to deny the benefits of the treaty in respect of items of income which are subject to no or low tax in the residence State. Members of the Committee believed that paragraph 3 is consistent with the basic philosophy of the allocation of taxing rights. Paragraph 20 of the Introduction to the UN Model, quoting paragraph 15.2 of the Introduction to the OECD Model, states that:

> Most of the provisions of tax treaties seek to alleviate double taxation by allocating taxing rights between the two States and it is assumed that where a State accepts treaty provisions that restrict its right to tax elements of income, it generally does so on the understanding that these elements of income are taxable in the other State.

Accordingly, in cases where paragraph 3 applies, the source jurisdiction shall have the right to impose tax in respect of such income under its domestic law. The tax is therefore a secondary taxing right that only is triggered if the jurisdiction that has the primary taxing right does

not exercise that right to impose a certain minimum level of tax on the relevant income. Paragraph 3 does not affect entitlement to tax treaty benefits in respect of income that is taxed at or above the minimum rate; it therefore is not a reallocation of taxing rights.

11. Consistent with this rationale, the rule could apply to any type of income where taxation by the source State is limited under the distributive rules of the relevant convention. For example, it could apply to payments by a resident of the source State for services rendered by an unrelated party that is a resident of the other Contracting State when the source State is prevented from taxing that payment because the recipient of the income does not have a permanent establishment in the source State. The provision uses the term "income" to be consistent with the use of the term throughout the UN Model. It should be given the wide meaning that it has for the purposes of the Convention and therefore applies to profits and gains as well; those countries that need to do so could add the words "or profits" and/or "or capital gains" throughout the provision in order to clarify the point.

12. Similarly, the rule is not limited to income derived in transactions between associated enterprises. A small minority of the Committee believed that paragraph 3 should be limited to addressing the concerns that are the focus of the OECD/G20 Base Erosion and Profit Shifting Project and, in line with that policy objective, that paragraph 3 should apply only to base eroding payments or mobile income between related parties.[16] Those holding that view may want to achieve that goal by modifying the provision to read:

> This Convention shall not affect the taxation by a Contracting State of any interest or royalty arising in that State and derived by a resident of the other Contracting State that is a connected person (within the meaning of paragraph 7(d) of Article 29) with respect to the payer if the interest or royalty is subject to a low level of taxation in that other State within the meaning of subparagraph (b).

13. Paragraph 3 applies not only when the income is completely exempt from tax in the residence State, but also when the taxation in

16 The decision to include that minority view in the Commentary was taken at the twenty-sixth session of the Committee held in March 2023.

the residence State is below an agreed minimum level. The standard will be met when the statutory rate of tax imposed by the residence State on that income is less than the rate agreed in bilateral negotiations. In many cases, a statutory rate will apply to all income derived by a taxpayer, and that statutory rate will exceed the agreed minimum, so the inquiry will end there. However, where the taxation laws of a State provide for a lower statutory rate on certain categories of income, or for taxpayers with certain characteristics or meeting certain conditions, that special rate will be the rate applicable for purposes of applying subdivision (b)(i) of paragraph 3.

14. Subdivision (b)(ii) describes a second situation in which income will be treated as having been taxed below the agreed minimum level. In this situation, the applicable tax rate exceeds the agreed minimum, but the beneficial owner is entitled to a special benefit that results in the amount of tax paid in the residence State being less than the amount that would have been paid if the agreed rate had been applied to the income, without regard to such benefit. This determination is not required if the beneficial owner does not receive such special benefits. (That is, there is no requirement to calculate an "effective tax rate".) For these purposes, the term "beneficial owner" means the person entitled to the benefits of a tax treaty with respect to an item of income under the applicable article.[17]

15. Subdivision (b)(ii) is not implicated by deductions for interest, royalties, salaries and other ordinary business expenses even though they reduce the taxpayer's tax base. It therefore would not apply to depreciation deductions or expensing of capital costs (whether accelerated or otherwise) that are limited to a taxpayer's investment in the relevant property. It would apply, however, to extraordinary deductions, such as depreciation deductions that exceed the taxpayer's investment in the relevant property. It would not apply to ordinary, relatively modest exemptions related to personal or family status, but would apply in the case of an individual who benefits from certain regimes that do not fully tax foreign-source income. It would not apply with respect to an exemption for pension distributions in a jurisdiction

17 See, for example, paragraph 15 of the Commentary on Article 10 of the UN Model, quoting paragraphs 12 to 12.7 of the Commentary on Article 10 of the OECD Model.

that does not provide benefits for contributions to private pension plans. However, it would apply to exemptions applicable to ordinary business income. Treaty negotiators are encouraged to consider aspects of their country's domestic tax law that provide preferential treatment to particular income or persons and to discuss their treatment under this provision with potential treaty partners.

16. The determination to be made under paragraph 3(b) applies separately with respect to each item of income derived by the taxpayer. For example, assume that paragraph 3(b)(i) of Article 1 of the State R-State S tax treaty provides for an agreed rate of 12 per cent. State R's corporate income tax rate is 20 per cent. However, State R's domestic law includes a headquarters company regime under which any income earned by a State R company from providing a number of "headquarters company services" (including financing and certain managerial services) to associated enterprises is excluded from the State R tax base. A State S company pays interest and management fees to its State R affiliate. The interest income derived by the State R company is subject to tax at the corporate income tax rate of 20%; accordingly, the State R company would benefit from any reduction in State S tax provided by Article 11 of the relevant convention. However, the management fees that qualify for the benefits of the headquarters company regime would be denied benefits under paragraph 3 because those management fees would not be subject to tax in State R, after application of the exclusion in State R's domestic law. Similarly, the receipt by a taxpayer of special benefits with respect to domestic-source income will not affect the taxpayer's entitlement to treaty benefits with respect to foreign-source income that is not eligible for the same benefits.

17. A small minority of Members agree that the determination of subdivision (b)(ii) should apply separately with respect to each item of income but believe that it is difficult to align the extraordinary deductions or other tax incentives with a specific item of foreign income.[18] They therefore believe that the application of subdivision (b)(ii) will give rise to uncertainty and disputes in practice and suggest that subdivision (b)(ii) should not apply in the case of tax incentives that are implemented through a taxpayer's costs or expenditures.

18 The decision to include that minority view in the Commentary was taken at the twenty-sixth session of the Committee held in March 2023.

18. The Model leaves the determination of the minimum level of taxation to be established through bilateral negotiations. While setting the minimum rate, countries should try to balance, on the one hand, providing for fair taxation by the source State with, on the other hand, the need to avoid excessive taxation, taking into account reasonable profitability margins. They may also want to consider how to take into account graduated rates, if any, provided in their domestic law for individual and corporate taxpayers with relatively low amounts of income.

19. Because paragraph 3 authorizes the imposition of tax by the source State in the circumstances described, such taxation is "in accordance with" the treaty, so the residence State would be required to provide relief under the terms of Article 23. In that connection, Subdivision 3(b)(ii) does not apply when the tax paid in a residence State would exceed the threshold rate but is reduced below that rate by a credit that is required by the terms of the treaty with the source State. For example, the tax treaty between State S and State R provides for a maximum source State tax on interest of 8%. State R imposes a final tax of 15% on investment income (less than the corporate rate of 20% but more than the 10% rate provided in paragraph (3) of the State S-State R treaty). A State S company pays 100x in interest to a State R resident and collects 8x of withholding tax, which it pays to State S. State R would impose tax of 15x, but under Article 23 of the State S-State R treaty, provides a credit for the 8x State S tax, so that the total tax paid to State R is 7x. This credit does not trigger the application of paragraph (3).

20. Countries therefore should consider the combined tax that would be imposed by the source State and the residence State after application of the rule and the relief of double taxation provisions of Article 23. In cases where the residence State exempts the income entirely, the application of Article 23 is straightforward. However, in cases where the relevant income is taxed in the residence State, but at a lower level, imposition of full domestic taxation by the source State may not result in the shared taxing right anticipated in the negotiation of a withholding rate, for example. For this reason, some Members of the Committee believe that there should be a cap on the tax that can be imposed by the source state. The following language could be adopted to implement such a cap:

> 3. (a) If income arising in a Contracting State and derived by a resident of the other Contracting State is subject to a low level of taxation in that other State within the meaning of subparagraph (b), that income may be taxed by the State in which the income arises under its domestic law, except that, if the resident of the other Contracting State is also the beneficial owner of the income, the tax so charged in the first-mentioned State shall not exceed ___ per cent of the gross amount of the income paid to that resident of the other Contracting State.

21. Some countries may want to reflect the fact that they have significant subnational income taxes in drafting the provisions. For example, it may be appropriate to agree to a lower minimum rate, if the rate takes into account only taxes imposed at the federal level. Alternatively, subdivision (i) could specifically refer to subnational taxes:

> (i) it is subject to a combined statutory tax rate of ___ per cent [the percentage is to be established through bilateral negotiations] or less, taking into account income taxes imposed by their political subdivisions and local authorities; or

22. Paragraph 3 applies no matter what circumstances led to its conditions being met (unlike paragraph 4 of Article 23 Alternative A, which addresses double non-taxation from the perspective of the resident State, but only when such double non-taxation results from a conflict of qualification [19]). It also applies to any legislation, regulation or administrative practice (including a ruling practice) that exists before or comes into effect after the treaty is signed. A small minority of Members believe, however, that the provision should provide more certainty to taxpayers and therefore should be limited to situations where the two Contracting States have agreed that the conditions of subparagraph (b) have been met.[20] Countries that share that view may want to include additional language to that effect along the following lines:

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19 See paragraph 19 of the Commentary on Article 23 Alternative A of the UN Model.

20 The decision to include that minority view in the Commentary was taken at the twenty-sixth session of the Committee held in March 2023.

(d) This paragraph shall not apply unless the Contracting States have identified, through an exchange of notes, an exemption, exclusion or reduction as falling within subdivision (b)(ii).

23. A number of Committee Members were of the view that certain non-taxable entities, such as pension funds, charities and collective investment vehicles, should not be denied benefits as a result of the application of the provision. It was also argued that common exemptions by the residence State, such as a participation exemption for dividends, should not trigger the provision. All of those exemptions likely would fall within subparagraph (b) by reason of the application of subdivision (b)(ii). Accordingly, subparagraph (c) of paragraph 3 is a placeholder provision intended to remind treaty negotiators to discuss whether there are any exemptions, exclusions or reductions under the tax laws of the two Contracting States that might fall within the literal terms of subdivision (b)(ii) but where the two Contracting States agree that the result is not problematic. Those cases should be excluded from the application of the paragraph. In that regard, the wording of subdivision (iv) of the definition of "special tax regime" found in paragraph 161 of this Commentary[21] may aid in the drafting of such exclusions.

24. Many countries relieve double taxation of their residents by exempting from taxation the business income earned in their foreign branches or permanent establishments. The possibility that such exemptions for foreign branch profits could produce inappropriate results is already addressed in paragraph 8 of Article 29. Accordingly, if that paragraph is included in the relevant bilateral treaty, it would be appropriate for subparagraph (c) to exclude from the operation of paragraph 3 income earned through exempt foreign branches and permanent establishments.

25. The Commentary on Article 18 sets out a number of options that countries should consider when negotiating the pension provisions of bilateral tax treaties. In doing so, they should also consider the application of paragraph 3 and whether any additional exclusion should be added to paragraph (c) in order to achieve an equitable result.

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21 Quoting paragraph 86 of the Commentary on Article 1 of the 2017 OECD Model.

26. Consideration should be given to how the rule would be implemented in the context of each country's general approach to providing treaty relief. Paragraph 166 of the Commentary on Article 1 of the UN Model, quoting paragraph 109 of the Commentary on Article 1 of the OECD Model, expresses a strong preference for providing relief at the time payment is made in order to ensure "expeditious implementation of taxpayers' benefits". It further suggests that a refund method should only be used in the case of "observable difficulties in identifying entitlement to treaty benefits". Some of the information necessary to determine whether subdivision (b)(ii) applies will not be available until after the end of the taxable year in which a payment is made. Countries that provide treaty relief at the time payment is made should consider whether it is possible to maintain normal withholding and relief operations, and to apply paragraph 3 to collect additional tax on an *ex post* basis when the relevant information becomes available. The delay in availability of relevant information may also affect countries that require a withholding tax to be collected at the time a payment is made and then provide treaty relief through a refund mechanism.

Paragraph 4

27. In the 2017 update, the Committee decided to introduce a so-called "saving clause" in Article 1. This followed the addition of the same provision in the 2017 OECD Model, following a recommendation included in the final report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[22] of the OECD/G20 BEPS Project, which was itself based on a similar provision included in the United States Model. The intent of the saving clause is to put to rest the argument that some provisions aimed at the taxation of non-residents could be interpreted as limiting a Contracting State's right to tax its own residents. While such interpretations have been rejected, the Committee considers that a saving clause in the UN Model puts the matter beyond doubt that a Contracting State is able to tax its own residents notwithstanding the other provisions of the relevant bilateral treaty, except those specifically listed in the saving clause.

28. The Committee considers that the following part of the Commentary on Article 1 of the 2017 OECD Model, which provides

22 See footnote 9 above.

additional explanations on the saving clause, is applicable to paragraph 4 of Article 1 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 17. Whilst some provisions of the Convention (e.g. Articles 23 A and 23 B) are clearly intended to affect how a Contracting State taxes its own residents, the object of the majority of the provisions of the Convention is to restrict the right of a Contracting State to tax the residents of the other Contracting State. In some limited cases, however, it has been argued that some provisions could be interpreted as limiting a Contracting State's right to tax its own residents in cases where this was not intended (see, for example, paragraph 81 *[of the Commentary on Article 1 of the 2017 OECD Model]*, which addresses the case of controlled foreign company provisions).
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> 18. Paragraph *[4]* confirms the general principle that the Convention does not restrict a Contracting State's right to tax its own residents except where this is intended and lists the provisions with respect to which that principle is not applicable.
>
> 19. The exceptions so listed are intended to cover all cases where it is envisaged in the Convention that a Contracting State may have to provide treaty benefits to its own residents (whether or not these or similar benefits are provided under the domestic law of that State). These provisions are:
>
> — *[…]*
>
> — Paragraph 2 of Article 9, which requires a Contracting State to grant to an enterprise of that State a corresponding adjustment following an initial adjustment made by the other Contracting State, in accordance with paragraph 1 of Article 9, to the amount of tax charged on the profits of an associated enterprise.
>
> — [Paragraph 2 of Article 18 (Alternative A) or paragraph 3 of Article 18 (Alternative B), depending on the alternative chosen, which may affect how a Contracting State taxes a resident of that State who receives a pension or other payment under a public scheme which is part of the social security system of the other Contracting State.]
>
> — Article 19, which may affect how a Contracting State taxes an individual who is resident of that State if that individual derives

income in respect of services rendered to the other Contracting State or a political subdivision or local authority thereof.

— Article 20, which may affect how a Contracting State taxes an individual who is resident of that State if that individual is also a student who meets the conditions of that Article.

— Articles 23 A and 23 B, which require a Contracting State to provide relief of double taxation to its residents with respect to the income that the other State may tax in accordance with the Convention (including profits that are attributable to a permanent establishment situated in the other Contracting State in accordance with paragraph 2 of Article 7).

— Article 24, which protects residents of a Contracting State against certain discriminatory taxation practices by that State (such as rules that discriminate between two persons based on their nationality).

— [Article 25 (Alternative A) or Article 25 (Alternative B), depending on the alternative chosen], which allows residents of a Contracting State to request that the competent authority of that State consider cases of taxation not in accordance with the Convention.

— Article 28, which may affect how a Contracting State taxes an individual who is resident of that State when that individual is a member of the diplomatic mission or consular post of the other Contracting State.

20. The list of exceptions included in paragraph *[4]* should include any other provision that the Contracting States may agree to include in their bilateral convention where it is intended that this provision should affect the taxation, by a Contracting State, of its own residents. *[…] [E]* xamples include the alternative provisions in paragraphs 23, *[…]*, 37 and 68 of the Commentary on Article 18 *[of the 2017 OECD Model, as quoted in paragraphs 6 and 18 of the Commentary on Article 18 of this Model]* because these provisions provide benefits that are typically intended to be granted to an individual who participated in a foreign pension scheme before becoming a resident of a Contracting State.

21. The term "resident", as used in paragraph *[4]* and throughout the Convention, is defined in Article 4. Where, under paragraph 1 of Article 4, a person is considered to be a resident of both Contracting States based on the domestic laws of these States, paragraphs 2 and 3 of that Article make it generally possible to determine a single State of residence for the purposes of the Convention. Thus, paragraph 3 does not apply to an individual or legal person who is a resident of

one of the Contracting States under the laws of that State but who, for the purposes of the Convention, is deemed to be a resident only of the other Contracting State.

Paragraph 5

29. A large part of cross-border investment is done through various vehicles that allow for the pooling of investments by groups of investors.[23] Such collective investment may be done, for example, through large employer-sponsored pension funds or through various categories of funds that seek to attract savings from individuals and to invest these savings in various assets (e.g. in immovable property assets through so-called "Real Estate Investment Funds" – REITs).

30. Such vehicles used to channel collective investment constitute one of the largest categories of investors in foreign capital markets. A country that wants to encourage portfolio investment on its territory may therefore find it useful to clarify whether and how tax treaties will apply to such collective investment. Without such clarification, these vehicles may be reluctant to invest in a country or, if they do invest, the tax administration may have to address difficult treaty issues without a clear indication of the policy that the country has adopted in relation to these types of investors. A country should also consider, however, whether treaty-shopping concerns could arise with the use, by investors of third States, of vehicles established in States with which it concludes treaties.

31. Paragraph 5 is intended to remind treaty negotiators of the importance of addressing tax treaty issues that arise in the case of cross-border investment by funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established, which are referred to as "collective investment vehicles" (CIVs). These funds adopt different legal structures and may be set up, for instance, as companies, partnerships, trusts or contractual arrangements that create a joint ownership.

23 It was estimated that in 2019 the total worldwide assets invested through regulated funds amounted to over US$54.9 trillion (https://www.ici.org/index.php/system/files/attachments/2020_factbook.pdf, accessed 10 May 2021), p. 11.

A general policy goal of many countries is to ensure that investing through a domestic CIV should result in a tax burden that is equal to the one that applies in the case of a direct investment, that is, an investment where the CIV would not exist and where the investor in the CIV would have acquired directly its share of the assets held by the CIV. That policy goal is achieved through different mechanisms that result in tax being paid exclusively either at the level of the CIV or at the level of the investors:

— The CIV may be set up, or treated for tax purposes, as a transparent entity: for instance, if the State where the CIV is set up treats partnerships or some trusts as transparent for tax purposes and taxes directly the partners (in the case of a partnership) or beneficiaries (in the case of a trust), no tax will be payable by the CIV and each investor in the CIV will pay tax on its respective share of the income derived through the CIV.

— The CIV may be set up as a contractual arrangement that does not create a separate entity: in such case, the CIV is not a separate taxpayer and each investor in the CIV is considered to be a joint owner of the assets held through the CIV and is taxed on its share, as joint owner, of the investment income derived from these assets.

— The tax law provides that CIVs are taxed on their income and that investors are not taxed on distributions by the CIV: in that case taxation takes place exclusively at the level of the CIV.

— The tax law provides that CIVs are taxed on their income but that distributions to the CIV investors are deductible from the CIV's tax base: in that case, while the CIV is technically taxable on its investment income, it does not, in fact, pay tax to the extent that it distributes the income that it has earned.

— The tax law provides that CIVs are taxed on their income but that investors get a credit for the tax paid by the CIVs: in that case, the tax paid by the CIV reduces the tax that the investor has to pay when it is taxed on the income from the CIV (e.g. upon distribution of that income).

The different legal structures and tax treatment of CIVs in the States in which they are established raise a number of technical issues as regards the application of the typical provisions of tax treaties.

32. These issues are discussed in a section of the Commentary on Article 1 of the 2017 OECD Model that refers to an OECD report produced on the issue. As noted at the beginning of that section:

> 22. Most countries have dealt with the domestic tax issues arising from groups of small investors who pool their funds in collective investment vehicles (CIVs). In general, the goal of such systems is to provide for neutrality between direct investments and investments through a CIV. Whilst those systems generally succeed when the investors, the CIV and the investment are all located in the same country, complications frequently arise when one or more of those parties or the investments are located in different countries. These complications are discussed in the report by the Committee on Fiscal Affairs entitled "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles",[1] the main conclusions of which have been incorporated below *[in paragraphs 23 to 30 of the OECD Commentary, as quoted at paragraph 35 of this Commentary]*. For purposes of the Report and for this discussion, the term "CIV" is limited to funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

1 Reproduced *[at page R(24)-1 of] Volume II* of the *[full-length]* version of the *[2017]* OECD Model Tax Convention*[*, available at *https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page2527,* accessed on 10 May 2021.*]*

33. Given the importance of CIVs' cross-border portfolio investment in developing countries, the fact that the tax authorities of these countries may be less familiar with the tax issues raised by such vehicles and the fact that paragraphs 1 to 7 of Article 29 of the UN Model put forward specific provisions intended to address the issue of treaty shopping, which is an issue that is discussed extensively in the OECD report and the Commentary on Article 1 of the 2017 OECD Model, the Committee concluded that a specific reference to a possible provision that would address the question of the application of tax treaties to CIVs would be useful.

34. This was done through the addition of paragraph 5 of Article 1. That paragraph does not, however, provide a standard form that a provision on collective investment vehicles could take. As indicated in the footnote to paragraph 5 and explained below, such a provision could

take different forms depending on the policy views of both Contracting States. Also, various policy or administrative considerations may not justify the inclusion of a provision on collective investment vehicles in a bilateral tax treaty or may require different provisions aimed at different categories of such vehicles. Some possible forms that a provision on collective investment vehicles could take are discussed in paragraphs 42 to 46 below.

35. If the Contracting States prefer not to address issues related to the treatment of CIVs, or of some types of CIVs, through specific treaty provisions, they will still need to consider how the other provisions of their bilateral treaty will apply to income derived by or through these vehicles. The Committee considers that the following parts of the Commentary on Article 1 of the 2017 OECD Model are relevant in such cases (the modifications that appear in italics and square brackets in the quotations included in this paragraph and in paragraphs 37 to 46 below, which are not part of the Commentary on the 2017 OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the treatment of CIVs in this Model and in the OECD Model):

> 23. The primary question that arises in the cross-border context is whether a CIV should qualify for the benefits of the Convention in its own right. In order to do so under treaties that *[…]* do not include a specific provision dealing with CIVs *[or do not deal with all types of CIVs]*, a CIV would have to qualify as a "person" that is a "resident" of a Contracting State and, as regards the application of Articles 10 and 11 *[as well as Articles 12, 12AA, 12B or 12C in the exceptional cases where a CIV would derive income covered by these Articles]*, that is the "beneficial owner" of the income that it receives.
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> 24. The determination of whether a CIV should be treated as a "person" begins with the legal form of the CIV, which differs substantially from country to country and between the various types of vehicles. In many countries, most CIVs take the form of a company. In others, the CIV typically would be a trust. In still others, many CIVs are simple contractual arrangements or a form of joint ownership. In most cases, the CIV would be treated as a taxpayer or a "person" for purposes of the tax law of the State in which it is established; for example, in some countries where the CIV is commonly established in the form of a trust, either the trust itself, or the trustees acting collectively in their

capacity as such, is treated as a taxpayer or a person for domestic tax law purposes. In view of the wide meaning to be given to the term "person", the fact that the tax law of the country where such a CIV is established would treat it as a taxpayer would be indicative that the CIV is a "person" for treaty purposes. Contracting States wishing to expressly clarify that, in these circumstances, such CIVs are persons for the purposes of their conventions may agree bilaterally to modify the definition of "person" to include them.

25. Whether a CIV is a "resident" of a Contracting State depends not on its legal form (as long as it qualifies as a person) but on its tax treatment in the State in which it is established. Although a consistent goal of domestic CIV regimes is to ensure that there is only one level of tax, at either the CIV or the investor level, there are a number of different ways in which States achieve that goal. In some States, the holders of interests in the CIV are liable to tax on the income received by the CIV, rather than the CIV itself being liable to tax on such income. Such a fiscally transparent CIV would not be treated as a resident of the Contracting State in which it is established because it is not liable to tax therein.

26. By contrast, in other States, a CIV is in principle liable to tax but its income may be fully exempt, for instance, if the CIV fulfils certain criteria with regard to its purpose, activities or operation, which may include requirements as to minimum distributions, its sources of income and sometimes its sectors of operation. More frequently, CIVs are subject to tax but the base for taxation is reduced, in a variety of different ways, by reference to distributions paid to investors. Deductions for distributions will usually mean that no tax is in fact paid. Other States tax CIVs but at a special low tax rate. Finally, some States tax CIVs fully but with integration at the investor level to avoid double taxation of the income of the CIV. For those countries that adopt the view, reflected in paragraph 8.11 of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 4 of this Model]*, that a person may be liable to tax even if the State in which it is established does not impose tax, the CIV would be treated as a resident of the State in which it is established in all of these cases because the CIV is subject to comprehensive taxation in that State. Even in the case where the income of the CIV is taxed at a zero rate, or is exempt from tax, the requirements to be treated as a resident may be met if the requirements to qualify for such lower rate or exemption are sufficiently stringent.

27. Those countries that adopt the alternative view, reflected in paragraph 8.12 of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 4 of this Model]*, that an entity that is exempt from tax therefore is not liable to tax may not view some or all of the CIVs described in the preceding paragraph as residents of the States in which they are established. States taking the latter view, and those States negotiating with such States, are encouraged to address the issue in their bilateral negotiations.

28. Some countries have questioned whether a CIV, even if it is a "person" and a "resident", can qualify as the beneficial owner of the income it receives. Because a "CIV" as defined in paragraph 22 *[of the Commentary on Article 1 of the 2017 OECD Model, as quoted in paragraph 32 above]* must be widely-held, hold a diversified portfolio of securities and be subject to investor-protection regulation in the country in which it is established, such a CIV, or its managers, often perform significant functions with respect to the investment and management of the assets of the CIV. Moreover, the position of an investor in a CIV differs substantially, as a legal and economic matter, from the position of an investor who owns the underlying assets, so that it would not be appropriate to treat the investor in such a CIV as the beneficial owner of the income received by the CIV. Accordingly, a vehicle that meets the definition of a widely-held CIV will also be treated as the beneficial owner of the dividends and interest that it receives, so long as the managers of the CIV have discretionary powers to manage the assets generating such income (unless an individual who is a resident of that State who would have received the income in the same circumstances would not have been considered to be the beneficial owner thereof).

29. Because these principles are necessarily general, their application to a particular type of CIV might not be clear to the CIV, investors and intermediaries. Any uncertainty regarding treaty eligibility is especially problematic for a CIV, which must take into account amounts expected to be received, including any withholding tax benefits provided by treaty, when it calculates its net asset value ("NAV"). The NAV, which typically is calculated daily, is the basis for the prices used for subscriptions and redemptions. If the withholding tax benefits ultimately obtained by the CIV do not correspond to its original assumptions about the amount and timing of such withholding tax benefits, there will be a discrepancy between the real asset value and the NAV used by investors who have purchased, sold or redeemed their interests in the CIV in the interim.

30. In order to provide more certainty under existing treaties, tax authorities may want to reach a mutual agreement clarifying the treatment of some types of CIVs in their respective States. With respect to some types of CIVs, such a mutual agreement might simply confirm that the CIV satisfies the technical requirements discussed above and therefore is entitled to benefits in its own right. In other cases, the mutual agreement could provide a CIV an administratively feasible way to make claims with respect to treaty-eligible investors (see paragraphs 36 to 40 of the report "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" for a discussion of this issue). Of course, a mutual agreement could not cut back on benefits that otherwise would be available to the CIV under the terms of a treaty.

36. A single member of the Committee did not agree with the view expressed in paragraph 28 of the Commentary on Article 1 of the 2017 OECD Model quoted in paragraph 35 above.[24] That member observed that the concept of "beneficial owner", as interpreted in the Commentary on Articles 10, 11, 12, 12A and 12B as they then stood refers essentially to a recipient of income having the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the payment received to another person (see paragraph 12.4 of the OECD Commentary quoted in paragraph 15 of the Commentary on Article 10). That member considered that the fact that the managers of a CIV have discretionary powers to manage assets generating income in question means that the CIV can use the income for making further investments but it cannot enjoy it. Ultimately, income has to be passed on to the investors, who alone would have right to use and enjoy the income unconstrained by legal or contractual obligations. Thus, according to that member, while the CIV may have more rights than an agent, nominee, conduit company acting as a fiduciary or administrator, it does not have what it takes to become a "beneficial owner" in terms of the criteria in the Commentary on Articles 10, 11, 12, 12AA, 12B and 12C.

37. The Contracting States may prefer to deal expressly with the technical issues identified in paragraph 35 above in a way that will provide for an appropriate tax treaty treatment of CIVs in the light

24 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

of different policy considerations, such as the different legal forms of CIVs in two Contracting States or in the same State and the potential for treaty shopping through the use of CIVs. These considerations are discussed in the following paragraphs of the Commentary on Article 1 of the 2017 OECD Model:

> 32. However, in negotiating new treaties or amendments to existing treaties, the Contracting States would not be restricted to clarifying the results of the application of other treaty provisions to CIVs, but could vary those results to the extent necessary to achieve policy objectives. For example, in the context of a particular bilateral treaty, the technical analysis may result in CIVs located in one of the Contracting States qualifying for benefits, whilst CIVs in the other Contracting State may not. This may make the treaty appear unbalanced, although whether it is so in fact will depend on the specific circumstances. If it is, then the Contracting States should attempt to reach an equitable solution. If the practical result in each of the Contracting States is that most CIVs do not in fact pay tax, then the Contracting States should attempt to overcome differences in legal form that might otherwise cause those in one State to qualify for benefits and those in the other to be denied benefits. On the other hand, the differences in legal form and tax treatment in the two Contracting States may mean that it is appropriate to treat CIVs in the two States differently. In comparing the taxation of CIVs in the two States, taxation in the source State and at the investor level should be considered, not just the taxation of the CIV itself. The goal is to achieve neutrality between a direct investment and an investment through a CIV in the international context, just as the goal of most domestic provisions addressing the treatment of CIVs is to achieve such neutrality in the wholly domestic context.
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> 33. A Contracting State may also want to consider whether existing treaty provisions are sufficient to prevent CIVs from being used in a potentially abusive manner. It is possible that a CIV could satisfy all of the requirements to claim treaty benefits in its own right, even though its income is not subject to much, if any, tax in practice. In that case, the CIV could present the opportunity for residents of third countries to receive treaty benefits that would not have been available had they invested directly. Accordingly, it may be appropriate to restrict benefits that might otherwise be available to such a CIV, either through generally applicable anti-abuse or anti-treaty shopping rules (as discussed under "Improper use of the Convention" below) or through a specific provision dealing with CIVs.

34. In deciding whether such a provision is necessary, Contracting States will want to consider the economic characteristics, including the potential for treaty shopping, presented by the various types of CIVs that are prevalent in each of the Contracting States. For example, a CIV that is not subject to any taxation in the State in which it is established may present more of a danger of treaty shopping than one in which the CIV itself is subject to an entity-level tax or where distributions to non-resident investors are subject to withholding tax.

38. The following version of a provision that could be included in paragraph 5 would address the considerations referred to in paragraph 37 above. It is based on the alternative provision found in paragraph 35 of the Commentary on Article 1 of the 2017 OECD Model, but with substantive modifications that reflect how this Model deals with the issue of derivative benefits, and the related issue of the definition of "equivalent beneficiary", in its Article 29:

5. Notwithstanding the other provisions of this Convention, a collective investment vehicle which is established in a Contracting State and which receives income arising in the other Contracting State shall be treated for purposes of applying the Convention to such income as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof), but only to the extent that the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established who are qualified persons within the meaning of paragraph 2 of Article 29 [possible addition of "or by equivalent beneficiaries"]. For the purposes of this paragraph, the term "collective investment vehicle" means, in the case of [State A], a [ ] and, in the case of [State B], a [ ], as well as any other investment fund, arrangement or entity established in either Contracting State which the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph [possible addition of a definition of "equivalent beneficiary" for the purposes of this paragraph].

39. The provision in paragraph 38 above and the alternatives discussed below in paragraphs 43, 44 and 46 operate to deem the CIV to be an individual resident of the Contracting State in which it is established with respect to the income that it receives from the other Contracting State without affecting the right of that other State to tax its own residents who have invested in that CIV. Also, these provisions clarify how the beneficial owner requirement of Articles 10, 11, 12, 12AA, 12B and 12C would apply to the collective investment vehicles to which these provisions would apply. The Committee considers that the following explanations found in the Commentary on Article 1 of the 2017 OECD Model are applicable in this respect:

> 47. *[The provisions of the alternatives discussed in paragraphs 38, 43, 44 and 46 treat]* the CIV as the resident and the beneficial owner of the income it receives for the purposes of the application of the Convention to such income, which has the simplicity of providing for one reduced rate of withholding with respect to each type of income. As confirmed by paragraph 3 *[of Article 1]*, these provisions, however, do not restrict in any way the right of the State of source from taxing its own residents who are investors in the CIV. Clearly, these provisions are intended to deal with the source taxation of the CIV's income and not the residence taxation of its investors.
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> 48. Also, each of these provisions is intended only to provide that the specific characteristics of the CIV will not cause it to be treated as other than the beneficial owner of the income it receives. Therefore, a CIV will be treated as the beneficial owner of all of the income it receives. The provision is not intended, however, to put a CIV in a different or better position than other investors with respect to aspects of the beneficial ownership requirement that are unrelated to the CIV's status as such. Accordingly, where an individual receiving an item of income in certain circumstances would not be considered as the beneficial owner of that income, a CIV receiving that income in the same circumstances could not be deemed to be the beneficial owner of the income. This result is confirmed by the parenthetical limiting the application of the provision to situations in which an individual in the same circumstances would have been treated as the beneficial owner of the income.

40. Since the provisions in paragraph 38 above and in paragraphs 43, 44 and 46 below apply notwithstanding the other provisions of the Convention, they override those of paragraph 2 of Article 1 dealing

with transparent entities. Thus, although a CIV legally structured as a partnership might be treated as fiscally transparent under the domestic law of either Contracting State, it would still be that CIV, rather than the partners, that would be considered, for the purposes of the application of the Convention, as the recipient of the income entitled to treaty benefits.

41. The provisions in paragraph 38 above and in paragraphs 43, 44 and 46 below do not seek to provide a substantive definition of the CIVs to which they would apply. They rather provide that these CIVs would be identified through the specific cross-references to the relevant tax or securities law provisions relating to CIVs of each State that would be included in the last part of these provisions. These CIVs would typically be funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.

42. The provision in paragraph 38 above reflects the approach put forward in paragraphs 1 to 7 of Article 29 in order to address potential treaty shopping. It therefore only applies to the extent that the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established who constitute "qualified persons" within the meaning of paragraph 2 of Article 29. Consistent with the approach put forward in Article 29, the provision recognizes that the Contracting States may wish to extend the scope of the provision to "equivalent beneficiaries" as this term is defined in paragraph 7(*e*) of Article 29 (see the explanations provided in paragraph 19 of the Commentary on Article 29 in relation to the possible addition to Article 29 of a "derivative benefit" rule as well as the explanations of the concept of "equivalent beneficiary" in paragraph 27 of the Commentary on Article 29). The justification for extending the scope of the provision to such "equivalent beneficiaries" is to ensure that investors who would have been entitled to benefits with respect to income derived from the source State had they received the income directly are not put in a worse position by investing through a CIV located in a third country. As noted in paragraph 37 of the Commentary on Article 1 of the 2017 OECD Model, such an extension "is beneficial for investors, particularly those from small countries, who will consequently enjoy a greater choice of investment vehicles. It also increases economies of scale, which are a primary economic benefit of investing through CIVs". The definition of equivalent beneficiary in paragraph 7(*e*) of Article 29 allows the application

of the provision when there are investors from third countries but without allowing its application with respect to an investor that would be an entity in a third country that would not be entitled to treaty benefits in the source State under provisions similar to those of paragraphs 1 to 7 of Article 29 (i.e. because of risks that such entity would itself be used for treaty shopping).

43. As recognized in paragraph 41 of the Commentary on Article 1 of the 2017 OECD Model, however, while the proportionate approach put forward in the provision in paragraph 38 above addresses treaty-shopping concerns, the determination of the treaty entitlement of every single investor may impose a substantial administrative burden for a CIV. Paragraph 41 of the OECD Commentary goes on to suggest that "[a] Contracting State may decide that the fact that a substantial proportion of the CIV's investors are treaty-eligible is adequate protection against treaty shopping, and thus that it is appropriate to provide an ownership threshold above which benefits would be provided with respect to all income received by the CIV. Including such a threshold would also mitigate some of the procedural burdens that otherwise might arise." In the context of the UN Model, the addition of such a threshold could be achieved by adding the following to the provision in paragraph 38 above:

> However, if at least […] per cent of the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established who are qualified persons of that State within the meaning of paragraph 2 of Article 29 [possible addition of "or by equivalent beneficiaries"], the collective investment vehicle shall be treated as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of all of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof).

44. In some cases, Contracting States might simply wish to address the technical issues discussed in paragraph 35 above and to confirm the treaty entitlement of CIVs through a simpler provision that would not expressly address potential treaty-shopping concerns. Such a provision is proposed in paragraph 31 of the Commentary on Article 1 of the 2017 OECD Model:

31. The same considerations would suggest that treaty negotiators address expressly the treatment of CIVs. Thus, even if it appears that CIVs in each of the Contracting States would be entitled to benefits, it may be appropriate to confirm that position publicly (for example, through an exchange of notes) in order to provide certainty. It may also be appropriate to expressly provide for the treaty entitlement of CIVs by including, for example, a provision along the following lines:

> Notwithstanding the other provisions of this Convention, a collective investment vehicle which is established in a Contracting State and which receives income arising in the other Contracting State shall be treated, for purposes of applying the Convention to such income, as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof). For purposes of this paragraph, the term "collective investment vehicle" means, in the case of [State A], a [ ] and, in the case of [State B], a [ ], as well as any other investment fund, arrangement or entity established in either Contracting State which the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph.

45. As discussed in paragraph 42 of the Commentary on Article 1 of the 2017 OECD Model, Contracting States may consider that certain types of CIVs should not be allowed to claim treaty benefits in their own name but should rather be allowed to claim the treaty benefits to which the investors in these CIVs are entitled:

> 42. In some cases, the Contracting States might wish to take a different approach from that put forward in *[paragraphs 38, 43, 44 and 46*] with respect to certain types of CIVs and to treat the CIV as making claims on behalf of the investors rather than in its own name. This might be true, for example, if a large percentage of the owners of interests in the CIV as a whole, or of a class of interests in the CIV, are pension funds that are exempt from tax in the source country under terms of the relevant treaty similar to those described in paragraph 69 of the Commentary on Article 18 *[of the 2017 OECD Model, as quoted in paragraph 18 of the Commentary on Article 18 of this Model]*. To ensure that the investors would not lose the benefit of the preferential rates to which they would have been entitled had they invested directly, the

Contracting States might agree to a provision along the following lines with respect to such CIVs (although likely adopting *[one or more of the alternatives discussed in paragraphs 38, 43, 44 and 46]* with respect to other types of CIVs):

a) A collective investment vehicle described in subparagraph *c*) which is established in a Contracting State and which receives income arising in the other Contracting State shall not be treated as a resident of the Contracting State in which it is established, but may claim, on behalf of the owners of the beneficial interests in the collective investment vehicle, the tax reductions, exemptions or other benefits that would have been available under this Convention to such owners had they received such income directly.

b) A collective investment vehicle may not make a claim under subparagraph *a*) for benefits on behalf of any owner of the beneficial interests in such collective investment vehicle if the owner has itself made an individual claim for benefits with respect to income received by the collective investment vehicle.

c) This paragraph shall apply with respect to, in the case of [State A], a [ ] and, in the case of [State B], a [ ], as well as any other investment fund, arrangement or entity established in either Contracting State to which the competent authorities of the Contracting States agree to apply this paragraph.

This provision would, however, limit the CIV to making claims on behalf of residents of the same Contracting State in which the CIV is established. If *[…]* the Contracting States deemed it desirable to allow the CIV to make claims on behalf of treaty-eligible residents of third States, that could be accomplished by replacing the words "this Convention" with "any Convention to which the other Contracting State is a party" in subparagraph *a*). If, as anticipated, the Contracting States would agree that the treatment provided in this paragraph would apply only to specific types of CIVs, it would be necessary to ensure that the types of CIVs listed in subparagraph *c*) did not include any of the types of CIVs listed in a more general provision such as that in [*one or more of the alternatives discussed in paragraphs 38, 43, 44 and 46]* so that the treatment of a specific type of CIV would be fixed, rather than elective. Countries wishing to allow individual CIVs to elect their treatment, either with respect to the CIV as a whole or with respect to one or more classes of interests in the CIV, are free to modify the paragraph to do so.

46. The practical application of the approach in the alternatives discussed in paragraphs 38, 43 and 45 above requires a collective investment vehicle to determine the proportion of its investors who would have been entitled to benefits had they invested directly. This raises practical difficulties, and requires administrative solutions, that are discussed in the following paragraphs of the Commentary on Article 1 of the 2017 OECD Model:

> 43. Under either the approach *[in the alternatives discussed in paragraphs 38, 43 and 45 above]*, it will be necessary for the CIV to make a determination regarding the proportion of holders of interests who would have been entitled to benefits had they invested directly. Because ownership of interests in CIVs changes regularly, and such interests frequently are held through intermediaries, the CIV and its managers often do not themselves know the names and treaty status of the beneficial owners of interests. It would be impractical for the CIV to collect such information from the relevant intermediaries on a daily basis. Accordingly, Contracting States should be willing to accept practical and reliable approaches that do not require such daily tracing.
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> 44. For example, in many countries the CIV industry is largely domestic, with an overwhelming percentage of investors resident in the country in which the CIV is established. In some cases, tax rules discourage foreign investment by imposing a withholding tax on distributions, or securities laws may severely restrict offerings to non-residents. Governments should consider whether these or other circumstances provide adequate protection against investment by non-treaty-eligible residents of third countries. It may be appropriate, for example, to assume that a CIV is owned by residents of the State in which it is established if the CIV has limited distribution of its shares or units to the State in which the CIV is established or to other States that provide for similar benefits in their treaties with the source State.
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> 45. In other cases, interests in the CIV are offered to investors in many countries. Although the identity of individual investors will change daily, the proportion of investors in the CIV that are treaty-entitled is likely to change relatively slowly. Accordingly, it would be a reasonable approach to require the CIV to collect from other intermediaries, on specified dates, information enabling the CIV to determine the proportion of investors that are treaty-entitled. This information could be required at the end of a calendar or fiscal year or, if market conditions suggest that turnover in ownership is high, it could be required more frequently, although no more often than the

end of each calendar quarter. The CIV could then make a claim on the basis of an average of those amounts over an agreed-upon time period. In adopting such procedures, care would have to be taken in choosing the measurement dates to ensure that the CIV would have enough time to update the information that it provides to other payers so that the correct amount is withheld at the beginning of each relevant period.

46. An alternative approach would provide that a CIV that is publicly traded in the Contracting State in which it is established will be entitled to treaty benefits without regard to the residence of its investors. This provision has been justified on the basis that a publicly-traded CIV cannot be used effectively for treaty shopping because the shareholders or unitholders of such a CIV cannot individually exercise control over it. Such a provision could read:

a) Notwithstanding the other provisions of this Convention, a collective investment vehicle which is established in a Contracting State and which receives income arising in the other Contracting State shall be treated for purposes of applying the Convention to such income as an individual who is a resident of the Contracting State in which it is established and as the beneficial owner of the income it receives (provided that, if an individual who is a resident of the first-mentioned State had received the income in the same circumstances, such individual would have been considered to be the beneficial owner thereof), if the principal class of shares or units in the collective investment vehicle is listed and regularly traded on a regulated stock exchange in that State.

b) For purposes of this paragraph, the term "collective investment vehicle" means, in the case of [State A], a [ ] and, in the case of [State B], a [ ], as well as any other investment fund, arrangement or entity established in either Contracting State which the competent authorities of the Contracting States agree to regard as a collective investment vehicle for purposes of this paragraph.

47. While the suggested provisions and explanations above apply to a Real Estate Investment Trust (REIT) that qualifies as a CIV, it is acknowledged that REITs do not always qualify as such and that they raise other specific treaty issues.

48. The Committee considers that the following part of the Commentary on Article 10 of the 2017 OECD Model, which describes REITs and addresses issues that arise with the application of tax treaties to the distributions that REITs make, is applicable to this Model (the

modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 67.1 In many States, a large part of portfolio investment in immovable property is done through Real Estate Investment Trusts (REITs). A REIT may be loosely described as a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property, distributes most of that income annually and does not pay income tax on the income related to immovable property that is so distributed. The fact that the REIT vehicle does not pay tax on that income is the result of tax rules that provide for a single-level of taxation in the hands of the investors in the REIT.
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> 67.2 The importance and the globalisation of investments in and through REITs have led the Committee on Fiscal Affairs to examine the tax treaty issues that arise from such investments. The results of that work appear in a report entitled "Tax Treaty Issues Related to REITS."[1]

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1 Reproduced *[at page R(23)-1 of] Volume II* of the *[full-length]* version of the *[2017]* OECD Model Tax Convention*[,* available at *https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page2503,* accessed on 10 May 2021.*]*

> 67.3 One issue discussed in the report is the tax treaty treatment of cross-border distributions by a REIT. In the case of a small investor in a REIT, the investor has no control over the immovable property acquired by the REIT and no connection to that property. Notwithstanding the fact that the REIT itself will not pay tax on its distributed income, it may therefore be appropriate to consider that such an investor has not invested in immovable property but, rather, has simply invested in a company and should be treated as receiving a portfolio dividend. Such a treatment would also reflect the blended attributes of a REIT investment, which combines the attributes of both shares and bonds. In contrast, a larger investor in a REIT would have a more particular interest in the immovable property acquired by the REIT; for that investor, the investment in the REIT may be seen as a substitute for an investment in the underlying property of the REIT. In this situation, it would not seem appropriate to restrict the source taxation of the distribution from the REIT since the REIT itself will not pay tax on its income.

67.4 States that wish to achieve that result may agree bilaterally to replace paragraph 2 of the Article by the following:

> 2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed:
>
> *a*) ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends (other than a paying company that is a REIT) throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);
>
> *b*) ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the dividends in all other cases.

According to this provision, a large investor in a REIT is an investor holding, directly or indirectly, capital that represents at least 10 per cent of the value of all the REIT's capital. States may, however, agree bilaterally to use a different threshold. Also, the provision applies to all distributions by a REIT; in the case of distributions of capital gains, however, the domestic law of some countries provides for a different threshold to differentiate between a large investor and a small investor entitled to taxation at the rate applicable to portfolio dividends and these countries may wish to amend the provision to preserve that distinction in their treaties. Finally, because it would be inappropriate to restrict the source taxation of a REIT distribution to a large investor, the drafting of subparagraph *a*) excludes dividends paid by a REIT from its application; thus, the subparagraph can never apply to such dividends, even if a company that did not hold capital representing 10 per cent or more of the value of the capital of a REIT held at least 25 per cent of its capital as computed in accordance with

paragraph 15 *[of the Commentary on Article 10 of the 2017 OECD Model, as quoted in paragraph 16 of the Commentary on Article 10 of this Model]*. The State of source will therefore be able to tax such distributions to large investors regardless of the restrictions in subparagraphs *a*) and *b*).

67.5 Where, however, the REITs established in one of the Contracting States do not qualify as companies that are residents of that Contracting State, the provision will need to be amended to ensure that it applies to distributions by such REITs.

67.6 For example, if the REIT is a company that does not qualify as a resident of the State, paragraphs 1 and 2 of the Article will need to be amended as follows to achieve that result:

> 1. Dividends paid by a company which is a resident, or a REIT organised under the laws, of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, dividends may also be taxed in, and according to the laws of, the Contracting State of which the company paying the dividends is a resident or, in the case of a REIT, under the laws of which it has been organised, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which such person holds, directly or indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed:
>
> *a*) ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends (other than a paying company that is a REIT) throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);
>
> *b*) ___ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the dividends in all other cases.

67.7 Similarly, in order to achieve that result where the REIT is structured as a trust or as a contractual or fiduciary arrangement and

does not qualify as a company, States may agree bilaterally to add to the alternative version of paragraph 2 set forth in paragraph 67.4 above an additional provision drafted along the following lines:

> For the purposes of this Convention, where a REIT organised under the laws of a Contracting State makes a distribution of income to a resident of the other Contracting State who is the beneficial owner of that distribution, the distribution of that income shall be treated as a dividend paid by a company resident of the first-mentioned State.

Under this additional provision, the relevant distribution would be treated as a dividend and not, therefore, as another type of income (e.g. income from immovable property or capital gain) for the purposes of applying Article 10 and the other Articles of the Convention. Clearly, however, that would not change the characterisation of that distribution for purposes of domestic law so that domestic law treatment would not be affected except for the purposes of applying the limitations imposed by the relevant provisions of the Convention.

49. REITs also raise a specific issue with respect to the application of paragraph 4 of Article 13 to the alienation of interests that investors hold in these vehicles. The Committee considers that the following part of the Commentary on Article 13 of the 2017 OECD Model, which explains this issue, is applicable to this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 28.10 Finally, a further possible exception [*to the application of paragraph 4 of Article 13*] relates to shares and comparable interests in a Real Estate Investment Trust (see paragraphs 67.1 to 67.7 of the Commentary on Article 10 *[of the 2017 OECD Model, as quoted in paragraph 48 above]* for background information on REITs). Whilst it would not seem appropriate to make an exception to paragraph 4 in the case of the alienation of a large investor's interests in a REIT, which could be considered to be the alienation of a substitute for a direct investment in immovable property, an exception to paragraph 4 for the alienation of a small investor's interest in a REIT may be considered to be appropriate.
>
> 28.11 As discussed in paragraph 67.3 of the Commentary on Article 10, it may be appropriate to consider a small investor's interest in a REIT as a security rather than as an indirect holding in immovable property.

In this regard, in practice it would be very difficult to administer the application of source taxation of gains on small interests in a widely held REIT. Moreover, since REITs, unlike other entities deriving their value primarily from immovable property, are required to distribute most of their profits, it is unlikely that there would be significant residual profits to which the capital gain tax would apply (as compared to other entities). States that share this view may agree bilaterally to add, before the phrase "may be taxed in that other State", words such as "except shares or comparable interests held by a person who holds, directly or indirectly, shares or interests representing less than 10 per cent of all the shares or interests in an entity if that entity is a REIT".

28.12 Some States, however, consider that paragraph 4 was intended to apply to any gain on the alienation of shares or similar interests in an entity that derives its value primarily from immovable property and that there would be no reason to distinguish between a REIT and a publicly held entity with respect to the application of that paragraph, especially since a REIT is not taxed on its income. These States consider that as long as there is no exception for the alienation of shares or similar interests in entities listed on a stock exchange *[…]*, there should not be a special exception for interests in a REIT.

Improper use of tax treaties

50. The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. However, the provisions of tax treaties are drafted in general terms and taxpayers may be tempted to enter into arrangements so as to obtain benefits in circumstances where the Contracting States did not intend that these benefits be provided. Such improper uses of tax treaties are a source of concern to all countries but particularly for countries that have limited experience in dealing with sophisticated tax-avoidance strategies.

51. The Committee considered that it would therefore be helpful to examine the various approaches through which those strategies may be dealt with and to provide specific examples of the application of these approaches. In examining this issue, the Committee recognized that for tax treaties to achieve their role, 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.

52. In the 2017 update, the Committee made several changes to this Model to prevent taxpayers from using improperly the provisions of bilateral tax conventions based on the Model to obtain treaty benefits. First, the title of bilateral tax treaties based on the Model has been amended to refer expressly to "the prevention of tax avoidance and evasion." Second, a new preamble has been added which clarifies that tax conventions are not intended to create opportunities for tax avoidance or evasion, including tax avoidance through treaty-shopping arrangements. Third, a new general anti-abuse rule has been included in paragraph 9 of Article 29. This general anti-abuse rule and the specific anti-abuse rules included in tax treaties are intended to deny treaty benefits with respect to certain transactions and arrangements where granting such benefits would be contrary to the object and purpose of the Convention.

53. These additions to the Model will make its provisions more effective in preventing treaty abuse. However, many countries may have existing bilateral tax conventions that do not contain these new provisions, in particular the general anti-abuse rule in paragraph 9 of Article 29. This part of the Commentary, describing the various approaches that countries may adopt to combat tax avoidance through the improper use of tax treaties, is especially important where their treaties do not include paragraph 9 of Article 29.

54. Paragraphs 55 to 82 below are based on the Commentary on Article 1 of the 2017 OECD Model with appropriate modifications. In general, the basic approaches to controlling treaty abuse described below are intended to be consistent with the relevant Commentary on Article 1 of the OECD Model.

55. There are a number of different approaches used by countries to prevent and address the improper use of tax treaties. In general, these approaches involve the interpretation and application of the provisions of a treaty or the interpretation and application of domestic law.

56. Dealing with tax avoidance through domestic law involves the possible application of:

a) specific anti-abuse rules in domestic law,

b) general anti-abuse rules in domestic law, and

c) judicial doctrines and principles of interpretation that are part of domestic law.

These domestic-law approaches are discussed generally in paragraphs 58 and 59 below and separately in more detail in paragraphs 73 to 89.

57. Dealing with tax avoidance through tax conventions involves the possible application of:

a) specific anti-abuse rules in tax treaties

b) general anti-abuse rules in tax treaties

c) the interpretation of tax treaty provisions.

These treaty-based approaches are discussed generally in paragraphs 60 to 72 below and separately in more detail in paragraphs 90 to 98.

1. Approaches to prevent the improper use of tax treaties

Addressing tax avoidance through domestic anti-abuse rules and judicial doctrines

58. Domestic anti-abuse rules and judicial doctrines may be used to address transactions and arrangements entered into for the purpose of obtaining treaty benefits in inappropriate circumstances. These rules and doctrines may also address situations where transactions or arrangements are entered into for the purpose of abusing both domestic laws and tax conventions.

59. For these reasons, domestic anti-abuse rules and judicial doctrines play an important role in preventing treaty benefits from being granted in inappropriate circumstances. The application of such domestic anti-abuse rules and doctrines, however, raises the issue of possible conflicts with treaty provisions, in particular where treaty provisions are relied upon in order to facilitate the abuse of domestic law provisions (e.g. where it is claimed that treaty provisions protect the taxpayer from the application of certain domestic anti-abuse rules). This issue is discussed below in relation to specific legislative anti-abuse rules, general legislative anti-abuse rules and judicial doctrines.

Addressing tax avoidance through tax conventions

60. Paragraph 9 of Article 29 and the specific treaty anti-abuse rules included in tax conventions are aimed at transactions and arrangements entered into for the purpose of obtaining treaty benefits in inappropriate

circumstances. Where, however, a tax convention does not include such rules, the question may arise whether the benefits of the tax convention should be granted when transactions that constitute an abuse of the provisions of that convention are entered into.

61. Many States address that question by taking account of the fact that taxes are ultimately imposed through the provisions of domestic law, as restricted (and in some rare cases, broadened) by the provisions of tax conventions. Thus, any abuse of the provisions of a tax convention could also be characterised as an abuse of the provisions of domestic law under which tax is levied. For these States, the issue becomes whether the provisions of tax conventions may prevent the application of the anti-abuse provisions of domestic law, which is the question addressed in paragraphs 77 to 87 below. As explained in these paragraphs, as a general rule, there will be no conflict between such rules and the provisions of tax conventions.

62. Other States prefer to view some arrangements as abuses of the convention itself, as opposed to abuses of domestic law. These States, however, consider that a proper construction of tax conventions allows them to disregard abusive transactions and arrangements, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions. This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them in good faith (see Article 31 of the *Vienna Convention on the Law of Treaties*).

63. Under both approaches, therefore, it is agreed that States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into.

64. It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above. A guiding principle is that the benefits of a double taxation convention should not be available where a 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. That principle applies independently from the provisions of paragraph 9 of Article 29, which merely confirm it.

65. The guiding principle in paragraph 64 above has been endorsed by the OECD and is reflected in paragraph 61 of the Commentary on Article 1 of the 2017 OECD Model Tax Convention (which corresponds to paragraph 9.5 of the Commentary on Article 1 of the 2014 OECD Model Tax Convention). The members of the Committee endorsed that principle in the 2011 update of the UN Model and they continue to endorse it. They consider that such guidance as to what constitutes an abuse of treaty provisions serves an important purpose as it attempts to balance the need to prevent treaty abuses with the need to ensure that countries respect their treaty obligations and provide legal certainty to taxpayers. Clearly, countries should not be able to escape their treaty obligations simply by arguing that legitimate transactions are abusive and domestic tax rules that affect these transactions in ways that are contrary to treaty provisions constitute anti-abuse rules.

66. Under the guiding principle presented above, two elements must therefore be present for certain transactions or arrangements to be found to constitute an abuse of the provisions of a tax treaty:

— a main purpose for entering into these transactions or arrangements was to secure a more favourable tax position, and

— obtaining that more favourable treatment would be contrary to the object and purpose of the relevant provisions.

67. These two elements will also often be found, explicitly or implicitly, in general anti-avoidance rules and doctrines developed in various countries.

68. In order to minimize the uncertainty that may result from the application of that approach, it is important that this guiding principle be applied on the basis of objective findings of facts, not solely the alleged intention of the parties. Thus, the determination of whether a main purpose for entering into transactions or arrangements is to obtain tax advantages should be based on an objective determination, based on all the relevant facts and circumstances, of whether, without these tax advantages, a reasonable taxpayer would have entered into the same transactions or arrangements.

69. The potential application of these principles or of paragraph 9 of Article 29 does not mean that the inclusion in tax conventions of specific provisions aimed at preventing particular forms of tax

avoidance is unnecessary. Where specific avoidance techniques have been identified or the use of such techniques is especially problematic, it will often be useful to add to the convention provisions that focus directly on the relevant avoidance strategy. Also, this will be necessary where a State which adopts the view described in paragraph 61 above believes that its domestic law lacks the anti-avoidance rules or principles necessary to properly address such a strategy.

70. For instance, some forms of tax avoidance have already been expressly dealt with in the Convention, for example, by the introduction of the concept of "beneficial owner" (in Articles 8 (Alternative A), 10, 11, 12, 12AA, 12B and 12C) and of special provisions such as paragraph 2 of Article 17 dealing with so-called artiste-companies.

71. Also, in some cases, claims to treaty benefits by subsidiary companies, in particular companies established in tax havens or benefiting from harmful preferential regimes, may be refused where careful consideration of the facts and circumstances of a case shows that the place of effective management of a subsidiary does not lie in its alleged State of residence but, rather, lies in the State of residence of the parent company so as to make it a resident of that latter State for domestic law purposes (this will be relevant where the domestic law of a State uses the place of management of a legal person, or a similar criterion, to determine its residence).

72. Careful consideration of the facts and circumstances of a case may also show that a subsidiary is managed in the State of residence of its parent in such a way that the subsidiary had a permanent establishment (e.g. by having a place of management) in that State to which all or a substantial part of its profits are properly attributable.

Specific legislative anti-abuse rules found in domestic law

73. Tax authorities seeking to address the improper use of a tax treaty may first consider the application of specific anti-abuse rules included in their domestic tax law.

74. Many specific anti-abuse rules found in domestic law may be relevant for that purpose. For instance, controlled foreign company (CFC) rules may apply to prevent certain arrangements involving the use,

by residents, of base or conduit companies that are residents of treaty countries; thin capitalization rules or earnings stripping rules may apply to restrict the deduction of base-eroding interest payments to residents of treaty countries; transfer pricing rules (even if not designed primarily as anti-abuse rules) may prevent the artificial shifting of income from a resident enterprise to an enterprise that is resident of a treaty country; exit or departure taxes rules may prevent the avoidance of capital gains tax through a change of residence before the realisation of a treaty-exempt capital gain and dividend stripping rules may prevent the avoidance of domestic dividend withholding taxes through transactions designed to transform dividends into treaty-exempt capital gains, and anti-conduit rules may prevent certain avoidance transactions involving the use of conduit arrangements.

75. A common problem that arises from the application of many of these and other specific anti-abuse rules to arrangements involving the use of tax treaties is possible conflicts with the provisions of tax treaties. Where two Contracting States take different views as to whether a specific anti-abuse rule found in the domestic law of one of these States conflicts with the provisions of their tax treaty, the issue may be addressed through the mutual agreement procedure having regard to the following principles.

76. Generally, where the application of provisions of domestic law and the provisions of tax treaties produces conflicting results, the provisions of tax treaties are intended to prevail. This is a logical consequence of the principle of *pacta sunt servanda* which is incorporated in Article 26 of the *Vienna Convention on the Law of Treaties*. Thus, if the application of specific anti-abuse rules found in domestic law were to result in a tax treatment that is not in accordance with the provisions of a tax treaty, this would conflict with the provisions of that treaty and the provisions of the treaty should prevail under public international law.

77. As explained below, however, such conflicts will often be avoided and each case must be analysed based on its own circumstances.

78. First, a treaty may specifically allow the application of certain types of specific domestic anti-abuse rules. For example, Article 9 of the Convention specifically authorizes the application of domestic transfer pricing rules in the circumstances defined by that Article. Also, many

treaties include specific provisions clarifying that there is no conflict or, even if there is a conflict, allowing the application of the domestic rules. This would be the case, for example, for a treaty provision that expressly allows the application of thin capitalization rules or departure tax rules or, more generally, rules aimed at preventing the avoidance of tax found in the domestic law of one or both of the Contracting States.

79. Second, many tax treaty provisions depend on the application of domestic law. This is the case, for instance, for the determination of the residence of a person, the determination of what is immovable property and the determination of when income from corporate rights might be treated as a dividend. More generally, paragraph 2 of Article 3 makes domestic rules relevant for the purposes of determining the meaning of terms that are not defined in the treaty. In many cases, therefore, the application of domestic anti-abuse rules will impact how the treaty provisions are applied rather than produce conflicting results. For example, if a domestic law provision treats the profits realised by a shareholder when a company redeems some of its shares as dividends, such a redemption could be considered to constitute an alienation for the purposes of paragraph 8 of Article 13. However, paragraph 28 of the Commentary on Article 10 of the 2017 OECD Model, as quoted in paragraph 18 of the Commentary on Article 10 of this Model, recognises that such profits will constitute dividends for the purposes of Article 10 if the profits are treated as dividends under domestic law.

80. Third, the application of tax treaty provisions in a case that involves an abuse of these provisions may be denied under the general anti-abuse rule in paragraph 9 of Article 29 or in the case of a treaty that does not include that Article, under a proper interpretation of the treaty in accordance with the principles in paragraphs 96 to 98 below. In such a case, there will be no conflict with the treaty provisions if the benefits of the treaty are denied under both the interpretation of the treaty and the application of domestic specific anti-abuse rules. Domestic specific anti-abuse rules, however, are often drafted by reference to objective facts, such as the existence of a certain level of shareholding or a certain debt-equity ratio. While this greatly facilitates their application and provides greater certainty, it may sometimes result in the application of these rules to transactions that do not constitute abuses. In such cases, the Convention will not allow the application of the domestic

rule to the extent of the conflict. For example, assume that State A has adopted a domestic rule to prevent temporary changes of residence for tax purposes under which an individual who is a resident of State B is taxable in State A on gains from the alienation of property situated in a third State if that individual was a resident of State A when the property was acquired and was a resident of State A for at least seven of the 10 years preceding the alienation. In such a case, to the extent that paragraph 8 of Article 13 would prevent the taxation of that individual by State A upon the alienation of the property, the Convention would prevent the application of State A's domestic rule unless the benefits of paragraph 8 of Article 13 could be denied, in that specific case, under paragraph 9 of Article 29 or the principles in paragraphs 96 to 98 below.

81. Fourth, the application of tax treaty provisions may be denied under judicial doctrines or principles applicable to the interpretation of the treaty (see paragraphs 85 to 89 and 96 to 98 below). In such a case, there will be no conflict with the treaty provisions if the benefits of the treaty are denied under both a proper interpretation of the treaty and as result of the application of domestic specific anti-abuse rules. Assume, for example, that the domestic law of State A provides for the taxation of gains derived from the alienation of shares issued by a domestic company in which the alienator holds more than 25 per cent of the capital if that alienator was a resident of State A for at least seven of the 10 years preceding the alienation. In year 2, an individual who was a resident of State A for the previous 10 years becomes a resident of State B. Shortly after becoming a resident of State B, the individual sells all the shares of a small company that he previously established in State A. The facts reveal, however, that all the elements of the sale were finalised in year 1, that an interest-free "loan" corresponding to the sale price was made by the purchaser to the seller at that time, that the purchaser cancelled the loan when the shares were sold to the purchaser in year 2 and that the purchaser exercised de facto control of the company from year 1. Although the gain from the sale of the shares might otherwise fall under paragraph 8 of Article 13 of the State A – State B treaty (assuming that the provisions of the treaty corresponding to paragraph 5 of Article 13 of this Model are not applicable), the circumstances of the transfer of the shares are such that the alienation in year 2 constitutes a sham within the meaning given to that term by the courts of State A. In that case, to the extent that the sham transaction doctrine developed by the courts

of State A does not conflict with the rules of interpretation of treaties, it would be possible to apply that doctrine when interpreting paragraph 8 of Article 13 of the State A – State B treaty, which would allow State A to tax the relevant gain under its domestic law rule.

82. A similar analysis applies in the case of controlled foreign company (CFC) rules. A significant number of countries have adopted CFC provisions to address issues related to the use of foreign base companies. Whilst the design of this type of legislation varies considerably among countries, a common feature of these rules, which are now internationally recognised as a legitimate instrument to protect the domestic tax base, is that they result in a Contracting State taxing its residents on income attributable to their participation in certain foreign entities. It has sometimes been argued, based on a certain interpretation of provisions of the Convention such as paragraph 1 of Article 7 and paragraph 5 of Article 10, that this common feature of CFC legislation conflicted with these provisions. Since CFC legislation results in a State taxing its own residents, the saving clause in paragraph 4 of Article 1 of the UN Model confirms that CFC legislation does not conflict with tax conventions. The same conclusion must be reached in the case of conventions that do not include a provision similar to paragraph 4 of Article 1. For the reasons explained in paragraph 13 of the Commentary on Article 7 of the 2008 OECD Model, as quoted in paragraph 15 of the Commentary on Article 7 of this Model, as well as in paragraph 37 of the Commentary on Article 10 of the 2017 OECD Model, the interpretation according to which these Articles would prevent the application of CFC provisions does not accord with the text of paragraph 1 of Article 7 and paragraph 5 of Article 10. It is also not valid when these provisions are read in their context. Thus, whilst some countries have felt it useful to expressly clarify, in their conventions, that their CFC legislation did not conflict with the Convention, such clarification is not necessary. It is recognised that CFC legislation structured in this way is not contrary to the provisions of the Convention.

General legislative anti-abuse rules found in domestic law

83. Many countries have included in their domestic law a legislative anti-abuse rule of general application, which is intended to prevent abusive arrangements that are not adequately dealt with through specific anti-abuse rules or judicial doctrines.

84. The application of such general anti-abuse rules also raises the question of a possible conflict with the provisions of a tax treaty. In the vast majority of cases, however, no such conflict will arise. Conflicts will first be avoided for reasons similar to those presented in paragraphs 78 and 79 above. In addition, where the main aspects of these domestic general anti-abuse rules are in conformity with the guiding principle in paragraph 64 above and are therefore similar to the main aspects of paragraph 9 of Article 29, which incorporates this guiding principle, it is clear that no conflict will be possible since the relevant domestic general anti-abuse rule will apply in the same circumstances in which the benefits of the Convention would be denied under paragraph 9 of Article 29 or, in the case of a treaty that does not include that Article, under the guiding principle in paragraph 64 above. This is the same general conclusion of the OECD, which is reflected in paragraph 77 of the Commentary on Article 1 of the 2017 OECD Model.

Judicial doctrines and principles of interpretation that are part of domestic law

85. In the process of determining how domestic tax law applies to tax avoidance transactions, the courts of many countries have developed different judicial doctrines or principles of interpretation that may have the effect of preventing domestic law abuses. These include the sham, business purpose, substance over form, economic substance, step transaction, abuse of law and *fraus legis* approaches. These judicial doctrines and principles of interpretation vary from country to country and evolve over time based on refinements or changes resulting from subsequent court decisions.

86. These doctrines are essentially views expressed by courts as to how tax legislation should be interpreted and typically become part of the domestic tax law.

87. While the interpretation of tax treaties is governed by general rules that have been codified in Articles 31 to 33 of the *Vienna Convention on the Law of Treaties*, nothing prevents the application of similar judicial approaches to the interpretation of the particular provisions of tax treaties. If, for example, the courts of one country have determined that, as a matter of legal interpretation, domestic tax provisions should apply on the basis of the economic substance of certain transactions, there is

nothing that prevents a similar approach to be adopted with respect to the application of the provisions of a tax treaty to similar transactions. This is illustrated by the example in paragraph 81 above.

88. As a general rule and having regard to paragraph 64, therefore, the preceding analysis leads to the conclusion that there will be no conflict between tax conventions and judicial anti-abuse doctrines or general domestic anti-abuse rules. For example, to the extent that the application of a general domestic anti-abuse rule or a judicial doctrine such as "substance over form" or "economic substance" results in a recharacterization of income or in a redetermination of the taxpayer who is considered to derive such income, the provisions of the Convention will be applied taking into account these changes.

89. Whilst these rules do not conflict with tax conventions, there is agreement that member countries should carefully observe the specific obligations enshrined in tax treaties to relieve double taxation as long as there is no clear evidence that the treaties are being abused.

Specific anti-abuse rules found in tax treaties

90. Some forms of treaty abuse can be addressed through specific treaty provisions. A number of such rules are already included in the UN Model; these include, in particular, the reference to an agent who maintains a stock of goods for delivery purposes (paragraph 5(*b*) of Article 5), the concept of "beneficial owner" (in Articles 8 (Alternative A), 10, 11, 12, 12AA, 12B and 12C), the "special relationship" rule applicable to interest, royalties, fees for services, income from automated digital services and insurance premiums (paragraph 6 of Article 11, paragraph 6 of Article 12, paragraph 7 of Article 12AA, paragraph 11 of Article 12B and paragraph 7 of Article 12C), the rule on alienation of shares of immovable property companies (paragraph 4 of Article 13) and the rule on "star-companies" (paragraph 2 of Article 17). Another example is the modified version of the limited force-of-attraction rule of paragraph 1 of Article 7 that is found in some tax treaties and that applies only to avoidance cases.

91. Clearly, such specific treaty anti-abuse rules provide more certainty to taxpayers than broad general anti-abuse rules or doctrines. This is acknowledged in paragraph 69 above and in paragraph 62 of

the Commentary on Article 1 of the 2017 OECD Commentary on Article 1, which explains that such rules can usefully supplement general anti-avoidance rules or judicial approaches.

92. One should not, however, underestimate the risks of relying extensively on specific treaty anti-abuse rules to deal with tax treaty avoidance strategies. First, specific anti-abuse rules are often drafted once a particular avoidance strategy has been identified. Second, the inclusion of a specific anti-abuse provision in a treaty can weaken the case as regards the application of general anti-abuse rules or doctrines to other forms of treaty abuses. Adding specific anti-abuse rules to a tax treaty could be wrongly interpreted as suggesting that an unacceptable avoidance strategy that is similar to, but slightly different from, one dealt with by a specific anti-abuse rule included in the treaty is allowed and cannot be challenged under general anti-abuse rules. Third, in order to specifically address complex avoidance strategies, complex rules may be required. This is especially the case where these rules seek to address the issue through the application of criteria that leave little room for interpretation rather than through more flexible criteria such as the purposes of a transaction or arrangement. For these reasons, whilst the inclusion of specific anti-abuse rules in tax treaties is the most appropriate approach to deal with certain situations, it cannot, by itself, provide a comprehensive solution to treaty abuses.

General anti-abuse rules found in tax treaties

93. In the 2017 update of this Model, a general anti-abuse rule was added to the Convention as paragraph 9 of Article 29. That paragraph 9 is intended to prevent the improper use of tax treaties by denying the benefits of a treaty where a main purpose of a transaction or arrangement is to obtain those benefits and granting those benefits would be contrary to the object and purpose of the relevant provisions of the treaty.

94. As explained in paragraph 64 above, paragraph 9 of Article 29 is consistent with, and confirms, the guiding principle for granting treaty benefits. Thus, many countries are able to deny treaty benefits in abusive cases without the need for a general anti-abuse rule, such as paragraph 9 of Article 29, in their treaties. For this purpose, these countries can apply a general anti-abuse rule found in domestic law, judicial doctrines or principles of interpretation found in domestic law

or they can interpret the provisions of their tax treaties in order to deny the benefits of a treaty in abusive cases.

95. Some countries may not feel confident that their domestic law and approach to the interpretation of tax treaties would allow them to adequately address improper uses of their tax treaties. These countries could consider including a general anti-abuse rule in their treaties, such as paragraph 9 of Article 29. A country that wishes to include a general anti-abuse rule in its treaties may need to adapt the wording to its own circumstances, particularly as regards the approach that its courts have adopted with respect to tax avoidance. In particular, a country that has a general anti-abuse rule in its domestic law should avoid, as far as possible, any inconsistency between that domestic rule and the general anti-abuse rule included in its treaties.

The interpretation of tax treaty provisions

96. Another approach that has been used to counter improper uses of treaties has been to consider that there can be abuses of the treaty itself and to disregard abusive transactions under a proper interpretation of the relevant treaty provisions that takes account of their context, the object and purpose of the treaty as well as the obligation to interpret these provisions in good faith in accordance with Article 31 of the *Vienna Convention on the Law of Treaties*. As noted in paragraph 62 above, a number of countries have long used a process of legal interpretation to counteract abuses of their domestic tax laws and it seems entirely appropriate to similarly interpret tax treaty provisions to counteract tax treaty abuses. The guiding principle in paragraph 64 above is equally applicable for the purpose of interpreting the provisions of a treaty to prevent the abuse of the treaty as it is for purposes of determining whether the provisions of a treaty prevent the application of specific or general anti-abuse rules found in domestic law.

97. Paragraphs 64 to 66 above provide guidance as to what should be considered to be a tax treaty abuse. That guidance would obviously be relevant for the purposes of the application of this approach.

98. As part of the 2017 update, the title of bilateral tax treaties based on this Model was amended to include an express reference to the prevention of tax avoidance and evasion as a purpose of such treaties.

In addition, a new preamble to the Convention was added to clarify that the Contracting States do not intend the provisions of the Convention to create opportunities for non-taxation or reduced taxation through tax avoidance or evasion including through treaty shopping. Treaty shopping is only one example of the improper use of tax treaties; other examples can be found in paragraphs 100 to 159 below. Since the title and preamble form part of the context of the UN Model, they should play an important role in the interpretation of the provisions of the Convention to prevent treaty abuse.

2. Examples of improper uses of tax treaties

99. The following paragraphs illustrate the application of the approaches described above in various cases involving the improper use of tax treaty provisions (these examples, however, are not intended to prejudge the legal treatment of these transactions in domestic law or under specific treaties).

Dual residence and transfer of residence

100. There have been cases where taxpayers have changed their tax residence primarily for the purposes of getting tax treaty benefits. The following examples illustrate some of these cases:

— *Example 1:* Mr. X is a resident of State A who has accumulated significant pension rights in that country. Under the treaty between State A and State B, pensions and other similar payments are only taxable in the State of residence of the recipient. Just before his retirement, Mr. X moves to State B for two years and becomes resident thereof under the domestic tax law of that country. Mr. X is careful to use the rules of paragraph 2 of Article 4 to ensure that he is resident of that country for the purposes of the treaty. During that period, his accrued pension rights are paid to him in the form of a lump-sum payment, which is not taxable under the domestic law of State B. Mr. X then returns to State A.

— *Example 2:* Company X, a resident of State A, is contemplating the sale of shares of companies that are also residents of State A. Such a sale would trigger a capital gain that would be taxable under the domestic law of State A. Prior to the sale, company X

arranges for meetings of its board of directors to take place in State B, a country that does not tax capital gains on shares of companies and in which the place where a company's directors meet is usually determinative of that company's residence for tax purposes. Company X claims that it has become a resident of State B for the purposes of the tax treaty between States A and B pursuant to paragraph 3 of Article 4 of that treaty, which, unlike the current version of paragraph 3 of Article 4 of the UN Model, uses the concept of place of effective management as the residence tie-breaker rule for legal entities. It then sells the shares and claims that the capital gain may not be taxed in State A pursuant to paragraph 8 of Article 13 of the treaty (paragraph 5 of that Article would not apply as Company X does not own substantial participations in the relevant companies).

— *Example 3:* Ms X, a resident of State A, owns all the shares of a company that is also a resident of State A. The value of these shares has increased significantly over the years. Both States A and B tax capital gains on shares; however, the domestic law of State B provides that residents who are not domiciled in that State are only taxed on income derived from sources outside the State to the extent that this income is effectively repatriated, or remitted, thereto. In contemplation of the sale of these shares, Ms X moves to State B for two years and becomes resident, but not domiciled, in that State. She then sells the shares and claims that the capital gain may not be taxed in State A pursuant to paragraph 8 of Article 13 of the treaty (the relevant treaty does not include a provision similar to paragraph 5 of Article 13 of the UN Model).

101. Depending on the facts of a particular case, it might be possible to argue that a change of residence that is primarily intended to access treaty benefits constitutes an abuse of a tax treaty. In cases similar to these three examples, however, it would typically be very difficult to find facts that would show that the change of residence has been done primarily to obtain treaty benefits, especially where the taxpayer has a permanent home or is present in another State for extended periods of time. Many countries have therefore found that specific rules were the best approach to deal with such cases.

102. One approach used by some of these countries has been to include in their tax treaties provisions allowing a State of which a taxpayer was previously resident to tax certain types of income, for example, capital gains on significant participations in companies or lump-sum payments of pension rights, realised during a certain period following the change of residence. An example of such a provision is found in paragraph 5 of Article 13 of the treaty signed in 2002 by the Netherlands and Poland, which reads as follows:

> The provisions of paragraph 4 shall not affect the right of each of the Contracting States to levy according to its own law a tax on gains from the alienation of shares or "jouissance" rights in a company, the capital of which is wholly or partly divided into shares and which under the laws of that State is a resident of that State, derived by an individual who is a resident of the other Contracting State and has been a resident of the first-mentioned State in the course of the last ten years preceding the alienation of the shares or "jouissance" rights.

103. Countries have also dealt with such cases through the use of so-called "departure tax" or "exit charge" provisions, under which the change of residence triggers the realisation of certain types of income, for example, capital gains and pensions. To the extent that the liability to such a tax arises when a person is still a resident of the State that applies the tax and does not extend to income accruing after the cessation of residence, nothing in the Convention, and in particular in Articles 13 and 18, prevents the application of that form of taxation. Thus, tax treaties do not prevent the application of domestic tax rules according to which a person is considered to have realised pension income, or to have alienated property for capital gain tax purposes, immediately before ceasing to be a resident.

104. A proper interpretation of the provisions of paragraphs 2 and 3 of Article 4 may also be useful in dealing with cases similar to these examples. Concepts such as "centre of vital interests" and "place of effective management", which was the residence tie-breaker rule for legal entities in paragraph 3 of Article 4 of the UN Model before that rule was changed in 2017, require a strong relationship between a taxpayer and a country. The fact that a taxpayer has a home available to him in a country where he sojourns frequently is not enough to claim that that country is his centre of vital interests; likewise, the mere fact that meetings of a

board of directors of a company take place in a country is not sufficient to conclude that this is where the company is effectively managed. However, because many cases with respect to the dual residence of legal entities involve abusive arrangements, the 2017 update replaced paragraph 3 of Article 4, which deals with cases of dual residence of legal persons, by a rule that leaves such cases of dual residence to be decided case by case under the mutual agreement procedure.

105. Example 3 raises the potential for tax avoidance arising from remittance-based taxation. This issue is dealt with in paragraph 108 of the Commentary on Article 1 of the 2017 OECD Model which is quoted in paragraph 161 below.

Treaty shopping

106. "Treaty shopping" is a form of improper use of tax treaties that refers to arrangements through which persons who are not entitled to the benefits of a tax treaty use other persons who are entitled to such benefits in order to indirectly access these benefits. For example, a company that is a resident of a treaty country would act as a conduit for channelling income that would economically accrue to a person that is not a resident of that country so as to improperly access the benefits provided by a tax treaty. The conduit entity is usually a company, but may also be a partnership, trust or similar entity that is entitled to treaty benefits. Granting treaty benefits in these circumstances would be detrimental to the State of source since the benefits of the treaty would be extended to persons who were not intended to obtain such benefits.

107. A treaty shopping arrangement may take the form of a "direct conduit" or that of a "stepping stone conduit", as illustrated below.[25]

108. Company X, a resident of State A, receives dividends, interest or royalties from Company Y, a resident of State B. Company X claims that, under the tax treaty between States A and B, it is entitled to full

25 See OECD (1986), *Double Taxation Conventions and the use of Conduit Companies*, reproduced at page R(6)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833, accessed on 10 May 2021, at paragraph 4, page R(6)-4.

or partial exemption from the domestic withholding taxes provided for under the tax legislation of State B. Company X is wholly-owned by a resident of third State C who is not entitled to the benefits of the treaty between States A and B. Company X was created for the purpose of obtaining the benefits of the treaty between States A and B and it is for that purpose that the assets and rights giving rise to the dividends, interest or royalties have been transferred to it. The income is exempt from tax in State A, for example, in the case of dividends, by virtue of a participation exemption provided for under the domestic laws of State A or under the treaty between States A and B. In that case, Company X constitutes a direct conduit of its shareholder who is a resident of State C.

109. The basic structure of a stepping stone conduit is similar. In that case, however, the income of Company X is fully taxable in State A and, in order to eliminate the tax that would be payable in that country, Company X pays high interest, commissions, service fees or similar deductible expenses to a second related conduit company, Company Z, a resident of State D. These payments, which are deductible in State A, are tax-exempt in State D by virtue of a special tax regime available in that State.[26] The shareholder who is a resident of State C is therefore seeking to access the benefits of the tax treaty between States A and B by using Company X as a stepping stone.

110. In order to deal with such situations, tax authorities have relied on the various approaches described in the previous sections.

111. For instance, specific anti-abuse rules have been included in the domestic law of some countries to deal with such arrangements. One example is that of the United States regulations dealing with financing arrangements. For the purposes of these regulations, a financing arrangement is a series of transactions by which the financing entity advances money or other property to the financed entity, provided that the money or other property flows through one or more intermediary entities. An intermediary entity will be considered a "conduit", and its participation in the financing arrangements will be disregarded by the tax authorities if (i) tax is reduced due to the existence of an intermediary, (ii) there is a tax avoidance plan, and (iii) it is established that the intermediary would not have participated in the transaction but

26 Ibid.

for the fact that the intermediary is a related party of the financing entity. In such cases, the related income shall be recharacterized according to its substance.

112. Other countries have dealt with the issue of treaty shopping through the interpretation of tax treaty provisions. According to a 1962 decree of the Swiss Federal Council, which is applicable to Swiss treaties with countries that, under the relevant treaties, grant relief from withholding tax that would otherwise be collected by these countries, a claim for such relief is considered abusive if, through such claim, a substantial part of the tax relief would benefit persons not entitled to the relevant tax treaty. The granting of tax relief shall be deemed improper (a) if the requirements specified in the tax treaty (such as residence, beneficial ownership, tax liability, etc.) are not fulfilled and (b) if it constitutes an abuse. The measures which the Swiss tax authorities may take if they determine that a tax relief has been claimed improperly include (a) refusal to certify a claim form, (b) refusal to transmit the claim form, (c) revoking a certification already given, (d) recovering the withholding tax, on behalf of the State of source, to the extent that the tax relief has been claimed improperly, and (e) informing the tax authorities of the State of source that a tax relief has been claimed improperly.

113. Other countries have relied on their domestic legislative general anti-abuse rules or judicial doctrines to address treaty shopping cases. As already noted, however, legislative general anti-abuse rules and judicial doctrines tend to be most effective when it is clear that transactions are intended to circumvent the object and purpose of tax treaty provisions.

114. Treaty shopping can also, to some extent, be addressed through anti-abuse rules already found in most tax treaties, such as the concept of "beneficial owner".

115. Some countries, however, consider that the most effective approach to deal with treaty shopping is to include in their tax treaties specific anti-abuse rules dealing with that issue, such as the rules in paragraphs 1 to 7 of Article 29, or the general anti-abuse rule of paragraph 9 of Article 29. These rules were added to the UN Model in 2017.

116. When considering the various approaches for dealing with treaty shopping, countries should take account of their ability to administer those approaches. For many developing countries, it may be difficult to

apply very detailed rules that require access to substantial information about foreign entities. These countries might consider that a more limited approach which has the effect of denying the benefits of the Convention where transactions have been entered into for a main purpose of obtaining those benefits, might be more adapted to their own circumstances. This corresponds to the general anti-abuse rule of paragraph 9 of Article 29.

117. Where, however, it is decided to not include the provisions of paragraph 9 of Article 29 in a bilateral treaty, a more limited approach which has the effect of denying the benefits of specific Articles of the Convention where transactions have been entered into for a main purpose of obtaining those benefits, might be more adapted. The main Articles concerned would be 10, 11, 12, 12AA, 12B, 12C and 21; the provision should be slightly modified as indicated below to deal with the specific type of income covered by each of these Articles:

> *In the case of Articles 10, 11, 12, 12C and 21:*
>
> The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the [Article 10: "shares or other rights"; Article 11: "debt claim"; Articles 12 and 21: "rights"; Article 12C: "contract (policy)"] in respect of which the [Article 10: "dividend"; Article 11: "interest"; Articles 12 "royalties" and Article 21: "income"; Article 12C: "insurance premium"] is paid to take advantage of this Article by means of that creation or assignment.
>
> *In the case of Articles 8, 12AA and 12B:*
>
> The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the performance of services, in respect of which the [Article 8: "income from the operation of ships and aircraft in international traffic arises"; Article 12AA: "fees for services are paid" and Article 12B: "payments underlying income from automated digital services are made"], to take advantage of this Article by means of such performance of services.

118. In the 2017 update, a new preamble was added to the Convention, which expressly states that the Convention is not intended to create

opportunities for tax avoidance including through treaty-shopping arrangements. In addition, the title of the Convention was amended to provide that the purposes of the Convention include the prevention of tax avoidance and evasion. These changes should play an important role in ensuring that the provisions of the Convention are interpreted and applied to prevent abusive treaty shopping arrangements.

Triangular cases

119. With respect to tax treaties, the phrase "triangular cases" refers to the application of tax treaties in situations where three States are involved. A typical triangular case that may constitute an improper use of a tax treaty is one in which:

— dividends, interest, royalties, fees for services, income from automated digital services or insurance premiums are derived from State S by a resident of State R, which is an exemption country;

— that income is attributable to a permanent establishment established in State P, a low tax jurisdiction where that income will not be taxed.[27]

120. Under the State R–State S tax treaty, State S has to apply the benefits of the treaty to such income because it is derived by a resident of State R, even though the income is not taxed in that State by reason of the exemption system applied by that State.

121. In the 2017 update, paragraph 8 of Article 29 was added to the Convention to deal with such triangular cases. Under that provision, the benefits of the Convention are denied if the tax imposed on the income by the State in which the permanent establishment is located is less than 60 per cent of the tax that would have been imposed by the residence State if the income had been derived by a resident of that State and was not attributable to a permanent establishment in a third State (see paragraphs 161 to 168 of the Commentary on Article 29 of

27 See OECD (1992), *Triangular Cases*, reproduced at page R(11)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1957, accessed on 10 May 2021.

the 2017 OECD Model, as quoted in paragraph 33 of the Commentary on Article 29 of this Model).

122. If similar provisions are not systematically included in the treaties that have been concluded by the State of source of such dividends, interest, royalties, fees for services, income from automated digital services or insurance premiums with countries that have an exemption system, there is a risk that the relevant assets will be transferred to, or the relevant services will be provided by, associated enterprises that are residents of countries that do not have that type of provision in their treaty with the State of source.

Attributing profits or income to a specific person or entity

123. A taxpayer may enter into transactions or arrangements in order that income that would normally accrue to that taxpayer accrues to a related person or entity so as to obtain treaty benefits that would not otherwise be available. Some of the ways in which this may be done (e.g. treaty shopping and the use of permanent establishments in low-tax countries) have already been discussed. The following discusses other income shifting scenarios.

i) Non arm's length transfer prices

124. It has long been recognized that profits can be shifted between associated enterprises through the use of non arm's length prices and the tax legislation of most countries now includes transfer pricing rules that address such cases. These rules are specifically authorized by Article 9 of the UN Model and of the OECD Model. This, however, is a complex area, as shown by the extensive guidance produced by the OECD[28] and the Committee[29] as to how these rules should operate.

28 OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris, https://doi.org/10.1787/tpg-2017-en, accessed on 10 May 2021.

29 United Nations, *Practical Manual on Transfer Pricing for Developing Countries (2021)*, United Nations, New York, 2021, available at https://financing.desa.un.org/sites/default/files/2026-08/2021%20UN%20TP%20Manual%20%282nd%20Ed%29%201.pdf, accessed on 10 May 2021.

ii) Thin capitalization

125. In almost all countries, interest is a deductible expense whereas dividends, being a distribution of profits, are not deductible. A foreign company that wants to provide financing to a wholly-owned subsidiary may therefore find it beneficial, for tax purposes, to provide that financing through debt rather than share capital, depending on the overall tax on the interest paid. A subsidiary may therefore have almost all of its financing provided in the form of debt rather than share capital, a practice known as "thin capitalization," or it may claim excessive interest deductions relative to its earnings, a practice known as "earnings stripping."

126. According to the OECD report *Thin Capitalisation*,[30] countries have developed different approaches to deal with this issue. These approaches may be broadly divided between those that are based on the application of general anti-abuse rules or the arm's length principle and those that involve the use of fixed debt-equity or interest-earnings ratios.

127. The former category refers to rules that require an examination of the facts and circumstances of each case in order to determine whether the real nature of the financing is that of debt or equity. This may be implemented through specific legislative rules, general anti-abuse rules, judicial doctrines or the application of transfer pricing legislation based on the arm's length principle.

128. The fixed ratio approach is typically implemented through specific legislative anti-abuse rules; under this approach, if the total debt/equity or interest/earnings ratio of a particular company exceeds a predetermined ratio, the interest on the excessive debt or the interest in excess of the specified percentage of earnings may be disallowed, deferred or treated as a dividend.

129. To the extent that a country's thin capitalization or earnings stripping rule applies to payments of interest to non-residents but not to similar payments that would be made to residents, it could be in

30 See OECD (1986), *Thin Capitalisation*, reproduced at page R(4)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1763, accessed on 10 May 2021.

violation of paragraph 4 of Article 24, which provides that "interest, royalties, fees for services, payments underlying income from automated digital services, insurance premiums and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State". There is a specific exception to that rule, however, where paragraph 1 of Article 9, which deals with transfer pricing adjustments, applies. For that reason, as indicated in paragraph 74 of the Commentary on Article 24 of the 2017 OECD Model, quoted in paragraph 2 of the Commentary on Article 24 of this Model:

> 74. Paragraph 4 does not prohibit the country of the borrower from applying its domestic rules on thin capitalisation insofar as these are compatible with paragraph 1 of Article 9 or paragraph 6 of Article 11. However, if such treatment results from rules which are not compatible with the said Articles and which only apply to non-resident creditors (to the exclusion of resident creditors), then such treatment is prohibited by paragraph 4.

130. Paragraph 3 of the Commentary on Article 9 of the 2017 OECD Model, quoted in paragraph 6 of the Commentary on Article 9 of this Model, clarifies that paragraph 1 of Article 9 allows the application of domestic rules on thin capitalization insofar as their effect is to assimilate the profits of the borrower to an amount corresponding to the profits which would have accrued in an arm's length situation. While this would typically be the case of thin capitalization rules that are based on the arm's length principle, a country that has adopted thin capitalization rules based on a fixed ratio approach would, however, typically find it difficult to establish that its thin capitalization rules, which do not refer to what independent parties would have done, satisfy that requirement.

131. For that reason, countries that have adopted thin capitalization or earnings stripping rules based on a fixed ratio approach often consider that they need to include in their treaties provisions that expressly allow the application of these rules. For example, Article 13 of the Protocol to the treaty between France and Estonia provides as follows:

> The provisions of the Convention shall in no case restrict France from applying the provisions of Article 212 of its tax code

(code général des impôts) relating to thin capitalization or any substantially similar provisions which may amend or replace the provisions of that Article.

iii) The use of base companies

132. Base companies situated in low-tax jurisdictions may be used for the purposes of diverting income to a country where that income will be subjected to taxes that are substantially lower than those that would have been payable if the income had been derived directly by the shareholders of that company.

133. Various approaches have been used to deal with such arrangements. For example, a company that is a mere shell with no employees and no substantial economic activity could, in some countries, be disregarded for tax purposes pursuant to general anti-abuse rules or judicial doctrines. It could also be possible to consider that a base company that is effectively managed by shareholders who are residents of another State has its residence or a permanent establishment in that State. The first approach is described in paragraphs 83 to 89 above. The second approach is described in paragraphs 71 and 72 above.

134. These approaches, however, might not be successful in dealing with arrangements involving companies that have substantial management and economic activities in the countries where they have been established. One of the most effective approaches to dealing with such cases is the inclusion, in domestic legislation, of controlled foreign company (CFC) legislation. While the view has sometimes been expressed that such legislation could violate certain provisions of tax treaties, the Committee considers that this would not be the case of typical CFC rules, as indicated in paragraph 82 above.

iv) Directors' fees and remuneration of top-level managers

135. According to Article 16 (Directors' fees and remuneration of top-level managerial officials), directors' fees and the remuneration of officials in a top-level managerial position of a company may be taxed in the State of residence of the company regardless of where the services of these directors and top-level managers are performed. A "salary split" arrangement could be used in order to reduce the taxes that would be

payable in that State pursuant to that Article. Assume, for example, that Company A, a resident of State A, has two subsidiaries, Company B and Company C, which are residents of State X and State Y respectively. Mr. D, a resident of State X, is a director and an official in a top-level managerial position of Company B. State X levies an income tax at progressive rates of up to 50 per cent. State Y has a similar income tax system but with a very low tax rate. Countries X and Y have a tax treaty which provides that State X applies the exemption method to income that may be taxed in State Y. For the purpose of reducing the tax burden of Mr. D, Company A may appoint him as a director and an official in a top-level managerial position of Company C and arrange for most of his remuneration to be attributed to these functions.

136. Paragraph 1 of Article 16 applies to directors' fees that a person receives "in his capacity" as a director of a company and paragraph 2 applies to salaries, wages and other similar remuneration that a person receives "in his capacity" as an official in top-level managerial position of a company. Thus, apart from the fact that such an arrangement could probably be successfully challenged under general anti-abuse rules or judicial doctrines, it could also be attacked through a proper analysis of the services rendered by Mr. D to each company from which he receives his income, as well as an analysis of the fees and remuneration paid to other directors and top-level managers of Company C, in order to determine the extent to which director's fees and remuneration received from that company by Mr. D can reasonably be considered to be derived from activities performed as a director or top-level manager of that company.

v) Attribution of interest to a tax-exempt or government entity

137. According to paragraph 12 of the Commentary on Article 11, countries may agree during bilateral negotiations to include in their treaties an exemption for interest of the following categories:[31]

— Interest paid to Governments or government agencies;

— Interest guaranteed by Governments or government agencies;

31 Many treaties additionally exempt from source taxation interest paid to financial institutions and interest on sales on credit (see paragraphs 12 and 13 of the Commentary on Article 11).

— Interest paid to central banks;
— Interest paid to banks or other financial institutions;
— Interest on long-term loans;
— Interest on loans to finance special equipment or public works; or
— Interest on other government-approved types of investments (e.g. export finance).

138. Where a tax treaty includes one or more of these provisions, it may be possible for a party that is entitled to such an exemption to engage in back-to-back arrangements with other parties that are not entitled to that exemption or, where a contract provides for the payment of interest and other types of income that would not be exempt (e.g. royalties), to attribute a greater share of the overall consideration to the payment of interest. Such arrangements would constitute improper uses of these exemptions.

139. While it could be argued that an easy solution would be to avoid including such exemptions in a tax treaty, it is important to note that these are included for valid policy purposes, taking into account that source taxation on gross payments of interest will frequently act as a tariff and be borne by the borrower. Also, as long as a country has agreed to include such exemptions in one of its treaties, it becomes difficult to refrain from granting these in treaty negotiations with other similar countries.

140. Many of the approaches referred to above in the case of treaty shopping may be relevant to deal with back-to-back arrangements aimed at accessing the benefits of these exemptions. Also, cases where the consideration provided for in a mixed contract has been improperly attributed to interest payments can be challenged using specific domestic anti-abuse rules applicable to such cases, general domestic anti-abuse rules or doctrines (including the general anti-abuse rule of paragraph 9 of Article 29) or a proper interpretation of the treaty provisions. Where the overall consideration is divided among related parties, paragraph 6 of Article 11 and paragraph 1 of Article 9 may also be relevant to ensure that the benefit of the treaty exemption only applies to the proper amount of interest. Finally, some countries have included specific anti-abuse rules in their treaties to deal with such back-to-back arrangements. An example of such a rule is found in paragraph *b*) of

Article 7 of the Protocol to the treaty signed in 2002 by Australia and Mexico, which reads as follows:

> The provisions of […] paragraph [2 of Article 11] shall not apply to interest derived from back-to-back loans. In such case, the interest shall be taxable in accordance with the domestic law of the State in which it arises.

Hiring-out of labour

141. The Commentary on Article 15 reproduces the part of the Commentary on the OECD Model that deals inter alia with arrangements known as "international hiring-out of labour". This refers to cases where a local enterprise that wishes to hire a foreign employee for a short period of time enters into an arrangement with a non-resident intermediary who will act as the formal employer. The employee thus appears to fulfil the three conditions of paragraph 2 of Article 15 so as to qualify for the tax exemption in the State where the employment will be exercised. The Commentary on Article 15 includes guidance on how this issue can be dealt with, recognizing that domestic anti-abuse rules and judicial doctrines, as well as a proper construction of the treaty, offer ways of challenging such arrangements.

Artistes and sportspersons

142. A number of older tax treaties do not include paragraph 2 of Article 17 (Artistes and sportspersons), which deals with the use of so-called "star-companies". In order to avoid the possible application of provisions based on paragraph 1 of that Article, residents of countries that have concluded such treaties may be tempted to arrange for the income derived from their activities as artistes or sportspersons, or part thereof, to be paid to a company set up for that purpose.

143. As indicated in paragraph 11*c*) of the Commentary on Article 17 of the 2010 OECD Model, as quoted in paragraph 2 of the Commentary on Article 17 of this Model, such arrangements may be dealt with under domestic law provisions that would attribute such income to the artistes or sportspersons:

> *[…]* The third situation involves certain tax avoidance devices in cases where remuneration for the performance of an artiste

> or sportsman is not paid to the artiste or sportsman himself but to another person, for example, a so-called artiste company, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the artiste or sportsman nor as profits of the enterprise, in the absence of a permanent establishment. Some countries "look through" such arrangements under their domestic law and deem the income to be derived by the artiste or sportsman; where this is so, paragraph 1 enables them to tax income resulting from activities in their territory *[...]*.

144. Abusive arrangements involving star-companies could also be dealt with under the provisions of paragraph 9 of Article 29 and, as explained in paragraph 11.2 of the Commentary on Article 17 of the 2010 OECD Model, as quoted in paragraph 2 of the Commentary on Article 17 of this Model, under a country's general anti-avoidance rules or judicial doctrines.

145. Finally, as regards the anti-abuse rule found in paragraph 2 of Article 17, tax administrations should note that the rule applies regardless of whether or not the star-company is a resident of the same country as the country in which the artiste or sportsperson is resident. This clarification appears in paragraph 11.1 of the Commentary on Article 17 of the 2010 OECD Model, as quoted in paragraph 2 of the Commentary on Article 17 of this Model:

> 11.1 The application of paragraph 2 is not restricted to situations where both the entertainer or sportsman and the other person to whom the income accrues, for example, a star-company, are residents of the same Contracting State. The paragraph allows the State in which the activities of an entertainer or sportsman are exercised to tax the income derived from these activities and accruing to another person regardless of other provisions of the Convention that may otherwise be applicable. Thus, notwithstanding the provisions of Article 7, the paragraph allows that State to tax the income derived by a star-company resident of the other Contracting State even where the entertainer or sportsman is not a resident of that other State. Conversely, where the income of an entertainer resident in one of the Contracting States accrues to a person, *for example,* a star-company, who is a resident of a third State with which the State of source does not have a tax convention, nothing will prevent the Contracting State from taxing that person in accordance with its domestic laws.

Transactions that modify the treaty classification of income

146. Articles 6 to 21 allocate taxing rights differently depending on the nature of the income. The classification of a particular item of income for the purposes of these rules is based on a combination of treaty definitions and domestic law. Since taxpayers determine the contents of the contracts on which classification for the purposes of domestic law and treaty provisions is typically based, they may, in some cases, try to influence that classification so as to obtain unintended treaty benefits.

147. The following paragraphs provide a few examples of arrangements that seek to change the treaty classification of income. Depending on the circumstances, such arrangements may be addressed through the provisions of paragraph 9 of Article 29, specific domestic or treaty anti-abuse rules or under general anti-abuse rules or judicial doctrines. A practical issue, however, will often be that, in some of these cases, it will be difficult to discover and establish the connection between various transactions that will be entered into for the purpose of altering the treaty classification.

(i) Conversion of dividends into interest

148. Converting dividends into interest will be advantageous under a treaty that provides for source taxation of dividends but not of interest payments. Assume that X, a resident of State R, owns all the shares of Company A, which is a resident of State S. In contemplation of the payment of an important dividend, X arranges for the creation of holding Company B, which will also be a resident of State S; X is the only shareholder of Company B. X then sells the shares of Company A to Company B in return for interest-bearing notes (State R and State S allow that transfer to be carried out free of tax). The payment of interest by Company B to X will be made possible by the payment of dividends by Company A to Company B, which will escape tax in State S under a participation exemption or similar regime or because of the deduction of interest payments on the notes issued to X; X will thus indirectly receive the dividend paid by Company A in the form of interest payments on the notes issued by Company B and will avoid source taxation in State S.

(ii) Allocation of price under a mixed contract

149. A mixed contract covers different considerations, such as the provision of goods, services, know-how and the licensing of intangibles. These generate different types of income for treaty purposes. In many cases, the acquirer will be indifferent to the allocation of the price between the various considerations and the provider may therefore wish, in the relevant contract, to allocate a disproportionate part of the price to items of income that will be exempt in the State of source. For instance, a franchising contract may involve the transfer of goods to be sold, the provision of various services, the provision of know-how and royalties for the use of intellectual property (e.g. trademarks and trade names). To the extent that the non-resident franchisor does not have a permanent establishment in the State of residence of the franchisee, Article 7 would not allow that State to tax the business profits attributable to the provision of inventory goods but Article 12 would allow the taxation of the royalties, which would include payments related to know-how, and Article 12AA would allow the taxation of fees for services. Since all of these payments would normally be deductible for the franchisee, it may not care about how the overall price is allocated. The contract may therefore be drafted so as to increase the price for the provision of the goods and reduce the royalties and the price for the provision of services.

150. Since the parties to the contract are independent, domestic transfer pricing legislation and Article 9 of the Convention would typically not apply to such transactions. Developing countries may be particularly vulnerable to such transactions since custom duties, which would typically have made it less attractive to allocate the price to the transfer of goods, are gradually being reduced and the determination of the proper consideration for intangible property is often a difficult matter, even for sophisticated tax administrations.

(iii) Conversion of royalties into capital gains

151. A non-resident who owns the copyrights in a literary work wishes to grant to a resident of State S the right to translate and reproduce that work in that State in consideration for royalty payments based on the sales of the translated work. Instead of granting a license to the resident, the non-resident enters into a "sale" agreement whereby all rights related to the translated version of that work in State S are disposed of by the

non-resident and acquired by the resident. The consideration for that "sale" is a percentage of the total sales of the translated work. The contract further provides that the non-resident will have the option to reacquire these rights after a period of five years.

152. Some countries have modified the definition of royalties to expressly address such cases. For example, subparagraph *a*) of paragraph 3 of Article 12 of the treaty between the United States and India provides that

> The term "royalties" as used in this Article means:
>
> *a)* payments of any kind received as a consideration for the use of, or the right to use, any copyright *[…]* including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof *[…]*.

(iv) Use of derivative transactions

153. Derivative transactions can allow taxpayers to obtain the economic effects of certain financial transactions under a different legal form. For instance, depending on the treaty provisions and domestic law of each country, a taxpayer may obtain treaty benefits such as no or reduced source taxation when it is in fact in the same economic position as a foreign investor in shares of a local company. Assume, for instance, that Company X, a resident of State A, wants to make a large portfolio investment in the shares of a company resident in State B, while Company Y, a resident in State B, wants to acquire bonds issued by the government of State A. In order to avoid the cross-border payments of dividends and interest, which would attract withholding taxes, Company X may instead acquire the bonds issued in its country and Company Y may acquire the shares of the company resident in its country that Company X wanted to acquire. Companies X and Y would then enter into a swap arrangement under which they would agree to make swap payments to each other based on the difference between the dividends and interest flows that they receive each year; they would also enter into futures contracts to buy from each other the shares and bonds at some future time. Through these transactions, the taxpayers would have mirrored the economic position of cross-border investments in the shares and bonds without incurring the liability to source withholding

taxes (except to the extent that the swap payments, which would only represent the difference between the flows of dividends and interest, would be subject to such taxes under Article 21 and the domestic law of each country).

Transactions that seek to circumvent thresholds found in treaty provisions

154. Tax treaty provisions sometimes use thresholds to determine a country's taxing rights. One example is that of the lower limit of source tax on dividends found in paragraph 2(*a*) of Article 10, which only applies if the beneficial owner of the dividends is a company which holds directly at least 25 per cent of the capital of the company paying the dividends.

155. Taxpayers may enter into arrangements in order to obtain the benefits of such provisions in unintended circumstances. For instance, a non-resident shareholder could, in contemplation of the payment of a dividend, arrange for shares to be temporarily transferred to a resident company or non-resident company in the hands of which the dividends would be exempt or taxed at a lower rate. Such a transfer could be structured in such a way that the value of the expected dividend would be transformed into a capital gain exempt from tax in the source State. Although paragraph 2 of Article 10 was amended in 2017 to add a 365-day holding period requirement, as long as the company to which the shares are transferred owns more than 25 per cent of the company paying the dividends for 365 days or more, the benefit of the lower rate in paragraph 2(*a*) of Article 10 would apply. Paragraph 9 of Article 29 could be used to deal with such arrangements where one of the principal purposes for the temporary transfer of the ownership of shares is to access treaty benefits. The following are other examples of arrangements intended to circumvent various thresholds found in the Convention.

Time limit for certain permanent establishments

156. The following are other examples of arrangements intended to circumvent various thresholds found in the Convention. Paragraph 3 of Article 5 includes a rule according to which, in certain circumstances, the furnishing of services by a foreign enterprise in a State for more than 183 days will constitute a permanent establishment. Taxpayers

may be tempted to circumvent the application of that provision by splitting a single project between associated enterprises so that none of the enterprises furnishes services in the State for more than 183 days. Paragraphs 26[32] and 27 of the Commentary on Article 5 deal with such arrangements.

Thresholds for the source taxation of capital gains on shares

157. Paragraph 4 of Article 13 allows a State to tax capital gains on shares of a company (and on interests in certain other entities) if the shares or interests derive more than 50 per cent of their value, directly or indirectly, from immovable property situated in that State at any time in the 365 days preceding the alienation of the shares. This 365-day period for testing whether more than 50 per cent of the value of the shares or interests are derived from immovable property was added to paragraph 4 of Article 13 of the UN Model in 2017.

158. Before the addition of the 365-day testing period to paragraph 4 of Article 13, one could attempt to circumvent that provision by diluting the percentage of the value of the shares or interests that derives from immovable property situated in a given State in contemplation of the alienation of these shares or interests. In the case of a company, that could be done by injecting a substantial amount of cash in the company in exchange for bonds or preferred shares the conditions of which would provide that such bonds or shares would be redeemed shortly after the alienation of the shares or interests.

159. If a treaty does not contain a testing period such as the 365-day period that is found in paragraph 4 of Article 13 of the UN Model and the facts establish that assets have been transferred to an entity for the purpose of avoiding the application of paragraph 4 of Article 13 to a prospective alienation of shares or interests in that entity, the provisions of paragraph 9 of Article 29 or a country's general anti-abuse rules or judicial doctrines may well be applicable. Some countries, however, may wish to provide expressly in their treaties that paragraph 4 will apply in these circumstances. This could be done by adding to Article 13 a provision along the following lines:

32 See in particular paragraph 52 of the Commentary on Article 5 of the 2017 OECD Model quoted in that paragraph.

> For the purposes of paragraph 4, in determining the aggregate value of all assets owned by a company, partnership, trust or estate, the assets that have been transferred to that entity primarily to avoid the application of the paragraph shall not be taken into account.

Restricting treaty benefits with respect to income that is subject to certain features of another State's tax system

160. As indicated in paragraph 15.2 of the Introduction of the 2017 OECD Model, as quoted in paragraph 20 of the Introduction of this Model:

> … it is assumed that where a State accepts treaty provisions that restrict its right to tax elements of income, it generally does so on the understanding that these elements of income are taxable in the other State. Where a State levies no or low income taxes, other States should consider whether there are risks of double taxation that would justify, by themselves, a tax treaty. States should also consider whether there are elements of another State's tax system that could increase the risk of non-taxation, which may include tax advantages that are ring-fenced from the domestic economy.

161. Accordingly, the Committee considers that the following part of the Commentary on Article 1 of the 2017 OECD Model is also relevant for the purposes of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 83. A State may conclude that certain features of the tax system of another State are not sufficient to prevent the conclusion of a tax treaty but may want to prevent the application of that treaty to income that is subject to no or low tax because of these features. Where the relevant features of the tax system of the other State are known at the time the treaty is being negotiated, it is possible to draft provisions that specifically deny treaty benefits with respect to income that benefits from these features (see, for example, paragraph 108 *[of the Commentary on Article 1 of the 2017 OECD Model quoted below]*).
>
> 84. Such features might, however, be introduced in the tax system of a treaty partner only after the conclusion of a tax treaty or might be

discovered only after the treaty has entered into force. When concluding a tax treaty, a Contracting State may therefore be concerned about features of the tax system of a treaty partner of which it is not aware at that time or that may subsequently become part of the tax system of that treaty partner. Controlled foreign company provisions (see paragraph *57* above) and other approaches discussed in the *[…]* section on "Improper use of the Convention" *[of the Commentary on Article 1 of this Model]* may assist in dealing with some of these features but since the difficulties created by these features arise from the design of the tax laws of treaty partners rather than from tax avoidance strategies designed by taxpayers or their advisers, Contracting States may wish to address these difficulties though specific treaty provisions. The following include examples of provisions that might be adopted for that purpose.

Provision on special tax regimes

85. Provisions could be included in a tax treaty in order to deny the application of specific treaty provisions with respect to income benefiting from regimes that satisfy the criteria of a general definition of "special tax regimes". For instance, the benefits of the provisions of Articles 11*[,]* 12*[, 12AA, 12B and 12C]* could be denied with respect to interest, royalties*[, fees for services, income from automated digital services and insurance premiums]* that would be derived from a connected person if such interest and royalties*[, fees for services, income from automated digital services or insurance premiums, as the case may be]* benefited, in the State of residence of their beneficial owner, from such a special tax regime; this would be done by adding to Articles 11*[,]* 12*[, 12AA, 12B and 12C]* a provision drafted along the following lines (which could be amended to fit the circumstances of the Contracting States or for inclusion in other Articles of the Convention):

> Notwithstanding the provisions of [(in the case of Article 11): paragraphs 1 and 2 but subject to the provisions of paragraph 4] [(in the case of Article 12): paragraph*[s]* 1 *[and 2]* but subject to the provisions of paragraph *[4]*] *[(in the case of Article 12AA): paragraphs 1 and 2 but subject to the provisions of paragraph 4] [in the case of Article 12B: paragraphs 1, 2 and 3 but subject to paragraph 8][in the case of Article 12C, paragraphs 1 and 2 but subject to the provisions of paragraph 4]* of this Article, [interest] [royalties] *[fees for services] [income from automated digital services] [insurance premiums]* arising in a Contracting State and beneficially owned by a resident of the other Contracting State

> that is connected to the payer may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident benefits from a special tax regime with respect to the [interest] [royalties] *[fees for services] [income from automated digital services] [insurance premiums]* in the State of which it is resident.

For the purposes of the above provision, the reference to a resident that is "connected" to the payer should be interpreted in accordance with the definition of "connected person" which is found in *[…]* paragraph 7*[d)]* of Article 29 *[of this Model]*. As indicated in paragraph 127 of *[the Commentary on Article 29 of the 2017 OECD Model, as quoted in paragraph 26 of the Commentary on Article 29 of this Model]*, *[…I]*t would seem appropriate to include that definition in paragraph 1 of Article 3, which includes the definitions that apply throughout the Convention. Some States, however, may prefer to replace the reference to a resident that is "connected" to the payer by a reference to a resident that is "closely related" to the payer, the main difference being that, unlike the definition of "connected" person, the definition of "closely related" person found in paragraph 8 of Article 5 does not apply where a person possesses directly or indirectly exactly 50 per cent of the aggregate vote and value of another person (if the definition of "closely related" person is used for the purposes of the above provision, that definition would be more appropriately included in paragraph 1 of Article 3).

86. Also, the above provision would require a definition of "special tax regime", which could be drafted as follows and added to the list of general definitions included in paragraph 1 of Article 3:

> the term "special tax regime" means any statute, regulation or administrative practice in a Contracting State with respect to a tax described in Article 2 that meets all of the following conditions:
>
> (i) results in one or more of the following:
>
> A) a preferential rate of taxation for interest, royalties*[, fees for services, income from automated digital services, insurance premiums]* or any combination thereof as compared to income from sales of goods*[…];*
>
> B) a permanent reduction in the tax base with respect to interest, royalties*[, fees for services, income from automated digital services, insurance premiums]* or any combination thereof without a comparable reduction for income from sales of goods *[…]*, by allowing:

1) an exclusion from gross receipts;
2) a deduction without regard to any corresponding payment or obligation to make a payment;
3) a deduction for dividends paid or accrued; or
4) taxation that is inconsistent with the principles of Article 7 or Article 9; or

C) a preferential rate of taxation or a permanent reduction in the tax base of the type described in subclauses 1), 2), 3) or 4) of clause B) of this subdivision with respect to substantially all of a company's income or substantially all of a company's foreign source income, for companies that do not engage in the active conduct of a business in that Contracting State;

(ii) in the case of any preferential rate of taxation or permanent reduction in the tax base for royalties*[, fees for services, income from automated digital services or insurance premiums]*, does not condition such benefits on

A) the extent of research and development activities that take place in the Contracting State; or

B) expenditures (excluding any expenditures which relate to subcontracting to a related party or any acquisition costs), which the person enjoying the benefits incurs for the purpose of actual research and development activities;

(iii) is generally expected to result in a rate of taxation that is less than the lesser of either:

A) [rate to be determined bilaterally]; or

B) 60 per cent of the general statutory rate of company tax applicable in the other Contracting State;

(iv) does not apply principally to:

A) recognised pension funds;

B) organisations that are established and maintained exclusively for religious, charitable, scientific, artistic, cultural or educational purposes;

C) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral), that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the Contracting

State and the interests in which are marketed primarily to retail investors; or

D) persons the taxation of which achieves a single level of taxation either in the hands of the person or the person's shareholders (with at most one year of deferral) and that hold predominantly immovable property; and

(v) after consultation with the first-mentioned Contracting State, has been identified by the other Contracting State through diplomatic channels to the first-mentioned Contracting State as satisfying subdivisions (i) through (iv) of this subparagraph.

No statute, regulation or administrative practice shall be treated as a special tax regime until 30 days after the date when the other Contracting State issues a written public notification identifying the regime as satisfying subdivisions (i) through (iv) of this subparagraph.

87. The above definition of the term "special tax regime" applies to any legislation, regulation or administrative practice (including a ruling practice) that exists before or comes into effect after the treaty is signed and that meets all of the following five conditions.

88. Under the first condition, described in subdivision (i) of the definition, the regime must result in one or more of the following:

A. a preferential rate of taxation for interest, royalties*[, fees for services, income from automated digital services, insurance premiums]* or any combination thereof as compared to income from sales of goods *[…]*;

B. certain permanent reductions in the tax base with respect to interest, royalties*[, fees for services, income from automated digital services, insurance premiums]* or any combination thereof without a comparable reduction for sales *[…]* income; or

C. a preferential rate of taxation or certain permanent reductions in the tax base with respect to substantially all income or substantially all foreign source income for companies that do not engage in the active conduct of a business in that Contracting State. This part of the definition is intended to identify regimes that, in general, tax mobile income more favourably than non-mobile income.

89. As provided in clause A), subdivision (i) shall be met if a regime provides a preferential rate of taxation for interest, royalties*[, fees for*

services, income from automated digital services, insurance premiums] or a combination *[thereof]* as compared to sales *[…]* income. For example, a regime that provides a preferential rate of taxation on royalty income earned by resident companies, but does not provide such preferential rate to income from sales or services, would meet this condition. Furthermore, a regime that provides a preferential rate of taxation for all classes of income, but such preferential rate is in effect available primarily for interest, royalties*[, fees for services, income from automated digital services, insurance premiums,]* or a combination *[thereof]*, would satisfy subdivision (i) despite the fact that the beneficial treatment is not explicitly limited to those classes of income. For example, a tax authority's administrative practice of issuing routine rulings that provide a preferential rate of taxation for companies that represent that they earn primarily interest income (such as group financing companies) would satisfy subdivision (i) even if such rulings as a technical matter provide that preferential rate to all forms of income.

90. Similarly, as provided in clause B), subdivision (i) shall be met if a regime provides for a permanent reduction in the tax base with respect to interest, royalties*[, fees for services, income from automated digital services, insurance premiums]* or a combination thereof as compared to *[sales income]*, in one or more of the following ways: an exclusion from gross receipts (such as an automatic fixed reduction in the amount of royalties included in income, whereas such reduction is not also available for income from the sale of goods *[…]*); a deduction without any corresponding payment or obligation to make a payment; a deduction for dividends paid or accrued; or taxation that is inconsistent with the principles of Articles 7 or 9 of the Convention. An example of a tax regime that results in taxation that is inconsistent with the principles of Article 9 is that of a regime under which no interest income would be imputed on an interest-free note that is held by a company resident of a Contracting State and is issued by an associated enterprise that is a resident of the other Contracting State.

91. A permanent reduction in a State's tax base does not arise merely from timing differences. For example, the fact that a particular country does not tax interest until it is actually paid, rather than when it economically accrues, is not regarded as a regime that provides a permanent reduction in the tax base, because such a rule represents an ordinary timing difference. However, a regime that results in excessive deferral over a period of many years shall be regarded as providing for a permanent reduction in the tax base, because such a rule in substance constitutes a permanent difference in the base of the taxing country.

92. Alternatively, as provided in clause C), subdivision (i) shall be satisfied if a regime provides a preferential rate of taxation or a permanent reduction in the tax base (of the type described above), with respect to substantially all income or substantially all foreign source income, for companies that do not engage in the active conduct of a business in the Contracting State. For example, regimes that provide preferential rates of taxation only to income of group financing companies or holding companies would generally satisfy subdivision (i).

93. A regime that provides for beneficial tax treatment that is generally applicable to all income (in particular to income from sales [of goods]) and across all industries should not *[satisfy the requirements of]* subdivision (i). Examples of generally applicable provisions that would not *[satisfy the requirements of]* subdivision (i) include regimes permitting standard deductions, accelerated depreciation, corporate tax consolidation, dividends received deductions, loss carryovers and foreign tax credits.

94. The second condition, described in subdivision (ii) of the definition, applies only with respect to royalties*[, fees for services, income from automated digital services, insurance premiums or a combination thereof]* and is met if a regime does not condition benefits either on the extent of research and development activities that take place in the Contracting State or on expenditures (excluding any expenditures which relate to subcontracting to a related party or any acquisition costs), which the person enjoying the benefits incurs for the purpose of actual research and development activities. Subdivision (ii) is intended to ensure that royalties *[and similar payments]* benefiting from patent box or innovation box regimes are eligible for treaty benefits only if such regimes satisfy one of these two requirements. Some States, however, would prefer that the requirements of subdivision (ii) be restricted so as to only be met if a regime conditions benefits on the extent of research and development activities that take place in the Contracting State. States that share that view may prefer to use the following alternative version of subdivision (ii):

(ii) in the case of any preferential rate of taxation or permanent reduction in the tax base for royalties*[, fees for services, income from automated digital services, insurance premiums, or a combination thereof]*, does not condition such benefits on the extent of research and development activities that take place in the Contracting State;

Under either version of subdivision (ii), royalty regimes that have been considered by the OECD's Forum on Harmful Tax Practices and were

not determined to be "actually harmful" generally would not meet subdivision (ii) and, if so, would not be treated as special tax regimes.

95. The third condition, described in subdivision (iii) of the definition, requires that a regime be generally expected to result in a rate of taxation that is less than the lesser of a rate that would be agreed bilaterally between the Contracting States and 60 per cent of the general statutory rate of company tax applicable in the Contracting State that considers the regime of the other State as a potential "special tax regime".

96. States may consider it useful to clarify the reference to "rate of taxation" for the purposes of subdivision (iii) by including the following in an instrument reflecting the agreed interpretation of the treaty:

> Except as provided below, the rate of taxation shall be determined based on the income tax principles of the Contracting State that has implemented the regime in question. Therefore, in the case of a regime that provides only for a preferential rate of taxation, the generally expected rate of taxation under the regime shall equal such preferential rate. In the case of a regime that provides only for a permanent reduction in the tax base, the rate of taxation shall equal the statutory rate of company tax generally applicable in the Contracting State to companies subject to the regime in question less the product of such rate and the percentage reduction in the tax base (with the baseline tax base determined under the principles of the Contracting State, but without regard to any permanent reductions in the tax base described in clause B) of subdivision (i)) that the regime is generally expected to provide. For example, a regime that generally provides for a 20 per cent permanent reduction in a company's tax base would have a rate of taxation equal to the applicable statutory rate of company tax reduced by 20 per cent of such statutory rate. In the case of a regime that provides for both a preferential rate of taxation and a permanent reduction in the tax base, the rate of taxation would be based on the preferential rate of taxation reduced by the product of such rate and the percentage reduction in the tax base.

97. The preceding would clarify that the rate of taxation should be determined based on the income tax principles of the Contracting State that has implemented the regime in question. Therefore, in the case of a regime that provides only for a preferential rate of taxation, the generally expected rate of taxation under the regime will equal such preferential rate. In the case of a regime that provides only for a

permanent reduction in the tax base, the rate of taxation will equal the statutory rate of company tax in the Contracting State that is generally applicable to companies subject to the regime in question less the product of such rate and the percentage reduction in the tax base (with the baseline tax base determined under the principles of the Contracting State, but without regard to any permanent reductions in the tax base described in clause B) of subdivision (i) of the definition) that the regime is generally expected to provide. For example, a regime that generally provides for a 20 per cent permanent reduction in a company's tax base would have a rate of taxation equal to the applicable statutory rate of company tax reduced by 20 per cent of such statutory rate. Therefore, if the applicable statutory rate of company tax in force in a Contracting State were 25 per cent, the rate of taxation resulting from such a regime would be 20 per cent (25 – (25 x 0.20)). In the case of a regime that provides for both a preferential rate of taxation and a permanent reduction in the tax base, the rate of taxation would be based on the preferential rate of taxation reduced by the product of such rate and the percentage reduction in the tax base.

98. The fourth condition, described in subdivision (iv) of the definition, provides that a regime shall not be regarded as a special tax regime if it applies principally to pension funds or organisations that are established and maintained exclusively for religious, charitable, scientific, artistic, cultural or educational purposes. Under subdivision (iv), a regime shall also not be regarded as a special tax regime if it applies principally to persons the taxation of which achieves a single level of taxation, either in the hands of the person or its shareholders (with at most one year of deferral), that hold a diversified portfolio of securities, that are subject to investor-protection regulation in the residence State, and interests in which are marketed primarily to retail investors. This would generally correspond to the collective investment vehicles referred to in paragraph *[31 above of this Commentary]*. Another exception provided in subdivision (iv) applies to regimes that apply principally to persons the taxation of which achieves a single level of taxation, either in the hands of the person or its shareholders (with at most one year of deferral), and such persons hold predominantly immovable property.

99. The fifth condition, described in subdivision (v) of the definition, provides that the Contracting State that wishes to treat a regime of the other State as a "special tax regime" must first consult the other Contracting State and notify that State through diplomatic channels that it has determined that the regime meets the other conditions of the definition.

100. The final part of the definition requires that the Contracting State that wishes to treat a regime of the other State as a "special tax regime" must issue a written public notification stating that the regime satisfies the definition. For the purposes of the Convention, a special tax regime shall be treated as such 30 days after the date of such written public notification.

Provision on subsequent changes to domestic law

101. Whilst the above suggested provision on special tax regimes would address the issue of targeted tax regimes, it would not deal with changes of a more general nature which could be introduced into the domestic law of a treaty partner after the conclusion of a tax treaty and which might have prevented the conclusion of the treaty if they had existed at that time. For instance, some Contracting States might be concerned if the overall tax rate that another State levies on corporate income falls below what they consider to be acceptable for the purposes of the conclusion of a tax treaty. Some States might also be concerned if a State that taxed most types of foreign income at the time of the conclusion of a tax treaty decided subsequently to exempt such income from tax when it is derived by a resident company. The following is an example of a provision that would address these concerns, it being understood that the features of that provision would need to be restricted or extended in order to deal adequately with the specific areas of concern of each State:

1. If at any time after the signing of this Convention, a Contracting State

   a) reduces the general statutory rate of company tax that applies with respect to substantially all of the income of resident companies with the result that such rate falls below the lesser of either

      (i) [rate to be determined bilaterally] or

      (ii) 60 per cent of the general statutory rate of company tax applicable in the other Contracting State, or

   b) the first-mentioned Contracting State provides an exemption from taxation to resident companies for substantially all foreign source income (including interest*[,]* royalties*[, fees for services, income from automated digital services and insurance premiums]*),

   the Contracting States shall consult with a view to amending this Convention to restore an appropriate allocation of taxing

rights between the Contracting States. If such consultations do not progress, the other State may notify the first-mentioned Contracting State through diplomatic channels that it shall cease to apply the provisions of Articles 10, 11, 12, *[12AA, 12B, 12C]* and 21. In such case, the provisions of such Articles shall cease to have effect in both Contracting States with respect to payments to resident companies six months after the date that the other Contracting State issues a written public notification stating that it shall cease to apply the provisions of these Articles.

2. For the purposes of determining the general statutory rate of company tax:

a) the allowance of generally available deductions based on a percentage of what otherwise would be taxable income, and other similar mechanisms to achieve a reduction in the overall rate of tax, shall be taken into account; and

b) the following shall not be taken into account:

(i) a tax that applies to a company only upon a distribution by such company, or that applies to shareholders; and

(ii) the amount of a tax that is refundable upon the distribution by a company of a dividend.

102. This suggested provision provides that if, at any time after the signing of the Convention, either Contracting State enacts certain changes to domestic law, the provisions of Articles 10, 11, 12, *[12AA, 12B, 12C]* and 21 may cease to have effect with respect to payments to companies if, after consultation, the Contracting States fail to agree on amendments to the Convention to restore an appropriate allocation of taxing rights between the Contracting States.

103. Paragraph 1 of the suggested provision addresses two types of subsequent changes that could be made by a State, after the signature of a tax treaty, to the tax rules applicable to companies resident of that State. The first type is when that State reduces the general statutory rate of company tax that applies with respect to substantially all of the income of its resident companies, with the result that such rate falls below the lesser of a minimum rate that would need to be determined bilaterally or 60 per cent of the general rate of company tax applicable in the other State.

104. For the purposes of paragraph 1, the "general statutory rate of company tax" refers to the general rate of company tax provided by legislation; if rates of company taxes are graduated, it refers to the

highest marginal rate, provided that such rate applies to a significantly large portion of corporate taxpayers and was not established merely to circumvent the application of this Article. A general statutory rate of company tax that is applicable to business profits generally or to so-called "trading income" (broadly defined to include income from manufacturing, services or dealing in goods or commodities) shall be treated as applying to substantially all of the income of resident companies, even if narrow categories of income (including income from portfolio investments or other passive activities) are excluded. A reduced rate of tax that applies only with respect to capital gains would not fall within the scope of this Article; the distinction between business profits and capital gains shall be made according to the domestic laws of the residence State. Paragraph 2 addresses specific issues that may arise in determining what is a State's general statutory rate of company tax. Subparagraph *a*) of paragraph 2 provides that paragraph 1 applies equally to reductions to the general statutory company tax rate, as well as to other changes in domestic law that would have the same effect using a different mechanism. For example, if the statutory company tax rate in a Contracting State was 20 per cent, but, after the signing of the Convention, companies resident in the Contracting State are permitted to claim deductions representing 50 per cent of what otherwise would be their taxable income, the general statutory rate of company tax would be 10 per cent (20 – (20 x 0.50)). Similarly, if the statutory company tax rate in a Contracting State was 20 per cent, but after the signing of the Convention, companies resident in the Contracting State are allowed to deduct an amount equal to a percentage of their equity up to 50 per cent of what otherwise would be their taxable income, and in general, most companies are able to utilize the maximum available deduction, the general rate of company tax would be 10 per cent. Subparagraph *b*) of paragraph 2 sets forth taxes that shall not be taken into account for purposes of determining the general statutory rate of company tax. First, as provided in subdivision (i) of subparagraph *b*), taxes imposed at either the company or shareholder level when the company distributes earnings shall not be taken into account when determining the general rate of company tax (e.g. if resident companies are not subject to any taxation at the company level until a distribution is made, the tax levied upon distribution would not be considered part of the general rate of company tax). Second, as provided in subdivision (ii) of subparagraph *b*), any amounts of corporate tax that under a country's domestic law would be refundable upon a company's distribution of earnings shall not be taken into account for purposes of determining the general statutory rate of company tax.

105. The second type of subsequent change in domestic tax law covered by paragraph 1 is when a State provides an exemption from taxation to companies resident of that State with respect to substantially all foreign source income (including interest and royalties) derived by these companies. The reference to an exemption for substantially all foreign source income earned by a resident company is intended to describe a taxation system under which income (including income from interest and royalties) from sources outside a State is exempt from tax solely by reason of its source being outside that State (so-called "territorial" systems). The reference does not include taxation systems under which only foreign source dividends or business profits from foreign permanent establishments are exempt from tax by the residence State (so-called "dividend exemption" systems).

106. When either type of subsequent domestic law change occurs, the Contracting States shall first consult with a view to concluding amendments to the Convention to restore an appropriate allocation of taxing rights between the two Contracting States. In the event that such amendments are agreed, or that the Contracting States agree, after such consultation, that the allocation of taxing rights in the Convention is not disrupted by the relevant change made to the domestic law of one of the States, paragraph 1 has no further application. If, however, after a reasonable period of time, such consultations do not progress, the other State may notify the State whose domestic law has changed, through diplomatic channels, that it shall cease to apply the provisions of Articles 10, 11, 12, *[12AA, 12B, 12C]* and 21. Once such diplomatic notification has been made, in order for paragraph 1 to apply, the source State must announce by written public notice that it shall cease to apply the provisions of these Articles. Six months after the date of such written public notification, the provisions of these Articles shall cease to have effect in both Contracting States with respect to payments to companies that are residents of either State.

Provision on notional deductions for equity

107. One example of a tax regime with respect to which treaty benefits might be specifically restricted relates to domestic law provisions that provide for a notional deduction with respect to equity. Contracting States which agree to prevent the application of the provisions of Article 11 to interest that is paid to connected persons who benefit from such notional deductions may do so by adding the following provision to Article 11:

> 2. Notwithstanding the provisions of paragraph 1 of this Article, interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State that is connected to the payer *[as defined in subparagraph 7(d) of Article 29]* may be taxed in the first-mentioned Contracting State in accordance with domestic law if such resident benefits, at any time during the taxable year in which the interest is paid, from notional deductions with respect to amounts that the Contracting State of which the beneficial owner is a resident treats as equity.

The explanations in paragraph 85 *[of the Commentary on Article 1 of the 2017 OECD Model quoted above]* concerning the reference to a resident that is "connected" to the payer apply equally to the above provision.

Provision on remittance based taxation

108. Another example of a tax regime with respect to which treaty benefits might be specifically restricted is that of remittance based taxation. Under the domestic law of some States, persons who qualify as residents but who do not have what is considered to be a permanent link with the State (sometimes referred to as domicile) are only taxed on income derived from sources outside the State to the extent that this income is effectively repatriated, or remitted, thereto. Such persons are not, therefore, subject to potential double taxation to the extent that foreign income is not remitted to their State of residence and it may be considered inappropriate to give them the benefit of the provisions of the Convention on such income. Contracting States which agree to restrict the application of the provisions of the Convention to income that is effectively taxed in the hands of these persons may do so by adding the following provision to the Convention:

> Where under any provision of this Convention income arising in a Contracting State is relieved in whole or in part from tax in that State and under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other State and not by reference to the full amount thereof, then any relief provided by the provisions of this Convention shall apply only to so much of the income as is taxed in the other Contracting State.

In some States, the application of that provision could create administrative difficulties if a substantial amount of time elapsed

between the time the income arose in a Contracting State and the time it were taxed by the other Contracting State in the hands of a resident of that other State. States concerned by these difficulties could subject the rule in the last part of the above provision, that is, that the income in question will be entitled to benefits in the first-mentioned State only when taxed in the other State, to the condition that the income must be so taxed in that other State within a specified period of time from the time the income arises in the first-mentioned State.

3. The importance of proper mechanisms for the application and interpretation of tax treaties

162. The Committee recognizes the role that proper administrative procedures can play in minimizing risks of improper uses of tax treaties. Many substantive provisions in tax treaties need to be supported by proper administrative procedures that are in line with the procedural aspects of domestic tax legislation. Developing countries may consider developing their own procedural provisions regarding treaty application by learning from countries that have successful experience of treaty application.

163. The Committee also recognizes the importance of proper mechanisms for tax treaty interpretation. In many countries, there is a long history of independent judicial interpretations of tax treaties, which provide guidance to tax administrations. Countries that have a weaker judicial system or where there is little judicial expertise in tax treaty interpretation may consider alternative mechanisms to ensure correct, responsive and responsible treaty interpretations.

164. While anti-abuse rules are important for preventing the improper use of treaties, the application of certain anti-abuse rules may be challenging for tax administrations, especially in developing countries. For instance, while an effective application of domestic transfer pricing rules may help countries to deal with certain improper uses of treaty provisions, countries that have limited expertise in the area of transfer pricing may be at a disadvantage. In addition, countries that have inadequate experience of combating improper uses of treaties may feel uncertain about how to apply general anti-abuse rules, especially where a purpose test is involved. This increases the need for appropriate mechanisms to ensure a proper interpretation of tax treaties.

165. Developing countries may also be hesitant to adopt or apply general anti-abuse rules if they believe that these rules would introduce an unacceptable level of uncertainty that could hinder foreign investment in their territory. Whilst a ruling system that would allow taxpayers to quickly know whether anti-abuse rules would be applied to prospective transactions could help reduce that concern, it is important that such a system safeguards the confidentiality of transactions and, at the same time, avoids discretionary interpretations (which, in some countries, could carry risks of corruption). Clearly, a strong independent judicial system will help to provide taxpayers with the assurance that anti-abuse rules are applied objectively. Similarly, an effective application of the mutual agreement procedure will ensure that disputes concerning the application of anti-abuse rules will be resolved according to internationally accepted principles so as to maintain the integrity of tax treaties.

Practical application of the restrictions to source taxation provided by the Convention

166. As indicated in paragraph 162 above, it is important that developing countries develop their own procedures regarding the application of tax treaties. One issue that should be addressed through such procedures is whether the restrictions to source taxation provided by various provisions of the Convention (e.g. Articles 8, 10, 11, 12, 12AA, 12B and 12C) should be granted automatically or through a refund mechanism. This issue is not addressed in the Convention and is therefore governed by the procedure provided in the domestic law of each State. The Committee considers that the following part of the Commentary on Article 1 of the 2017 OECD Model is applicable in that respect (the modification that appears in italics between square brackets, which is not part of the Commentary on the OECD Model, has been inserted in order to provide additional explanations):

> 109. A number of Articles of the Convention limit the right of a State to tax income derived from its territory. As noted in paragraph 19 of the Commentary on Article 10 *[of the 2017 OECD Model, as quoted in paragraph 16 of the Commentary on Article 10 of this Model]* as concerns the taxation of dividends, the Convention does not settle procedural questions and each State is free to use the procedure provided in its domestic law in order to apply the limits provided by the Convention.

A State can therefore automatically limit the tax that it levies in accordance with the relevant provisions of the Convention, subject to possible prior verification of treaty entitlement, or it can impose the tax provided for under its domestic law and subsequently refund the part of that tax that exceeds the amount that it can levy under the provisions of the Convention. As a general rule, in order to ensure expeditious implementation of taxpayers' benefits under a treaty, the first approach is the highly preferable method. If a refund system is needed, it should be based on observable difficulties in identifying entitlement to treaty benefits. Also, where the second approach is adopted, it is extremely important that the refund be made expeditiously, especially if no interest is paid on the amount of the refund, as any undue delay in making that refund is a direct cost to the taxpayer.

Article 2

TAXES COVERED

A. General considerations

1. Article 2 of the UN Model reproduces Article 2 of the OECD Model.

2. This Article is designed to clarify the terminology and nomenclature concerning the taxes to be covered by the convention. In this connection, it may be observed that the same income or capital may be subject in the same country to various taxes – either taxes which differ in nature or taxes of the same nature levied by different political subdivisions or local authorities. Hence double taxation cannot be wholly avoided unless the methods for the relief of double taxation applied in each Contracting State take into account all the taxes to which such income or capital is subject. Consequently, the terminology and nomenclature relating to the taxes covered by a treaty must be clear, precise and as comprehensive as possible. As noted in the Commentary on Article 2 of the 2017 OECD Model, this is necessary:

> 1. *[...]* to ensure identification of the Contracting States' taxes covered by the Convention, to widen as much as possible the field of application of the Convention by including, as far as possible, and in harmony with the domestic laws of the Contracting States, the taxes imposed by their political subdivisions or local authorities, to avoid the necessity of concluding a new convention whenever the Contracting States' domestic laws are modified, and to ensure for each Contracting State notification of significant changes in the taxation laws of the other State.

B. Commentary on the paragraphs of Article 2

Paragraph 1

3. This paragraph states that the Convention applies to taxes on income and on capital, irrespective of the authority on behalf of which such taxes are imposed (e.g. the State itself or its political subdivisions or local authorities) and irrespective of the method by which the taxes are levied (e.g. by direct assessment or by deduction at the source, in the form of surtaxes or surcharges or as additional taxes).

Paragraph 2

4. This paragraph defines taxes on income and on capital as taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on capital appreciation and taxes on the total amounts of wages or salaries paid by enterprises. Negotiations of a tax convention that includes Article 12C should consider excise taxes or other indirect taxes on insurance premiums or policies (see paragraphs 63 and 64 of this Model's Commentary on Article 5 and paragraphs 11 and 12 of the Commentary on Article 12C). Practices regarding the coverage of taxes on the total amount of wages and salaries paid by enterprises vary from country to country and this matter should be taken into account in bilateral negotiations. As noted in paragraph 3 of the Commentary on Article 2 of the 2017 OECD Model, taxes on the total amount of wages do not include "[s]ocial security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received". Also, the Committee considers that the following part of the Commentary on Article 2 of the 2017 OECD Model is applicable to paragraph 2 of Article 2 of this Model:

> 4. Clearly a State possessing the right to tax an item of income or capital under the Convention may levy the taxes imposed by its legislation together with any duties or charges accessory to them: increases, costs, interest, penalties etc. It has not been considered necessary to specify this in the Article, as it is obvious that a Contracting State that has the right to levy a tax may also levy the accessory duties or charges related to the principal duty. Most States, however, do not consider that interest and penalties accessory to taxes covered by Article 2 are themselves included within the scope of Article 2 and, accordingly, would generally not treat such interest and penalties as payments to which all the provisions concerning the rights to tax of the State of source (or situs) or of the State of residence are applicable, including the limitations of the taxation by the State of source and the obligation for the State of residence to eliminate double taxation. Nevertheless, where taxation is withdrawn or reduced in accordance with a mutual agreement under Article 25, interest and administrative penalties accessory to such taxation should be withdrawn or reduced to the extent that they are directly connected to the taxation (i.e. a tax liability) that is relieved under the mutual agreement. This would be the case, for example, where the additional charge is computed

with reference to the amount of the underlying tax liability and the competent authorities agree that all or part of the underlying taxation is not in accordance with the provisions of the Convention. This would also be the case, for example, where administrative penalties are imposed by reason of a transfer pricing adjustment and that adjustment is withdrawn because it is considered not in accordance with paragraph 1 of Article 9.

5. The Article does not mention "ordinary taxes" or "extraordinary taxes". Normally, it might be considered justifiable to include extraordinary taxes in a model convention, but experience has shown that such taxes are generally imposed in very special circumstances. In addition, it would be difficult to define them. They may be extraordinary for various reasons; their imposition, the manner in which they are levied, their rates, their objects, etc. This being so, it seems preferable not to include extraordinary taxes in the Article. But, as it is not intended to exclude extraordinary taxes from all conventions, ordinary taxes have not been mentioned either. The Contracting States are thus free to restrict the convention's field of application to ordinary taxes, to extend it to extraordinary taxes, or even to establish special provisions.

Paragraph 3

5. This paragraph provides the Contracting States an opportunity to enumerate the taxes to which the Convention is to apply. According to the Commentary on paragraph 3 of Article 2 of the 2017 OECD Model, the list "is not exhaustive", for "it serves to illustrate the preceding paragraphs of the Article". In principle, however, it is expected to be "a complete list of taxes imposed in each State at the time of signature and covered by the Convention".

Paragraph 4

6. This paragraph reproduces paragraph 4 of Article 2 of the OECD Model. The Committee considers that the following part of the Commentary on Article 2 of the 2017 OECD Model is applicable to paragraph 4 of Article 2 of the UN Model:

7. This paragraph provides, since the list of taxes in paragraph 3 is purely declaratory, that the Convention is also to apply to all identical or substantially similar taxes that are imposed in a Contracting State after the date of signature of the Convention in addition to, or in place of, the existing taxes in that State.

8. Each State undertakes to notify the other of any significant changes made to its taxation laws by communicating to it, for example, details of new or substituted taxes. Member countries are encouraged to communicate other significant developments as well, such as new regulations or judicial decisions; many countries already follow this practice. Contracting States are also free to extend the notification requirement to cover any significant changes in other laws that have an impact on their obligations under the convention; Contracting States wishing to do so may replace the last sentence of the paragraph by the following:

> The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws or other laws affecting their obligations under the Convention.

Commentary on chapter II

DEFINITIONS

Article 3

GENERAL DEFINITIONS

A. General considerations

1. Article 3 of the UN Model is the same as Article 3 of the OECD Model.

2. Several general definitions are normally necessary for the understanding and application of a bilateral tax convention, although terms relating to more specialized concepts are usually defined or interpreted in special provisions. On the other hand, there are terms whose definitions are not included in the Convention but are left to bilateral negotiations.

3. Article 3 of the UN Model, like Article 3 of the OECD Model, sets forth a number of general definitions required for the interpretation of the terms used in the Convention. These terms are "person", "company", "enterprise", "enterprise of a Contracting State", "international traffic", "competent authority", "national", "business" and "recognized pension fund". Article 3 leaves space for the designation of the "competent authority" of each Contracting State. The terms "resident" and "permanent establishment" are defined in Articles 4 and 5 respectively, while the interpretation of certain terms used in the Articles on special categories of income (e.g. immovable property, dividends) is clarified in the Articles concerned. The parties to a convention are left free to agree bilaterally on a definition of the terms "a Contracting State" and "the other Contracting State". They also may include in the definition of a Contracting State a reference to continental shelves.

4. Also, a small minority of members were of the view that it would be better to include in Article 3 of the UN Model a definition of the term "beneficial owner" for the purposes of Articles 8, 10, 11, 12, 12AA, 12B and 12C, besides the explanations found in the Commentary on

those provisions.[33] These members pointed towards courts deciding differently in countries on whether the term should take its meaning from the domestic law of the Contracting State concerned or should be given an international fiscal meaning. Such definition gets elaborated in the Commentaries on Articles 8, 10, 11, 12, 12AA, 12B and 12C.

B. Commentary on the paragraphs of Article 3

Paragraph 1

(a) The term "person"

5. The term "person", which is defined in subparagraph (*a*) as including an individual, a company and any other body of persons, should be interpreted very broadly. According to paragraph 2 of the Commentary on Article 3 of the 2017 OECD Model, the term also includes "any entity that, although not incorporated, is treated as a body corporate for tax purposes. Thus, a foundation (*fondation, Stiftung*), for example, may fall within the meaning of the term "person". Partnerships will also be considered to be "persons" either because they fall within the definition of "company" or, where this is not the case, because they constitute "other bodies of persons."

(b) The term "company"

6. The definition of the term "company", like the corresponding definition in the OECD Model, is formulated with special reference to Article 10 on dividends. The definition is relevant to that Article and also to paragraphs 7 and 8 of Article 5 as well as Articles 16 and 29.

(c) and (d) The terms "enterprise", "enterprise of a Contracting State" and "enterprise of the other Contracting State"

7. The question whether an activity is performed within an enterprise or is deemed to constitute, in itself, an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term "enterprise"

33 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

has therefore been attempted in this Article. However, subparagraph 1(c) provides that the term "enterprise" applies to the carrying on of any business. Since the term "business" is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional activities and other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term "enterprise" from their bilateral conventions.

8. Subparagraph (d) defines the terms "enterprise of a Contracting State" as, respectively, an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State.

(e) The term "international traffic"

9. Subparagraph 1(e) defines the term "international traffic." The term means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places within a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State. This definition is applicable principally in the context of Article 8 (International Shipping and Air Transport). However, the Contracting States may agree on a bilateral basis to modify the definition of "international traffic" to refer to the State in which the place of effective management of the enterprise is situated, as was the case before 2017. In such a case, as noted in paragraph 5 of the Commentary on Article 3 of the 2017 OECD Model, the definition would read: "the term 'international traffic' means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in a Contracting State in which the enterprise that operates the ship or aircraft does not have its place of effective management."

10. Paragraph 6 of the Commentary on Article 3 of the 2017 OECD Model notes that "[t]he definition of the term 'international traffic' is broader than is normally understood. The broader definition is intended to preserve for the State of the enterprise the right to tax purely domestic traffic as well as international traffic between third States, and to allow the other Contracting State to tax traffic solely within its borders". A ship

or aircraft is operated solely between places in the other Contracting State in relation to a particular voyage if the place of departure and the place of arrival of the ship are both in that other Contracting State. Thus, for example, a cruise beginning and ending in that other Contracting State without a stop in a foreign port does not constitute a transport of passengers in international traffic. Conversely, a cruise beginning and ending in that other Contracting State with a stop in a foreign port constitutes a transport of passengers in international traffic and for this purpose a "stop" has taken place if passengers are permitted to go ashore, even temporarily, but only at a scheduled intermediate destination.

11. Also, paragraph 6.1 of the Commentary on Article 3 of the 2017 OECD Model explains that "[t]he definition was amended in 2017 to ensure that it also applied to a transport by a ship or aircraft operated by an enterprise of a third State. Whilst this change does not affect the application of Article 8, which only deals with profits of an enterprise of a Contracting State, it allows the application of paragraph 3 of Article 15 to a resident of a Contracting State who derives remuneration from employment exercised aboard a ship or aircraft operated by an enterprise of a third State."

(f) The term "competent authority"

12. As in the OECD Model, the definition of the term "competent authority" is left to the Contracting States, which are free to designate one or more authorities as being competent for the purpose of applying the Convention. This approach is necessary because in some countries the implementation of double taxation conventions may not lie solely within the jurisdiction of the highest tax authorities insofar as some matters may be reserved to, or may fall within the competence of, other authorities.

(g) The term "national"

13. The definition of the term "national" was initially found in paragraph 2 of Article 24 (Non-discrimination). As a result, the definition of the term "national" would have applied only for the purposes of Article 24. Since the term "national" is referred to in other Articles of the Convention as well, namely, in subparagraphs 2(*c*) and 2(*d*) of Article 4 and in Articles 19 and 25, it was decided in 1999 to shift the definition of

the term "national" from paragraph 2 of Article 24 to subparagraph (*f*) of paragraph 1 of Article 3. For natural persons, the definition merely states that the term applies to any individual possessing the nationality of a Contracting State. It has not been found necessary to introduce into the text of the Convention any considerations on the signification of the concept of nationality, any more than it seemed appropriate to make any special comment on the meaning and application of the word. In determining what is meant by "the nationals of a Contracting State" in relation to individuals, reference must be made to the sense in which the term is usually employed and to each State's rules on the acquisition or loss of nationality.

14. Subparagraph (*g*) is more specific as to legal persons, partnerships and associations. By declaring that any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State is considered to be a national, the provision disposes of a difficulty which often arises in determining the nationality of companies. In defining the nationality of companies, some States have regard less to the law which governs the company than to the origin of the capital with which the company was formed or the nationality of the individuals or legal persons controlling it.

15. Moreover, in view of the legal relationship created between the company and the State under whose laws it is constituted, which resembles the relationship of nationality for individuals, it seems appropriate not to deal with legal persons, partnerships and associations in a special provision, but to assimilate them with individuals under the term "national".

(h) The term "business"

16. The Convention does not contain an exhaustive definition of the term "business", which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Subparagraph 1(h), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in 2025 at the same time as former Article 14, which dealt with Independent Personal Services, was deleted from the Convention. This addition, which ensures that the term "business" includes the performance of the

activities which were previously covered by Article 14, was intended to prevent the interpretation of the term "business" in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition.

(i) The term "recognized pension fund"

17. The definition of "recognized pension fund" in subparagraph (*i*) was added in 2021. It broadly corresponds to the definition found in the OECD Model. The Committee considers that the following part of the Commentary on Article 3 of the 2017 OECD Model is applicable to the definition of "recognized pension fund" found in this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 10.3 The definition of the term "recognized pension fund" found in subparagraph *(i)* was included in *[2021]* when this term was added to paragraph 1 of Article 4 in order to ensure that a pension fund that meets the definition is considered as a resident of the Contracting State in which it is established.
>
> 10.4 The effect of the definition of "recognized pension fund" and of the reference to that term in paragraph 1 of Article 4 will depend to a large extent on the domestic law and on the legal characteristics of the pension funds established in each Contracting State as well as on the other provisions of the Convention where the definition might be relevant.
>
> 10.5 In some States, a fund might be established within a legal entity (such as a company engaged in commercial activities, an insurance company or the State itself, or a political subdivision or local authority thereof) for the main purpose of providing retirement benefits to individuals, such as the employees of that entity or of other employers, or of investing funds for the benefit of other recognized pension funds. Such a fund might not, however, constitute a separate "person" (as this term is defined in subparagraph *a*)) under the taxation laws of the State in which it is established and, if that is the case, it would not meet the

definition of recognized pension fund. To the extent, however, that the income derived from the investment assets of that fund is attributed, under the domestic law of the State in which it is established, to the legal entity (e.g. company engaged in commercial activities, insurance company or State) within which the fund has been established, the provisions of the Convention will apply to that income to the extent that the legal entity itself qualifies as a resident of a Contracting State under paragraph 1 of Article 4. As explained in paragraphs 8.7 to 8.10 of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 4 of this Model]*, the inclusion of the term "recognized pension fund" in paragraph 1 of Article 4 is irrelevant for such a fund.

10.6 There are also some States where a fund established for the main purpose of providing retirement benefits to individuals does not formally constitute a separate person under the taxation laws of the State in which it is established but where these taxation laws provide that the investment assets of the fund constitute a separate and distinct patrimony the income of which is not allocated to any person for tax purposes. These States may want to ensure that their domestic law and the definition of "person" in subparagraph *a*) are broad enough to include such a fund in order to make sure that the Convention, which applies to persons that are residents of the Contracting States, is applicable to the income derived through these funds.

10.7 As indicated in paragraph 69 of the Commentary on Article 18 *[of the 2017 OECD Model, as quoted in paragraph 18 of the Commentary on Article 18 of this Model]*, where two Contracting States follow the same approach of generally exempting from tax the investment income of pension funds established in their territory, these States may include in their convention a provision extending that exemption to the investment income that a pension fund established in one State derives from the other State. The definition of "recognized pension fund" might then be used for that purpose. If that is the case, however, it would be necessary to ensure that a fund described in paragraph 10.5 above may qualify as a "recognized pension fund" in its own right notwithstanding the fact that it does not constitute a separate "person" under the taxation laws of the State in which it is established. Doing so, however, would require that, for the purposes of the Convention, the assets and income of such a fund are treated as the assets and income of a separate person so that, for example:

— the fund may constitute a person for the purposes of Article 1 and of all the relevant provisions of the Convention;

— the assets and income of the fund are considered those of a separate person and not those of the person within which the fund is established so that, for example, for the purposes of subparagraph *a*) of paragraph 2 of Article 10, any part of the capital of a company paying dividends to the fund that is held through the fund would not be aggregated with the capital of the same company that is held by the person within which the fund is established but that is not held through the fund;

— for the purposes of Articles 6 to 21, the income of the fund would be treated as derived, received and beneficially owned by the fund itself and not by the person within which the fund is established;

— the fund's entitlement to treaty benefits under the limitation on benefits provisions of Article 29 is determined without consideration of the entitlement to treaty benefits of the person within which the fund is established.

10.8 The following is an example of a provision that could be added to the definition of "recognized pension fund" for that purpose:

> Where an arrangement established in a Contracting State would constitute a recognized pension fund under subdivision (i) or (ii) if it were treated as a separate person under the taxation law of that State, it shall be considered, for the purposes of this Convention, as a separate person treated as such under the taxation law of that State and all the assets and income to which the arrangement applies shall be treated as assets held and income derived by that separate person and not by another person.

10.9 The first part of the definition of "recognized pension fund" refers to "an entity or arrangement established in that State". There is considerable diversity in the legal and organisational characteristics of pension funds around the world and it is therefore necessary to adopt a broad formulation. The reference to an "arrangement" is intended to cover, among other things, cases where pension benefits are provided through vehicles such as a trust which, under the relevant trust law, would not constitute an entity: the definition will apply as long as the trust or the body of trustees is treated, for tax purposes, as a separate entity recognized as a separate person. It is required, however, that the entity or arrangement be treated as a separate person under the taxation laws of the State in which it is established: if that is not the case, it is not necessary to deal with the issue of the residence of the pension fund itself as the income of that fund is treated as the income of another person for tax purposes (see paragraph 10.5 above).

10.10 Subdivision (i) provides that in order to qualify as a "recognized pension fund", an entity or arrangement must be established and operated exclusively or almost exclusively to administer or provide retirement and ancillary or incidental benefits to individuals. It does not matter how many individuals are entitled to such retirement benefits: a recognized pension fund may be set up, for instance, for a large group of employees or for a single self-employed individual. States are free to replace the phrase "retirement and ancillary or incidental benefits" by a different formulation, such as "retirement and similar benefits", as long as this formulation is interpreted broadly to include benefits such as death benefits.

10.11 The phrase "exclusively or almost exclusively" makes it clear that all or almost all the activities of a recognized pension fund must be related to the administration or the provision of retirement benefits and ancillary or incidental benefits to individuals. The words "almost exclusively" recognise that a very small part of the activities of a pension fund might involve activities that are not strictly related to administration or provision of such benefits (e.g. such as marketing the services of the pension fund). Some states, however, have a broader view of the term "recognized pension fund" and may want, for example, to cover entities or arrangements established and operated exclusively or almost exclusively to provide pensions and benefits, such as disability pensions, that are not related to retirement. These states are free to amend the definition so as to adapt it to their circumstances. In doing so, however, these States should take account of the fact that, as noted in paragraph 10.7 above, the definition of recognized pension fund may be used for the purposes of provisions exempting from source taxation the investment income that a pension fund established in one State derives from the other State; it will therefore be important for these States to ensure that the scope of that exemption is not inadvertently extended by changes made to the definition of "recognized pension fund".

10.12 The entity or arrangement must be established and operated exclusively or almost exclusively for the purpose of administering or providing retirement benefits and ancillary or incidental benefits to individuals. A pension paid upon retirement from active employment or when an employee reaches retirement age would be the typical example of a "retirement benefit" but this term is broad enough to cover one or more payments made at or after retirement, or upon reaching retirement age, to an employee, a self-employed person or a director or officer of a company, even if these payments are not made in the form of regular pension payments.

10.13 In many States, pension funds provide a number of benefits that are not strictly linked to retirement and the phrase "ancillary or incidental benefits" is intended to cover such benefits. The words "ancillary or incidental" make it clear that such benefits are provided in addition to retirement benefits: a fund that would be set up primarily in order to provide benefits that are not retirement benefits would therefore not meet the definition. Whilst it would be impossible to provide an exhaustive list of all benefits that would qualify as "ancillary or incidental benefits", the following are typical examples of such benefits:

— payments made as a result of the death or disability of an individual;

— pension or other types of payments made to surviving members of the family of a deceased individual who was entitled to retirement benefits;

— payments made to an individual suffering from a terminal illness;

— income substitution payments made in the case of long-term sickness or unemployment;

— housing benefits, such as a loan at a preferential rate granted from accumulated pension contributions to a pension contributor for the acquisition of a principal residence;

— education benefits, such as the withdrawal of accumulated pension contributions that a pension contributor would be allowed to make for the purpose of financing her education or that of her children;

— the provision of financial advice to pension contributors.

10.14 Subdivision (i) also requires that the entity or arrangement established and operated exclusively or almost exclusively to administer or provide retirement and ancillary or incidental benefits to individuals be "regulated as such". The requirement is intended to restrict the definition to entities or arrangements that are subject to some conditions imposed by the State where it is established (or one of its political subdivisions or local authorities) in order to ensure that the entity or arrangement is used as a vehicle for investment in order to provide retirement and ancillary or incidental benefits to individuals. That part of the definition would therefore exclude an entity, such as a private company, that might be set up and used by a person to invest funds in order to provide retirement benefits to persons related to, or employed by, that person but that would not be subject

to any special treatment or to rules imposed by the State, political subdivision or local authority concerning the use of that entity as a vehicle to provide retirement benefits. It does not matter whether the regulatory framework to which the entity or arrangement is subjected is provided in tax laws or in other legal instruments (for example, the legislation that establishes a State-owned entity that will operate a public pension fund); what matters is that the entity or arrangement be recognized by law as a vehicle established to finance retirement benefits for individuals and be subject to conditions intended to ensure that it is used for that purpose.

10.15 An example of an entity or arrangement that would satisfy the requirements of the definition of "recognized pension fund" is an agency or instrumentality of a State set up exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits under the social security legislation of that State. Another example would be a company or other entity that is established in a State for the purpose of administering or providing retirement benefits and ancillary or incidental benefits to individuals and whose only assets include funds that are covered by a retirement scheme regulated by the tax laws of that State which provide that the income from that scheme is exempt from tax. The definition of recognized pension fund would apply to that company or entity regardless of whether that company or entity otherwise qualifies as a resident of a Contracting State because it is "liable to tax therein" by reason of the criteria mentioned in the first sentence of paragraph 1 of Article 4, for example, because it must pay tax on any income not derived from the scheme (see paragraphs 8.8 to 8.10 of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 4 of this Model]*).

[…]

10.17 Subdivision (*ii*) of the definition covers entities or arrangements that pension funds covered by subdivision (*i*) use to invest indirectly. Pension funds often invest together with other pension funds pooling their assets in certain entities or arrangements and may, for various commercial, legal or regulatory reasons, invest via wholly owned entities or arrangements that are residents of the same State. Since such arrangements and entities act only as intermediaries for the investment of funds used to provide retirement benefits to individuals, it is appropriate to treat them like the pension funds that invest through them.

> 10.18 The phrase "exclusively or almost exclusively" found in subdivision (*ii*) makes it clear that all or almost all of the activities of such an intermediary entity or arrangement must be related to the investment of funds for the benefit of entities or arrangements that qualify as recognized pension funds under subparagraph (*i*). The words "almost exclusively" recognise that a very small part of the activities of such entities or arrangements might involve other activities, such as the investment of funds for pension funds that are established in other States and, for that reason, are not covered by subdivision (*i*). *[…]*

18. As noted in paragraph 10.16 of the Commentary on Article 3 of the 2017 OECD Model, "[s]ubdivision (*i*) of the definition applies regardless of whether the benefits to which it refers are provided to individuals who are residents of the State in which the entity or arrangement is established or are residents of other States." As indicated in paragraph 41 of the Commentary on Article 29 of the 2017 OECD Model, "some States […] consider that the risk of treaty shopping by recognized pension funds does not warrant the costs of compliance inherent in requiring funds to identify the treaty residence and entitlement of the individuals entitled to receive pension benefits."

19. Other States, however, may prefer to restrict the scope of the definition of "recognized pension fund" instead of relying solely on the general anti-abuse rule in paragraph 9 of Article 29 to address possible treaty-shopping concerns related to that definition. This may be done by adopting the following alternative version of the definition:

(*i*) the term "recognized pension fund" of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:

(i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities provided that more than 50 per cent of the beneficial interests in that entity or arrangement are owned by individuals resident of either Contracting State, or more than [___ per cent] of the beneficial interests in that person are owned by individuals resident of either Contracting State or of any other State with respect to which the following conditions are met:

(A) individuals who are residents of that other State are entitled to the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed, and

(B) with respect to income referred to in Articles 10 and 11 of this Convention, if the person were a resident of that other State entitled to all the benefits of that other convention, the person would be entitled, under such convention, to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

(ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements to which subdivision (i) applies.

20. Subdivision (i) of this alternative definition generally applies if more than 50 per cent of the beneficial interests in the entity or arrangement are owned by individuals resident of either Contracting State. Taking into account the fact that, in some countries, it is common for pension funds to cover residents of other countries, the scope of the definition is extended to cover individuals who, although non-residents of either Contracting State, meet certain conditions. In that case the definition also applies as long as a certain percentage (to be determined through bilateral negotiations) of the beneficial interests in the entity or arrangement are held by individuals resident of either Contracting State or by residents of third states who meet the following two conditions: first, these individuals are entitled to the benefits of a comprehensive tax convention concluded between that third State and the State of source and, second, that convention provides for a similar or greater reduction of source taxes on interest and dividends derived by pension funds of that third State. For the purposes of subdivision (i) of this alternative, the term "beneficial interests in that person" should be understood to refer to the interests held by persons entitled to receive pension benefits from the entity or arrangement.

21. A single member of the Committee did not agree with the inclusion of a definition of "recognized pension fund" in Article 3.[34] That member considered that this definition was intended to address the situation of pension funds which formally constitute separate persons under the domestic law of a State but, in that member's view, pension funds would not be considered separate persons in most countries. For that member, there was not enough justification to make this change.

Paragraph 2

22. Like paragraph 2 of Article 3 of the OECD Model, this paragraph contains a general rule concerning the meaning of terms used but not defined in the Convention.

23. Two modifications made in 1995 to paragraph 2 of the OECD Model were also made to this Model in 1999. First, the paragraph was amended to make it explicit that when the domestic law of a Contracting State is referred to in order to determine the meaning of terms that are not defined in the treaty, the relevant domestic law is that in force at the time of the application of the treaty rather than at the time the treaty was signed. The second modification clarified that the reference to the domestic law is not restricted to the domestic tax laws but, in case of variations in the meaning given to a term under different domestic laws, the meaning that prevails is that given to the term for the purposes of the laws imposing the taxes to which the Convention applies. The Committee considers that the following part of the Commentary on Article 3 of the 2017 OECD Model, which explains these two modifications, is applicable to paragraph 2 of Article 3 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 11. This paragraph provides a general rule of interpretation for terms used in the Convention but not defined therein. However, the question arises which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being

34 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

between the legislation in force when the Convention was signed or that in force when the Convention is being applied, that is, when the tax is imposed. *[It was]* concluded that the latter interpretation should prevail, and in 1995 *[the OECD Model was]* amended *[…]* to make this point explicitly.

12. However, paragraph 2 specifies that the domestic law meaning of an undefined term applies only if the context does not require an alternative interpretation *[…]*. The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based). The wording of the Article therefore allows the competent authorities some leeway.

13. Consequently, the wording of paragraph 2 provides a satisfactory balance between, on the one hand, the need to ensure the permanency of commitments entered into by States when signing a convention (since a State should not be allowed to make a convention partially inoperative by amending afterwards in its domestic law the scope of terms not defined in the Convention) and, on the other hand, the need to be able to apply the Convention in a convenient and practical way over time (the need to refer to outdated concepts should be avoided).

13.1 Paragraph 2 was amended in 1995 to conform its text more closely to the general and consistent understanding of member states. For purposes of paragraph 2, the meaning of any term not defined in the Convention may be ascertained by reference to the meaning it has for the purpose of any relevant provision of the domestic law of a Contracting State, whether or not a tax law. However, where a term is defined differently for the purposes of different laws of a Contracting State, the meaning given to that term for purposes of the laws imposing the taxes to which the Convention applies shall prevail over all others, including those given for the purposes of other tax laws.

24. The Committee also agrees with the statement, which was included at the end of paragraph 13.1 of the Commentary on Article 3 of the 2014 OECD Model, according to which "States that are able to enter into mutual agreements (under the provisions of Article 25 and, in particular, paragraph 3 thereof) that establish the meanings of terms not defined in the Convention should take those agreements into account in interpreting those terms."

Article 4

RESIDENT

A. General considerations

1. Article 4 of the United Nations Model reproduces Article 4 of the OECD Model with one adjustment, namely, the addition of "place of incorporation" to the list of criteria in paragraph 1. According to the Commentary on Article 4 of the 2017 OECD Model:

> 1. The concept of "resident of a Contracting State" has various functions and is of importance in three cases:
>
> *a*) in determining a convention's personal scope of application;
>
> *b*) in solving cases where double taxation arises in consequence of double residence;
>
> *c*) in solving cases where double taxation arises as a consequence of taxation in the State of residence and in the State of source or situs.

2. Like Article 4 of the OECD Model, Article 4 of this Model defines the expression "resident of a Contracting State" and establishes rules for resolving cases of double residence. In the two typical cases of conflict between two residences and between residence and source or *situs*, the conflict arises because, under their domestic laws, one or both Contracting States claim that the person concerned is resident in their territory. The Committee considers that the following explanations included in the Commentary on Article 4 of the 2017 OECD Model are applicable to Article 4 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 3. Generally the domestic laws of the various States impose a comprehensive liability to tax – "full tax liability" – based on the taxpayers' personal attachment to the State concerned (the "State of residence"). This liability to tax is not imposed only on persons who are "domiciled" in a State in the sense in which "domicile" is usually taken in the legislations (private law). The cases of full liability to tax are extended to comprise also, for instance, persons who stay continually, or maybe only for a certain period, in the territory of the State. Some

legislations impose full liability to tax on individuals who perform services on board ships which have their home harbour in the State.

4. Conventions for the avoidance of double taxation do not normally concern themselves with the domestic laws of the Contracting States laying down the conditions under which a person is to be treated fiscally as "resident" and, consequently, is fully liable to tax in that State. They do not lay down standards which the provisions of the domestic laws on "residence" have to fulfil in order that claims for full tax liability can be accepted between the Contracting States. In this respect the States take their stand entirely on the domestic laws.

5. This manifests itself quite clearly in the cases where there is no conflict at all between two residences, but where the conflict exists only between residence and source or situs. But the same view applies in conflicts between two residences. The special point in these cases is only that no solution of the conflict can be arrived at by reference to the concept of residence adopted in the domestic laws of the States concerned. In these cases special provisions must be established in the Convention to determine which of the two concepts of residence is to be given preference.

B. Commentary on the paragraphs of Article 4

Paragraph 1

3. Paragraph 1, similar to the corresponding provision of the OECD Model, refers to the concept of residence contained in the domestic laws of the Contracting States and lists the criteria for taxation as a resident: domicile, residence, place of management (to which this Model adds "place of incorporation") or any other criterion of a similar nature. Thus formulated, the definition of the term "resident of a Contracting State" is, according to paragraph 8 of the Commentary on Article 4 of the 2017 OECD Model, aimed at covering, as far as individuals are concerned, "*[…]* the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax)".

4. Paragraph 1 was modified in 1999 to clarify that the definition of "resident of a Contracting State" applied to the State itself as well as to any of its political subdivisions or local authorities. Similarly, in 2021, the reference to a "recognized pension fund" was added to the definition

of "resident of a Contracting State" in paragraph 1. This corresponded to a similar addition made to the OECD Model in 2017 and was intended to clarify how tax treaties apply to investments made by pension funds.

5. The Committee considers that the following explanations included in the Commentary on Article 4 of the 2017 OECD Model are applicable to paragraph 1 of Article 4 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 8.4 It has been the general understanding of most member countries that the government of each State, as well as any political subdivision or local authority thereof, is a resident of that State for purposes of the Convention. Before 1995, the Model did not explicitly state this; in 1995, Article 4 was amended to conform the text of the Model to this understanding.*[35]*
>
> *[…]*
>
> 8.6 Paragraph 1 also refers expressly to a "recognized pension fund". Most member countries have long considered that a pension fund established in a Contracting State is a resident of that State regardless of the fact that it may benefit from a limited or complete exemption from taxation in that State. Until 2017, that view was reflected in the previous version of paragraph 8.11, which referred to "pension funds, charities and other organisations" as entities that most States viewed as residents. Paragraph 1 of the Article was modified in 2017 to remove any doubt about the fact that a pension fund that meets the definition of "recognized pension fund" in paragraph 1 of Article 3 constitutes a resident of the Contracting State in which it is established.
>
> 8.7 As indicated in paragraph 10.4 of the Commentary on Article 3 *[of the 2017 OECD Model, as quoted in paragraph 17 of the Commentary on Article 3 of the UN Model]*, the effect of the definition of "recognized pension fund" and of the reference to that term in paragraph 1 of the Article will depend to a large extent on the domestic law and on the legal characteristics of the pension funds established in each Contracting State. The type of fund established within a legal entity that is described in paragraph 10.5 of the Commentary on Article 3 *[of the 2017 OECD Model, as quoted in paragraph 17 of the Commentary*

35 *[The same change was made to this Model in 1999.]*

on Article 3 of the UN Model] would not be covered by the definition of "recognized pension fund", which applies to an entity or arrangement that constitutes a separate person, but since the income of these funds is attributed to the legal entity of which it is part, the provisions of the Convention will apply to that income to the extent that the legal entity itself qualifies as a resident of a Contracting State under paragraph 1 of the Article.

8.8 Where, however, a fund constitutes a "person" which is distinct from any other person by whom, or for the benefit of whom, it has been established and is operated, the definition of "recognized pension fund" will be relevant and, to the extent that the conditions of that definition are met, the fund will itself constitute a "resident of a Contracting State". This will be the case in many countries because it is "liable to tax therein" by reason of the criteria mentioned in the first sentence of paragraph 1, as this sentence is interpreted by the Contracting States or, if that is not the case, because of the specific inclusion of the term "recognized pension fund" in paragraph 1.

8.9 Contracting States are of course free to omit the reference to "recognized pension funds" in paragraph 1 if they conclude that the income of the pension arrangements established in both States is derived by persons that otherwise qualify as residents of the Contracting States, although they might prefer to keep that reference in the paragraph simply to remove any uncertainty.

8.10 Given the diversity of arrangements through which retirement benefits are provided, it will therefore often be useful for the Contracting States to review the main types of pension arrangements used in each State and to clarify whether or not the definition of "recognized pension fund" applies to each type of arrangement and, more generally, how the provisions of the tax convention between these States apply to these arrangements. This could be done at the time of the negotiation of that convention or subsequently through the mutual agreement procedure.

8.11 Paragraph 1 refers to persons who are "liable to tax" in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such

entities as residents for purposes of the Convention (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).

8.12 In some States, however, these entities are not considered liable to tax if they are exempt from tax under domestic tax laws. These States may not regard such entities as residents for purposes of a convention unless these entities are expressly covered by the convention. Contracting States taking this view are free to address the issue in their bilateral negotiations.

8.13 Where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State. In that case, however, paragraph 2 of Article 1 clarifies that the Convention will apply to the partnership's income to the extent that the income is treated, for purposes of taxation by that State, as the income of a partner who is a resident of that State. The same treatment will apply to income of other entities or arrangements that are treated as fiscally transparent under the tax law of a Contracting State (see paragraphs 2 to 16 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 7 of the Commentary on Article 1 of the UN Model]*).

6. Some countries may prefer to abstain from addressing the issue of the residence of pension funds in their conventions. These countries could amend paragraph 1 of Article 4 by deleting the reference to recognized pension funds and omit the definition of "recognized pension fund" in Article 3. In such a case, however, there could be risks that pension funds would not be entitled to treaty benefits if they did not otherwise qualify as "residents of a Contracting State".

7. A small minority of members of the Committee did not agree with the inclusion of "recognized pension fund" in paragraph 1 of Article 4 as a separate class on the same footing as State, political subdivision or local authority, without the condition of being "liable to tax" under the laws of a State based on the criteria of domicile, residence, place of management etc. being necessarily met.[36] According to these members, the problem is not in regarding cases of "limited or complete exemption from taxation in that State" (see paragraph 8.6 of the Commentary on

36 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

Article 4 of the 2017 OECD Model quoted in paragraph 5 above) as residents but where the fund may not itself be "liable to tax" in the first place. The issue of not regarding a limited or partial exemption as "liable to tax" is in any case not unique to recognized pension funds but may be relevant for other exempt entities. Hence this cannot be the justification for waiving the condition of being liable to tax to qualify for becoming resident. For these members, the insertion of "recognized pension fund" in Article 4(1) does not appear to be acceptable technically.

8. As regards paragraph 8.13 of the Commentary on Article 4 of the 2017 OECD Model quoted in paragraph 5 above, some members of the Committee of Experts consider that the partners of fiscally transparent partnerships cannot claim the benefits of the convention in the absence of a rule such as paragraph 2 of Article 1. They are of the view that a special rule is indeed required in a convention to provide such a result. Paragraph 2 of Article 1 clarifies that the Convention will apply to the partnership's income to the extent that the income is treated, for purposes of taxation by that State, as the income of a partner who is a resident of that State. The same treatment will apply to income of other entities or arrangements that are treated as fiscally transparent under the tax law of a Contracting State.

9. When the former Group of Experts decided to draft paragraph 1 on the basis of paragraph 1 of Article 4 of the OECD Model, it initially omitted the second sentence of the paragraph. That sentence was included in the OECD Model to deal, for example, with the special situation of foreign diplomats and consular staffs serving in a country which taxed residents on the basis of their worldwide income, who might be considered as residents under the domestic law of the country in which they are serving but who, because of their special status, might nevertheless be taxable only on income from sources in that State. That second sentence, however, was incorporated in paragraph 1 of Article 4 of the UN Model in 1999. The Committee considers that the following explanations on that second sentence found in the Commentary on Article 4 of the 2017 OECD Model are applicable to the second sentence of paragraph 1 of Article 4 of the UN Model:

> 8.1 In accordance with the provisions of the second sentence of paragraph 1, however, a person is not to be considered a "resident of a Contracting State" in the sense of the Convention if, although not

domiciled in that State, he is considered to be a resident according to the domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State. That situation exists in some States in relation to individuals, for example, in the case of foreign diplomatic and consular staff serving in their territory.

8.2 According to its wording and spirit the second sentence also excludes from the definition of a resident of a Contracting State foreign held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies. It also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States. The exclusion of certain companies or other persons from the definition would not of course prevent Contracting States from exchanging information about their activities (see paragraph 2 of the Commentary on Article 26). Indeed States may feel it appropriate to develop spontaneous exchanges of information about persons who seek to obtain unintended treaty benefits.

Paragraph 2

10. This paragraph, which reproduces paragraph 2 of Article 4 of the OECD Model, lists in decreasing order of relevance a number of subsidiary criteria to be applied when an individual is a resident of both Contracting States and the preceding criteria do not provide a clear-cut determination of his status as regards residence. The Committee considers that the following part of the Commentary on Article 4 of the 2017 OECD Model is applicable to paragraph 2 of this Model:

9. This paragraph relates to the case where, under the provisions of paragraph 1, an individual is a resident of both Contracting States.

10. To solve this conflict special rules must be established which give the attachment to one State a preference over the attachment to the other State. As far as possible, the preference criterion must be of such a nature that there can be no question but that the person concerned will satisfy it in one State only, and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State. The facts to which the special rules will apply are those existing during the period when the residence of the

taxpayer affects tax liability, which may be less than an entire taxable period. For example, in one calendar year an individual is a resident of State A under that State's tax laws from 1 January to 31 March, then moves to State B. Because the individual resides in State B for more than 183 days, the individual is treated by the tax laws of State B as a State B resident for the entire year. Applying the special rules to the period 1 January to 31 March, the individual was a resident of State A. Therefore, both State A and State B should treat the individual as a State A resident for that period, and as a State B resident from 1 April to 31 December.

11. The Article gives preference to the Contracting State in which the individual has a permanent home available to him. This criterion will frequently be sufficient to solve the conflict, for example, where the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State.

12. Subparagraph *a*) means, therefore, that in the application of the Convention (that is, where there is a conflict between the laws of the two States) it is considered that the residence is that place where the individual owns or possesses a home; this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration.

13. As regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room). But the permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc.). For instance, a house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an unrelated party so that the individual no longer has the possession of the house and the possibility to stay there.

14. If the individual has a permanent home in both Contracting States, paragraph 2 gives preference to the State with which the personal and economic relations of the individual are closer, this being understood as the centre of vital interests. In the cases where the

residence cannot be determined by reference to this rule, paragraph 2 provides as subsidiary criteria, first, habitual abode, and then nationality. If the individual is a national of both States or of neither of them, the question shall be solved by mutual agreement between the States concerned according to the procedure laid down in Article 25.

15. If the individual has a permanent home in both Contracting States, it is necessary to look at the facts in order to ascertain with which of the two States his personal and economic relations are closer. Thus, regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc. The circumstances must be examined as a whole, but it is nevertheless obvious that considerations based on the personal acts of the individual must receive special attention. If a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first State.

16. Subparagraph *b*) establishes a secondary criterion for two quite distinct and different situations:

a) the case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;

b) the case where the individual has a permanent home available to him in neither Contracting State.

Preference is given to the Contracting State where the individual has an habitual abode.

17. In the first situation, the case where the individual has a permanent home available to him in both States, the fact of having an habitual abode in one State but not in the other appears therefore as the circumstance which, in case of doubt as to where the individual has his centre of vital interests, tips the balance towards the State where he stays more frequently. For this purpose regard must be had to stays made by the individual not only at the permanent home in the State in question but also at any other place in the same State.

18. The second situation is the case of an individual who has a permanent home available to him in neither Contracting State, as for example, a person going from one hotel to another. In this case also

all stays made in a State must be considered without it being necessary to ascertain the reasons for them.

19. The application of the criterion provided for in subparagraph *b*) requires a determination of whether the individual lived habitually, in the sense of being customarily or usually present, in one of the two States but not in the other during a given period; the test will not be satisfied by simply determining in which of the two Contracting States the individual has spent more days during that period. The phrase "*séjourne de façon habituelle*", which is used in the French version of subparagraph *b*), provides a useful insight as to the meaning of "habitual abode", a notion that refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual's life and are therefore more than transient. As recognised in subparagraph *c*), it is possible for an individual to have an habitual abode in the two States, which would be the case if the individual was customarily or usually present in each State during the relevant period, regardless of the fact that he spent more days in one State than in the other. Assume, for instance, that over a period of five years, an individual owns a house in both States A and B but the facts do not allow the determination of the State in which the individual's centre of vital interests is situated. The individual works in State A where he habitually lives but returns to State B two days a month and once a year for a three-week holiday. In that case, the individual will have an habitual abode in State A but not in State B. Assume, however, that over the same period of five years, the individual works short periods of time in State A, where he returns 15 times a year for stays of two weeks each time, but is present in State B the rest of the time (assume also that the facts of the case do not allow the determination of the State in which the individual's centre of vital interests is situated). In that case, the individual will have an habitual abode in both State A and State B.

19.1 Subparagraph *b*) does not specify over what length of time the determination of whether an individual has an habitual abode in one or both States must be made. The determination must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual's life. Care should be taken, however, to consider a period of time during which there were no major changes of personal circumstances that would clearly affect the determination (such as a separation or divorce). The relevant period for purposes of the determination of whether an individual has an habitual abode in one or both States will not always correspond to the period of dual-residence,

especially where the period of dual-residence is very short. This is illustrated by the following example. Assume that an individual resident of State C moves to State D to work at different locations for a period of 190 days. During that 190-day period, he is considered a resident of both States C and D under their respective domestic tax laws. The individual lived in State C for many years before moving to State D, remains in State D for the entire period of his employment there and returns to State C to live there permanently at the end of the 190-day period. During the period of his employment in State D, the individual does not have a permanent home available to him in either State C or State D. In this example, the determination of whether the individual has an habitual abode in one or both States would appropriately consider a period of time longer than the 190-day period of dual-residence in order to ascertain the frequency, duration and regularity of stays that were part of the settled routine of the individual's life.

20. Where, in the two situations referred to in subparagraph *b)* the individual has an habitual abode in both Contracting States or in neither, preference is given to the State of which he is a national. If, in these cases still, the individual is a national of both Contracting States or of neither of them, subparagraph *d*) assigns to the competent authorities the duty of resolving the difficulty by mutual agreement according to the procedure established in Article 25.

Paragraph 3

11. Paragraph 3 reproduces paragraph 3 of Article 4 of the OECD Model. In 2017, following a recommendation included in the final report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[37] of the OECD/G20 BEPS Project, changes were made to paragraph 3 of both Models to replace the previous rule based on place of effective management. The Committee considers that the following explanations found in the Commentary on Article 4 of the 2017 OECD Model are applicable to paragraph 3 of this Model:

21. This paragraph concerns companies and other bodies of persons, irrespective of whether they are or not legal persons. It may be rare in practice for a company, etc. to be subject to tax as a resident in more than one State, but it is, of course, possible if, for instance, one State attaches importance to the registration and the other State to the place

37 See footnote 9 above.

of effective management. So, in the case of companies, etc., also, special rules as to the preference must be established.

22. When paragraph 3 was first drafted, it was considered that it would not be an adequate solution to attach importance to a purely formal criterion like registration and preference was given to a rule based on the place of effective management, which was intended to be based on the place where the company, etc. was actually managed.

23. In 2017, however, the *[OECD]* Committee on Fiscal Affairs recognised that although situations of double residence of entities other than individuals were relatively rare, there had been a number of tax avoidance cases involving dual resident companies. It therefore concluded that a better solution to the issue of dual residence of entities other than individuals was to deal with such situations on a case-by-case basis.

24. As a result of these considerations, the current version of paragraph 3 provides that the competent authorities of the Contracting States shall endeavour to resolve by mutual agreement cases of dual residence of a person other than an individual.

24.1 Competent authorities having to apply paragraph 3 would be expected to take account of various factors, such as where the meetings of the person's board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc. Countries that consider that the competent authorities should not be given the discretion to solve such cases of dual residence without an indication of the factors to be used for that purpose may want to supplement the provision to refer to these or other factors that they consider relevant.

24.2 A determination under paragraph 3 will normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25. Such a request may be made as soon as it is probable that the person will be considered a resident of each Contracting State under paragraph 1. Due to the notification requirement in paragraph 1 of Article 25, it should in any event be made within three years from the first notification to that person

of taxation measures taken by one or both States that indicate that reliefs or exemptions have been denied to that person because of its dual-residence status without the competent authorities having previously endeavoured to determine a single State of residence under paragraph 3. The competent authorities to which a request for determination of residence is made under paragraph 3 should deal with it expeditiously and should communicate their response to the taxpayer as soon as possible.

24.3 Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.

24.4 The last sentence of paragraph 3 provides that in the absence of a determination by the competent authorities, the dual-resident person shall not be entitled to any relief or exemption under the Convention except to the extent and in such manner as may be agreed upon by the competent authorities. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person. This will mean, for example, that the condition in subparagraph *b*) of paragraph 2 of Article 15 will not be met with respect to an employee of that person who is a resident of either Contracting State exercising employment activities in the other State. Similarly, if the person is a company, it will be considered to be a resident of each State for the purposes of the application of Article 10 to dividends that it will pay.

12. While paragraph 3 of Article 4 no longer includes a rule based solely on the place of effective management of the entity, some States may consider it to be preferable to deal with cases of dual residence of entities using such a rule. These States may consider that this rule can be interpreted in such a way to prevent it from being abused and may therefore wish to include the following version of paragraph 3, which appeared in the UN Model prior to the 2017 update:

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

Article 5

PERMANENT ESTABLISHMENT

A. General considerations

1. Article 5 of this Model is based on Article 5 of the OECD Model but contains several significant differences. In essence these are that under this Model:

- there is a six-month test for a building or construction site constituting a permanent establishment, rather than the twelve-month test under the OECD Model, and it expressly extends to assembly projects, as well as supervisory activities in connection with building sites and construction, assembly or installation projects (paragraph 3 (*a*));
- the furnishing of services by an enterprise through employees or other personnel results in a permanent establishment where such activities continue for a total of more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned (paragraph 3 (*b*));
- in the list of what is deemed not to constitute a permanent establishment in paragraph 4 (often referred to as the list of "preparatory and auxiliary activities") "delivery" is not mentioned in this Model but is mentioned in the OECD Model. Therefore, a delivery activity might result in a permanent establishment under this Model, without doing so under the OECD Model;
- the actions of a "dependent agent" may constitute a permanent establishment, even without that person habitually concluding, or habitually playing the principal role leading to the conclusion of, certain contracts to be performed by the foreign enterprise, where that person habitually maintains a stock of goods or merchandise and regularly makes deliveries from the stock (paragraph 5 (*b*)).

These differences are considered in more detail below.

2. The concept of "permanent establishment" is used in bilateral tax treaties to determine the right of a State to tax the profits of an enterprise of the other State. Specifically, under Article 7, the profits of an enterprise of one State are taxable in the other State only if the enterprise maintains a permanent establishment in the latter State and

only to the extent that the profits are attributable to the permanent establishment. The concept of permanent establishment is found in the early model conventions including the 1928 model conventions of the League of Nations. The UN Model reaffirms the concept.

B. Commentary on the paragraphs of Article 5

Paragraph 1

3. This paragraph, which reproduces paragraph 1 of Article 5 of the OECD Model, defines the term "permanent establishment", emphasizing its essential nature as a "fixed place of business" with a specific "situs". According to paragraph 6 of the Commentary on Article 5 of the 2017 OECD Model, this definition contains the following conditions:

- the existence of a "place of business", that is, a facility such as premises or, in certain instances, machinery or equipment;
- this place of business must be "fixed", that is, it must be established at a distinct place with a certain degree of permanence;
- the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.

4. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable to Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 5. In many States, a foreign enterprise may be allowed or required to register for the purposes of a value added tax or goods and services tax (VAT/GST) regardless of whether it has in that State a fixed place of business through which its business is wholly or partly carried on or whether it is deemed to have a permanent establishment in that State under paragraph 5 of Article 5. By itself, however, treatment under VAT/GST is irrelevant for the purposes of the interpretation and application of the definition of permanent establishment in the Convention; when applying that definition, one should not, therefore,

draw any inference from the treatment of a foreign enterprise for VAT/GST purposes, including from the fact that a foreign enterprise has registered for VAT/GST purposes.[1] *[38]*

1 See paragraph 337 of the Report on Action 1 of the BEPS Project ("… it is important to underline that registration for VAT purposes is independent from the determination of whether there is a permanent establishment (PE) for income tax purposes."), OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241046-en. Cf. footnote 24 of the International VAT/GST Guidelines ("For the purpose of these Guidelines, it is assumed that an establishment comprises a fixed place of business with a sufficient level of infrastructure in terms of people, systems and assets to be able to receive and/or make supplies. Registration for VAT purposes by itself does not constitute an establishment for the purposes of these Guidelines. Countries are encouraged to publicise what constitutes an "establishment" under their domestic VAT legislation."), OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en.

[…]

7. It could perhaps be argued that in the general definition some mention should also be made of the other characteristic of a permanent establishment to which some importance has sometimes been attached in the past, namely that the establishment must have a productive character, that is, contribute to the profits of the enterprise. In the present definition this course has not been taken. Within the framework of a well-run business organisation it is surely axiomatic to assume that each part contributes to the productivity of the whole. It does not, of course, follow in every case that because in the wider context of the whole organisation a particular establishment has a "productive character" it is consequently a permanent establishment to which profits can properly be attributed for the purpose of tax in a particular territory (see Commentary on paragraph 4).

8. It is also important to note that the way in which business is carried on evolves over the years so that the facts and arrangements applicable at one point in time may no longer be relevant after a

38 *[Clearly, however, facts and information obtained under VAT/GST legislation could be relevant in applying the treaty definition of permanent establishment.]*

change in the way that the business activities are carried on in a given State. Clearly, whether or not a permanent establishment exists in a State during a given period must be determined on the basis of the circumstances applicable during that period and not those applicable during a past or future period, such as a period preceding the adoption of new arrangements that modified the way in which business is carried on.[39]

9. Also, the determination of whether or not an enterprise of a Contracting State has a permanent establishment in the other Contracting State must be made independently from the determination of which provisions of the Convention apply to the profits derived by that enterprise. For instance, a farm or apartment rental office situated in a Contracting State and exploited by a resident of the other Contracting State may constitute a permanent establishment regardless of whether or not the profits attributable to such permanent establishment would constitute income from immovable property covered by Article 6; whilst the existence of a permanent establishment in such cases may not be relevant for the application of Article 6, it would remain relevant for the purposes of other provisions such as paragraphs 4 and 5 of Article 11, subparagraph *c*) of paragraph 2 of Article 15 and paragraph 3 of Article 24.

10. The term "place of business" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or

39 *[This principle, however, does not affect the application of the parts of the definition of permanent establishment that expressly require the consideration of previous facts or arrangements. For instance, in the context of subparagraph 3(b) of Article 5, the determination of whether a permanent establishment exists in a given fiscal year will often require the consideration of whether services were provided during part of a previous year that would be included in a twelve-month period ending in that given fiscal year. Assume, for instance that State B's fiscal year corresponds to the calendar year. If an enterprise of State A furnishes services in State B from 1 July 00 to 31 January 01 through employees or other personnel engaged by the enterprise for such purpose, the services rendered during year 00 will be relevant for the purposes of the application, by State B, of subparagraph 3(b) during its fiscal year 01.]*

installations are owned or rented by or are otherwise at the disposal of the enterprise. A place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (e.g. for the storage of dutiable goods). Again, the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise.

11. As noted above, the mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is therefore required. Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business.

12. Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a "place of business through which the business of [that] enterprise is wholly or partly carried on" will depend on that enterprise having the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there. This is illustrated by the following examples. Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities (e.g. where it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time. This will not be the case, however, where the enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier

> or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise (see also paragraphs 65, 66 and 121 below *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted in paragraphs 40 and 57 below]*). It is also important to remember that even if a place is a place of business through which the activities of an enterprise are partly carried on, that place will be deemed not to be a permanent establishment if paragraph 4 applies to the business activities carried on at that place.

5. A small minority of members of the Committee indicated that they did not agree with the sixth and seventh sentences of paragraph 12 of the Commentary on Article 5 of the 2017 OECD Model quoted above.[40] These members considered that it will be difficult to draw a line how intermittent presence at a location should be to regard it as a place of business. It will depend on facts and circumstances of each case. For these members, the disposal test should be whether the presence at that location is able to serve the business interest of the enterprise rather than the duration and whether it is continuous or intermittent.

6. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model, which provides additional examples illustrating the application of the principles in paragraph 12 of that Commentary, is applicable to Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 13. These principles are illustrated by the following additional examples where representatives of one enterprise are present on the premises of another enterprise.
>
> 14. A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a place of business through which the business of that

40 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

15. A second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g. a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company. In that case, the employee is carrying on activities related to the business of the former company and the office that is at his disposal at the headquarters of the other company will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a "fixed place of business" (see paragraphs 28 to 34 *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted in paragraphs 11 and 13 below]*) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.

16. A third example is that of a road transportation enterprise which would use a delivery dock at a customer's warehouse every day for a number of years for the purpose of delivering goods purchased by that customer. In that case, the presence of the road transportation enterprise at the delivery dock would be so limited that that enterprise could not consider that place as being at its disposal so as to constitute a permanent establishment of that enterprise.

17. A fourth example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitutes a permanent establishment of that painter.

18. Even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise (see paragraph 12 above). Where, however, a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the

facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office),[41] the home office may be considered to be at the disposal of the enterprise.

19. A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities.[42] It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4.

7. A small minority of members of the Committee indicated that they did not agree with the last two sentences of paragraph 19 of the Commentary on Article 5 of the 2017 OECD Model quoted above.[43] Their view is that both these statements cannot be generalized and would depend on facts. For these members, there could be business models where employees would be required to work predominantly from home,

41 *[The Committee observed, however, that this is not the case where the employer, due to special circumstances (such as a pandemic), requires employees to work from home rather than to report to the offices that it normally provides to these employees.]*

42 *[The mere fact that the employer did not formally require the employee to use the employee's home for the purposes of the employer's business should not be sufficient for that purpose. Whether or not the employer requires the employee to use the home for its business activities should be determined on the basis of all the relevant facts and circumstances.]*

43 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

despite the employer having several offices in the State due to various reasons, flexibility being one such reason. In many of these situations, activities from home would not be auxiliary.

8. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model, which provides additional explanations on the definition included in paragraph 1 of the Article, is applicable to Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 20. The words "through which" must be given a wide meaning so as to apply to any situation where business activities are carried on at a particular location that is at the disposal of the enterprise for that purpose. Thus, for instance, an enterprise engaged in paving a road will be considered to be carrying on its business "through" the location where this activity takes place.
>
> 21. According to the definition, the place of business has to be a "fixed" one. Thus, in the normal way there has to be a link between the place of business and a specific geographical point. It is immaterial how long an enterprise of a Contracting State operates in the other Contracting State if it does not do so at a distinct place, but this does not mean that the equipment constituting the place of business has to be actually fixed to the soil on which it stands. It is enough that the equipment remains on a particular site (but see paragraph 57 below *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted in paragraph 30 below]*).
>
> 22. Where the nature of the business activities carried on by an enterprise is such that these activities are often moved between neighbouring locations, there may be difficulties in determining whether there is a single "place of business" (if two places of business are occupied and the other requirements of Article 5 are met, the enterprise will, of course, have two permanent establishments). As recognised in paragraphs 51 and 57 below *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted in paragraphs 26 and 30 below]* a single place of business will generally be considered to exist where, in light of the nature of the business, a particular location within which the activities are moved may be identified as constituting a coherent whole commercially and geographically with respect to that business.

> 23. This principle may be illustrated by examples. A mine clearly constitutes a single place of business even though business activities may move from one location to another in what may be a very large mine as it constitutes a single geographical and commercial unit as concerns the mining business. Similarly, an "office hotel" in which a consulting firm regularly rents different offices may be considered to be a single place of business of that firm since, in that case, the building constitutes a whole geographically and the hotel is a single place of business for the consulting firm. For the same reason, a pedestrian street, outdoor market or fair in different parts of which a trader regularly sets up his stand represents a single place of business for that trader.

9. The Commentary on paragraph 1 of Article 5 of the 2017 OECD Model includes some examples relating to the provision of services. While the Committee considers that the examples in the following paragraphs 24 and 25 of that Commentary are applicable with respect to paragraph 1 of this Model, the Committee notes that paragraph 3(*b*) of Article 5 of this Model provides a specific provision dealing with the furnishing of services by an enterprise through employees or personnel engaged for that purpose. In practice, therefore, the points made in the following paragraphs of the OECD Commentary (as with other parts of the Commentary on paragraph 1 of Article 5 of the OECD Model) may have less significance for the UN Model than in their original context.

> 24. By contrast, where there is no commercial coherence, the fact that activities may be carried on within a limited geographic area should not result in that area being considered as a single place of business. For example, where a painter works successively under a series of unrelated contracts for a number of unrelated clients in a large office building so that it cannot be said that there is one single project for repainting the building, the building should not be regarded as a single place of business for the purpose of that work. However, in the different example of a painter who, under a single contract, undertakes work throughout a building for a single client, this constitutes a single project for that painter and the building as a whole can then be regarded as a single place of business for the purpose of that work as it would then constitute a coherent whole commercially and geographically.

> 25. Conversely, an area where activities are carried on as part of a single project which constitutes a coherent commercial whole may lack the necessary geographic coherence to be considered as a single place of business. For example, where a consultant works at different

branches in separate locations pursuant to a single project for training the employees of a bank, each branch should be considered separately. However, if the consultant moves from one office to another within the same branch location, he should be considered to remain in the same place of business. The single branch location possesses geographical coherence which is absent where the consultant moves between branches in different locations.

10. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model, which deals with the application of Article 5 to a ship, is also applicable to paragraph 1 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 26. A ship that navigates in international waters or within one or more States is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship is restricted to a particular area that has commercial and geographic coherence). Business activities carried on aboard such a ship, such as the operation of a shop or restaurant, must be treated the same way for the purposes of determining whether paragraph 1 applies (paragraph*[s 3,]* 5 *[and 6]* could apply, however, to some of these activities, for example, where contracts are concluded when such shops or restaurants are operated within a State).

11. The Committee also considers that the following paragraphs 28 to 31 of the Commentary on Article 5 of the 2017 OECD Model, which deal with the temporal aspect of the word "fixed" in paragraph 1 of the Article, are applicable to paragraph 1 of Article 5 of this Model, while recognizing that such exceptional situations will not often arise in practice and that special care should therefore be taken when relying on these paragraphs in an actual case:

> 28. Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, that is, if it is not of a purely temporary nature. A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time.

It is sometimes difficult to determine whether this is the case. Whilst the practices followed by member countries have not been consistent insofar as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months).

29. One exception to this general practice has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). That exception is illustrated by the following example. An enterprise of State R carries on drilling operations at a remote arctic location in State S. The seasonal conditions at that location prevent such operations from going on for more than three months each year but the operations are expected to last for five years. In that case, given the nature of the business operations at that location, it could be considered that the time requirement for a permanent establishment is met due to the recurring nature of the activity regardless of the fact that any continuous presence lasts less than six months; the time requirement could similarly be met in the case of shorter recurring periods of time that would be dictated by the specific nature of the relevant business.

30. Another exception to this general practice has been made where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. That exception is illustrated by the following example. An individual resident of State R has learned that a television documentary will be shot in a remote village in State S where her parents still own a large house. The documentary will require the presence of a number of actors and technicians in that village during a period of four months. The individual contractually agrees with the producer of the documentary to provide catering services to the actors and technicians during the four month period and, pursuant to that contract, she uses the house of her parents as a cafeteria that she operates as sole proprietor during that period. These are the only business activities that she has carried on and the enterprise is terminated after that period; the cafeteria will therefore be the only

location where the business of that enterprise will be wholly carried on. In that case, it could be considered that the time requirement for a permanent establishment is met since the restaurant is operated during the whole existence of that particular business. This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four-month production of a documentary. In that case, the company's business, which is permanently carried on in State R, is only temporarily carried on in State S.

31. For ease of administration, countries may want to consider the practices reflected in paragraphs 28 to 30 when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.

12. A small minority of members of the Committee indicated that they did not agree with the last two sentences of paragraph 30 of the Commentary on Article 5 of the 2017 OECD Model quoted above because they considered that the operation of catering facilities in that example meets the time requirement for constituting a permanent establishment.[44] For these members, the exception to the duration test is applicable depending upon the specific nature of the business irrespective of the fact that such business is carried on exclusively in the source State; if the business (a cafeteria in the example) is carried out in some other country as well, that is no reason to make the exception not applicable. These members consider that the exception is applicable depending upon the specific nature of the business and hence it will be wrong to say that if the business is not carried out exclusively in source State, the duration test is not met.

13. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model, which provides additional explanations related to the temporal aspect of the word "fixed" in paragraph 1 of the Article, is also applicable to paragraph 1 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

44 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

32. As mentioned in paragraphs 44 and 55 *[of the Commentary on Article 5 of the 2017 OECD Model]*, temporary interruptions of activities do not cause a permanent establishment to cease to exist. Similarly, as discussed in paragraph *[29 of the Commentary on Article 5 of the 2017 OECD Model]*, where a particular place of business is used for only very short periods of time, but such usage takes place regularly over long periods of time, the place of business should not be considered to be of a purely temporary nature.

33. Also, there may be cases where a particular place of business would be used for very short periods of time by a number of similar businesses carried on by the same or related persons in an attempt to avoid that the place be considered to have been used for more than purely temporary purposes by each particular business. The remarks of paragraphs 52 and 53 *[of the Commentary on Article 5 of the 2017 OECD Model]* on arrangements intended to abuse the *[six]* month period provided for in paragraph 3 would equally apply to such cases.

34. Where a place of business which was, at the outset, designed to be used for such a short period of time that it would not have constituted a permanent establishment but is in fact maintained for such a period that it can no longer be considered as a temporary one, it becomes a fixed place of business and thus – retrospectively – a permanent establishment. A place of business can also constitute a permanent establishment from its inception even though it existed, in practice, for a very short period of time, if as a consequence of special circumstances (e.g. death of the taxpayer, investment failure), it was prematurely liquidated.

35. For a place of business to constitute a permanent establishment the enterprise using it must carry on its business wholly or partly through it. As stated in paragraph *[7 of the Commentary on Article 5 of the 2017 OECD Model]* above, the activity need not be of a productive character. Furthermore, the activity need not be permanent in the sense that there is no interruption of operation, but operations must be carried out on a regular basis.

14. The Committee also considers that the following paragraph of the Commentary on Article 5 of the 2017 OECD Model, which primarily deals with the leasing of property, is applicable to paragraph 1 of Article 5 of this Model (the modification that appears in italics in square brackets, which is not part of the Commentary on the OECD Model, has been inserted in order to reflect a difference between the provisions of the

OECD Model and those of this Model). The Committee notes, however, that where the lessor of industrial, commercial or scientific equipment also supplies personnel after installation to operate or maintain the equipment, such activities could constitute a permanent establishment under the provisions of paragraph 3(*b*) of Article 5 of the UN Model:

> 36. Where tangible property such as facilities, industrial, commercial or scientific (ICS) equipment, buildings, or intangible property such as patents, procedures and similar property, are let or leased to third parties through a fixed place of business maintained by an enterprise of a Contracting State in the other State, this activity will, in general, render the place of business a permanent establishment. The same applies if capital is made available through a fixed place of business. If an enterprise of a State lets or leases facilities, ICS equipment, buildings or intangible property to an enterprise of the other State without maintaining for such letting or leasing activity a fixed place of business in the other State, the leased facility, ICS equipment, building or intangible property, as such, will not constitute a permanent establishment of the lessor provided the contract is limited to the mere leasing of the ICS equipment etc. This remains the case even when, for example, the lessor supplies personnel after installation to operate the equipment provided that their responsibility is limited solely to the operation or maintenance of the ICS equipment under the direction, responsibility and control of the lessee. If the personnel have wider responsibilities, for example participation in the decisions regarding the work for which the equipment is used, or if they operate, service, inspect and maintain the equipment under the responsibility and control of the lessor, the activity of the lessor may go beyond the mere leasing of ICS equipment and may constitute an entrepreneurial activity. In such a case a permanent establishment could be deemed to exist if the criterion of permanency is met. When such activity is connected with, or is similar in character to, those mentioned in paragraph 3, the time limit of *[six]* months applies. Other cases have to be determined according to the circumstances.

15. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model, which deals with the interpretation of the phrase "through which the business of an enterprise is wholly or partly carried on" in paragraph 1 of the Article, is applicable to paragraph 1 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to

provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 39. There are different ways in which an enterprise may carry on its business. In most cases, the business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business of the enterprise (see paragraph 100 *[of the Commentary on Article 5 of the 2017 OECD Model Tax Convention]*). As explained in paragraph 8.11 of the Commentary on Article 15 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 15 of this Model]*, however, there may be cases where individuals who are formally employed by an enterprise will actually be carrying on the business of another enterprise and where, therefore, the first enterprise should not be considered to be carrying on its own business at the location where these individuals will perform that work. Within a multinational group, it is relatively common for employees of one company to be temporarily seconded to another company of the group and to perform business activities that clearly belong to the business of that other company. In such cases, administrative reasons (e.g. the need to preserve seniority or pension rights) often prevent a change in the employment contract. The analysis described in paragraphs 8.13 to 8.15 of the Commentary on Article 15 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 15 of this Model]* will be relevant for the purposes of distinguishing these cases from other cases where employees of a foreign enterprise perform that enterprise's own business activities.
>
> 40. An enterprise may also carry on its business through subcontractors, acting alone or together with employees of the enterprise. In that case, a permanent establishment will only exist for the enterprise if the other conditions of Article 5 are met (this, however, does not address the separate question of how much profit is attributable to such a permanent establishment). In the context of paragraph 1, the existence of a permanent establishment in these circumstances will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise. Whether a fixed place of business where subcontractors perform work of an enterprise is at the disposal of that enterprise will

be determined on the basis of the guidance in paragraph 12 *[of the Commentary on Article 5 of the 2017 OECD Model]*; in the absence of employees of the enterprise, however, it will be necessary to show that such a place is at the disposal of the enterprise on the basis of other factors showing that the enterprise clearly has the effective power to use that site, for example, because the enterprise owns or has legal possession of that site and controls access to and use of the site. Paragraph 54 *[of the Commentary on Article 5 of the 2017 OECD Model as quoted in paragraph 28 below]* illustrates such a situation in the case of a construction site; this could also happen in other situations. An example would be where an enterprise that owns a small hotel and rents out the hotel's rooms through the Internet has subcontracted the on-site operation of the hotel to a company that is remunerated on a cost-plus basis.

41. Also, a permanent establishment may exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment. Whether or not gaming and vending machines and the like set up by an enterprise of a State in the other State constitute a permanent establishment thus depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines. A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises. A permanent establishment may exist, however, if the enterprise which sets up the machines also operates and maintains them for its own account. This also applies if the machines are operated and maintained by an agent dependent on the enterprise.

42. It follows from the definition of "enterprise of a Contracting State" in Article 3 that this term, as used in Article 7, and the term "enterprise" used in Article 5, refer to any form of enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form. Different enterprises may collaborate on the same project and the question of whether their collaboration constitutes a separate enterprise (e.g. in the form of a partnership) is a question that depends on the facts and the domestic law of each State. Clearly, if two persons each carrying on a separate enterprise decide to form a company in which these persons are shareholders, the company constitutes a legal person that will carry on what becomes another separate enterprise. It will often be the case, however, that different enterprises will simply

agree to each carry on a separate part of the same project and that these enterprises will not jointly carry on business activities, will not share the profits thereof and will not be liable for each other's activities related to that project even though they may share the overall output from the project or the remuneration for the activities that will be carried on in the context of that project. In such a case, it would be difficult to consider that a separate enterprise has been set up. Although such an arrangement would be referred to as a "joint venture" in many countries, the meaning of "joint venture" depends on domestic law and it is therefore possible that, in some countries, the term "joint venture" would refer to a distinct enterprise.

43. In the case of an enterprise that takes the form of a fiscally transparent partnership, the enterprise is carried on by each partner and, as regards the partners' respective shares of the profits, is therefore an enterprise of each Contracting State of which a partner is a resident. If such a partnership has a permanent establishment in a Contracting State, each partner's share of the profits attributable to the permanent establishment will therefore constitute, for the purposes of Article 7, profits derived by an enterprise of the Contracting State of which that partner is a resident (see also paragraph 56 *[of the Commentary on Article 5 of the 2017 OECD Model]* below).

44. A permanent establishment begins to exist as soon as the enterprise commences to carry on its business through a fixed place of business. This is the case once the enterprise prepares, at the place of business, the activity for which the place of business is to serve permanently. The period of time during which the fixed place of business itself is being set up by the enterprise should not be counted, provided that this activity differs substantially from the activity for which the place of business is to serve permanently. The permanent establishment ceases to exist with the disposal of the fixed place of business or with the cessation of any activity through it, that is when all acts and measures connected with the former activities of the permanent establishment are terminated (winding up current business transactions, maintenance and repair of facilities). A temporary interruption of operations, however, cannot be regarded as a closure. If the fixed place of business is leased to another enterprise, it will normally only serve the activities of that enterprise instead of the lessor's; in general, the lessor's permanent establishment ceases to exist, except where he continues carrying on a business activity of his own through the fixed place of business.

Paragraph 2

16. Paragraph 2, which reproduces paragraph 2 of Article 5 of the OECD Model, lists examples of places that will often constitute a permanent establishment. However, the provision is not self-standing. While paragraph 2 notes that offices, factories, etc., are common types of permanent establishments, when one is looking at the operations of a particular enterprise, the requirements of paragraph 1 must also be met. Paragraph 2 therefore simply provides an indication that a permanent establishment may well exist; it does not provide that one necessarily does exist. This is also the position put forward in paragraph 45 of the Commentary on Article 5 of the 2017 OECD Model, where it is provided that States interpret the terms listed in paragraph 2 "in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1".

17. Developing countries often wish to broaden the scope of the term "permanent establishment" and some believe that a warehouse should be included among the specific examples in paragraph 2. However, the deletion of "delivery" from the excluded activities described in subparagraphs (*a*) and (*b*) of paragraph 4 means that a "warehouse" used for any purpose is (subject to the conditions in paragraph 1 being fulfilled) a permanent establishment under the general principles of the Article.

18. Paragraph 46 of the Commentary on Article 5 of the 2017 OECD Model points out that the term "place of management" is mentioned separately because it is not necessarily an "office" and that "where the laws of the two Contracting States do not contain the concept of a 'place of management' as distinct from an 'office', there will be no need to refer to the former term in their bilateral convention".

19. In discussing paragraph 2(*f*) of Article 5, which provides that the term "permanent establishment" includes mines, oil or gas wells, quarries or any other place of extraction of natural resources, Paragraph 47 of the Commentary on Article 5 of the 2017 OECD Model states that "the term 'any other place of extraction of natural resources' should be interpreted broadly" to include, for example, all places of extraction of hydrocarbons whether on or offshore. Because subparagraph (*f*) does not mention exploration for natural resources, whether on or offshore,

paragraph 1 governs whether exploration activities are carried on through a permanent establishment. This gap has been filled by the addition in 2025 of Article 5A (Income from the Exploration for, or Exploitation of, Natural Resources) to this Model.

20. As mentioned above, the expression "any other place of extraction of natural resources" found in paragraph 2(*f*) should be interpreted broadly. Some have argued that, for this purpose, a fishing vessel could be treated as a place of extraction or exploitation of natural resources since "fish" constitute a natural resource. In their analysis, although it is true that all places or apparatus designated as "permanent establishments" in paragraphs 2(*a*) to (*e*) have a certain degree of permanence or constitute "immovable property", fishing vessels can be considered as a place used for extraction of natural resources, which may not necessarily mean only minerals embedded in the earth. In this view, fishing vessels can be compared to the movable drilling platform that is used in offshore drilling operations for gaining access to oil or gas. Where such fishing vessels are used in the territorial waters or the exclusive economic zone of the coastal State, their activities would constitute a permanent establishment, situated in that State. However, others are of the view that such an interpretation was open to objection in that it constituted too broad a reading of the term "permanent establishment" and of the natural language of the subparagraph. Accordingly, in their opinion, any treaty partner countries which sought to advance such a proposition in respect of fishing activities, should make that explicit by adopting it as a new and separate category in the list contained in this Article. Consequently, the interpretation on the nature of this activity had been left to negotiations between Contracting States so that, for example, countries which believe that a fishing vessel can be a permanent establishment might choose to make that explicit in this Article, such as by the approach outlined in paragraph 33 of this Commentary. These questions also have now been rendered less urgent by the addition of Article 5A (Income from the Exploration for, or Exploitation of, Natural Resources) to this Model.

Paragraph 3

21. This paragraph covers a broader range of activities than paragraph 3 of Article 5 of the OECD Model, which states, "[a] building site or construction or installation project constitutes a permanent

establishment only if it lasts more than twelve months". In addition to the term "installation project" used in the OECD Model, paragraph 3(*a*) of Article 5 of the UN Model includes an "assembly project" as well as "supervisory activities" in connection with "a building site, a construction, assembly or installation project". Another difference is that while the OECD Model uses a time limit of 12 months, this Model reduces the minimum duration to six months. In special cases, this six-month period could be reduced in bilateral negotiations to not less than three months. The Committee notes that there are differing views about whether paragraph 3(*a*) is a "self-standing" provision (so that no resort to paragraph 1 is required) or whether (in contrast) only building sites and the like that meet the criteria of paragraph 1 would constitute permanent establishments, subject to there being a specific six-month test. However, the Committee considers that where a building site exists for six months, it will in practice almost invariably also meet the requirements of paragraph 1. In fact, an enterprise having a building site, etc., at its disposal, through which its activities are wholly or partly carried on will also meet the criteria of paragraph 1.

22. Some countries support a more elaborate version of paragraph 3(*a*) which would extend the provision to encompass a situation "where such project or activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or activities exceed 10 per cent of the sale price of the machinery or equipment". Other countries believe that such a provision would not be appropriate, particularly if the machinery were installed by an enterprise other than the one doing the construction work.

23. Paragraph 3(*b*) deals with the furnishing of services, the performance of which does not, of itself, create a permanent establishment in the OECD Model. Many developing countries believe that services, such as management and consultancy services, should be covered because the provision of those services in developing countries by enterprises of industrialized countries can generate large profits. In the 2011 revision of the UN Model, the Committee agreed to a slight change in the wording of paragraph 3(*b*), which was amended to read: "but only if activities of that nature continue … within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year

concerned", rather than, "but only if activities of that nature continue … within a Contracting State for a period or periods aggregating more than six months within any twelve-month period", as it formerly read. This was seen as providing greater consistency with the approach taken in paragraph 1(*b*) of former Article 14.

24. In the 2017 revision, the Committee made a further change to paragraph 3(*b*) to remove the words in parenthesis "(for the same or a connected project)". This change is discussed in more detail in paragraph 31 below.

25. A few developing countries oppose the six-month and 183-day thresholds in paragraphs 3(*a*) and (*b*). They have two main reasons: first, they maintain that construction, assembly and similar activities could, as a result of modern technology, be of very short duration and still result in a substantial profit for the enterprise; second, and more fundamentally, they simply believe that the period during which foreign personnel remain in the source country is irrelevant to their right to tax the income (as it is in the case of artistes and sportspersons under Article 17). Other developing countries oppose a time limit because it could be used by foreign enterprises to set up artificial arrangements to avoid taxation in their territory. However, the purpose of bilateral treaties is to promote international trade, investment, and development, and the reason for the time limit (indeed for the permanent establishment threshold more generally) is to encourage businesses to undertake preparatory or ancillary operations in another State that will facilitate a more permanent and substantial commitment later on, without becoming immediately subject to tax in that State.

26. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable to paragraph 3(*a*) of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 49. The paragraph provides expressly that a building site*[, a construction, assembly or installation project or supervisory activities in connection therewith]* constitutes a permanent establishment only if it lasts more than *[six]* months. Any of those items which do not meet this

condition does not of itself constitute a permanent establishment *[under paragraph 3(a) of Article 5 of this Model]*, even if there is within it an installation, for instance an office or a workshop within the meaning of paragraph 2, associated with the construction activity. Where, however, such an office or workshop is used for a number of construction projects and the activities performed therein go beyond those mentioned in paragraph 4, it will be considered a permanent establishment if the conditions of the Article are otherwise met even if none of the projects involve a building site*[, a construction, assembly or installation project or supervisory activities in connection therewith]* that lasts more than *[six]* months. In that case, the situation of the workshop or office will therefore be different from that of these sites or projects, none of which will constitute a permanent establishment *[under paragraph 3(a) of Article 5 of this Model]*, and it will be important to ensure that only the profits properly attributable to the functions performed through that office or workshop, taking into account the assets used and the risks assumed through that office or workshop, are attributed to the permanent establishment. This could include profits attributable to functions performed in relation to the various construction sites but only to the extent that these functions are properly attributable to the office.

50. The term "building site*[, a construction, assembly or installation project]*" includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipe-lines and excavating and dredging. Additionally, the term "installation project" is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are covered by [*paragraph 3(a) of Article 5 of this Model*]. *[…]*

51. The *[six-]*month test applies to each individual site or project. In determining how long the site or project has existed, no account should be taken of the time previously spent by the contractor concerned on other sites or projects which are totally unconnected with it. A building site should be regarded as a single unit, even if it is based on several contracts, provided that it forms a coherent whole commercially and geographically. Subject to this proviso, a building site forms a single unit even if the orders have been placed by several persons (e.g. for a row of houses).

52. The *[six-]*month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or subcontractors working on the continental shelf or engaged in activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period less than *[six]* months and attributed to a different company, which was, however, owned by the same group. Apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial anti-avoidance rules, these abuses could also be addressed through the application of the anti-abuse rule of paragraph 9 of Article 29, as shown by example J in paragraph 182 of the Commentary on Article 29 *[of the 2017 OECD Model, as quoted in paragraph 35 of the Commentary on Article 29 of this Model, as well as in example N in the same paragraph 35 of the Commentary on Article 29 of this Model]*. Some States may nevertheless wish to deal expressly with such abuses. Moreover, States that do not include paragraph 9 of Article 29 in their treaties should include an additional provision to address contract splitting. Such a provision could, for example, be drafted along the following lines:

> For the sole purpose of determining whether the *[six-]*month period referred to in paragraph 3 has been exceeded,
>
> (*a*) where an enterprise of a Contracting State carries on activities in the other Contracting State at a place that constitutes a building site or construction*[, assembly]* or installation project *[or supervisory activities in connection therewith]* and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding *[six]* months, and
>
> (*b*) connected activities are carried on at the same building site, or construction*[, assembly]* or installation project *[or supervisory activities in connection therewith,]* during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise,
>
> these different periods of time shall be added to the period of time during which the first-mentioned enterprise has carried on activities at that building site or construction*[, assembly]* or installation project *[or supervisory activities in connection therewith]*.

The concept of "closely related enterprises" that is used in the above provision is defined in paragraph *[9]* of the Article (see paragraphs 119

> to 121 *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted at paragraph 57]* below).
>
> 53. For the purposes of the alternative provision found in paragraph 52, the determination of whether activities are connected will depend on the facts and circumstances of each case. Factors that may especially be relevant for that purpose include:
>
> — whether the contracts covering the different activities were concluded with the same person or related persons;
>
> — whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons;
>
> — whether the activities would have been covered by a single contract absent tax planning considerations;
>
> — whether the nature of the work involved under the different contracts is the same or similar;
>
> — whether the same employees are performing the activities under the different contracts.

27. The Committee points out that measures to counteract abuses would apply equally in cases under paragraph 3(*b*) of Article 5. The anti-contract splitting rule provided in paragraph 52 of the Commentary on the 2017 OECD Model quoted above can be amended to also counteract abuses under subparagraph (*b*). A further possibility is to include the following text immediately after subparagraph (*b*), which is based on a similar provision found in the 2016 treaty between Chile and Japan, but which utilizes the closely related enterprise wording contained in the OECD provision:

> The duration of activities under subparagraphs (*a*) and (*b*) shall be determined by aggregating the periods during which activities are carried on in a Contracting State by closely related enterprises, provided that the activities of such a closely related enterprise in that Contracting State are connected with the activities carried on in that Contracting State by its closely related enterprises. The period during which two or more closely related enterprise are carrying on concurrent activities shall be counted only once for the purpose of determining the duration of activities.

28. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is also applicable to paragraph 3(*a*) of Article 5 of this Model (the modifications that appear

in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model). As regards paragraph 55 of the OECD Commentary quoted below, however, the Committee notes that where an enterprise undertakes work on a construction site after the construction work has been completed, whether or not pursuant to a guarantee that requires an enterprise to make repairs, the period during which such work is performed would be taken into account together with the work done during the construction period for the purposes of determining whether a permanent establishment exists pursuant to paragraph 3(*b*) of Article 5 of this Model):

> 54. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, for example, if he installs a planning office for the construction. If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts all or parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project for purposes of determining whether a permanent establishment exists for the general contractor. In that case, the site should be considered to be at the disposal of the general contractor during the time spent on that site by any subcontractor where circumstances indicate that, during that time, the general contractor clearly has the construction site at its disposal by reason of factors such as the fact that he has legal possession of the site, controls access to and use of the site and has overall responsibility for what happens at that location during that period. The subcontractor himself has a permanent establishment at the site if his activities there last more than *[six]* months.
>
> 55. In general, a construction site continues to exist until the work is completed or permanently abandoned. The period during which the building or its facilities are being tested by the contractor or subcontractor should therefore generally be included in the period during which the construction site exists. In practice, the delivery of the building or facilities to the client will usually represent the end of the period of work, provided that the contractor and subcontractors no longer work on the site after its delivery for the purposes of completing its construction. A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other

> temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1 *[July]*, stopped on 1 November because of bad weather conditions or a lack of materials but resumed work on 1 February the following year, completing the road on June, his construction project should be regarded as a permanent establishment because *[eleven]* months elapsed between the date he first commenced work (1 *[July]*) and the date he finally finished (1 June of the following year). Work that is undertaken on a site after the construction work has been completed pursuant to a guarantee that requires an enterprise to make repairs would normally not be included in the original construction period. Depending on the circumstances, however, any subsequent work (including work done under a guarantee) performed on the site during an extended period of time may need to be taken into account in order to determine whether such work is carried on through a distinct permanent establishment. For example, where after delivery of a technologically advanced construction project, employees of the contractor or subcontractor remain for four weeks on the construction site to train the owner's employees, that training work shall not be considered work done for the purposes of completing the construction project. Concerns related to the splitting-up of contracts for the purposes of avoiding the inclusion of subsequent construction work in the original construction project are dealt with in paragraph 52 above *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted in paragraph 26 above]*.

29. A small minority of members of the Committee indicated that they did not agree with the fourth, third and second sentences from the end of paragraph 55 of the Commentary on Article 5 of the OECD Model quoted above.[45] According to these members, contrary to what is stated in the fourth sentence from the end of the paragraph, any work undertaken on the site shortly after the construction work has been completed, including repair work undertaken pursuant to a guarantee, needs to be taken into account as part of the original construction period for determining whether a permanent establishment exists. Their view is the same regarding the following sentence that excludes a

45 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

period of training of employees after delivery of the project. For these members, an additional important and relevant aspect in this regard is the difference between the formulation of paragraph 3(*a*) of Article 5 of the UN Model and that of paragraph 3 of Article 5 of the OECD Model due to the fact that the UN Model refers to "supervisory activities in connection therewith". The repairs after completion and training to employees would both be part of supervisory activities as well.

30. The Committee considers that the following part of the Commentary on paragraph 3 of Article 5 of the 2017 OECD Model, which deals with the application of paragraph 3 in the case of transparent entities and in situations where construction activities are relocated, is also applicable to paragraph 3(*a*) of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 56. In the case of fiscally transparent partnerships, the *[six-]m*onth test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the partners and the employees of the partnership exceeds *[six]* months, the enterprise carried on through the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site. Assume for instance that a resident of State A and a resident of State B are partners in a partnership established in State B which carries on its construction activities on a construction site situated in State C that lasts 10 months. Whilst the tax treaty between States A and C is identical to the *[UN Model]*, paragraph 3 of Article 5 of the treaty between State B and State C provides that a construction site constitutes a permanent establishment only if it lasts more than *[12]* months. In that case, the time threshold of each treaty would be applied at the level of the partnership but only with respect to each partner's share of the profits covered by that treaty; since the treaties provide for different time-thresholds, State C will have the right to tax the share of the profits of the partnership attributable to the partner who is a resident of State *[A]* but *[unless a permanent establishment exists under the other provisions of Article 5]* will not have the right to tax the share attributable to the partner who is a resident of State *[B]*. This results from the fact that whilst the provisions

of paragraph 3*[(a)]* of each treaty are applied at the level of the same enterprise (i.e. the partnership), the outcome differs with respect to the different shares of the profits of the partnership depending on the time-threshold of the treaty that applies to each share.

57. The very nature of a construction or installation project may be such that the contractor's activity has to be relocated continuously or at least from time to time, as the project progresses. This would be the case for instance where roads or canals were being constructed, waterways dredged, or pipelines laid. Similarly, where parts of a substantial structure such as an offshore platform are assembled at various locations within a country and moved to another location within the country for final assembly, this is part of a single project. In such cases the fact that the work force is not present for *[six]* months in one particular location is immaterial. The activities performed at each particular spot are part of a single project, and that project must be regarded as a permanent establishment if, as a whole, it lasts for more than *[six]* months.

31. Until the 2017 update, the UN Model contained the words "(for the same or a connected project)" in paragraph 3(*b*). This wording was removed as the "project" limitation was easy to manipulate and created difficult interpretive issues and factual determinations for tax authorities, which in particular for developing countries is an undesired administrative burden. Moreover, from a policy perspective, if a non-resident provides services in a country for more than 183 days, the non-resident's involvement in the commercial life of that country clearly justifies the country taxing the income from those services whether the services are provided for one project or multiple projects. The degree of the non-resident's involvement in the source country's economy is the same, regardless of the number of projects involved. It has been argued that taxpayers can more easily monitor the location of the activities of their employees and independent contractors on a project-by-project basis. Requiring enterprises, even large enterprises with multiple projects, to keep records with regard to the countries in which their employees and independent contractors are working does not appear to be unduly onerous or unreasonable – especially in light of technological advances. However, countries that are concerned about the uncertainty involved in adding together unrelated projects and the undesirable distinction it creates between an enterprise with, for example, one project of 95 days duration and another enterprise with two unrelated projects, each of

95 days duration, one following the other, may add the words "(for the same or a connected project)" in paragraph 3(*b*).

32. The Committee observed in general terms that broadening the scope of paragraph 3(*b*) means that the revised provision will apply in certain circumstances instead of Article 12AA in relation to fees for services.

33. The phrase "including consultancy services" was deleted because a distinction between consultancy and other services is no longer relevant under the Convention as a result of the addition of Article 12AA to replace former Article 12A and Article 14.

34. If States wish to treat fishing vessels in their territorial waters as constituting a permanent establishment (see paragraph 20 above) in circumstances that are not covered in Article 5A, they could add a suitable provision to paragraph 3 of Article 5, which, for example, might apply only to catches over a specified level, or by reference to some other criterion.

35. If a permanent establishment is considered to exist under paragraph 3, only profits attributable to the activities carried on through that permanent establishment (and to the activities referred to in paragraphs 1(*b*) and (*c*) of Article 7) are taxable in the source country.

Paragraph 4

36. In 2017, a number of changes were made to paragraphs 4, 5 and 7 of Article 5 and paragraphs 4.1 and 9 were added to the Article as a result of the recommendations included in the final report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status)[46] of the OECD/G20 BEPS Project. A number of consequential changes were then made to this Commentary. These Commentary changes are prospective only and, as such, do not affect the interpretation of the former provisions of the Model and of treaties in which these provisions are included, in particular as regards the interpretation of paragraphs 4 and 5 of the Article as they read before these changes.

46 OECD (2015), *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, available at http://dx.doi.org/10.1787/9789264241220-en, accessed on 10 May 2021.

37. At that time, the Committee agreed to include in this Model an amended paragraph 4 of Article 5, as recommended in the OECD/G20 Final Report on Action 7. Paragraph 4 was modified so that all of the activities covered by paragraph 4 are subject to the condition that they are preparatory or auxiliary.

38. The new paragraph 4 of Article 5 in this Model still omits the reference to "delivery" in subparagraphs (*a*) and (*b*). The deletion of the word "delivery" reflects the majority view of the Committee that a "warehouse" used for that purpose should, if the requirements of paragraph 1 are met, be a permanent establishment.

39. In view of the similarities to the recommended text and the general relevance of its Commentary, the general principles of paragraph 4 of Article 5 of both Models are first noted below and then the practical relevance of the deletion of references to "delivery" in this Model is considered.

40. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable with respect to paragraph 4 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 58. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which, when carried on through fixed places of business, are not sufficient for these places to constitute permanent establishments. The final part of the paragraph provides that these exceptions only apply if the listed activities have a preparatory or auxiliary character. Since subparagraph *e*) applies to any activity that is not otherwise listed in the paragraph (as long as that activity has a preparatory or auxiliary character), the provisions of the paragraph actually amount to a general restriction of the scope of the definition of permanent establishment contained in paragraph 1 and, when read with that paragraph, provide a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree, these provisions limit the definition in paragraph 1 and exclude from its rather wide scope a number of fixed places of business which, because the business activities exercised through these places are merely preparatory or auxiliary,

should not be treated as permanent establishments. It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question. Moreover, subparagraph *f*) provides that combinations of activities mentioned in subparagraphs *a*) to *e*) in the same fixed place of business shall be deemed not to be a permanent establishment, subject to the condition, expressed in the final part of the paragraph, that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. Thus, the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State if it only carries on activities of a purely preparatory or auxiliary character in that State. The provisions of paragraph 4.1 (see below) complement that principle by ensuring that the preparatory or auxiliary character of activities carried on at a fixed place of business must be viewed in the light of other activities that constitute complementary functions that are part of a cohesive business and which the same enterprise or closely related enterprises carry on in the same State.

59. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise does not exercise a preparatory or auxiliary activity.

60. As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries, the training that takes place at the first location constitutes a preparatory activity for that enterprise. An activity that has an auxiliary character, on the other

hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.

61. Subparagraphs *a*) to *e*) refer to activities that are carried on for the enterprise itself. A permanent establishment would therefore exist if such activities were performed on behalf of other enterprises at the same fixed place of business. If, for instance, an enterprise that maintained an office for the advertising of its own products or services were also to engage in advertising on behalf of other enterprises at that location, that office would be regarded as a permanent establishment of the enterprise by which it is maintained.

62. Subparagraph *a*) relates to a fixed place of business constituted by facilities used by an enterprise for storing *[or]* displaying *[…]* its own goods or merchandise. Whether the activity carried on at such a place of business has a preparatory or auxiliary character will have to be determined in the light of factors that include the overall business activity of the enterprise. Where, for example, an enterprise of State R maintains in State S a very large warehouse in which a significant number of employees work for the main purpose of storing *[…]* goods owned by the enterprise that the enterprise sells online to customers in State S, paragraph 4 will not apply to that warehouse since the storage *[…]* activities that are performed through that warehouse, which represents an important asset and requires a number of employees, constitute an essential part of the enterprise's sale/distribution business and do not have, therefore, a preparatory or auxiliary character.

63. Subparagraph *a*) would cover, for instance, a bonded warehouse with special gas facilities that an exporter of fruit from one State maintains in another State for the sole purpose of storing fruit in a controlled environment during the customs clearance process in that other State. It would also cover a fixed place of business that an enterprise maintained solely for the *[storage]* of spare parts to customers for machinery sold to those customers. Paragraph 4 would not apply, however, where an enterprise maintained a fixed place of business for the *[storage]* of spare parts *[…]* for machinery supplied to *[…]* customers and, in addition, for the maintenance or repair of such machinery, as this would go beyond the pure *[storage]* mentioned in subparagraph *a*) and would not constitute preparatory or auxiliary activities since these after-sale activities constitute an essential and significant part of the services of an enterprise vis-à-vis its customers.

64. Issues may arise concerning the application of the definition of permanent establishment to facilities such as cables or pipelines that cross the territory of a country. Apart from the fact that income derived by the owner or operator of such facilities from their use by other enterprises is covered by Article 6 where these facilities constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether subparagraph *[e)]* applies to them. *[…]* Subparagraph *e*) *[…]* will not be applicable as concerns that enterprise since the cable or pipeline is not used solely for the enterprise and its use is not of preparatory or auxiliary character given the nature of the business of that enterprise. *[…]* A separate question is whether the cable or pipeline could constitute a permanent establishment for the customer of the operator of the cable or pipeline, that is, the enterprise whose data, power or property is transmitted or transported from one place to another. In such a case, the enterprise is merely obtaining transmission or transportation services provided by the operator of the cable or pipeline and does not have the cable or pipeline at its disposal. As a consequence, the cable or pipeline cannot be considered to be a permanent establishment of that enterprise.

65. Subparagraph *b*) relates to the maintenance of a stock of goods or merchandise belonging to the enterprise. This subparagraph is irrelevant in cases where a stock of goods or merchandise belonging to an enterprise is maintained by another person in facilities operated by that other person and the enterprise does not have the facilities at its disposal as the place where the stock is maintained cannot therefore be a permanent establishment of that enterprise. Where, for example, a logistics company operates a warehouse in State S and continuously stores in that warehouse goods or merchandise belonging to an enterprise of State R to which the logistics company is not closely related, the warehouse does not constitute a fixed place of business at the disposal of the enterprise of State R and subparagraph *b*) is therefore irrelevant. Where, however, that enterprise is allowed unlimited access to a separate part of the warehouse for the purpose of inspecting and maintaining the goods or merchandise stored therein, subparagraph *b*) is applicable and the question of whether a permanent establishment exists will depend on whether these activities constitute a preparatory or auxiliary activity.

66. For the purposes of the application of subparagraphs *a*) and *b*), it does not matter whether the storage or *[display]* takes place before or after the goods or merchandise have been sold, provided that the goods or merchandise belong to the enterprise whilst they are at the

relevant location (e.g. the subparagraphs could apply regardless of the fact that some of the goods that are stored at a location have already been sold as long as the property title to these goods only passes to the customer upon or after delivery). Subparagraphs *a*) and *b*) also cover situations where a facility is used, or a stock of goods or merchandise is maintained, for any combination of storage *[and]* display *[…]* since facilities used for the *[display]* of goods will almost always be also used for the storage of these goods, at least for a short period. For the purposes of subparagraphs, *a*) to *d*), the words "goods" and "merchandise" refer to tangible property and would not cover, for example, immovable property and data (although the subparagraphs would apply to tangible products that include data such as CDs and DVDs).

67. Subparagraph *c*) covers the situation where a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise on behalf of, or for the account of, the first-mentioned enterprise. As explained in paragraph 65 *[of the Commentary on Article 5 of the 2017 OECD Model]*, the mere presence of goods or merchandise belonging to an enterprise does not mean that the fixed place of business where these goods or merchandise are stored is at the disposal of that enterprise. Where, for example, a stock of goods belonging to RCO, an enterprise of State R, is maintained by a toll-manufacturer located in State S for the purposes of processing by that toll-manufacturer, no fixed place of business is at the disposal of RCO and the place where the stock is maintained cannot therefore be a permanent establishment of RCO. If, however, RCO is allowed unlimited access to a separate part of the facilities of the toll-manufacturer for the purpose of inspecting and maintaining the goods stored therein, subparagraph *c*) will apply and it will be necessary to determine whether the maintenance of that stock of goods by RCO constitutes a preparatory or auxiliary activity. This will be the case if RCO is merely a distributor of products manufactured by other enterprises as in that case the mere maintenance of a stock of goods for the purposes of processing by another enterprise would not form an essential and significant part of RCO's overall activity. In such a case, unless paragraph 4.1 applies, paragraph 4 will deem a permanent establishment not to exist in relation to such a fixed place of business that is at the disposal of the enterprise of State R for the purposes of maintaining its own goods to be processed by the toll-manufacturer.

68. The first part of subparagraph *d*) relates to the case where premises are used solely for the purpose of purchasing goods or merchandise for the enterprise. Since this exception only applies if that activity has a preparatory or auxiliary character, it will typically

not apply in the case of a fixed place of business used for the purchase of goods or merchandise where the overall activity of the enterprise consists in selling these goods and where purchasing is a core function in the business of the enterprise. The following examples illustrate the application of paragraph 4 in the case of fixed places of business where purchasing activities are performed:

— *Example 1:* RCO is a company resident of State R that is a large buyer of a particular agricultural product produced in State S, which RCO sells from State R to distributors situated in different countries. RCO maintains a purchasing office in State S. The employees who work at that office are experienced buyers who have special knowledge of this type of product and who visit producers in State S, determine the type/quality of the products according to international standards (which is a difficult process requiring special skills and knowledge) and enter into different types of contracts (spot or forward) for the acquisition of the products by RCO. In this example, although the only activity performed through the office is the purchasing of products for RCO, which is an activity covered by subparagraph *d*), paragraph 4 does not apply and the office therefore constitutes a permanent establishment because that purchasing function forms an essential and significant part of RCO's overall activity.

— *Example 2:* RCO, a company resident of State R which operates a number of large discount stores, maintains an office in State S during a two-year period for the purposes of researching the local market and lobbying the government for changes that would allow RCO to establish stores in State S. During that period, employees of RCO occasionally purchase supplies for their office. In this example, paragraph 4 applies because subparagraph *f*) applies to the activities performed through the office (since subparagraphs *d*) and *e*) would apply to the purchasing, researching and lobbying activities if each of these was the only activity performed at the office) and the overall activity of the office has a preparatory character.

69. The second part of subparagraph *d*) relates to a fixed place of business that is used solely to collect information for the enterprise. An enterprise will frequently need to collect information before deciding whether and how to carry on its core business activities in a State. If the enterprise does so without maintaining a fixed place of business in that State, subparagraph *d*) will obviously be irrelevant. If, however, a fixed place of business is maintained solely for that purpose, subparagraph *d*)

will be relevant and it will be necessary to determine whether the collection of information goes beyond the preparatory or auxiliary threshold. Where, for example, an investment fund sets up an office in a State solely to collect information on possible investment opportunities in that State, the collecting of information through that office will be a preparatory activity. The same conclusion would be reached in the case of an insurance enterprise that sets up an office solely for the collection of information, such as statistics, on risks in a particular market and in the case of a newspaper bureau set up in a State solely to collect information on possible news stories without engaging in any advertising activities: in both cases, the collecting of information will be a preparatory activity.

70. Subparagraph *e*) applies to a fixed place of business maintained solely for the purpose of carrying on, for the enterprise, any activity that is not expressly listed in subparagraphs *a*) to *d*); as long as that activity has a preparatory or auxiliary character, that place of business is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an exhaustive list of the activities to which the paragraph may apply, the examples listed in subparagraphs *a*) to *d*) being merely common examples of activities that are covered by the paragraph because they often have a preparatory or auxiliary character.

71. Examples of places of business covered by subparagraph *e*) are fixed places of business used solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character. Paragraph 4 would not apply, however, if a fixed place of business used for the supply of information would not only give information but would also furnish plans etc. specially developed for the purposes of the individual customer. Nor would it apply if a research establishment were to concern itself with manufacture. Similarly, where the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of paragraph 4. A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If an enterprise with international ramifications establishes a so-called "management office" in a State in which it maintains subsidiaries, permanent establishments, agents or licensees, such office having supervisory and coordinating functions for all departments of

the enterprise located within the region concerned, subparagraph *e*) will not apply to that "management office" because the function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of paragraph 4.

72. Also, where an enterprise that sells goods worldwide establishes an office in a State and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State without habitually concluding contracts or playing the principal role leading to the conclusion of contracts (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts), such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph *e*) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment.

73. As already mentioned in paragraph 58 above *[of the Commentary on Article 5 of the 2017 OECD Model]*, paragraph 4 is designed to provide exceptions to the general definition of paragraph 1 in respect of fixed places of business which are engaged in activities having a preparatory or auxiliary character. Therefore, according to subparagraph *f*), the fact that one fixed place of business combines any of the activities mentioned in the subparagraphs *a*) to *e*) does not mean of itself that a permanent establishment exists. As long as the combined activity of such a fixed place of business is merely preparatory or auxiliary a permanent establishment should be deemed not to exist. Such combinations should not be viewed on rigid lines, but should be considered in the light of the particular circumstances.

74. Unless the anti-fragmentation provisions of paragraph 4.1 are applicable (see below), subparagraph *f*) is of no relevance in a case where an enterprise maintains several fixed places of business to which subparagraphs *a*) to *e*) apply as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists.

75. The fixed places of business to which paragraph 4 applies do not constitute permanent establishments so long as the business activities performed through those fixed places of business are restricted to the

activities referred to in that paragraph. This will be the case even if the contracts necessary for establishing and carrying on these business activities are concluded by those in charge of the places of business themselves. The conclusion of such contracts by these employees will not constitute a permanent establishment of the enterprise under paragraph 5 as long as the conclusion of these contracts satisfies the conditions of paragraph 4 (see paragraph 97 *[of the Commentary on Article 5 of the 2017 OECD Model as quoted at paragraph 49]* below). An example would be where the manager of a place of business where preparatory or auxiliary research activities are conducted concludes the contracts necessary for establishing and maintaining that place of business as part of the activities carried on at that location.

76. If, under paragraph 4, a fixed place of business is deemed not to be a permanent establishment, this exception applies likewise to the disposal of movable property forming part of the business property of the place of business at the termination of the enterprise's activity at that place (see paragraph 44 *[of the Commentary on Article 5 of the 2017 OECD Model as quoted at paragraph 15]* above and paragraph 2 of Article 13). Where, for example, the display of merchandise during a trade fair or convention is excepted under subparagraphs *a*) and *b*), the sale of that merchandise at the termination of the trade fair or convention is covered by subparagraph *e*) as such sale is merely an auxiliary activity. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.

77. Where paragraph 4 does not apply because a fixed place of business used by an enterprise for activities that are listed in that paragraph is also used for other activities that go beyond what is preparatory or auxiliary, that place of business constitutes a single permanent establishment of the enterprise and the profits attributable to the permanent establishment with respect to both types of activities may be taxed in the State where that permanent establishment is situated.

41. The Committee took note that some members thought that the scope of paragraph 4 is too wide and poses challenges (see paragraph 40 above quoting paragraph 59 of the Commentary on Article 5 of the 2017 OECD Model) which may be particularly difficult for developing countries to handle due to the lack of administrative capacity. Countries that have those concerns may consider eliminating the paragraph entirely. Another option that may also be considered for those that want to limit the scope of the paragraph is to eliminate subparagraphs which may be

regarded as too extensive in scope; in this respect, members mentioned in particular subparagraphs (*e*) and (*f*). However, negotiators of an agreement should make sure that the application of the remaining parts of the paragraph is limited by the preparatory or auxiliary requirement in order for the paragraph to eliminate from the permanent establishment concept in paragraph 1 only work that is of no or very little significance in view of the other work performed by the enterprise.

42. It was also noted that some States may consider that the activities in paragraph 4 are intrinsically preparatory or auxiliary in nature and take the view that these activities should not be subject to the preparatory or auxiliary condition since any concern about the inappropriate use of these exceptions are addressed through the provisions of paragraph 4.1. States that share this view are free to amend paragraph 4 as follows (and may also agree to delete some of the activities listed in subparagraphs (*a*) to (*d*) below if they consider that these activities should be subject to the preparatory or auxiliary condition in subparagraph (*e*)):

> 4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:
>
> (*a*) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
>
> (*b*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
>
> (*c*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
>
> (*d*) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
>
> (*e*) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; or
>
> (*f*) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (*a*) to (*e*), provided that the overall activity of the fixed

place of business resulting from this combination is of a preparatory or auxiliary character.

43. As noted above, this Model, in contrast to the OECD Model, does not refer to "delivery" in subparagraphs (*a*) or (*b*). The question whether the use of facilities for the "delivery of goods" should give rise to a permanent establishment has been debated extensively. A 1997 study revealed that almost 75 per cent of the tax treaties of developing countries included the "delivery of goods" in the list of exceptions in subparagraphs (*a*) and (*b*) of paragraph 4. Nevertheless, some countries regard the omission of the expression in the UN Model as an important point of departure from the OECD Model, believing that a stock of goods for prompt delivery facilitates sales of the product and thereby the earning of profit in the host country.

44. After reviewing this Model, the Committee retained this distinction between the two Models, but noted that even if the delivery of goods is treated as giving rise to a permanent establishment, it may be that little income could properly be attributed to this activity. Tax authorities might be led into attributing too much income to this activity if they do not give the issue close consideration, which would lead to prolonged litigation and inconsistent application of tax treaties. Therefore, although the reference to "delivery" is absent from this Model, countries may wish to consider both points of view when entering into bilateral tax treaties, for the purpose of determining the practical results of utilizing either approach.

Paragraph 4.1

45. In 2017 the Committee decided to add a new paragraph 4.1 to Article 5. The new paragraph 4.1 is an anti-fragmentation rule that was recommended for the OECD Model by the OECD/G20 final report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status).[47] The purpose of this new paragraph is to prevent an enterprise from fragmenting its activities – either within the enterprise or between closely related enterprises – in order to qualify for the specific activity exemptions in paragraph 4 of Article 5. The final report on Action 7 also included new Commentary that

47 See footnote 46.

provided guidance on the application of paragraph 4.1 in situations where an enterprise or a group of closely related enterprises attempts to circumvent the preparatory or auxiliary activity rule in paragraph 4 by fragmenting a cohesive business operation into several small operations. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable with respect to paragraph 4.1 of Article 5 of this Model (the changes that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 79. *[…]* Under paragraph 4.1, the exceptions provided for by paragraph 4 do not apply to a place of business that would otherwise constitute a permanent establishment where the activities carried on at that place and other activities of the same enterprise or of closely related enterprises exercised at that place or at another place in the same State constitute complementary functions that are part of a cohesive business operation. For paragraph 4.1 to apply, however, at least one of the places where these activities are exercised must constitute a permanent establishment or, if that is not the case, the overall activity resulting from the combination of the relevant activities must go beyond what is merely preparatory or auxiliary.
>
> 80. The provisions of paragraph *8* are applicable in order to determine whether an enterprise is a closely related enterprise with respect to another one (see paragraphs 119 to 121 *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted at paragraph 57]* below).
>
> 81. The following examples illustrate the application of paragraph 4.1:
>
> — *Example A:* RCO, a bank resident of State R, has a number of branches in State S which constitute permanent establishments. It also has a separate office in State S where a few employees verify information provided by clients that have made loan applications at these different branches. The results of the verifications done by the employees are forwarded to the headquarters of RCO in State R where other employees analyse the information included in the loan applications and provide reports to the branches where the decisions to grant the loans are made. In that case, the exceptions of paragraph 4 will not apply to the office because another place (i.e. any of the other branches where the loan applications are made) constitutes a permanent establishment of RCO in State S and the business activities carried on by RCO

at the office and at the relevant branch constitute complementary functions that are part of a cohesive business operation (i.e. providing loans to clients in State S).

— *Example B:* RCO, a company resident of State R, manufactures and sells appliances. SCO, a resident of State S that is a wholly owned subsidiary of RCO, owns a store where it sells appliances that it acquires from RCO. RCO also owns a small warehouse in State S where it stores a few large items that are identical to some of those displayed in the store owned by SCO. When a customer buys such a large item from SCO, SCO employees go to the warehouse where they take possession of the item before delivering it to the customer; the ownership of the item is only acquired by SCO from RCO when the item leaves the warehouse. In this case, paragraph 4.1 prevents the application of the exceptions of paragraph 4 to the warehouse and it will not be necessary, therefore, to determine whether paragraph 4, and in particular subparagraph *a*) thereof, applies to the warehouse. The conditions for the application of paragraph 4.1 are met because
  — SCO and RCO are closely related enterprises;
  — SCO's store constitutes a permanent establishment of SCO (the definition of permanent establishment is not limited to situations where a resident of one Contracting State uses or maintains a fixed place of business in the other State; it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State); and
  — The business activities carried on by RCO at its warehouse and by SCO at its store constitute complementary functions that are part of a cohesive business operation (i.e. storing goods in one place for the purpose of delivering these goods as part of the obligations resulting from the sale of these goods through another place in the same State).

Paragraph 5

46. In 2017 the Committee decided to modify paragraphs 5 and 6 of Article 5. The new paragraphs address the artificial avoidance of permanent establishment status through *commissionnaire* arrangements and similar strategies. The addition of these paragraphs and the relevant Commentary to the UN Model is in line with the recommendations for the OECD Model included in the OECD/G20 final report

on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status).[48]

47. It is generally accepted that, if a person acts in a State for an enterprise in such a way as to closely tie up the activity of the enterprise with the economic life of that State, the enterprise should be treated as having a permanent establishment in that State – even if it does not have a fixed place of business in that State under paragraph 1. Paragraph 5 achieves this by deeming a permanent establishment to exist if the person is a so-called dependent agent who carries out on behalf of the enterprise an activity specified in subparagraph (*a*) or (*b*).

48. Subparagraph (*a*) follows the substance of the OECD Model and proceeds on the basis that if a person habitually concludes contracts in the name of the enterprise, for the transfer of ownership or the granting of the right to use the enterprise's property, or for the provision of services by that enterprise (or if they are habitually playing the principal role leading to the conclusion of such contracts), then it is appropriate to deem such an enterprise as having a permanent establishment because such activities create for that enterprise a sufficiently close association with a State. The condition in subparagraph (*b*), relating to the maintenance of a stock of goods, is discussed below.

49. In relation to subparagraph (*a*), a dependent agent causes a "permanent establishment" to be deemed to exist only if that person repeatedly, and not merely in isolated cases, concludes contracts or plays the principal role leading to the conclusion of contracts. The Committee considers that the following part of the Commentary on paragraph 5 of Article 5 of the 2017 OECD Model is applicable with respect to paragraph 5(*a*) of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 84. For *[subparagraph (a) of]* paragraph 5 to apply, all the following conditions must be met:
>
> — a person acts in a Contracting State on behalf of an enterprise;

48 See footnote 46.

— in doing so, that person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and

— these contracts are either in the name of the enterprise or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.

85. Even if these conditions are met, however, *[subparagraph (a) of]* paragraph 5 will not apply if the activities performed by the person on behalf of the enterprise are covered by the independent agent exception of paragraph 6 or are limited to activities mentioned in paragraph 4 which, if exercised through a fixed place of business, would be deemed not to create a permanent establishment. This last exception is explained by the fact that since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for the purposes of preparatory or auxiliary activities is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes should not create a permanent establishment either. Where, for example, a person acts solely as a buying agent for an enterprise and, in doing so, habitually concludes purchase contracts in the name of that enterprise, paragraph 5 will not apply even if that person is not independent of the enterprise as long as such activities are preparatory or auxiliary (see paragraph 68 *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted at paragraph 40]* above).

86. A person is acting in a Contracting State on behalf of an enterprise when that person involves the enterprise to a particular extent in business activities in the State concerned. This will be the case, for example, where an agent acts for a principal, where a partner acts for a partnership, where a director acts for a company or where an employee acts for an employer. A person cannot be said to be acting on behalf of an enterprise if the enterprise is not directly or indirectly affected by the action performed by that person. As indicated in paragraph 83 *[of the Commentary on Article 5 of the 2017 OECD Model]*, the person acting on behalf of an enterprise can be a company; in that case, the actions of the employees and directors of that company are considered together for the purpose of determining whether and to what extent that company acts on behalf of the enterprise.

87. The phrase "concludes contracts" focuses on situations where, under the relevant law governing contracts, a contract is considered

to have been concluded by a person. A contract may be concluded without any active negotiation of the terms of that contract; this would be the case, for example, where the relevant law provides that a contract is concluded by reason of a person accepting, on behalf of an enterprise, the offer made by a third party to enter into a standard contract with that enterprise. Also, a contract may, under the relevant law, be concluded in a State even if that contract is signed outside that State; where, for example, the conclusion of a contract results from the acceptance, by a person acting on behalf of an enterprise, of an offer to enter into a contract made by a third party, it does not matter that the contract is signed outside that State. In addition, a person who negotiates in a State all elements and details of a contract in a way binding on the enterprise can be said to conclude the contract in that State even if that contract is signed by another person outside that State.

88. The phrase "or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise" is aimed at situations where the conclusion of a contract directly results from the actions that the person performs in a Contracting State on behalf of the enterprise even though, under the relevant law, the contract is not concluded by that person in that State. Whilst the phrase "concludes contracts" provides a relatively well-known test based on contract law, it was found necessary to supplement that test with a test focusing on substantive activities taking place in one State in order to address cases where the conclusion of contracts is clearly the direct result of these activities although the relevant rules of contract law provide that the conclusion of the contract takes place outside that State. The phrase must be interpreted in the light of the object and purpose of paragraph 5, which is to cover cases where the activities that a person exercises in a State are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that is, where that person acts as the sales force of the enterprise. The principal role leading to the conclusion of the contract will therefore typically be associated with the actions of the person who convinced the third party to enter into a contract with the enterprise. The words "contracts that are routinely concluded without material modification by the enterprise" clarify that where such principal role is performed in that State, the actions of that person will fall within the scope of paragraph 5 even if the contracts are not formally concluded in the State, for example, where the contracts are routinely subject, outside that State, to review and approval without such review resulting in a modification of the key aspects of these contracts.

89. The phrase "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise" therefore applies where, for example, a person solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods belonging to the enterprise are delivered and where the enterprise routinely approves these transactions. It does not apply, however, where a person merely promotes and markets goods or services of an enterprise in a way that does not directly result in the conclusion of contracts. Where, for example, representatives of a pharmaceutical enterprise actively promote drugs produced by that enterprise by contacting doctors that subsequently prescribe these drugs, that marketing activity does not directly result in the conclusion of contracts between the doctors and the enterprise so that the paragraph does not apply even though the sales of these drugs may significantly increase as a result of that marketing activity.

90. The following is another example that illustrates the application of *[subparagraph (a) of]* paragraph 5. RCO, a company resident of State R, distributes various products and services worldwide through its websites. SCO, a company resident of State S, is a wholly owned subsidiary of RCO. SCO's employees send emails, make telephone calls to, or visit large organisations in order to convince them to buy RCO's products and services and are therefore responsible for large accounts in State S; SCO's employees, whose remuneration is partially based on the revenues derived by RCO from the holders of these accounts, use their relationship building skills to try to anticipate the needs of these account holders and to convince them to acquire the products and services offered by RCO. When one of these account holders is persuaded by an employee of SCO to purchase a given quantity of goods or services, the employee indicates the price that will be payable for that quantity, indicates that a contract must be concluded online with RCO before the goods or services can be provided by RCO and explains the standard terms of RCO's contracts, including the fixed price structure used by RCO, which the employee is not authorised to modify. The account holder subsequently concludes that contract online for the quantity discussed with SCO's employee and in accordance with the price structure presented by that employee. In this example, SCO's employees play the principal role leading to the conclusion of the contract between the account holder and RCO and such contracts are routinely concluded without material modification by the enterprise. The fact that SCO's employees cannot vary the terms of the contracts

does not mean that the conclusion of the contracts is not the direct result of the activities that they perform on behalf of the enterprise, convincing the account holder to accept these standard terms being the crucial element leading to the conclusion of the contracts between the account holder and RCO.

91. The wording of *[subdivisions (i), (ii) and (iii)]* ensures that *[subparagraph (a) of]* paragraph 5 applies not only to contracts that create rights and obligations that are legally enforceable between the enterprise on behalf of which the person is acting and the third parties with which these contracts are concluded but also to contracts that create obligations that will effectively be performed by such enterprise rather than by the person contractually obliged to do so.

92. A typical case covered by these *[subdivisions]* is where contracts are concluded with clients by an agent, a partner or an employee of an enterprise so as to create legally enforceable rights and obligations between the enterprise and these clients. These *[subdivisions]* also cover cases where the contracts concluded by a person who acts on behalf of an enterprise do not legally bind that enterprise to the third parties with which these contracts are concluded but are contracts for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise. A typical example would be the contracts that a "commissionnaire" would conclude with third parties under a commissionnaire arrangement with a foreign enterprise pursuant to which that commissionnaire would act on behalf of the enterprise but in doing so, would conclude in its own name contracts that do not create rights and obligations that are legally enforceable between the foreign enterprise and the third parties even though the results of the arrangement between the commissionnaire and the foreign enterprise would be such that the foreign enterprise would directly transfer to these third parties the ownership or use of property that it owns or has the right to use.

93. The reference to contracts "in the name of" in *[subdivision (i)]* does not restrict the application of the *[subdivision]* to contracts that are literally in the name of the enterprise; it may apply, for example, to certain situations where the name of the enterprise is undisclosed in a written contract.

94. The crucial condition for the application of *[subdivisions (ii) and (iii)]* is that the person who habitually concludes the contracts, or habitually plays the principal role leading to the conclusion of the

contracts that are routinely concluded without material modification by the enterprise, is acting on behalf of an enterprise in such a way that the parts of the contracts that relate to the transfer of the ownership or use of property, or the provision of services, will be performed by the enterprise as opposed to the person that acts on the enterprise's behalf.

95. For the purposes of *[subdivision (ii)]*, it does not matter whether or not the relevant property existed or was owned by the enterprise at the time of the conclusion of the contracts between the person who acts for the enterprise and the third parties. For example, a person acting on behalf of an enterprise might well sell property that the enterprise will subsequently produce before delivering it directly to the customers. Also, the reference to "property" covers any type of tangible or intangible property.

96. The cases to which *[subparagraph (a) of]* paragraph 5 applies must be distinguished from situations where a person concludes contracts on its own behalf and, in order to perform the obligations deriving from these contracts, obtains goods or services from other enterprises or arranges for other enterprises to deliver such goods or services. In these cases, the person is not acting "on behalf" of these other enterprises and the contracts concluded by the person are neither in the name of these enterprises nor for the transfer to third parties of the ownership or use of property that these enterprises own or have the right to use or for the provision of services by these other enterprises. Where, for example, a company acts as a distributor of products in a particular market and, in doing so, sells to customers products that it buys from an enterprise (including an associated enterprise), it is neither acting on behalf of that enterprise nor selling property that is owned by that enterprise since the property that is sold to the customers is owned by the distributor. This would still be the case if that distributor acted as a so-called "low-risk distributor" (and not, for example, as an agent) but only if the transfer of the title to property sold by that "low-risk" distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold) so that the distributor would derive a profit from the sale as opposed to a remuneration in the form, for example, of a commission.

97. The contracts referred to in paragraph 5 cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person concluded employment contracts for the enterprise to assist that person's activity for the enterprise or if the person concluded, in the name of the enterprise,

similar contracts relating to internal operations only. Moreover, whether or not a person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise should be determined on the basis of the commercial realities of the situation. The mere fact that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has concluded contracts or played the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.

98. The requirement that an agent must "habitually" conclude contracts or play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is "habitually" concluding contracts or playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in paragraphs 28 to 30 *[of the Commentary on Article 5 of the 2017 OECD Model, as quoted above at paragraph 11]* would be relevant in making that determination.

50. The Committee discussed the significance of the reference to contracts "that are routinely concluded without material modification by the enterprise." The Committee noted that, even if the enterprise makes material modifications to some contracts (and even to the majority of contracts resulting from the activities of the local sales force) before the contracts are approved, as long as there is a person who habitually plays a principal role leading to the conclusion of other contracts that the enterprise concludes without any material modification, a permanent establishment will still arise as a result of the activities of that person. Some Committee members still preferred to omit that phrase because they favoured a broader formulation. They also thought

it would encourage enterprises to claim that the condition was not met and to artificially avoid having a permanent establishment. Countries that share this concern are free to omit the words "that are routinely concluded without material modification by the enterprise".

51. With the addition of paragraph 5(*b*) relating to the maintenance of a stock of goods, paragraph 5 of Article 5 of this Model is broader in scope than paragraph 5 of Article 5 of the OECD Model. Some countries believe that a narrow formulation might encourage an agent who was in fact dependent to represent himself as acting on his own behalf.

52. The former Group of Experts understood that paragraph 5(*b*) was to be interpreted such that if all the sales-related activities take place outside the host State and only delivery, by an agent, takes place there, such a situation would not lead to a permanent establishment.[49] The former Group of Experts noted, however, that if sales-related activities (for example, advertising or promotion) are also conducted in that State on behalf of the resident (whether or not by the enterprise itself or by its dependent agents) and have contributed to the sale of such goods or merchandise, a permanent establishment may exist.[50]

Paragraph 6

53. This paragraph reproduces paragraph 6 of Article 5 of the OECD Model. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable with respect to paragraph 6 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 102. Where an enterprise of a Contracting State carries on business dealings through an independent agent carrying on business as such, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of that business (see paragraph 83 *[of the Commentary on Article 5 of the 2017 OECD*

49 See paragraph 25 of the Commentary on Article 5 of the 1999 version of the UN Model.

50 Ibid.

Model Tax Convention]). The activities of such an agent, who represents a separate and independent enterprise, should not result in the finding of a permanent establishment of the foreign enterprise.

103. The exception of paragraph *6* only applies where a person acts on behalf of an enterprise in the course of carrying on a business as an independent agent. It would therefore not apply where a person acts on behalf of an enterprise in a different capacity, such as where an employee acts on behalf of her employer or a partner acts on behalf of a partnership. As explained in paragraph 8.1 of the Commentary on Article 15 *[of the 2017 OECD Model]*, it is sometimes difficult to determine whether the services rendered by an individual constitute employment services or services rendered by a separate enterprise and the guidance in paragraphs 8.2 to 8.28 of the Commentary on Article 15 *[of the 2017 OECD Model]* will be relevant for that purpose. Where an individual acts on behalf of an enterprise in the course of carrying on his own business and not as an employee, however, the application of paragraph *6* will still require that the individual do so as an independent agent; as explained in paragraph 111 *[of the Commentary on Article 5 of the 2017 OECD Model]* below, this independent status is less likely if the activities of that individual are performed exclusively or almost exclusively on behalf of one enterprise or closely related enterprises.

104. Whether a person acting as an agent is independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents. In any event, the last sentence of paragraph *6* provides that in certain circumstances a person shall not be considered to be an independent agent (see paragraphs 119 to 121 *[of the Commentary on Article 5 of the 2017 OECD Model quoted at paragraph 57]* below). The following considerations should be borne in mind when determining whether an agent to whom that last sentence does not apply may be considered to be independent.

105. It should be noted that, where the last sentence of paragraph *6* does not apply because a subsidiary does not act exclusively or almost exclusively for closely related enterprises, the control which a parent company exercises over its subsidiary in its capacity as shareholder is not relevant in a consideration of the dependence or otherwise of the subsidiary in its capacity as an agent for the parent. This is consistent

with the rule in paragraph *7* of Article 5 (see also paragraph 113 *[of the Commentary on Article 5 of the 2017 OECD Model]* below).

106. An independent agent will typically be responsible to his principal for the results of his work but not subject to significant control with respect to the manner in which that work is carried out. He will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an indication of independence.

107. Limitations on the scale of business which may be conducted by the agent clearly affect the scope of the agent's authority. However such limitations are not relevant to dependency which is determined by consideration of the extent to which the agent exercises freedom in the conduct of business on behalf of the principal within the scope of the authority conferred by the agreement.

108. It may be a feature of the operation of an agreement that an agent will provide substantial information to a principal in connection with the business conducted under the agreement. This is not in itself a sufficient criterion for determination that the agent is dependent unless the information is provided in the course of seeking approval from the principal for the manner in which the business is to be conducted. The provision of information which is simply intended to ensure the smooth running of the agreement and continued good relations with the principal is not a sign of dependence.

109. Another factor to be considered in determining independent status is the number of principals represented by the agent. As indicated in paragraph 111 *[of the Commentary on Article 5 of the 2017 OECD Model]*, independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative. All the facts and circumstances must be taken into account to determine whether the agent's activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge. Where an agent acts for a number of principals in the ordinary course of his business and none of these is predominant in terms of the business carried on by the agent, dependence may exist if the principals act in concert to control the acts of the agent in the course of his business on their behalf.

110. An independent agent cannot be said to act in the ordinary course of its business as agent when it performs activities that are unrelated to

that agency business. Where, for example, a company that acts on its own account as a distributor for a number of companies also acts as an agent for another enterprise, the activities that the company undertakes as a distributor will not be considered to be part of the activities that the company carries on in the ordinary course of its business as an agent for the purposes of the application of paragraph 6. Activities that are part of the ordinary course of a business that an enterprise carries on as an agent will, however, include intermediation activities which, in line with the common practice in a particular business sector, are performed sometimes as agent and sometimes on the enterprise's own account, provided that these intermediation activities are, in substance, indistinguishable from each other. Where, for example, a broker-dealer in the financial sector performs a variety of market intermediation activities in the same way but, informed by the needs of the clients, does it sometimes as an agent for another enterprise and sometimes on its own account, the broker-dealer will be considered to be acting in the ordinary course of its business as an agent when it performs these various market intermediation activities.

111. The last sentence of paragraph *6* provides that a person is not considered to be an independent agent where the person acts exclusively or almost exclusively for one or more enterprises to which it is closely related. That last sentence does not mean, however, that paragraph 6 will apply automatically where a person acts for one or more enterprises to which that person is not closely related. Paragraph *6* requires that the person must be carrying on a business as an independent agent and be acting in the ordinary course of that business. Independent status is less likely if the activities of the person are performed wholly or almost wholly on behalf of only one enterprise (or a group of enterprises that are closely related to each other) over the lifetime of that person's business or over a long period of time. Where, however, a person is acting exclusively for one enterprise, to which it is not closely related, for a short period of time (e.g. at the beginning of that person's business operations), it is possible that paragraph *6* could apply. As indicated in paragraph 109 *[of the Commentary on Article 5 of the 2017 OECD Model]* above, all the facts and circumstances would need to be taken into account to determine whether the person's activities constitute the carrying on of a business as an independent agent.

112. The last sentence of paragraph 6 applies only where the person acts "exclusively or almost exclusively" on behalf of closely related enterprises, as defined in paragraph 8. This means that where the person's activities on behalf of enterprises to which it is not closely

related do not represent a significant part of that person's business, that person will not qualify as an independent agent. Where, for example, the sales that an agent concludes for enterprises to which it is not closely related represent less than 10 per cent of all the sales that it concludes as an agent acting for other enterprises, that agent should be viewed as acting "exclusively or almost exclusively" on behalf of closely related enterprises.

113. The rule in the last sentence of paragraph *6* and the fact that the definition of "closely related" in paragraph *8* covers situations where one company controls or is controlled by another company do not restrict in any way the scope of paragraph *7* of Article 5. As explained in paragraph 117 *[of the Commentary on Article 5 of the 2017 OECD Model, quoted at paragraph 55]* below, it is possible that a subsidiary will act on behalf of its parent company in such a way that the parent will be deemed to have a permanent establishment under paragraph 5; if that is the case, a subsidiary acting exclusively or almost exclusively for its parent will be unable to benefit from the "independent agent" exception of paragraph *6*. This, however, does not imply that the parent-subsidiary relationship eliminates the requirements of paragraph 5 and that such a relationship could be sufficient in itself to conclude that any of these requirements are met.

54. In the 1999 revision of this Model, the wording of this paragraph was amended to clarify that the essential criterion for treating an agent as not being of "an independent status" was the absence of an arm's length relationship. In the 2017 update, however, the Committee decided that the lack of an arm's length relationship should not be a deciding factor in determining that an agent does not qualify as an agent of independent status and removed this requirement from the independent agent rule. In making its decision, the Committee noted that the removal of the arm's length condition was made because, prior to the 2017 update, it was easier to qualify as "an independent agent" under the UN Model than under the OECD Model.

Paragraph 7

55. This paragraph reproduces paragraph 7 of Article 5 of the OECD Model. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable with respect to paragraph 7 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of

the Commentary on the OECD Model, have been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 115. It is generally accepted that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company constitutes an independent legal entity. Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company.
>
> 116. A parent company may, however, be found, under the rules of paragraphs 1 or *5* of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company (see paragraphs 10 to 19 *[of the Commentary on Article 5 of the 2017 OECD Model, quoted at paragraphs 5 and 6]* above) and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraphs 3 and 4 of the Article (see for instance, the example in paragraph 15 *[of the Commentary on Article 5 of the 2017 OECD Model]* above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the conditions of that paragraph are met (see paragraphs *[84 to 98 of the Commentary on Article 5 of the 2017 OECD Model, quoted above at paragraph 49 of this Commentary]*), unless paragraph *6* of the Article applies.
>
> 117. The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal *[…]* and uses premises belonging to another company of the group, or if the former company is deemed to have a permanent establishment under paragraph 5 of the Article (see paragraphs 82 to 99 *[of the Commentary on Article 5 of the 2017 OECD Model Tax Convention]*). The determination of the existence of a permanent establishment under the rules of paragraphs 1 or *5* of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.

56. The Committee notes that determining whether or not a permanent establishment exists on a separate entity basis may entail vulnerability to abusive arrangements. Depending on the domestic law of States, safeguards against purely artificial structures may be found through application of a rule according to which substance overrides form. In this respect, the Committee also considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable to Article 5 of this Model:

> 118. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services (e.g. management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided. Indeed, the fact that a company's own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through that location: clearly, a company that merely purchases parts produced or services supplied by another company in a different country would not have a permanent establishment because of that, even though it may benefit from the manufacturing of these parts or the supplying of these services.

Paragraph 8

57. This paragraph reproduces paragraph 8 of Article 5 of the OECD Model. The Committee considers that the following part of the Commentary on Article 5 of the 2017 OECD Model is applicable with respect to paragraph 8 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

119. Paragraph *8* explains the meaning of the concept of a person or enterprise "closely related to an enterprise" for the purposes of the Article and, in particular, of paragraphs 4.1 and 7. That concept is to be distinguished from the concept of "associated enterprises" which is used for the purposes of Article 9; although the two concepts overlap to a certain extent, they are not intended to be equivalent.

120. The first part of paragraph 8 includes the general definition of a person or enterprise closely related to an enterprise. It provides that a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. This general rule would cover, for example, situations where a person or enterprise controls an enterprise by virtue of a special arrangement that allows that person or enterprise to exercise rights that are similar to those that it would hold if it possessed directly or indirectly more than 50 per cent of the beneficial interests in the enterprise. As in most cases where the plural form is used, the reference to the "same persons or enterprises" at the end of the first sentence of paragraph *8* covers cases where there is only one such person or enterprise.

121. The second part of paragraph 8 provides that the requirements of the definition of a person or enterprise closely related to an enterprise are automatically met in certain circumstances. Under that second part, a person or enterprise is considered to be closely related to an enterprise if either one possesses directly or indirectly more than 50 per cent of the beneficial interests in the other or if a third person possesses directly or indirectly more than 50 per cent of the beneficial interests in both the person and the enterprise or in both enterprises. In the case of a company, this condition is met where a person holds directly or indirectly more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company.

Insurance Activities

58. Until 2025, this article contained a paragraph intended to deal with certain aspects of the insurance business. The prior paragraph read:

> 6. Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other

Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

This paragraph was included because of concerns that, in the absence of a fixed place of business, insurance companies could do large-scale business in a State without being taxed in that State. This is because insurance agents may be seen as not having authority to conclude contracts; if that is the case, the conditions of paragraph 5(*a*) might not be fulfilled. Moreover, if an insurance agent is independent, the profits of the insurance company arising from the activities of that agent are not taxable in the source State because the provisions of paragraph 6 of Article 5 would be fulfilled and the enterprise would not be deemed to have a permanent establishment.

59. The prior paragraph was included in Article 5 because some members of the Ad Hoc Group that first drafted the UN Model favoured extending the provision to allow taxation even where there is representation by such an independent agent. They believed this approach was appropriate because of the nature of the insurance business, the fact that the risks are situated within the country claiming tax jurisdiction, and the ease with which persons could, on a part-time basis, represent insurance companies on the basis of an "independent status", making it difficult to distinguish between dependent and independent insurance agents. Other members of that Ad Hoc Group saw no reason why the insurance business should be treated differently from activities such as the sale of tangible commodities. In 2025, Members of the Committee agreeing with this latter point also noted that the changes to paragraphs 5 and 6 made in 2017 have addressed some of the concerns that such a provision is intended to address.

60. Some Members of the Committee have concerns that go beyond the agency questions set out above. They believe that it is also important to consider how much profit might be reported by a permanent establishment deemed to exist by application of the prior paragraph 6 of Article 5. The Commentary to Article 7 of the Model does not provide guidance regarding the determination of the profits of a permanent establishment that is deemed to exist by reason of that paragraph 6. The Model retains Article 7(4), allowing for an apportionment of the total profits of an enterprise, a provision that may be used to determine the taxable profits of a deemed permanent establishment of an insurance

company if the conditions of paragraph 7(4) are met.[51] These Members also note that, if a resident insurance company reinsures its risk with a reinsurance company in the other country, the profits of that insurance company will be reduced by the premiums paid to the reinsurance company, but under the prior paragraph 6, the source country would not have been able to tax the reinsurance company on those premiums. This would also be true with respect to reinsurance premiums paid by a branch of the insurance company located in the source State. Therefore, depending on their domestic law, some countries may find that the inclusion of the prior paragraph 6 of Article 5 in their bilateral treaties does not result in retention of significant tax revenues.

61. One approach that deals only with the reinsurance question set out in paragraph 60 would be to include the provision from the prior paragraph 6 without the exception for reinsurance. Such a provision would read:

> 6. Notwithstanding the preceding provisions of this Article but subject to the provisions of paragraph 7, an insurance enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

62. However, the Committee viewed this approach as only a partial solution to the problem of taxing insurance enterprises as it would not resolve any of the difficult issues regarding the determination of the profits to be taxed under Article 7. Accordingly, in 2025, a new Article 12C was added to the Model to allow source State taxation of insurance, including reinsurance, premiums without regard to whether the entity providing the insurance or reinsurance has a permanent establishment in that State. The alternative provisions set out in paragraphs 58 and 61, which create a deemed permanent establishment, should not be included in a bilateral treaty that includes Article 12C.

63. In deciding on the best approach to these issues, countries may want to consider an additional issue, which is that the different ways

51 See paragraph 27 of the Commentary on Article 7 of the UN Model, quoting paragraph 54 of the Commentary on Article 7 of the 2008 OECD Model.

that insurance premiums are taxed in different countries may result in unintentional asymmetries in tax treaties. The prior paragraph 6 of Article 5 would restrict the source State's right to tax only in cases where the tax imposed with respect to the premiums is a covered tax under Article 2. This is likely to be the case if a Contracting State imposes taxes on insurance premiums in the form of an income tax, such as a gross-basis withholding tax. However, many countries impose excise taxes or other indirect taxes on insurance premiums or policies. In the case of a bilateral tax treaty entered into between two countries with different domestic law systems for taxing insurance premiums, it is possible that the taxing rights of a country that imposes a withholding tax could be limited while those of a country that imposes an excise tax would not be. Countries may want to consider these differences while drafting Article 2 in order to avoid inadvertent asymmetric treatment under their treaties.

64. For example, if State W imposes an income tax, in the form of a withholding tax, on insurance premiums and State X imposes an excise tax, then one option is to include both taxes as covered taxes in Article 2. In that case, if the treaty included the previous paragraph 6 of Article 5, then an insurance company that is a resident of State X would be subject to tax on the profits attributable to the deemed permanent establishment in State W and to business activities referred to in subparagraph (c) of paragraph 1 of Article 7. An insurance company that is a resident of State W would be subject to the State X excise tax because it is deemed to have a permanent establishment, allowing the imposition of the tax. Alternatively, if the treaty excluded both taxes from Article 2, then each of State W and State X could apply its domestic law without limit.

Electronic commerce

65. The Committee considers that the following section of the Commentary on Article 5 of the 2017 OECD Model which relates to electronic commerce is generally applicable with respect to Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

Electronic commerce

122. There has been some discussion as to whether the mere use in electronic commerce operations of computer equipment in a country could constitute a permanent establishment. That question raises a number of issues in relation to the provisions of the Article.

123. Whilst a location where automated equipment is operated by an enterprise may constitute a permanent establishment in the country where it is situated (see below), a distinction needs to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment. For instance, an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a "place of business" as there is no "facility such as premises or, in certain instances, machinery or equipment" (see paragraph 6 *[of the Commentary on Article 5 of the 2017 OECD Model, quoted above at paragraph 3 of this Commentary]*) as far as the software and data constituting that web site is concerned. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server.

124. The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise (see paragraphs 10 to 19 *[of the Commentary on Article 5 of the 2017 OECD Model, quoted above at paragraphs 4 and 6 of this Commentary]*), even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and

operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.

125. Computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1.

126. Another issue is whether the business of an enterprise may be said to be wholly or partly carried on at a location where the enterprise has equipment such as a server at its disposal. The question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed.

127. Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise is required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, for example, automatic pumping equipment used in the exploitation of natural resources.

128. Another issue relates to the fact that no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as preparatory or auxiliary include:

— providing a communications link – much like a telephone line – between suppliers and customers;

— advertising of goods or services;

— relaying information through a mirror server for security and efficiency purposes;
— gathering market data for the enterprise;
— supplying information.

129. Where, however, such functions form in themselves an essential and significant part of the business activity of the enterprise as a whole, or where other core functions of the enterprise are carried on through the computer equipment, these would go beyond the activities covered by paragraph 4 and if the equipment constituted a fixed place of business of the enterprise (as discussed in paragraphs 123 to 127 *[of the Commentary on Article 5 of the 2017 OECD Model]* above), there would be a permanent establishment.

130. What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an "e-tailer") that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there), these activities cannot be considered to be merely preparatory or auxiliary.

> 131. A last issue is whether paragraph 5 may apply to deem an ISP to constitute a permanent establishment. As already noted, it is common for ISPs to provide the service of hosting the web sites of other enterprises on their own servers. The issue may then arise as to whether paragraph 5 may apply to deem such ISPs to constitute permanent establishments of the enterprises that carry on electronic commerce through web sites operated through the servers owned and operated by these ISPs. Whilst this could be the case in very unusual circumstances, paragraph 5 will generally not be applicable because the ISPs will not constitute an agent of the enterprises to which the web sites belong, because they will not conclude contracts or play the principal role leading to the conclusion of contracts in the name of these enterprises, or for the transfer of property belonging to these enterprises or the provision of services by these enterprises, or because they will act in the ordinary course of a business as an independent agent, as evidenced by the fact that they host the web sites of many different enterprises. It is also clear that since the web site through which an enterprise carries on its business is not itself a "person" as defined in Article 3, paragraph 5 cannot apply to deem a permanent establishment to exist by virtue of the web site being an agent of the enterprise for purposes of that paragraph.

66. The Committee notes that paragraph 124 of the Commentary on Article 5 of the 2017 OECD Model, as quoted in paragraph 65 above, draws a distinction between a contract with an Internet Service Provider and one with a place of business at the disposal of the enterprise. In this regard, the Committee recognizes that some businesses could seek to avoid creating a permanent establishment by managing the contractual terms in cases where the circumstances would justify the conclusion that a permanent establishment exists. Such abuses may fall under the application of the anti-abuse rule of paragraph 9 of Article 29 or of domestic legislative or judicial anti-avoidance rules.

Article 5A

INCOME FROM THE EXPLORATION FOR, OR EXPLOITATION OF, NATURAL RESOURCES

A. General considerations

1. This Article was added to the Model in 2025 to ensure that the State in which natural resources are located will capture an appropriate share of the location-specific economic rents attributable to these valuable assets. The Committee viewed the addition of such a provision as a high priority because of the importance of natural resources in the economies of many developing countries.

2. Many bilateral tax treaties, entered into by both developed and developing countries, include provisions that deal with natural resources. Such provisions vary significantly; some deal only with hydrocarbons while others address only activities taking place offshore. The inclusion in the Model of Article 5A should support greater consistency of such provisions across treaties, which will aid countries in negotiating such provisions in the future. The Committee decided that the provision should have a broad scope to ensure that it will continue to provide an appropriate allocation of taxing rights as technologies and business models evolve over time.

B. Commentary on the Paragraphs of Article 5A

Paragraph 1

3. Paragraph 1 establishes the relationship between Article 5A and Articles 5 and 8 of the Model. Article 5A provides specific nexus tests that apply notwithstanding the provisions of those other Articles. Accordingly, a resident of a Contracting State that meets the requirements of Article 5A with respect to a Contracting State will have a permanent establishment in that State even if it would not have had a permanent establishment in that State under Article 5. Article 5A does not affect the application of Article 6 to income from "rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources" as the taxing

rights under Article 6 do not depend on the existence of a permanent establishment.

4. The permanent establishment exists for all purposes of the Convention. For example, for purposes of Article 13(2), equipment used in the relevant activities in a Contracting State will constitute movable property forming part of the business property of a permanent establishment in that State. As a result, such movable property will be taken into account when determining whether the 50 per cent threshold of Article 13(7)(b) has been met.

5. Furthermore, if an enterprise of a Contracting State has a permanent establishment in the other Contracting State as a result of the application of Article 5A, that enterprise's employees who are working in that other Contracting State and whose remuneration is borne by that permanent establishment will not qualify for the exemption of Article 15(2) with respect to their income from such employment. Article 5A will not have any effect on the treatment under Article 15 of any employees of the enterprise whose remuneration is not borne by the permanent establishment, such as auditors or other head office employees who visit a working site for a few days. There is no need for Article 5A to make a specific reference to Article 15 to achieve these results because it is a natural consequence of the existence of a permanent establishment of the enterprise.

6. Some countries also wish to tax employment income derived in connection with relevant activities, even if the employer does not have a permanent establishment in that State. Those countries could do so by including the following additional paragraph in Article 5A:

> Salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and connected with relevant activities in the other Contracting State may be taxed in that other State if the resident is present in that other State for a period or periods exceeding in the aggregate 30 days in any twelve-month period commencing or ending in the fiscal year concerned.

Terms used in this alternative provision should be interpreted consistently with paragraph 3 of the Commentary on Article 15 of this Model, quoting paragraphs 4 to 5.1 of the Commentary on Article 15 of

the 2017 OECD Model. In particular, the 30-day requirement applies to the term "is present", not the word "exercised". That is, once the resident has been present for more than 30 days in the State in which relevant activities are conducted that resident may be taxed in that State, even if those 30 days include only a few days in which the resident exercises the relevant employment and the rest of the days constitute leisure or sick days, for example.

7. If this alternative provision is included in a bilateral tax treaty, paragraph 1 should read as follows:

> The provisions of this Article shall apply notwithstanding the provisions of Articles 5, 8 and 15 of this Convention.

8. As discussed in paragraphs 20 and 21 below, paragraph 2(b) of Article 5A limits the application of Article 8 in the case of relevant activities.

9. Some bilateral provisions address additional matters relating to natural resources that are not included in Article 5A. In most cases, this is because such matters are already addressed in a more comprehensive manner (that is, not limited to the context of natural resources) elsewhere in the Model. This is the case, for example, with respect to gains relating to natural resources as Article 13 includes a comprehensive set of provisions allowing for taxation in the situs State of gains from the alienation of a wide range of assets, including gains from the transfer of rights to resources naturally occurring in that State. Another case is fees for services related to natural resources. Article 12AA of the Model provides that the State in which such fees arise may tax such fees, without the requirement that the beneficial owner have a permanent establishment in that State. As noted in paragraph 14 below, many of the services performed by subcontractors fall within the scope of Article 12AA.

Paragraph 2

10. Paragraph 2(a) deems a resident of a Contracting State to have a permanent establishment in the other Contracting State if it conducts certain activities in the other Contracting State for at least 30 days in any twelve-month period commencing or ending in the fiscal year concerned. The "relevant activities" consist of, or are connected with,

the exploration for, or exploitation of, natural resources in that other State, as defined in paragraph 4.

11. Paragraph 2(a) refers to activities conducted "in" a Contracting State, and natural resources that are present "in" a Contracting State due to natural conditions These are two different requirements, each of which must be met in order for Article 5A to apply. For example, ore may be extracted from Country A and transported to Country B for smelting. The extraction activities in Country A would be covered by Article 5A, as would the transport from Country A to Country B. However, the smelting process in Country B would not be covered as the ore is not present in Country B as a result of natural conditions.

12. There is no question that activities taking place on land, such as mining activities, fall within the scope of paragraph 2(a). Although Article 3 (Definitions) of the Model does not include a definition of each of the Contracting States, many, if not most, bilateral treaties include such definitions. These definitions generally are intended to ensure that activities taking place offshore in areas over which a Contracting State exercises certain economic rights will give rise to the same taxing rights as such activities that take place onshore. Care should be taken to ensure that any definition of the Contracting States included in Article 3 supports the intended allocation of taxing rights under Article 5A.

13. In many cases, an enterprise engaged in relevant activities will have one or more permanent establishments in a Contracting State under Article 5 because its facilities will constitute a fixed place of business through which the business of the enterprise is carried on, within the meaning of Article 5(1). For example, production facilities represent significant capital investments and therefore are relatively permanent, so that they will meet the six-month rule of thumb applicable under Article 5(1); in those cases, the lower, 30-day threshold provided by paragraph 5A(2) therefore generally will not expand the source State's taxing rights. The detailed guidance under Article 5 should be applied to determine when the permanent establishment is created and when it ceases to exist with respect to those enterprises.

14. Paragraph 2(a) will be most relevant to the taxation of contractors and subcontractors. For example, in the absence of Article 5A, independent drilling contractors engaged in the exploration for oil

could spend significant amounts of time on a country's continental shelf without establishing a fixed place of business within the meaning of Article 5. Similar considerations could apply to operators of windmill farm vessels, which engage in the construction, maintenance, repair and disassembly of windmills at sea. Under Article 5A(2), they will be treated as having a permanent establishment as soon as they are engaged in such activities in a Contracting State for more than 30 days.

15. A small minority of the Committee were of the view that the State in which natural resources are located should have the right to tax relevant activities without a threshold.[52] Countries sharing that view with respect to either 2(a) or 2(b) or both are free to use the following versions of those paragraphs:

> 2. (a) For purposes of this Convention, a resident of a Contracting State which carries on activities in the other Contracting State which consist of, or are connected with, the exploration for, or exploitation of, natural resources in that other State (the "relevant activities") shall be deemed in relation to those activities to be carrying on business in that other State through a permanent establishment situated therein.
>
> (b) Article 8 shall not apply to income from the operation of ships or aircraft in international traffic constituting relevant activities in a Contracting State as defined in subparagraph (a).

Inclusion of these paragraphs would result in an enterprise engaged in relevant activities in a Contracting State being deemed to have a permanent establishment in that State and being subject to taxation of the relevant income under Article 7.

16. Many of the fees for services performed by contractors would be taxable under Article 12AA. However, once the 30-day threshold has been met, so that the contractor is deemed to have a permanent establishment, paragraph 4 of Article 12AA provides that such fees will be taxable under Article 7. The same would be true of any income from automated digital services that were connected to relevant activities in the Contracting State.

52 The decision to include that minority view in the Commentary was taken at the twenty-ninth session of the Committee held in October 2024.

17. Paragraph 2(a) applies to all persons conducting activities that take place in connection with the exploration or exploitation of natural resources, not only those persons who are performing specialized services. Accordingly, the provision would apply to contractors who provide, for example, catering services on an oil rig or at a mining facility. It will not matter if this catering company also provides services to other non-extractive businesses around the world. The provision will not apply, however, to persons conducting activities that utilize the natural resources in businesses that are not connected to exploration or extraction, such as enterprises using steel or aluminum to manufacture automobiles. Some Members of the Committee expressed concern that the services were not limited to specialized services, noting that two companies providing the same service may be treated differently depending on whether they provide the service at a mining facility or a non-extractive business location.

18. The determination of whether the 30-day threshold has been met is made independently with respect to each taxpayer. If a taxpayer's relevant activities continue in a Contracting State for 30 days or more, the taxpayer will have a permanent establishment from the day that its activities begin, without regard to whether or when any other entity (such as a license holder) has a permanent establishment. In the example in paragraph 12, the drilling contractors would have a permanent establishment if their activities continue for at least 30 days, even if the company for which they are providing the services never has a permanent establishment. Conversely, a mining company may have had a permanent establishment for years, but an independent contractor brought in to conduct a rescue after a mine cave-in will only have a permanent establishment under Article 5A if the 30-day threshold is met with respect the activities of that contractor.

19. Article 5A merely changes the relevant threshold for source State taxation under Articles 7. The manner of taxation under those articles is not changed by Article 5A.

20. Paragraph 2(b) provides that Article 8 will apply to income from the operation of ships or aircraft in international traffic that constitute relevant activities only if any of the transport constituting such operation continues in that State for 30 days or less. In the case of international traffic that involves transport that takes place between

the state in which natural resources are present and another state, days in which any part of the transport that constitutes relevant activities takes place in the Contracting State are counted in order to determine whether the 30-day threshold is met.

21. This provision will be most relevant when the relevant bilateral treaty includes Article 8 (Alternative B), which provides for exclusive residence State taxation. In that case, an enterprise of a Contracting State that was engaged in transporting ore from a mine in the other Contracting State to a processing facility outside that other State would not be taxable in that other Contracting State on the income from such transport. The Committee viewed this result as inequitable and provided, in subparagraph 2(b), for taxation in the State in which the ore is mined as long as the shipping enterprise conducts its activities in that State for at least 30 days in the relevant twelve-month period.

22. Paragraph 2(b) applies only if the international transport is "connected" to the exploration or exploitation of natural resources. Accordingly, it would apply to flights that are contracted or chartered to transport personnel to a remote mine or oil rig but not to regularly-scheduled commercial flights that happen to carry such personnel to an airport close to a mine.

Paragraph 3

23. Paragraph 3 provides rules for aggregating the activities of related parties for purposes of determining whether the 30-day threshold in paragraph 2 has been exceeded. The aggregation rule is intended to prevent taxpayers from avoiding the time threshold by artificially splitting activities between different related entities. If they do, the period of time that each of the enterprises conducts such activities shall be added to the period of time during which the closely-related enterprise has carried on such activities in order to determine whether each of them has exceeded the 30-day limit.

24. Thus, the rule will not apply to the extent that the activities of the two persons are being carried on at the same time. For example, if an enterprise of State R that carries on exploration activities for twenty days in State S is closely related to another enterprise of State R, and that closely-related enterprise carries on substantially similar exploration

activities in State S for twenty days after the first-mentioned enterprise has ceased such activities in State S, each of the enterprises will be deemed to have satisfied the threshold so that the income derived from the relevant activities will be attributable to a permanent establishment of that enterprise. For purposes of paragraph 3, paragraph 8 of Article 5 will be used to determine whether two persons are closely related to each other.

Paragraph 4

25. Paragraph 4 defines the terms that are used in the substantive rules of Article 5A.

26. Subparagraph 4(a) defines the term "natural resources" as any natural assets that can be used for economic production or consumption, whether non-renewable or renewable, including fish, hydrocarbons, minerals, pearls and solar power, wind power, hydropower, geothermal power and similar sources of renewable energy. Renewable natural resources are those that are not reduced by their exploitation or that, after exploitation, can return to their previous stock levels by natural processes of growth or replenishment while non-renewable natural resources are exhaustible natural resources such as mineral resources that cannot be regenerated after exploitation. The list of specific natural resources is not exclusive; the term is intended to be expansive and flexible. In determining whether it applies in other circumstances, the key issue is whether the exploitation of the product results in location-specific economic rents.

27. Under subparagraph 4(b), the term "exploration for, or exploitation of natural resources" is intended to cover every stage in the value chain, from exploration to decommissioning. This is necessary because, even though a company may not have started, or may no longer be, generating income from production activities in the situs State of the natural resources, contractors may be doing so.

28. Accordingly, subparagraph 4(b) specifically refers to the exploration or exploitation of the natural resources described in subparagraph (a), including the extraction, development, production, processing, transport or storage of such natural resources and the decommissioning and abandonment of facilities used in connection

with such activities and the restoration and rehabilitation of the land or other site. "Processing" can relate to either non-renewable resources (refining or smelting of ore, for example) or renewable resources (e.g. fish processing on a ship). As in the case of subparagraph (a), the list of activities is intended to be illustrative, not exhaustive.

Commentary on chapter III

TAXATION OF INCOME

Article 6

INCOME FROM IMMOVABLE PROPERTY

A. General considerations

1. Article 6 of the UN Model reproduces Article 6 of the OECD Model.

2. In taxing income from immovable property, the object should be the taxation of profits rather than of gross income; the expenses incurred in earning income from immovable [real] property or from agriculture or forestry should therefore be taken into account. This objective should not, however, preclude the use of a withholding tax on rents from immovable [real] property, based on gross income; in such cases the rate should take into account the fact that expenses have been incurred. On the other hand, if a withholding tax on gross rents is used, it will be just as satisfactory if the owner of the immovable [real] property can elect to have the income from the property taxed on a net basis under the regular income tax. Article 6 is not intended to prevent a country which taxes income from agriculture or other immovable property on an estimated or similar basis from continuing to use that method.

3. Some members of the former Group of Experts were of the view that the distribution of dividends by a company referred to in paragraph 4 of Article 13 should be treated as income from immovable property and, therefore, as covered by Article 6. However, this view was not shared by most other members.

4. It was noted that in some countries, a person may receive income (typically rental income) from immovable property in circumstances where that person instead of directly owning the immovable property owns shares of a company owning that property and that the ownership

of those shares entitles that person to the use or enjoyment of the property. Contracting States are free to expand the scope of the Article to cover the deemed income from that use or enjoyment. They may also expand the scope of Article 22 to allow source taxation of shares of such companies.

B. Commentary on the paragraphs of Article 6

Paragraph 1

5. This paragraph provides that income from immovable property (including income from agriculture or forestry) may be taxed in the State where the property in question is situated. It does not, however, provide that income from immovable property may be taxed exclusively in that State and therefore leaves the possibility of taxation by the State of residence of the recipient of the income from such immovable property. Double taxation is eliminated or reduced through exemption or tax credit in the residence country.

6. Paragraph 1 of the Commentary on Article 6 of the 2017 OECD Model explains that this provision is based on "the fact that there is always a very close economic connection between the source of this income and the State of source" and provides the following additional explanations, which the Committee considers to be applicable to paragraph 1 of Article 6 of this Model:

> *[…]* Although income from agriculture or forestry is included in Article 6, Contracting States are free to agree in their bilateral conventions to treat such income under Article 7. Article 6 deals only with income which a resident of a Contracting State derives from immovable property situated in the other Contracting State. It does not, therefore, apply to income from immovable property situated in the Contracting State of which the recipient is a resident within the meaning of Article 4 or situated in a third State; the provisions of paragraph 1 of Article 21 shall apply to such income.

Paragraph 2

7. This paragraph, which gives the term "immovable property" the meaning that it has under the law of the Contracting State in which the

property is situated, is intended to alleviate difficulties of interpretation with regard to whether an asset or a right is to be regarded as immovable property. The paragraph additionally lists a number of assets and rights which are in any case to be regarded as covered by the term. On the other hand, the paragraph provides that ships and aircraft shall not be regarded as immovable property. Interest from debt secured by immovable property is not covered by Article 6 but is instead dealt with under Article 11 relating to interest.

8. Some Members of the Committee have expressed concerns that the reference to domestic law may give rise to unintended results where the law of a Contracting State has a wide range of items defined or deemed as immovable property, including properties which are normally recognized as movable properties, or when the domestic definition of immovable property is amended after the conclusion of the treaty. The principles of international law for the interpretation of treaties, as embodied in Articles 26, 31 and 32 of the Vienna Convention on the Law of Treaties could alleviate the concern to some extent. Countries also could address such concerns by including in their bilateral conventions a definition of "immovable property" tailored to the situation in the two Contracting States.

Paragraph 3

9. This paragraph provides that the general rule set forth in paragraph 1 shall apply regardless of the way in which immovable property is used.

Paragraph 4

10. This paragraph stipulates that the provisions of paragraphs 1 and 3 apply also to income from immovable property of industrial, commercial and other enterprises. The Committee considers that the following explanations found in the Commentary on Article 6 of the 2017 OECD Model are applicable to paragraph 4 of this Model:

> 4. *[…]* the right to tax of the State of source has priority over the right to tax of the other State and applies also where in the case of an enterprise income is only indirectly derived from immovable property. This does not prevent income from immovable property, when derived

through a permanent establishment, from being treated as income of an enterprise, but secures that income from immovable property will be taxed in the State in which the property is situated also in the case where such property is not part of a permanent establishment situated in that State. It should further be noted that the provisions of the Article do not prejudge the application of domestic law as regards the manner in which income from immovable property is to be taxed.

Article 7

BUSINESS PROFITS

A. General considerations

1. Article 7 of the UN Model consists of several provisions of Article 7 of the 2008 OECD Model, either unchanged or substantially amended, and some new provisions. The Committee decided at its 2009 annual session not to adopt the OECD approach to Article 7 arising from the OECD's 2008 report *Attribution of Profits to Permanent Establishment*[53] (the 2008 Permanent Establishments Report). The 2008 Permanent Establishments Report envisions taking into account dealings between different parts of an enterprise such as a permanent establishment and its head office to a greater extent than is recognized by the UN Model. That approach by the OECD is reflected in the different version of Article 7 and the Commentary on that Article that was included in the 2010 OECD Model and which appears in the subsequent versions of that Model. The Committee decided not to adopt this OECD approach because it was in direct conflict with paragraph 3 of Article 7 of the UN Model which generally disallows deductions for amounts "paid" (other than toward reimbursement of actual expenses) by a permanent establishment to its head office. That rule is seen as continuing to be appropriate in the context of the UN Model, whatever changes have been made to the OECD Model. It should therefore be noted that in this Commentary, references to Article 7 of the OECD Model and its Commentary generally relate to the 2008 OECD Model. Article 7 of the UN Model and Article 7 of the 2008 OECD Model are largely consistent (except for some additions specific to the UN Model). However, some aspects of the Commentary on Article 7 of the 2008 OECD Model reflect views contained in the 2008 Permanent Establishments Report. Where the Commentary on Article 7 of the 2008 OECD Model reflects the approach of that Report, reference is instead made to the Commentary on Article 7 of the 2005 OECD Model which does not reflect that approach.

53 OECD (2008), *Report on the Attribution of Profits to Permanent Establishments*, available at http://www.oecd.org/dataoecd/20/36/41031455.pdf, accessed on 10 May 2021.

2. There is general acceptance of the arm's length principle embodied in the OECD Model, under which the profits attributable to a permanent establishment are those which would be earned by the establishment if it were a wholly independent entity dealing with its head office as if it were a distinct and separate enterprise operating under conditions and selling at prices prevailing in the regular market. The profits so attributable are normally the profits shown on the books of the establishment. Nevertheless, this principle permits the authorities of the country in which the permanent establishment is located to rectify the accounts of the enterprise, so as to reflect properly income which the establishment would have earned if it were an independent enterprise dealing with its head office at arm's length. The application of the arm's length principle to the allocation of profits between the home office and its permanent establishment presupposes for most countries that the domestic legislation authorizes a determination on the basis of the arm's length principle.

3. The application of the arm's length principle is particularly important in connection with the difficult and complex problem of deductions to be allowed to the permanent establishment. It is also generally accepted that in calculating the profits of a permanent establishment, allowance should be made for expenses, wherever incurred, for the purpose of the business of the permanent establishment, including executive and general administrative expenses. Apart from what may be regarded as ordinary expenses, there are some classes of expenditure that give rise to special problems. These include interest and royalties etc. paid by the permanent establishment to its head office in return for money lent or patent rights licensed by the latter to the permanent establishment. They further include commission fees (except for reimbursement of actual expenses) for specific services or for the exercise of management services by the enterprise for the benefit of the establishment. In this case, it is considered that the payments should not be allowed as deductions in computing the profits of the permanent establishment. Conversely, such payments made to a permanent establishment by the head office should be excluded from the profits of the permanent establishment. On the other hand, an allocable share of such payments, for example, interest and royalties, paid by the enterprise to third parties should be allowed. As noted in paragraph 1 above, this approach is consistent with the approach adopted in interpreting

Article 7 of the 2008 OECD Model but it varies from the approach adopted by the OECD in its 2008 Permanent Establishments Report.

4. Under the OECD Model, only profits attributable to the permanent establishment may be taxed in the source country. The UN Model amplifies this attribution principle by a limited force of attraction rule, which permits the enterprise, once it carries out business through a permanent establishment in the source country, to be taxed on some business profits in that country arising from transactions by the enterprise in the source country, but not through the permanent establishment. Where, owing to the force of attraction principle, the profits of an enterprise other than those attributable directly to the permanent establishment may be taxed in the State where the permanent establishment is situated, such profits should be determined in the same way as if they were attributable directly to the permanent establishment.

5. Until 2021, a note at the end of Article 7 of the UN Model provided that "[t]he question of whether profits should be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods and merchandise for the enterprise was not resolved. It should therefore be settled in bilateral negotiations." That note was deleted in 2021 in recognition of the fact that the purchasing activity may contribute to the overall profit of the enterprise, and some portion of that profit thus may appropriately be taxed by that country. This conforms with the view expressed in the following paragraph 43 of the Commentary on Article 7 of the 2017 OECD Model which explains why a provision according to which "[n]o profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise" was deleted from that Model in 2010:

> 43. A final provision that was deleted from the Article at the same time provided that "[n]o profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise." Subparagraph 4 *d*) of Article 5, as it read at that time, recognised that where an enterprise of a Contracting State maintained in the other State a fixed place of business exclusively for the purpose of purchasing goods for itself, its activity at that location should not be considered to have reached a level that justified taxation in that other State (changes made to Article 5 in 2017 have restricted the scope of that exception). Where,

however, subparagraph 4 *d*) was not applicable because other activities were carried on by the enterprise through that place of business, which therefore constituted a permanent establishment, it was appropriate to attribute profits to all the functions performed at that location. Indeed, if the purchasing activities had been performed by an independent enterprise, the purchaser would have been remunerated on an arm's length basis for its services. Also, since a tax exemption restricted to purchasing activities undertaken for the enterprise required that expenses incurred for the purposes of performing these activities be excluded in determining the profits of the permanent establishment, such an exemption could raise administrative problems. The Committee therefore considered that a provision according to which no profits should be attributed to a permanent establishment by reason of the mere purchase of goods or merchandise for the enterprise was not consistent with the arm's length principle and should not be included in the Article.

B. Commentary on the paragraphs of Article 7

Paragraph 1

6. This paragraph reproduces paragraph 1 of Article 7 of the 2008 OECD Model with the addition of subparagraphs (*b*) and (*c*). In the discussion preceding the adoption by the former Group of Experts of this paragraph, several members from developing countries expressed support for the force of attraction rule, although they would limit its application. Subparagraphs (*b*) and (*c*) mean that the UN Model amplifies the corresponding Article in the OECD Model by including a limited force of attraction rule. This allows the country in which the permanent establishment is located to tax not only the profits attributable to that permanent establishment but other profits of the enterprise derived in that country to the extent allowed under the Article. It is noted that the force of attraction rule is limited to business profits covered by Article 7 and does not extend to income from capital (dividends, interest and royalties) covered by other treaty provisions. Those in favour of such a rule argue that neither sales through independent commission agents nor purchasing activities would become taxable to the principal under that rule. Some members from developed countries pointed out that the force of attraction rule had been found unsatisfactory and abandoned in recent tax treaties concluded by them because of the undesirability

of taxing income from an activity that was totally unrelated to the establishment and that was in itself not extensive enough to constitute a permanent establishment. They also stressed the uncertainty that such an approach would create for taxpayers. Members from developing countries pointed out that the force of attraction approach avoids some administrative problems because, under that approach, it is not necessary to determine whether particular activities are related to the permanent establishment or the income involved attributable to it. That was the case especially with respect to transactions conducted directly by the home office within the country that are similar in nature to those conducted by the permanent establishment. However, after discussion, it was proposed that the "force of attraction" rule in Article 7 should be limited to that last situation so that it would apply to sales of goods or merchandise and other business activities as follows:

— If an enterprise has a permanent establishment in the other Contracting State for the purpose of selling goods or merchandise, sales of the same or a similar kind may be taxed in that State even if they are not conducted through the permanent establishment;

— A similar rule applies if the permanent establishment is used for other business activities and the same or similar activities are performed without any connection with the permanent establishment.

7. However, when the UN Model was revised in 1999, some members considered that the limited force of attraction rule of subparagraphs (*b*) and (*c*) should not apply where an enterprise is able to demonstrate that the sales or business activities were carried out for reasons other than obtaining treaty benefits. This would recognize that an enterprise may have legitimate business reasons for choosing not to carry out sales or business activities through its permanent establishment.

8. Problems may arise with respect to the application of paragraphs 1 and 2 of Article 7 with regard to turnkey contracts as well as engineering, procurement and construction (EPC) contracts. Under a turnkey contract a contractor agrees to construct a factory or similar facility and make it ready for operation; when the facility is ready for operation, it is handed over to the purchaser, who can then begin operations. Under an EPC contract, the home office of an enterprise of a Contracting State undertakes the provision of goods and services

through engineering and procurement activities conducted in the home country while construction, assembly or installation activities in connection with such goods and services are performed through a permanent establishment of the enterprise in the other Contracting State. Under both types of contracts, activities such as the purchase of capital goods, the performance of architectural and engineering services and the provision of technical assistance are sometimes completed before construction activities actually start (and hence, before the creation of a permanent establishment) and are often performed outside the country in which the permanent establishment is situated.

9. The question thus arises how much of the total profits from these contracts is properly taxable in the country in which the permanent establishment is situated under the rules of paragraphs 1 and 2. When the issue of turnkey contracts was considered by the former Group of Experts, a member from a developed country said that there were instances in which countries had sought to attribute the entire profits of the contract to the permanent establishment. It was this member's view, however, that only the profits attributable to activities carried on by the permanent establishment should be taxed in the country in which the permanent establishment was situated, unless the profits included items of income dealt with separately in other Articles of the Convention and were taxable in that country accordingly.

10. As was done by the former Group of Experts with respect to turnkey contracts, the Committee recognized that the application of tax treaties to EPC and turnkey contracts involved many interrelated treaty issues, such as the source of income rules, the potential application of other Articles (such as former Article 12A), the application of the definition of permanent establishment and the concept of profits of an enterprise.

11. Nevertheless, the Committee considers that the following part of the Commentary on Article 7 of the 2008 OECD Model is applicable as regards the application to such contracts of paragraph 1(*a*) and paragraph 2 of Article 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the 2008 OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 24. *[…]* In these circumstances, it is necessary to pay close attention to the general principle that profits are attributable to a permanent establishment only *[with respect to]* activities carried on by the enterprise through that permanent establishment.
>
> 25. For example, where such goods are supplied by the other parts of the enterprise, the profits arising from that supply do not result from the activities carried on through the permanent establishment and are not attributable to it. Similarly, profits resulting from the provision of services (such as planning, designing, drawing blueprints, or rendering technical advice) by the parts of the enterprise operating outside the State where the permanent establishment is located do not result from the activities carried on through the permanent establishment and are not attributable to it.

12. Where, however, functions are performed through the permanent establishment in relation to the acquisition of goods supplied, or services performed, by other parts of the enterprise, profits may be attributable to the permanent establishment with respect to the performance of these functions.

13. While they apply in different circumstances, subparagraphs (*b*) and (*c*) of paragraph 1 share one underlying theme: in both cases, the activities that give rise to the taxable business profits must be performed within the Contracting State in which the permanent establishment is situated. Accordingly, in the case of subparagraph (*b*), the sale of the referenced goods or merchandise that are of the same or similar kind as those sold through the permanent establishment must take place within the Contracting State where the permanent establishment is situated, and profits from any sales that take place outside of that State may not be taxed by that State.

14. Similarly, in the case of subparagraph (*c*), the business activity or activities conducted by the enterprise that are of the same or similar nature as the business activity of the permanent establishment must take place within the Contracting State in which the permanent establishment is situated. Therefore, profits arising from a business activity conducted within the home office State would clearly not be taxable by the State in which the permanent establishment is situated.

15. The Committee considers that the following part of the Commentary on paragraph 1 of Article 7 of the 2008 OECD Model is

applicable to paragraph 1 of Article 7 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the 2008 OECD Model and those of this Model):

> 11. When referring to the part of the profits of an enterprise that is attributable to a permanent establishment, *[subparagraph (a)]* of paragraph 1 refers directly to paragraph 2, which provides the directive for determining what profits should be attributed to a permanent establishment. As paragraph 2 is part of the context in which *[subparagraph (a)]* must be read, that *[subparagraph]* should not be interpreted in a way that could contradict paragraph 2, for example, by interpreting it as restricting the amount of profits that can be attributed to a permanent establishment to the amount of profits of the enterprise as a whole. Thus, whilst *[subparagraph (a)]* provides that a Contracting State may only tax the profits of an enterprise of the other Contracting State to the extent that they are attributable to a permanent establishment situated in the first State, it is paragraph 2 that determines the meaning of the phrase "profits attributable to a permanent establishment". In other words, the directive of paragraph 2 may result in profits being attributed to a permanent establishment even though the enterprise as a whole has never made profits: conversely, that directive may result in no profits being attributed to a permanent establishment even though the enterprise as a whole has made profits.
>
> 12. Clearly however, the Contracting State of the enterprise has an interest in the directive of paragraph 2 being correctly applied by the State where the permanent establishment is located. Since that directive applies to both Contracting States, the State of the enterprise must, in accordance with Article 23, eliminate double taxation on the profits properly attributable to the permanent establishment. In other words, if the State where the permanent establishment is located attempts to tax profits that are not attributable to the permanent establishment *[or otherwise taxable in that State]* under Article 7, this may result in double taxation of profits that should properly be taxed only in the State of the enterprise.
>
> 13. The purpose of paragraph 1 is to provide limits to the right of one Contracting State to tax the business profits of enterprises of the other Contracting State. The paragraph does not limit the right of a Contracting State to tax its own residents under controlled foreign companies provisions found in its domestic law even though such tax

> imposed on these residents may be computed by reference to the part of the profits of an enterprise *[…]* of the other Contracting State that is attributable to these residents' participation in that enterprise. Tax so levied by a State on its own residents does not reduce the profits of the enterprise of the other State and may not, therefore, be said to have been levied on such profits (see also paragraph 23 of the Commentary on Article 1 *[of the 2008 OECD Model]* and paragraphs 37 to 39 of the Commentary on Article 10 *[of the 2008 OECD Model]*).

16. Some countries disagree with the approach taken in the second sentence of paragraph 13 of the Commentary on Article 7 of the 2008 OECD Model quoted in paragraph 15 above which states that paragraph 1 of Article 7 does not limit the right of a Contracting State to tax its own residents under controlled foreign companies provisions found in its domestic law. However, following the addition, in 2017, of the so-called "saving clause" of paragraph 4 of Article 1, this Model expressly retains this right for the Contracting States.

Paragraph 2

17. Paragraph 2 reproduces paragraph 2 of Article 7 of the 2008 OECD Model. When the UN Model was revised in 1999, some members of the former Group of Experts were of the view that the last part of paragraph 2 was too narrow, as they considered that it refers only to transactions between the permanent establishment and the home office, and does not take into account transactions between the permanent establishment and, for example, other permanent establishments of the same enterprise. For this purpose, Contracting States may consider the alternative clarification:

> There shall in each Contracting State be attributed to that permanent establishment the profits that it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

18. Although the point in controversy relating to the allocation of profits between different permanent establishments as opposed to allocation between a permanent establishment and its head office was not in doubt, it was generally accepted that the concern of the former Group of Experts should be clearly noted.

19. As observed in paragraph 14 of the Commentary on Article 7 of the 2008 OECD Model, that paragraph 2 (which continues unchanged as the UN paragraph 2): "contains the central directive on which the allocation of profits to a permanent establishment is intended to be based." As stated in paragraph 2, this is of course subject to the provisions of paragraph 3 of the Article. Paragraph 14 of the OECD Commentary continues:

> *[…]* The paragraph incorporates the view that was generally contained in bilateral conventions, that the profits to be attributed to a permanent establishment are those which that permanent establishment would have made if, instead of dealing with the rest of the enterprise, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the "arm's length" principle discussed in the Commentary on Article 9. Normally, the profits so determined would be the same profits that one would expect to be determined by the ordinary processes of business accountancy.

20. Since the arm's length principle also extends to the attribution of profits which the permanent establishment may derive from transactions with other permanent establishments of the enterprise, the existing paragraph 2 should be construed to make it applicable to such situations. Therefore, where an enterprise of a Contracting State carries on its business activities in the other Contracting State through a permanent establishment situated therein, it would be necessary to attribute to such permanent establishment the profits which it could be in a position to make if it were a distinct enterprise engaged in the same or similar activities under the same or similar conditions and operating at arm's length, and dealing wholly independently with the enterprise of which it is a permanent establishment or the other permanent establishments of that enterprise.

21. The determination of the profits attributable to a specific permanent establishment is an instance where the Commentary on Article 7 of the 2008 OECD Model refers to the 2008 Permanent Establishments Report. Given the comments in paragraph 1 above, the Committee considers that the following part of the Commentary on paragraph 2 of Article 7 of the 2005 OECD Model is applicable to paragraph 2 of Article 7 of the UN Model (an ellipsis that appears in italics in square brackets indicates that a cross-reference to another part of the Commentary on Article 7 of the OECD Model has been omitted):

12. In the great majority of cases, trading accounts of the permanent establishment – which are commonly available if only because a well-run business organisation is normally concerned to know what is the profitability of its various branches – will be used by the taxation authorities concerned to ascertain the profit properly attributable to that establishment. Exceptionally there may be no separate accounts *[…]*. But where there are such accounts they will naturally form the starting point for any processes of adjustment in case adjustment is required to produce the amount of properly attributable profits. It should perhaps be emphasized that the directive contained in paragraph 2 is no justification for tax administrations to construct hypothetical profit figures in vacuo; it is always necessary to start with the real facts of the situation as they appear from the business records of the permanent establishment and to adjust as may be shown to be necessary the profit figures which those facts produce.

12.1 This raises the question as to what extent such accounts should be relied upon when they are based on agreements between the head office and its permanent establishments (or between the permanent establishments themselves). Clearly, such internal agreements cannot qualify as legally binding contracts. However, to the extent that the trading accounts of the head office and the permanent establishments are both prepared symmetrically on the basis of such agreements and that those agreements reflect the functions performed by the different parts of the enterprise, these trading accounts could be accepted by tax authorities. In that respect, accounts could not be regarded as prepared symmetrically unless the values of transactions or the methods of attributing profits or expenses in the books of the permanent establishment corresponded exactly to the values or methods of attribution in the books of the head office in terms of the national currency or functional currency in which the enterprise recorded its transactions. However, where trading accounts are based on internal agreements that reflect purely artificial arrangements instead of the real economic functions of the different parts of the enterprise, these agreements should simply be ignored and the accounts corrected accordingly. This would be the case if, for example, a permanent establishment involved in sales were, under such an internal agreement, given the role of principal (accepting all the risks and entitled to all the profits from the sales) when in fact the permanent establishment concerned was nothing more than an intermediary or agent (incurring limited risks and entitled to receive only a limited share of the resulting income) or, conversely, were given the role of intermediary or agent when in reality it was a principal.

12.2 In this respect, it should also be noted that the principle set out in paragraph 2 is subject to the provisions contained in paragraph 3, especially as regards the treatment of payments which, under the name of interest, royalties, etc. are made by a permanent establishment to its head office in return for money loaned, or patent rights conceded by the latter to the permanent establishment *[…]*.

13. Even where a permanent establishment is able to produce detailed accounts which purport to show the profits arising from its activities, it may still be necessary for the taxation authorities of the country concerned to rectify those accounts in accordance with the arm's length principle *[…]*. Adjustment of this kind may be necessary, for example, because goods have been invoiced from the head office to the permanent establishment at prices which are not consistent with this principle, and profits have thus been diverted from the permanent establishment to the head office, or vice versa.

14. In such cases, it will usually be appropriate to substitute for the prices used ordinary market prices for the same or similar goods supplied on the same or similar conditions. Clearly the price at which goods can be bought on open market terms varies with the quantity required and the period over which they will be supplied; such factors would have to be taken into account in deciding the open market price to be used. It is perhaps only necessary to mention at this point that there may sometimes be perfectly good commercial reasons for an enterprise invoicing its goods at prices less than those prevailing in the ordinary market; this may, for example, be a perfectly normal commercial method of establishing a competitive position in a new market and should not then be taken as evidence of an attempt to divert profits from one country to another. Difficulties may also occur in the case of proprietary goods produced by an enterprise, all of which are sold through its permanent establishments; if in such circumstances there is no open market price, and it is thought that the figures in the accounts are unsatisfactory, it may be necessary to calculate the permanent establishment's profits by other methods, for example, by applying an average ratio of gross profit to the turnover of the permanent establishment and then deducting from the figure so obtained the proper amount of expenses incurred. Clearly many special problems of this kind may arise in individual cases but the general rule should always be that the profits attributed to a permanent establishment should be based on that establishment's accounts insofar as accounts are available which represent the real facts of the situation. If available accounts do not represent the real facts then new accounts

will have to be constructed, or the original ones rewritten, and for this purpose the figures to be used will be those prevailing in the open market.

15. Many States consider that there is a realisation of a taxable profit when an asset, whether or not trading stock, forming part of the business property of a permanent establishment situated within their territory is transferred to a permanent establishment or the head office of the same enterprise situated in another State. Article 7 allows such States to tax profits deemed to arise in connection with such a transfer. Such profits may be determined as indicated below. In cases where such transfer takes place, whether or not it is a permanent one, the question arises as to when taxable profits are realised. In practice, where such property has a substantial market value and is likely to appear on the balance sheet of the importing permanent establishment or other part of the enterprise after the taxation year during that in which the transfer occurred, the realisation of the taxable profits will not, so far as the enterprise as a whole is concerned, necessarily take place in the taxation year of the transfer under consideration. However, the mere fact that the property leaves the purview of a tax jurisdiction may trigger the taxation of the accrued gains attributable to that property as the concept of realisation depends on each country's domestic law.

15.1 Where the countries in which the permanent establishments operate levy tax on the profits accruing from an internal transfer as soon as it is made, even when these profits are not actually realised until a subsequent commercial year, there will be inevitably a time lag between the moment when tax is paid abroad and the moment it can be taken into account in the country where the enterprise's head office is located. A serious problem is inherent in the time lag, especially when a permanent establishment transfers fixed assets or – in the event that it is wound up – its entire operating equipment stock, to some other part of the enterprise of which it forms part. In such cases, it is up to the head office country to seek, on a case by case basis, a bilateral solution with the outward country where there is serious risk of overtaxation.

15.2 Another significant problem concerning the transfer of assets, such as bad loans, arises in relation to international banking. Debts may be transferred, for supervisory and financing purposes, from branch to head office or from branch to branch within a single bank. Such transfers should not be recognised where it cannot be reasonably considered that they take place for valid commercial reasons or that they would have taken place between independent enterprises, for instance where they are undertaken solely for tax purposes with the

aim of maximising the tax relief available to the bank. In such cases, the transfers would not have been expected to take place between wholly independent enterprises and therefore would not have affected the amount of profits which such an independent enterprise might have been expected to make in independent dealing with the enterprise of which it is a permanent establishment.

15.3 However, there may exist a commercial market for the transfer of such loans from one bank to another and the circumstances of an internal transfer may be similar to those which might have been expected to have taken place between independent banks. An instance of such a transfer might be a case where a bank closed down a particular foreign branch and had therefore to transfer the debts concerned either back to its head office or to another branch. Another example might be the opening of a new branch in a given country and the subsequent transfer to it, solely for commercial reasons, of all loans previously granted to residents of that country by the head office or other branches. Any such transfer should be treated (to the extent that it is recognised for tax purposes at all) as taking place at the open market value of the debt at the date of the transfer. Some relief has to be taken into account in computing the profits of the permanent establishment since, between separate entities, the value of the debt at the date of transfer would have been taken into account in deciding on the price to be charged and principles of sound accounting require that the book value of the asset should be varied to take into account market values.

15.4 Where loans which have gone bad are transferred, in order that full, but not excessive, relief for such a loss be granted, it is important that the two jurisdictions concerned reach an agreement for a mutually consistent basis for granting relief. In such cases, account should be taken of whether the transfer value, at the date of the internal transfer, was the result of mistaken judgment as to the debtor's solvency or whether the value at that date reflected an appropriate judgment of the debtor's position at that time. In the former case, it might be appropriate for the country of the transferring branch to limit relief to the actual loss suffered by the bank as a whole and for the receiving country not to tax the subsequent apparent gain. Where, however, the loan was transferred for commercial reasons from one part of the bank to another and did, after a certain time, improve in value, then the transferring branch should normally be given relief on the basis of the actual value at the time of the transfer. The position is somewhat different where the receiving entity is the head office of a bank in a credit country because normally the credit country will tax the bank

on its worldwide profits and will therefore give relief by reference to the total loss suffered in respect of the loan between the time the loan was made and the time it was finally disposed of. In such a case, the transferring branch should receive relief for the period during which the loan was in the hands of that branch by reference to the principles above. The country of the head office will then give relief from double taxation by granting a credit for the tax borne by the branch in the host country.

Paragraph 3

22. The first sentence of paragraph 3 of Article 7 reproduces with minor drafting differences the entire text of paragraph 3 of Article 7 of the 2008 OECD Model. The rest of the paragraph consists of additional provisions formulated by the former Group of Experts in 1980. These provisions stem from a proposal by members from developing countries who felt that it would be helpful to include all the necessary definitions and clarifications in the text, with a view, in particular, to assisting developing countries not represented in the Group. Some of those members also felt that provisions prohibiting the deduction of certain expenses should be included in the text of a bilateral tax treaty to make it clear that taxpayers were fully informed about their fiscal obligations. In the course of the discussion it was pointed out that the additions to the OECD text would ensure that the permanent establishment would be able to deduct interest, royalties and other expenses incurred by the head office on behalf of the establishment. The Group agreed that if billings by the head office included the full costs, both direct and indirect, then there should not be a further allocation of the executive and administrative expenses of the head office, since that would produce a duplication of such charges on the transfer between the head office and the permanent establishment. It was pointed out that it was important to determine how the price was fixed and what elements of cost it included. Where an international wholesale price was used, it would normally include indirect costs. There was general agreement within the Group that any duplication of costs and expenses should be prevented.

23. Under paragraph 1 of Article 7, the business profits of an enterprise of a Contracting State are taxable in that State alone unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. The profits and gains of the

business would be worked out by deducting all expenses related to the business activity, other than capital expenditures which are currently not deductible or expenses of a personal or non-business nature which cannot be attributed to the business of the enterprise. Normally, many countries while considering the question of deductibility of business expenses apply the criteria of such expenditure being wholly, exclusively and necessarily for the purposes of the business. The basic objective in this regard is to ensure that the expenditure claimed as a deduction in determining the taxable profits is relevant, referable and necessary for carrying out the business operations. There has to exist a nexus between the expenditure and the business activity so that the expenditure incurred is justified by business expediency, necessity or efficiency. After it has been determined that an item is deductible under the foregoing criteria, then it should be considered whether there are specific legislative provisions placing a monetary or other ceiling on the deduction of business expenditure, otherwise a claim for deductibility of expenditure will have to be considered in its entirety, without considering the reasonableness of the amount or its impact on the profitability of business operations.

24. The Committee considers that the following part of the Commentary on paragraph 3 of Article 7 of the 2008 OECD Model is applicable to the first part of paragraph 3 of Article 7 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 27. This paragraph clarifies, in relation to the expenses of a permanent establishment, the general directive laid down in paragraph 2. The paragraph specifically recognises that in calculating the profits of a permanent establishment allowance is to be made for expenses, wherever incurred, that were incurred for the purposes of the permanent establishment. Clearly in some cases it will be necessary to estimate or to calculate by conventional means the amount of expenses to be taken into account. In the case, for example, of general administrative expenses incurred at the head office of the enterprise, it may be appropriate to take into account a proportionate part based on the ratio that the permanent establishment's turnover (or perhaps gross profits) bears to that of the enterprise as a whole. Subject to this, it is considered that the amount of expenses to be taken into account as

incurred for the purposes of the permanent establishment should be the actual amount so incurred. The deduction allowable to the permanent establishment for any of the expenses of the enterprise attributed to it does not depend upon the actual reimbursement of such expenses by the permanent establishment.

28. It has sometimes been suggested that the need to reconcile paragraphs 2 and 3 created practical difficulties as paragraph 2 required that prices between the permanent establishment and the head office be normally charged on an arm's length basis, giving to the transferring entity the type of profit which it might have been expected to make were it dealing with an independent enterprise, whilst the wording of paragraph 3 suggested that the deduction for expenses incurred for the purposes of permanent establishments should be the actual cost of those expenses, normally without adding any profit element.

29. In fact, whilst the application of paragraph 3 may raise some practical difficulties, especially in relation to the separate enterprise and arm's length principles underlying paragraph 2, there is no difference of principle between the two paragraphs. Paragraph 3 indicates that in determining the profits of a permanent establishment, certain expenses must be allowed as deductions whilst paragraph 2 provides that the profits determined in accordance with the rule contained in paragraph 3 relating to the deduction of expenses must be those that a separate and distinct enterprise engaged in the same or similar activities under the same or similar conditions would have made. Thus, whilst paragraph 3 provides a rule applicable for the determination of the profits of the permanent establishment, paragraph 2 requires that the profits so determined correspond to the profits that a separate and independent enterprise would have made.

30. Also, paragraph 3 only determines which expenses should be attributed to the permanent establishment for purposes of determining the profits attributable to that permanent establishment. It does not deal with the issue of whether those expenses, once attributed, are deductible when computing the taxable income of the permanent establishment since the conditions for the deductibility of expenses are a matter to be determined by domestic law, subject to the rules of Article 24 on Non-discrimination (in particular, paragraphs 3 and 4 of that Article).

31. In applying these principles to the practical determination of the profits of a permanent establishment, the question may arise as to whether a particular cost incurred by an enterprise can truly be

considered as an expense incurred for the purposes of the permanent establishment, keeping in mind the separate and independent enterprise principles of paragraph 2. Whilst in general independent enterprises in their dealings with each other will seek to realise a profit and, when transferring property or providing services to each other, will charge such prices as the open market would bear, nevertheless, there are also circumstances where it cannot be considered that a particular property or service would have been obtainable from an independent enterprise or when independent enterprises may agree to share between them the costs of some activity which is pursued in common for their mutual benefit. In these particular circumstances, it may be appropriate to treat any relevant costs incurred by the enterprise as an expense incurred for the permanent establishment. The difficulty arises in making a distinction between these circumstances and the cases where a cost incurred by an enterprise should not be considered as an expense of the permanent establishment and the relevant property or service should be considered, on the basis of the separate and independent enterprises principle, to have been transferred between the head office and the permanent establishment at a price including an element of profit. The question must be whether the internal transfer of property and services, be it temporary or final, is of the same kind as those which the enterprise, in the normal course of its business, would have charged to a third party at an arm's length price, that is, by normally including in the sale price an appropriate profit.

32. On the one hand, the answer to that question will be in the affirmative if the expense is initially incurred in performing a function the direct purpose of which is to make sales of a specific good or service and to realise a profit through a permanent establishment. On the other hand, the answer will be in the negative if, on the basis of the facts and circumstances of the specific case, it appears that the expense is initially incurred in performing a function the essential purpose of which is to rationalise the overall costs of the enterprise or to increase in a general way its sales.

33. Where goods are supplied for resale whether in a finished state or as raw materials or semi-finished goods, it will normally be appropriate for the provisions of paragraph 2 to apply and for the supplying part of the enterprise to be allocated a profit, measured by reference to arm's length principles. But there may be exceptions even here. One example might be where goods are not supplied for resale but for temporary use in the trade so that it may be appropriate for the parts of the enterprise which share the use of the material to bear only their share of the cost of

such material, for example, in the case of machinery, the depreciation costs that relate to its use by each of these parts. It should of course be remembered that *[where the only activity performed by the permanent establishment is]* the mere purchase of goods *[for the enterprise and that activity has a preparatory or auxiliary character, a permanent establishment is deemed not to exist, subject to paragraph 4.1 of Article 5]* (subparagraph 4 *d*) of Article 5) so that no question of attribution of profits arises in such circumstances.

34. In the case of intangible rights, the rules concerning the relations between enterprises of the same group (e.g. payment of royalties or cost sharing arrangements) cannot be applied in respect of the relations between parts of the same enterprise. Indeed, it may be extremely difficult to allocate "ownership" of the intangible right solely to one part of the enterprise and to argue that this part of the enterprise should receive royalties from the other parts as if it were an independent enterprise. Since there is only one legal entity it is not possible to allocate legal ownership to any particular part of the enterprise and in practical terms it will often be difficult to allocate the costs of creation exclusively to one part of the enterprise. It may therefore be preferable for the costs of creation of intangible rights to be regarded as attributable to all parts of the enterprise which will make use of them and as incurred on behalf of the various parts of the enterprise to which they are relevant accordingly. In such circumstances it would be appropriate to allocate between the various parts of the enterprise the actual costs of the creation or acquisition of such intangible rights as well as the costs subsequently incurred with respect to these intangible rights, without any mark-up for profit or royalty. In so doing, tax authorities must be aware of the fact that the possible adverse consequences deriving from any research and development activity (e.g. the responsibility related to the products and damages to the environment) shall also be allocated to the various parts of the enterprise, therefore giving rise, where appropriate, to a compensatory charge.

35. The area of services is the one in which difficulties may arise in determining whether in a particular case a service should be charged between the various parts of a single enterprise at its actual cost or at that cost plus a mark-up to represent a profit to the part of the enterprise providing the service. The trade of the enterprise, or part of it, may consist of the provision of such services and there may be a standard charge for their provision. In such a case it will usually be appropriate to charge a service at the same rate as is charged to the outside customer.

36. Where the main activity of a permanent establishment is to provide specific services to the enterprise to which it belongs and where these services provide a real advantage to the enterprise and their costs represent a significant part of the expenses of the enterprise, the host country may require that a profit margin be included in the amount of the costs. As far as possible, the host country should then try to avoid schematic solutions and rely on the value of these services in the given circumstances of each case.

37. However, more commonly the provision of services is merely part of the general management activity of the company taken as a whole as where, for example, the enterprise conducts a common system of training and employees of each part of the enterprise benefit from it. In such a case it would usually be appropriate to treat the cost of providing the service as being part of the general administrative expenses of the enterprise as a whole which should be allocated on an actual cost basis to the various parts of the enterprise to the extent that the costs are incurred for the purposes of that part of the enterprise, without any mark-up to represent profit to another part of the enterprise.

38. The treatment of services performed in the course of the general management of an enterprise raises the question whether any part of the total profits of an enterprise should be deemed to arise from the exercise of good management. Consider the case of a company that has its head office in one country but carries on all its business through a permanent establishment situated in another country. In the extreme case it might well be that only the directors' meetings were held at the head office and that all other activities of the company apart from purely formal legal activities, were carried on in the permanent establishment. In such a case there is something to be said for the view that at least part of the profits of the whole enterprise arose from the skillful management and business acumen of the directors and that part of the profits of the enterprise ought, therefore, to be attributed to the country in which the head office was situated. If the company had been managed by a managing agency, then that agency would doubtless have charged a fee for its services and the fee might well have been a simple percentage participation in the profits of the enterprise. But whatever the theoretical merits of such a course, practical considerations weigh heavily against it. In the kind of case quoted the expenses of management would, of course, be set against the profits of the permanent establishment in accordance with the provisions of paragraph 3, but when the matter is looked at as a whole, it is thought that it would not be right to go further by deducting and taking into account some notional figure for "profits of management". In

cases identical to the extreme case mentioned above, no account should therefore be taken in determining taxable profits of the permanent establishment of any notional figure such as profits of management.

39. It may be, of course, that countries where it has been customary to allocate some proportion of the total profits of an enterprise to the head office of the enterprise to represent the profits of good management will wish to continue to make such an allocation. Nothing in the Article is designed to prevent this. Nevertheless, it follows from what is said in paragraph 38 above that a country in which a permanent establishment is situated is in no way required to deduct when calculating the profits attributable to that permanent establishment an amount intended to represent a proportionate part of the profits of management attributable to the head office.

40. It might well be that if the country in which the head office of an enterprise is situated allocates to the head office some percentage of the profits of the enterprise only in respect of good management, while the country in which the permanent establishment is situated does not, the resulting total of the amounts charged to tax in the two countries would be greater than it should be. In any such case the country in which the head office of the enterprise is situated should take the initiative in arranging for such adjustments to be made in computing the taxation liability in that country as may be necessary to ensure that any double taxation is eliminated.

41. The treatment of interest charges raises particular issues. First, there might be amounts which, under the name of interest, are charged by a head office to its permanent establishment with respect to internal "loans" by the former to the latter. Except for financial enterprises such as banks, it is generally agreed that such internal "interest" need not be recognised. This is because:

— From the legal standpoint, the transfer of capital against payment of interest and an undertaking to repay in full at the due date is really a formal act incompatible with the true legal nature of a permanent establishment.

— From the economic standpoint, internal debts and receivables may prove to be non existent, since if an enterprise is solely or predominantly equity funded it ought not to be allowed to deduct interest charges that it has manifestly not had to pay. Whilst, admittedly, symmetrical charges and returns will not distort the enterprise's overall profits, partial results may well be arbitrarily changed.

> 42. For these reasons, the ban on deductions for internal debts and receivables should continue to apply generally, subject to the special situation of banks, as mentioned below.
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> 43. A different issue, however, is that of the deduction of interest on debts actually incurred by the enterprise. Such debts may relate in whole or in part to the activities of the permanent establishment; indeed, loans contracted by an enterprise will serve either the head office, the permanent establishment or both. The question that arises in relation to these debts is how to determine the part of the interest that should be deducted in computing the profits attributable to the permanent establishment.
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> 44. The approach suggested *[…]* before 1994, namely the direct and indirect apportionment of actual debt charges, did not prove to be a practical solution, notably since it was unlikely to be applied in a uniform manner. Also, it is well known that the indirect apportionment of total interest payment charges, or of the part of interest that remains after certain direct allocations, comes up against practical difficulties. It is also well known that direct apportionment of total interest expense may not accurately reflect the cost of financing the permanent establishment because the taxpayer may be able to control where loans are booked and adjustment may need to be made to reflect economic reality, in particular the fact that an independent enterprise would normally be expected to have a certain level of "free" capital.

25. Despite the comments in paragraph 30 of the Commentary on Article 7 of the 2008 OECD Model quoted in paragraph 24 above, the Committee notes that some countries may wish to point out in the treaty text that they allow only those deductions that are permitted by their domestic laws.

26. Also, as regards the question of the determination of the part of the interest incurred by an enterprise that should be deducted in computing the profits attributable to a permanent establishment, which is discussed in paragraph 44 of the Commentary on Article 7 of the 2008 OECD Model quoted in paragraph 24 above, the Committee considers that, as a consequence of the problems identified in the quoted paragraph 44, it is preferable to look for a practical solution. This would take into account a capital structure appropriate to both the organization and the functions performed taking into account the need to recognize that a distinct, separate and independent enterprise should be expected to have adequate funding.

Paragraph 4

27. This paragraph reproduces paragraph 4 of Article 7 of the 2008 OECD Model. The Committee considers that the following part of the Commentary on paragraph 4 of Article 7 of the 2008 OECD Model is applicable to paragraph 4 of Article 7 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 52. It has in some cases been the practice to determine the profits to be attributed to a permanent establishment not on the basis of separate accounts or by making an estimate of arm's length profit, but simply by apportioning the total profits of the enterprise by reference to various formulae. Such a method differs from those envisaged in paragraph 2, since it contemplates not an attribution of profits on a separate enterprise footing, but an apportionment of total profits; and indeed it might produce a result in figures which would differ from that which would be arrived at by a computation based on separate accounts. Paragraph 4 makes it clear that such a method may continue to be employed by a Contracting State if it has been customary in that State to adopt it, even though the figure arrived at may at times differ to some extent from that which would be obtained from separate accounts, provided that the result can fairly be said to be in accordance with the principles contained in the Article. It is emphasized, however, that in general the profits to be attributed to a permanent establishment should be determined by reference to the establishment's accounts if these reflect the real facts. It is considered that a method of allocation which is based on apportioning total profits is generally not as appropriate as a method which has regard only to the activities of the permanent establishment and should be used only where, exceptionally, it has as a matter of history been customary in the past and is accepted in the country concerned both by the taxation authorities and taxpayers generally there as being satisfactory. It is understood that paragraph 4 may be deleted where neither State uses such a method. Where, however, Contracting States wish to be able to use a method which has not been customary in the past the paragraph should be amended during the bilateral negotiations to make this clear.
>
> *[…]*
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> 54. The essential character of a method *[for apportioning]* total profits is that a proportionate part of the profits of the whole enterprise

is allocated to a part thereof, all parts of the enterprise being assumed to have contributed on the basis of the criterion or criteria adopted to the profitability of the whole. The difference between one such method and another arises for the most part from the varying criteria used to determine what is the correct proportion of the total profits *[…]. [T]*he criteria commonly used can be grouped into three main categories, namely those which are based on the receipts of the enterprise, its expenses or its capital structure. The first category covers allocation methods based on turnover or on commission, the second on wages and the third on the proportion of the total working capital of the enterprise allocated to each branch or part. It is not, of course, possible to say *in vacuo* that any of these methods is intrinsically more accurate than the others; the appropriateness of any particular method will depend on the circumstances to which it is applied. In some enterprises, such as those providing services or producing proprietary articles with a high profit margin, net profits will depend very much on turnover. For insurance enterprises, it may be appropriate to make an apportionment of total profits by reference to premiums received from policy holders in each of the countries concerned. In the case of an enterprise manufacturing goods with a high-cost raw material or labour content, profits may be found to be related more closely to expenses. In the case of banking and financial concerns the proportion of total working capital may be the most relevant criterion. *[…] [T]*he general aim of any method *[for apportioning]* total profits ought to be to produce figures of taxable profit that approximate as closely as possible to the figures that would have been produced on a separate accounts basis, and *[…]* it would not be desirable to attempt in this connection to lay down any specific directive other than that it should be the responsibility of the taxation authority, in consultation with the authorities of other countries concerned, to use the method which in the light of all the known facts seems most likely to produce that result.

55. The use of any method which allocates to a part of an enterprise a proportion of the total profits of the whole does, of course, raise the question of the method to be used in computing the total profits of the enterprise. This may well be a matter which will be treated differently under the laws of different countries. This is not a problem which it would seem practicable to attempt to resolve by laying down any rigid rule. It is scarcely to be expected that it would be accepted that the profits to be apportioned should be the profits as they are computed under the laws of one particular country; each country concerned would have to be given the right to compute the profits according to the provisions of its own laws.

Paragraph 5

28. Paragraph 5 reproduces paragraph 6 of Article 7 of the 2008 OECD Model (as explained in paragraph 5 above, Article 7 of the UN Model does not include a paragraph corresponding to paragraph 5 of Article 7 of the 2008 OECD Model). The Committee considers that the following part of the Commentary on paragraph 6 of Article 7 of the 2008 OECD Model is applicable to paragraph 5 of Article 7 of this Model:

> 58. This paragraph is intended to lay down clearly that a method of allocation once used should not be changed merely because in a particular year some other method produces more favourable results. One of the purposes of a double taxation convention is to give an enterprise of a Contracting State some degree of certainty about the tax treatment that will be accorded to its permanent establishment in the other Contracting State as well as to the part of it in its home State which is dealing with the permanent establishment; for this reason, paragraph 6 gives an assurance of continuous and consistent tax treatment.

Paragraph 6

29. Paragraph 6 reproduces paragraph 7 of Article 7 of the 2008 OECD Model. The Committee considers that the following part of the Commentary on paragraph 7 of Article 7 of the 2008 OECD Model is applicable to paragraph 6 of Article 7 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 59. Although it has not been found necessary in the Convention to define the term "profits", it should nevertheless be understood that the term when used in this Article and elsewhere in the Convention has a broad meaning including all income derived in carrying on an enterprise. Such a broad meaning corresponds to the use of the term made in the tax laws of most OECD member countries.
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> 60. This interpretation of the term "profits", however, may give rise to some uncertainty as to the application of the Convention. If the profits of an enterprise include categories of income which are treated separately in other Articles of the Convention, for example, dividends,

it may be asked whether the taxation of those profits is governed by the special Article on dividends etc., or by the provisions of this Article.

61. To the extent that an application of this Article and the special Article concerned would result in the same tax treatment, there is little practical significance to this question. Further, it should be noted that some of the special Articles contain specific provisions giving priority to a specific Article (cf. paragraph 4 of Article 6, paragraph 4 of Articles 10 and 11, paragraph *[4]* of Article 12*[, paragraph 4 of Article 12AA, paragraph 8 of Article 12B, paragraph 4 of Article 12C]* and paragraph 2 of Article 21).

62. It has seemed desirable, however, to lay down a rule of interpretation in order to clarify the field of application of this Article in relation to the other Articles dealing with a specific category of income. In conformity with the practice generally adhered to in existing bilateral conventions, paragraph *[6]* gives first preference to the special Articles on dividends, interest etc. It follows from the rule that this Article will be applicable to business profits which do not belong to categories of income covered by the special Articles, and, in addition, to dividends, interest etc. which under paragraph 4 of Articles 10 and 11, paragraph *[4]* of Article 12*[, paragraph 4 of Article 12AA, paragraph 8 of Article 12B, paragraph 4 of Article 12C]* and paragraph 2 of Article 21, fall within this Article *[…]*. It is understood that the items of income covered by the special Articles may, subject to the provisions of the Convention, be taxed either separately, or as business profits, in conformity with the tax laws of the Contracting States.

63. It is open to Contracting States to agree bilaterally upon special explanations or definitions concerning the term "profits" with a view to clarifying the distinction between this term and, for example, the concept of dividends. It may in particular be found appropriate to do so where in a convention under negotiation a deviation has been made from the definitions in the special Articles on dividends, interest*[, royalties, fees for services, income from automated digital services and insurance premiums]*. It may also be deemed desirable if the Contracting States wish to place on notice, that, in agreement with the domestic tax laws of one or both of the States, the term "profits" includes special classes of receipts such as income from the alienation or the letting of a business or of movable property used in a business. In this connection it may have to be considered whether it would be useful to include also additional rules for the allocation of such special profits.

30. It is important to note that in the UN Model, payments "for the use of, or the right to use, industrial, commercial or scientific equipment" are treated differently than under the OECD Model. They remain within the definition of "royalties" in paragraph 3 of Article 12 and accordingly, subject to paragraph 4 of Article 12, continue to fall under the provisions of Article 12, rather than those of Article 7, by reason of paragraph 6 of Article 7.

Article 8

INTERNATIONAL SHIPPING AND AIR TRANSPORT

A. General considerations

1. Two alternative versions are given for Article 8 of the Model, namely Article 8 (Alternative A) and Article 8 (Alternative B). Article 8 (Alternative A) allows income arising in a Contracting State from the operation of ships or aircraft in international traffic by a resident of the other Contracting State to be taxed in the first-mentioned State. Article 8 (Alternative B) reproduces Article 8 of the OECD Model, which provides for exclusive residence State taxation of income from the operation of ships or aircraft in international traffic.

2. When the former Ad Hoc Group of Experts considered the taxation of profits from the operation of ships in international traffic, many members supported exclusive residence State taxation of such profits. In their view, shipping enterprises should not be exposed to the tax laws of the numerous countries to which their operations extend. They argued that if every country taxed a portion of the profits of a shipping line, computed according to its own rules, the sum of those portions might well exceed the total income of the enterprise. Consequently, that would constitute a serious problem, especially because, in their view, taxes in developing countries could be excessively high, and the total profits of shipping enterprises were frequently quite modest.

3. Other members of the Ad Hoc Group asserted that developing countries were not in a position to forgo even the limited revenue to be derived from taxing foreign shipping enterprises as long as their own shipping industries were not more fully developed. They recognized, however, that considerable difficulties were involved in determining a taxable profit in such a situation and allocating the profit to the various countries concerned in the course of the operation of ships in international traffic.

4. Since no consensus could be reached on a provision concerning the taxation of shipping profits, it was decided to include two alternatives in the Model, one providing for exclusive residence State taxation of income from international shipping and the other allowing source State

taxation of shipping income, leaving the question of such taxation to bilateral negotiations. Under both alternatives, however, profits from the operation of aircraft in international traffic were subject to exclusive residence taxation.

5. In connection with the 2025 revision of the Model, the Committee of Experts returned to the issue of whether exclusive residence State taxation of income from international transport is justified. Proponents of source State taxation of income from international traffic noted that, since the original work of the Ad Hoc Group, source State taxation in the Model has been expanded to cover fees for services and income from automated digital services, to address cases where substantial amounts of income can be generated by a non-resident without creating a permanent establishment in the source State. In their view, the logic underlying these expanded taxing rights applies equally to income from international traffic – a residence-only rule heavily favours developed countries, and income from international traffic is, by definition, highly mobile. For some developing countries, the "revenue sacrifice" from the exclusive residence State taxation of such income is substantial in view of their economic circumstances (whether or not the relevant amount would be viewed as substantial in developed countries).

6. They also questioned the administrative rationale for exclusive residence-State taxation. They pointed out that the domestic laws of many countries provide for source taxation of such income, which would apply in the absence of tax treaties or other agreements relating to the taxation of income from international transportation. They argue that the development of agreed source rules would help to reduce the risk of multiple taxation. They also find the allocation of exclusive taxing rights to the residence State to be troubling in the case of income from international shipping because residence States frequently do not tax that income. Many developed countries have adopted "tonnage tax" regimes that result in much lower levels of taxation than would apply under normal corporate income tax rules. For these reasons, a medium-sized minority would have eliminated entirely the alternative providing for exclusive residence State taxation.[54]

54 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

7. Other members noted that the vast majority of tax treaties currently in place provide for exclusive residence taxation on income from international traffic. This is especially true for income from operation of aircraft in international traffic. They noted that the operation of ships and aircraft typically involves large expenses and expressed a concern that taxing on a gross basis, with no recognition of expenses, could lead to over-taxation. In addition, they expressed concern that the sourcing rule and administrative challenges, including with the allocation of payments, could potentially lead to double and multiple taxation.

8. As a result of these discussions, the current Model continues to include two alternatives for the taxation of income from international transport, although the alternative allowing source State taxation is now presented as the first option as it was the preference of a majority of the Committee. Countries should consider carefully their economic circumstances in deciding on their policy in this area. For example, they may want to consider the extent to which they rely on international shipping and air transportation for essential goods, and whether a source State tax on shipping income would affect the cost of such goods. Similarly, a country that relies heavily on tourism should consider the potential impact of taxing international air transport or cruise lines at source, possibly on a gross basis, on a core sector of its economy.

9. Until 2017, the text of both Article 8 (Alternative A) and Article 8 (Alternative B) referred to the "place of effective management of the enterprise". Taking into account the practice of most countries, the Committee then decided to follow the wording of other Articles and to refer instead to an "enterprise of a Contracting State" and the wording of both alternatives was changed accordingly. Some countries may, however, prefer to continue to use the previous formulation and to refer to the "State in which the place of effective management of the enterprise is situated" (see paragraphs 35 and 36 below).

10. Depending on the frequency or volume of cross-border traffic, countries may, during bilateral negotiations, wish to extend the provisions of Article 8 to cover rail or road transport. As explained in paragraph 41 below, they may also want to cover inland waterways transport.

11. Some countries also believe that profits from the operation of vessels engaged in fishing, dredging or hauling activities on the high seas should be treated as falling under Article 8. If the specific bilateral treaty includes Article 8 (Alternative B), providing for exclusive residence-State taxation, it would be a simple matter of adding a provision expanding the scope of the Article to cover the additional activities. If, however, the relevant bilateral treaty includes Article 8 (Alternative A), it would be necessary also to provide source and/or nexus rules to make such a provision operable, as income from such activities would not be treated as arising in a Contracting State under the source rules of Article 8 (Alternative A).

B. Commentary on the Paragraphs of Article 8 (Alternatives A and B)

Paragraph 1 of Article 8 (Alternative A)

12. This paragraph provides that income arising in a Contracting State from the operation of ships or aircraft in international traffic by a resident of the other Contracting State may be taxed in that other State. It does not, however, provide that such income may be taxed exclusively in that State. Before 2025, the equivalent paragraph, which was then in Alternative B, referred to "profits" of an enterprise because that Alternative B contemplated a formulary allocation of the net profits of an enterprise engaged in the operation of ships or aircraft in international traffic. As described below, new Alternative A allows taxpayers to pay the smaller of two amounts, one based on net profits arising in a State and the other determined by applying a negotiated tax rate to the gross amount of the payment. Accordingly, the Committee agreed that use of the term "income" is more appropriate.

13. Paragraph 1 applies to both income from shipping and income from international air transport. The Committee did not see a basis to distinguish one form of international transport from another. They also believe that developments in information technology and information sharing have enabled transport companies to identify local revenue and that digitalization of filing and payment of taxes lowers compliance costs as compared to the 1920s when the policy of exclusive residence State taxation of income from international traffic was adopted. They

note that many countries provide for source State taxation of foreign air carriers notwithstanding the policy set out by the International Civil Aviation Organization.[55] In their view, the principle of reciprocity that underpins the ICAO policy may not be fair for developing countries unless the number of flights operated in and out of a country are equally shared by foreign airlines and domestic airlines.

14. A large minority of the Committee Members were of the view that Article 8 (Alternative A) should not apply to income from international air transport.[56] In their view, the arguments in favour of source State taxation of income from shipping do not apply to income from international air transport. They point out that, while shipping companies may benefit from tonnage tax or other regimes in their countries of residence, such regimes do not apply to air transport companies, which are generally subject to tax on their worldwide income. Moreover, they question whether the imbalance referred to in paragraph 5 of this Commentary applies equally to air transport, noting that many airlines are resident in developing countries. In addition, they argue that, unlike shipping companies, airlines do not have the same ability to choose where to establish themselves, as there is significant regulation on ownership of air transport companies, which ensures that they are truly resident and owned and managed in their home jurisdiction. Many airlines are national carriers, owned by governments. Further, they note that airlines historically have had modest profits and operating an airline involves large expenses, such that taxation on a gross basis, with no recognition of expenses, may result in over-taxation. They also note that, unlike a ship, multiple airlines are often involved in the carriage of the passenger and air cargo and revenue from the sale of the ticket may be shared among airlines. As a result, the sourcing rule in paragraph 4 could result in multiple taxation and taxation of revenue which the airline issuing the ticket is contractually obligated to pay to another airline providing service for one of the legs of the journey. They note further that there is uncertainty in the sourcing rule regarding where the carriage "ends", especially in a multi-city journey. It increases the risk of multiple taxation if states do not agree on the state or states in

55 ICAO's Policies on Taxation in the Field of International Air Transport (2nd edition), Doc 8632-C/968, (1994); Supplement to Doc 8632 (2021).

56 The decision to include that minority view in the Commentary was taken at the thirtieth session of the Committee held in March 2025.

which the carriage starts and ends. Moreover, they believe that there are significant complexities and challenges for air transport companies: (i) increased number of sales channels/distribution methods, including online and via other airlines; (ii) multiple touchpoints of individual passengers; (iii) unique methods of collaboration between airlines such as interlining, code-sharing and joint ventures; (iv) significant ancillary sales; (v) revenue recognition and advance sales of one year; and (vi) no separate accounts maintained and challenges in preparing them. Finally, they argue that Article 8 (Alternative A) is directly in conflict with the official policy on taxation of the International Civil Aviation Organization (a specialized agency of the United Nations).

15. Countries that prefer to have Article 8 (Alternative A) apply only to income from shipping and not to international air transport can achieve that result by (1) deleting the words "or aircraft" throughout the provision, apart from paragraph 5, and (2) replacing paragraph 1 and the first part of paragraph 2 by the following:

> 1. Profits of an enterprise of a Contracting State from the operation of aircraft in international traffic shall be taxable only in that State.
>
> 2. Income arising in a Contracting State from the operation by a resident of the other Contracting State of ships in international traffic may be taxed in that other State. However, such income may also be taxed in the Contracting State in which it arises and according to the laws of that State…

Paragraph 2 of Article 8 (Alternative A)

16. This paragraph allows income from the operation of ships or aircraft in international traffic to be taxed in the source country. it provides an independent operative rule for income arising in a Contracting State from the operation of ships or aircraft in international traffic that is not qualified by Articles 5 and 7 relating to business profits governed by the permanent establishment rule. It covers both regular or frequent visits and unplanned or isolated visits by ships or aircraft, provided the latter were not merely fortuitous.

17. This paragraph lays down the principle that the Contracting State in which income from the operation of ships or aircraft in international

traffic arises may tax the underlying payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the income is a resident of the other Contracting State, the amount of tax imposed by the State in which such income arises is limited to the lower of two amounts. The first limit applies only if the domestic law of the source State would tax the income covered by this paragraph on a net basis. In that case, the relevant amount is 50 per cent of the tax that would have been imposed in that State in the absence of the convention on the net profits of the enterprise relating to the underlying payments. The second limit is determined by applying a negotiated rate to the gross amount of the payments underlying such income.

18. Because the first limit refers to the tax that would have been imposed in the absence of the convention, net profits would be determined by the authorities of the source State according to its domestic law. The 50 per cent reduction in the tax computed on the basis of the profits so determined is intended to achieve a sharing of revenues between the two Contracting States, particularly when each is a source State under the rule of paragraph 4. This limitation may not be necessary or appropriate if the domestic law of a State already provides for reduced taxation of income from international transport; countries in that situation may consider modifying or omitting subparagraph (a). For these purposes, it is understood that an enterprise may have net profits from its activities arising in a Contracting State within the meaning of paragraph 4 (calculated by determining the gross income from such activities and deducting related expenses) even if the enterprise as a whole has incurred losses in that year.

19. The first limit, in subparagraph (a), was included in Article 8 (Alternative A) because it is a common approach adopted in those tax treaties that allow for source State taxation of income from international traffic. The second limit in subparagraph (b) was included to provide a cap on the amount of source State taxation that is not tied to the domestic law of the source State. Subparagraph (b) therefore provides certainty that source State taxation on income from the operation of ships or aircraft in international traffic will not exceed an amount envisioned by the two parties. Moreover, if the domestic law of one or both of the Contracting States does not provide for net basis taxation of income from the operation in international traffic of ships or aircraft, the condition for the application of subparagraph (a) will not be met with

respect to that State, so that the only applicable limitation on taxation by such a State would be the limit in subparagraph (b). Countries are free, in their bilateral negotiations, to provide for only one of the limits in subparagraph (a) or (b) rather than both.

20. The maximum rate of tax under subparagraph (b) is to be established through the bilateral negotiations between the Contracting States. It is recommended, however, that it be set at a modest value. In addition, the rate should take into account the risk of multiple taxation arising from the source rule of paragraph 4, discussed in paragraph 30 below.

21. Where there is an existing shipping or air services agreement between the Contracting States that provides for a different allocation rule, such as exclusive residence State taxation, States including paragraph 2 of Article 8 (Alternative A) should clarify how the two agreements interact, which may require modifying or terminating the tax provisions of such other agreement in order to provide certainty.

Paragraph 3 of Article 8 (Alternative A)

22. Under Paragraph 3 "income from the operation of ships or aircraft in international traffic" means the income obtained by the enterprise from the transportation of passengers, mail, livestock or goods in international traffic, irrespective of whether the relevant ships or aircraft are owned, leased or otherwise at the disposal of the enterprise. As in the case of Article 8 (Alternative B), the term includes income obtained by leasing a ship or aircraft on charter fully equipped, crewed and supplied.

23. Paragraph 3 includes only income received in consideration for the carriage of passengers, mail, livestock or goods. It therefore excludes some income that is treated as covered by Alternative B because it is ancillary to the profits earned directly from the carriage of passengers or cargo in international traffic. For example, Article 11 will apply to interest and Article 12, not Article 8 (Alternative A) will apply to income from the rental of containers or the leasing of a ship or aircraft on a bare boat charter basis. The scope of Article 8 (Alternative A) therefore will be narrower in certain respects than the scope of Article 8 (Alternative B), as described in paragraph 24 below. In part, this is because it would

be difficult to apply the source rule of paragraph 4 to certain types of ancillary income.

Paragraph 4 of Article 8 (Alternative A)

24. Paragraph 4 lays down the principle that income from the operation of ships or aircraft in international traffic arises in a Contracting State if such income is received in consideration for the carriage of passengers, livestock, mail or goods, where that carriage starts from a location in one State and ends at a location outside of that State, or ends at a location in a Contracting State and starts from a location outside that State. That is, a Contracting State will be allowed to tax fees received for carriage when the journey of the passenger, livestock, mail or goods starts within it, and when the journey ends in that State. Under this definition, the simple case of carriage from one Contracting State to the other Contracting State will result in income being taxable in both Contracting States; in that case, the limit imposed by subparagraph (a) of paragraph 2 will allow each State to impose a tax of no more than 50 per cent of the tax otherwise imposed, effectively splitting the taxing rights.

25. The source rule of paragraph 4 focuses on "carriage" of the passengers, livestock, mail or goods, rather than on the operation of individual airplanes or ships. That is, the source rule of Article 8 (Alternative A) depends on the overall contract between the customer and the transportation company. In general, that agreement (ticket) will specify the place of departure and the destination. The "carriage" begins at the former and ends at the latter. The agreement/ticket usually provides for a return journey, which will constitute a separate "carriage" for purposes of these rules.

26. Because the relevant "carriage" focuses on the two endpoints of the journey, it is irrelevant whether the ticket provides for intermediate stops in other States. If a passenger buys a ticket to travel by ship from State A to State B, the entire revenue from that ticket is treated as arising in each of State A and State B, but not in any country in which the ship stops while voyaging between State A and State B. In the case of air travel, this is true even if a traveller is required to disembark and board a different plane, which may be operated by another airline. It is also irrelevant if the passenger is re-routed through a different State because the flight that was booked was cancelled. If, however, the passenger

has purchased two different tickets, artificially splitting up his or her journey, then paragraph four will be applied separately to each ticket because there is no ticket which covers the entire journey.

27. For example, if a traveller purchases a ticket from Airline A in State A, to fly from City X in State A to City Y in State B, State A and State B each are treated as source States under paragraph 4. If Airline A does not fly directly to City Y, but to City Z in State B, it would be common for the ticket to provide for the passenger to take a State B domestic airline from City Z to City Y. As long as the ticket issued by Airline A covers the entire journey from City X to City Y, this is treated as one contract for "carriage" that begins in State A and ends in State B. However, only Airline A, which issued the ticket, will receive payment and be required to pay tax under Article 8 (Alternative A).

28. Similarly, if a traveller purchases a ticket from Airline A in State A, to fly from City X in State A to City Y in State B, only State A and State B are treated as source States under paragraph 4, even if the plane makes a stop in State C to drop off or pick up other passengers. Moreover, the amount of income that is treated as being from sources in State A and State B is the entire ticket price, even if multiple airlines are involved in the carriage of the passenger. However, in the example in paragraph 27, depending on circumstances, the passenger may find that the overall cost of his desired trip is lower if he or she buys an international ticket from City X to City Z and a separate ticket from the State B domestic airline to travel from City Z to City Y. In that case, only the ticket issued by Airline A is covered by paragraph 4 because, with respect to the portion of the journey constituting international traffic, the port of embarkation is City X and the port of disembarkation is City Z.

29. There may also be more complicated situations where the 50 per cent limit may reduce, but not eliminate, multiple taxation. For example, assume ManuCo, a company resident in Country H, pays ShipCo, a company resident in Country S, to pick up goods manufactured by its subsidiary in Country F and deliver them to Country M, where ManuCo's distribution subsidiary will sell them to unrelated parties. If the Country S-Country F treaty and the Country S-Country M treaty each includes Article 8 (Alternative A), Country F would be able to tax the fees received by ShipCo under subparagraph 4(a) , subject to the limitation in paragraph 2, while Country M would be able to tax the

fees received by ShipCo under subparagraph 4(b), again subject to the limitation in paragraph 2.

30. Because of the risk of multiple taxation of the same income, some countries choose to tax only when carriage begins in that country or when carriage ends in that country; if both countries agree, paragraph 4 can be modified accordingly by dropping subparagraph (a) or (b), as appropriate. Otherwise, countries may want to take account of the risk of multiple taxation when establishing the withholding rate under subparagraph 2(b).

31. A small minority of Committee Members did not agree that a Contracting State should be treated as a source State with respect to legs of a journey that do not begin or end in that State.[57] For example, if a passenger buys a ticket to travel by airplane from State A to State B, with a stop in State C, those Members believe that only the amount attributable to the State A-State C leg of the trip should be treated as arising from sources in State A. The State C-State B leg should, in their view, be treated as arising in State C and State B but not in State A. Countries that wish to reach that result may substitute the following language:

> For the purposes of this Article, income from the operation of ships or aircraft in international traffic shall be deemed to arise in a Contracting State if that operation of ships or aircraft is:
>
> (a) from a location in that Contracting State to a location outside that Contracting State; or
>
> (b) to a location in that Contracting State from a location outside that State.

It should be noted that the consequence of using this language is that more States would tax a smaller portion of the income arising from the trip. That is, State A and State C would be treated as source States with respect to the portion of the ticket price attributable to the State A-State C leg while State C and State B would be treated as source States with respect to the State C-State B leg. This contrasts with the approach under paragraph 4, in which State C is not treated as a source State at all. It also increases the risk of multiple taxation if the States do not agree on the amount of the ticket price attributable to each leg of the trip.

57 The decision to include that minority view in the Commentary was taken at the thirtieth session of the Committee held in March 2025.

32. Some countries that rely on withholding taxes may foresee difficulty collecting taxes under paragraph 4 when the payer of the fees is not a resident of their State and does not have a permanent establishment therein, as is the case of the payment from ManuCo to ShipCo in the example in paragraph 28. Some countries have solved this problem in the case of shipping by requiring proof of payment of taxes before permission to embark is granted. In some cases, responsibility for administration of the tax is delegated to the port authorities. However, taxpayers must have the ability to file returns after the close of the year in order to determine whether subparagraph 2(a) or 2(b) results in a lower tax (for example, as a result of losses).

Paragraph 1 of Article 8 (Alternative B)

33. This paragraph, which reproduces paragraph 1 of Article 8 of the OECD Model, has the objective of ensuring that profits from the operation of ships or aircraft in international traffic will be taxed in one State alone. The paragraph's effect is that these profits are wholly exempt from tax at source and are taxed exclusively in the Contracting State of the enterprise engaged in international traffic, except when paragraph 2(b) of Article 5A applies. It provides an independent operative rule for these activities and is not qualified by Articles 5 and 7 relating to business profits governed by the permanent establishment rule. Articles 12AA and 12B, which allow source taxation of fees for services and income from automated digital services, respectively, are also subject to the operation of Article 8 (see paragraph 2 of Article 12AA and paragraph 33 of the Commentary on Article 12AA, paragraphs 2 and 3 of Article 12B and paragraph 37 of the Commentary on Article 12B).

34. The exemption from tax in the source country is predicated largely on the premise that the income of shipping enterprises is earned on the high seas, that exposure to the tax laws of numerous countries is likely to result in double taxation or at best in difficult allocation problems, and that exemption in places other than the home country ensures that the enterprises will not be taxed in foreign countries if their overall operations turn out to be unprofitable. Considerations relating to international air traffic are similar. Since a number of countries with water boundaries do not have resident shipping companies but do have ports used to a significant extent by ships from other countries, they

have traditionally disagreed with the principle of such an exemption of shipping profits and would argue in favour of Alternative A.

35. Paragraph 2 of the Commentary on Article 8 of the 2017 OECD Model notes that while paragraph 1 is based on the principle that the taxing right shall be left to the Contracting State of the enterprise, some countries may wish to refer instead to the place of effective management of the enterprise and draft the paragraph along the following lines:

> Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

36. As noted in paragraph 3 of the Commentary on Article 8 of the 2017 OECD Model, countries wishing to refer to the "place of effective management of the enterprise" in paragraph 1 may also want to deal with the particular case where the place of effective management of the enterprise is aboard a ship, which could be done by adding the following provision:

> If the place of effective management of a shipping enterprise is aboard a ship, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship is a resident.

37. Referring to the meaning of the term "profits from the operation of ships or aircraft in international traffic", the Commentary on Article 8 of the 2017 OECD Model sets down two categories of profits which should fall within the scope of paragraph 1 of Article 8. The first relates to profits directly obtained by the enterprise from the carriage of passengers or cargo in international traffic and the second to profits from activities to permit, facilitate or support international traffic operations. Within the second category, the Commentary distinguishes two different types of activities: those directly connected with such operations and those not directly connected but "ancillary" to such operations. The Committee considers that the following part of the Commentary on Article 8 of the 2017 OECD Model, which provides additional explanations as regards these different categories of profits, is applicable to Article 8 (Alternative B) of this Model:

4. The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to permit, facilitate or support their international traffic operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise's ships or aircraft in international traffic as long as they are ancillary to such operation.

4.1 Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.

4.2 Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.

38. Applying the principles set out above, the Commentary on Article 8 of the 2017 OECD Model deals with a number of activities in relation to the extent to which paragraph 1 will apply when those activities are carried on by an enterprise engaged in the operation of ships or aircraft in international traffic. The Committee considers that the following part of the Commentary on Article 8 of the 2017 OECD Model is applicable to paragraph 1 of Article 8 (Alternative B) of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

5. Profits obtained by leasing a ship or aircraft on charter fully equipped, crewed and supplied must be treated like the profits from the carriage of passengers or cargo. Otherwise, a great deal of business of shipping or air transport would not come within the scope of the provision. However, Article [12], and not Article 8, applies to profits

from leasing a ship or aircraft on a bare boat charter basis except when it is an ancillary activity of an enterprise engaged in the international operation of ships or aircraft.

6. Profits derived by an enterprise from the transportation of passengers or cargo otherwise than by ships or aircraft that it operates in international traffic are covered by the paragraph to the extent that such transportation is directly connected with the operation, by that enterprise, of ships or aircraft in international traffic or is an ancillary activity. One example would be that of an enterprise engaged in international transport that would have some of its passengers or cargo transported internationally by ships or aircraft operated by other enterprises, for example, under code-sharing or slot-chartering arrangements or to take advantage of an earlier sailing. Another example would be that of an airline company that operates a bus service connecting a town with its airport primarily to provide access to and from that airport to the passengers of its international flights.

7. A further example would be that of an enterprise that transports passengers or cargo by ships or aircraft operated in international traffic which undertakes to have those passengers or that cargo picked up in the country where the transport originates or transported or delivered in the country of destination by any mode of inland transportation operated by other enterprises. In such a case, any profits derived by the first enterprise from arranging such transportation by other enterprises are covered by the paragraph even though the profits derived by the other enterprises that provide such inland transportation would not be.

8. An enterprise will frequently sell tickets on behalf of other transport enterprises at a location that it maintains primarily for purposes of selling tickets for transportation on ships or aircraft that it operates in international traffic. Such sales of tickets on behalf of other enterprises will either be directly connected with voyages aboard ships or aircraft that the enterprise operates (e.g. sale of a ticket issued by another enterprise for the domestic leg of an international voyage offered by the enterprise) or will be ancillary to its own sales. Profits derived by the first enterprise from selling such tickets are therefore covered by the paragraph.

8.1 Advertising that the enterprise may do for other enterprises in magazines offered aboard ships or aircraft that it operates or at its business locations (e.g. ticket offices) is ancillary to its operation of these ships or aircraft and profits generated by such advertising fall within the paragraph.

9. Containers are used extensively in international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers are usually either directly connected or ancillary to its operation of ships or aircraft in international traffic and in such cases fall within the scope of the paragraph. The same conclusion would apply with respect to profits derived by such an enterprise from the short-term storage of such containers (e.g. where the enterprise charges a customer for keeping a loaded container in a warehouse pending delivery) or from detention charges for the late return of containers.

10. An enterprise that has assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic may derive income from providing goods or services in that country to other transport enterprises. This would include (for example) the provision of goods and services by engineers, ground and equipment-maintenance staff, cargo handlers, catering staff and customer services personnel. Where the enterprise provides such goods to, or performs services for, other enterprises and such activities are directly connected or ancillary to the enterprise's operation of ships or aircraft in international traffic, the profits from the provision of such goods or services to other enterprises will fall under the paragraph.

10.1 For example, enterprises engaged in international transport may enter into pooling arrangements for the purposes of reducing the costs of maintaining facilities needed for the operation of their ships or aircraft in other countries. For instance, where an airline enterprise agrees, under an International Airlines Technical Pool agreement, to provide spare parts or maintenance services to other airlines landing at a particular location (which allows it to benefit from these services at other locations), activities carried on pursuant to that agreement will be ancillary to the operation of aircraft in international traffic.

[…]

12. The paragraph does not apply to a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country.

[…]

14. Investment income of shipping or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment ordinarily applied to this class of income, except where the investment that generates the income is made as an integral part of

the carrying on of the business of operating the ships or aircraft in international traffic in the Contracting State so that the investment may be considered to be directly connected with such operation. Thus, the paragraph would apply to interest income generated, for example, by the cash required in a Contracting State for the carrying on of that business or by bonds posted as security where this is required by law in order to carry on the business: in such cases, the investment is needed to allow the operation of the ships or aircraft at that location. The paragraph would not apply, however, to interest income derived in the course of the handling of cash-flow or other treasury activities for permanent establishments of the enterprise to which the income is not attributable or for associated enterprises, regardless of whether these are located within or outside that Contracting State, or for the head office (centralisation of treasury and investment activities), nor would it apply to interest income generated by the short-term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation.

14.1 Enterprises engaged in the operation of ships or aircraft in international traffic may be required to acquire and use emissions permits and credits for that purpose (the nature of these permits and credits is explained in paragraph 75.1 of the Commentary on Article 7 *[of the 2017 OECD Model]*). Paragraph 1 applies to income derived by such enterprises with respect to such permits and credits where such income is an integral part of carrying on the business of operating ships or aircraft in international traffic, for example, where permits are acquired for the purpose of operating ships or aircraft or where permits acquired for that purpose are subsequently traded when it is realised that they will not be needed.

39. Some members of the Committee do not fully agree with the interpretation of the phrase "profits from the operation of ships or aircraft in international traffic" in paragraphs 37 and 38 above. Some of those members consider that activities of an ancillary nature are not covered by the text of Article 8 as such activities are not mentioned in the text of that Article of the Model. Others consider that some of the examples given in the OECD Commentary quoted above may fall within the definition of "profits from the operation of ships or aircraft in international traffic" while others do not.

Paragraph 5 of Article 8 (Alternative A) and paragraph 2 of Article 8 (Alternative B)

40. Paragraph 5 of Article 8 (Alternative A) reproduces paragraph 2 of Article 8 of the OECD Model, with one adjustment, namely, the replacement of the phrase "paragraph 1" by the words "paragraphs 1 and 2". Paragraph 2 of Article 8 (Alternative B) also reproduces paragraph 2 of OECD Model Article 8. The Committee considers that the following part of the Commentary on Article 8 of the 2017 OECD Model, which provides additional explanations with respect to paragraph 2 of that Article, is applicable to paragraph 5 of Article 8 (Alternative A) and to paragraph 2 of Article 8 (Alternative B) of this Model:

> 23. Various forms of international co-operation exist in shipping or air transport. In this field international co-operation is secured through pooling agreements or other conventions of a similar kind which lay down certain rules for apportioning the receipts (or profits) from the joint business.
>
> 24. In order to clarify the taxation position of the participant in a pool, joint business or in an international operating agency and to cope with any difficulties which may arise the Contracting States may bilaterally add the following, if they find it necessary:
>
> > … but only to so much of the profits so derived as is attributable to the participant in proportion to its share in the joint operation.

Operation of boats engaged in inland waterways transport

41. Profits of an enterprise of a Contracting State derived from inland waterways transport fall within the scope of paragraph 3 of Article 8 (Alternative A) or paragraph 1 of Article 8 (Alternative B) only to the extent that such transport constitutes international traffic pursuant to the definition of that term in Article 3. Some countries (e.g. countries where foreign enterprises are allowed to carry on cabotage operations on a river that flows through them) may wish, however, to extend the treatment provided for in paragraph 1 of Article 8 (Alternative B) to the profits derived from any transport on rivers, canals and lakes; these countries may do so by including the following provision in their bilateral treaties:

> Profits of an enterprise of a Contracting State from the operation of boats engaged in inland waterways transport shall be taxable only in that State.

Where such a provision is included, the title of Article 8 should logically be amended to read "Shipping, inland waterways transport and air transport".

42. Other countries, however, consider that inland waterways transport that does not constitute international traffic should not be treated differently from other business activities taking place within their borders. These countries consider that although it is possible that inland waterways transport that does not constitute international traffic could give rise to problems of double taxation, such problems can be addressed through the rules of Articles 7 and 23 A or 23 B in the cases where foreign enterprises are allowed to carry on such transportation activities.

43. The rules set out in paragraphs 35 to 38 above relating to taxing rights and profits covered apply equally to the alternative provision set forth in paragraph 41 above. The Committee considers that the following part of the Commentary on Article 8 of the 2017 OECD Model is applicable with respect to the application of that alternative provision (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 16. The above provision would apply not only to inland waterways transport between two or more countries (in which case it would overlap with paragraph 1), but also to inland waterways transport carried on by an enterprise of one State between two points in another State. The alternative formulation set forth in paragraph 2 [of the Commentary on Article 8 of the 2017 OECD Model] according to which the taxing right would be granted to the State in which the place of effective management of the enterprise is situated also applies to the above provision. If this alternative provision is used, it would be appropriate to add a reference to "boats engaged in inland waterways transport" in paragraph 3 of Articles 13 and 22 in order to ensure that such boats are treated in the same way as ships and aircraft operated in international traffic (see also paragraph 9.4 of the Commentary on Article 15 *[of the 2017 OECD Model, as quoted at paragraph 6 of*

the Commentary on Article 15]). Also, the principles and examples included in paragraphs 4 and 14 *[of the Commentary on Article 8 of the 2017 OECD Model, as quoted above at paragraphs 37 and 38]* would be applicable, with the necessary adaptations, for purposes of determining which profits may be considered to be derived from the operation of boats engaged in inland waterways transport. Specific tax problems which may arise in connection with inland waterways transport, in particular between adjacent countries, could also be settled specially by bilateral agreement.

17. Whilst the above alternative provision uses the word "boat" with respect to inland waterways transport, this reflects a traditional distinction that should not be interpreted to restrict in any way the meaning of the word "ship" used throughout the Convention, which is intended to be given a wide meaning that covers any vessel used for water navigation.

Enterprises not exclusively engaged in shipping or air transport

44. The Committee considers that the following part of the Commentary on Article 8 of the 2017 OECD Model, which deals with enterprises not exclusively engaged in shipping or air transport, is applicable to both alternatives of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

19. *[Neither alternative of Article 8 requires]* enterprises *[to be]* exclusively engaged in shipping or air transport *[to]* come within the provisions of *[Article 8]* as regards *[income or]* profits arising to them from the operation of ships or aircraft belonging to them.

20. If such an enterprise has in a foreign country permanent establishments exclusively concerned with the operation of its ships or aircraft, there is no reason to treat such establishments differently from the permanent establishments of enterprises engaged exclusively in shipping or air transport.

21. Nor does any difficulty arise in applying the provisions of paragraph 1 if the enterprise has in another State a permanent establishment which is not exclusively engaged in shipping or air transport. If its goods are carried in its own ships to a permanent establishment belonging to it in a foreign country, it is right to say

that none of the profit obtained by the enterprise through acting as its own carrier can properly be taxed in the State where the permanent establishment is situated. The same must be true even if the permanent establishment maintains installations for operating the ships or aircraft (e.g. consignment wharves) or incurs other costs in connection with the carriage of the enterprise's goods (e.g. staff costs). In this case, even though certain functions related to the operation of ships and aircraft in international traffic may be performed by the permanent establishment, the profits attributable to these functions are taxable exclusively in the State to which the enterprise belongs. Any expenses, or part thereof, incurred in performing such functions must be deducted in computing that part of the profit that is not taxable in the State where the permanent establishment is located and will not, therefore, reduce the part of the profits attributable to the permanent establishment which may be taxed in that State pursuant to Article 7.

22. Where ships or aircraft are operated in international traffic, the application of the alternative formulation in paragraph 2 [of the Commentary on Article 8 of the 2017 OECD Model Tax Convention] to the profits arising from such operation will not be affected by the fact that the ships or aircraft are operated by a permanent establishment which is not the place of effective management of the whole enterprise; thus, even if such profits could be attributed to the permanent establishment under Article 7, they will only be taxable in the State in which the place of effective management of the enterprise is situated *[…]*.

Article 9

ASSOCIATED ENTERPRISES

A. General considerations

1. Article 9 of the U N Model reproduces Article 9 of the OECD Model, except for the additional paragraph 3 in the UN Model's version of the Article. Both Models embody the arm's length principle that forms the basis for allocating profits resulting from transactions between associated enterprises. Article 9 should be considered in conjunction with Article 25 on mutual agreement procedure and Article 26 on exchange of information.

2. The application of the arm's length principle for the allocation of profits between the associated enterprises presupposes for most countries that the domestic legislation authorizes a determination on the basis of the arm's length principle.

3. The Committee noted that paragraph 1 of the Commentary on Article 9 of the 2017 OECD Model includes the following general statement on the Article:

> 1. This Article deals with adjustments to profits that may be made for tax purposes where transactions have been entered into between associated enterprises (parent and subsidiary companies and companies under common control) on other than arm's length terms. The Committee has spent considerable time and effort (and continues to do so) examining the conditions for the application of this Article, its consequences and the various methodologies which may be applied to adjust profits where transactions have been entered into on other than arm's length terms. Its conclusions are set out in the report entitled *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*,[1],[58] which is periodically updated to reflect the progress of the work of the Committee in this area.

1 The original version of that report was approved by the Council of the OECD on 27 June 1995. Published in a loose-leaf format as *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD, Paris, 1995.

58 *[For the latest version of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, see footnote 28.]*

4. Paragraph 1 of the Commentary on Article 9 of the 2017 OECD Model continues by stating that the report entitled *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* "represents internationally agreed principles and provides guidelines for the application of the arm's length principle of which the Article is the authoritative statement." The Committee considers that those guidelines contain valuable guidance relevant for the application of the arm's length principle under Article 9 of bilateral tax conventions following the two Models. The Committee also considers it to be highly important for avoiding international double taxation of corporate profits that a common understanding prevails on how the arm's length principle should be applied, and that the two Models provide a common framework for preventing and resolving transfer pricing disputes where they would occur. With that aim in mind, the Committee has developed the *United Nations Practical Manual on Transfer Pricing for Developing Countries*[59] which pays special attention to the experience of developing countries, reflects the realities for such countries, at their relevant stages of capacity development, and seeks consistency with the guidance provided by the OECD Transfer Pricing Guidelines.

B. Commentary on the paragraphs of Article 9

Paragraph 1

5. Paragraph 1 provides that in cases involving associated enterprises, the tax authorities of 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. It is evidently appropriate that an adjustment should be sanctioned in such circumstances. The provision applies only if special conditions have been made or imposed between the two enterprises. Clearly no re-writing of the accounts with a consequential adjustment should be made if the transactions between the associated enterprises have taken place on a normal open market commercial basis, in other words, at arm's length.

59 See footnote 29.

6. In the OECD report on "Thin Capitalisation",[60] it is stated that there is an interplay between tax treaties and domestic rules on thin capitalization which is relevant to the scope of the Article. The Committee considers that the following part of the Commentary on Article 9 of the 2017 OECD Model, which deals with that interplay, is applicable to Article 9 of this Model (the modification that appears in italics between square brackets is not part of the Commentary on the OECD Model):

> 3. *[…]*
>
> *a)* the Article does not prevent the application of national rules on thin capitalisation insofar as their effect is to assimilate the profits of the borrower to an amount corresponding to the profits which would have accrued in an arm's length situation;
>
> *b)* the Article is relevant not only in determining whether the rate of interest provided for in a loan contract is an arm's length rate, but also whether a *prima facie* loan can be regarded as a loan or should be regarded as some other kind of payment, in particular a contribution to equity capital;
>
> *c)* the application of rules designed to deal with thin capitalisation should normally not have the effect of increasing the taxable profits of the relevant domestic enterprise to more than the arm's length profit, and that this principle should be followed in applying existing tax treaties.
>
> 4. The question arises as to whether special procedural rules which some countries have adopted for dealing with transactions between related parties are consistent with the Convention. For instance, it may be asked whether the reversal of the burden of proof or presumptions of any kind which are sometimes found in domestic laws are consistent with the arm's length principle. A number of countries interpret the Article in such a way that it by no means bars the adjustment of profits under national law under conditions that differ from those of the Article and that it has the function of raising the arm's length principle at treaty level. Also, almost all member countries consider that additional information requirements which would be more stringent

60 Adopted by the Council of the OECD on 26 November 1986 and reproduced at page R(4)-1 of volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1763, accessed on 10 May 2021.

than the normal requirements, or even a reversal of the burden of proof, would not constitute discrimination within the meaning of Article 24. However, in some cases the application of the national law of some countries may result in adjustments to profits at variance with the principles of the Article. Contracting States are enabled by the Article to deal with such situations by means of corresponding adjustments *[…]* and under mutual agreement procedures.

Paragraph 2

7. The Committee considers that the following part of the Commentary on Article 9 of the 2017 OECD Model, which explains the purpose and application of paragraph 2 of the Article, is applicable to paragraph 2 of Article 9 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

5. The re-writing of transactions between associated enterprises in the situation envisaged in paragraph 1 may give rise to economic double taxation (taxation of the same income in the hands of different persons), insofar as an enterprise of State A whose profits are revised upwards will be liable to tax on an amount of profit which has already been taxed in the hands of its associated enterprise in State B. Paragraph 2 provides that in these circumstances, State B shall make an appropriate adjustment so as to relieve the double taxation.

6. It should be noted, however, that an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length. In other words, the paragraph may not be invoked and should not be applied where the profits of one associated enterprise are increased to a level which exceeds what they would have been if they had been correctly computed on an arm's length basis. State B is therefore committed to make an adjustment of the profits of the affiliated company only if it considers that the adjustment made in State A is justified both in principle and as regards the amount.

[…]

7. The paragraph does not specify the method by which an adjustment is to be made. OECD member countries use different methods to provide relief in these circumstances and it is therefore left open for Contracting States to agree bilaterally on any specific rules which they wish to add to the Article. Some States, for example, would prefer the system under which, where the profits of enterprise X in State A are increased to what they would have been on an arm's length basis, the adjustment would be made by re-opening the assessment on the associated enterprise Y in State B containing the doubly taxed profits in order to reduce the taxable profit by an appropriate amount. Some other States, on the other hand, would prefer to provide that, for the purposes of Article 23, the doubly taxed profits should be treated in the hands of enterprise Y of State B as if they may be taxed in State A; accordingly, the enterprise of State B is entitled to relief in State B, under Article 23, in respect of tax paid by its associate enterprise in State A.

8. It is not the purpose of the paragraph to deal with what might be called "secondary adjustments". Suppose that an upward revision of taxable profits of enterprise X in State A has been made in accordance with the principle laid down in paragraph 1 and suppose also that an adjustment is made to the profits of enterprise Y in State B in accordance with the principle laid down in paragraph 2. The position has still not been restored exactly to what it would have been had the transactions taken place at arm's length prices because, as a matter of fact, the money representing the profits which are the subject of the adjustment is found in the hands of enterprise Y instead of in those of enterprise X. It can be argued that if arm's length pricing had operated and enterprise X had subsequently wished to transfer these profits to enterprise Y, it would have done so in the form of, for example, a dividend or a royalty (if enterprise Y were the parent of enterprise X) or in the form of, for example, a loan (if enterprise X were the parent of enterprise Y) and that in those circumstances there could have been other tax consequences (*e.g.* the operation of a withholding tax) depending upon the type of income concerned and the provisions of the Article dealing with such income.

9. These secondary adjustments, which would be required to establish the situation exactly as it would have been if transactions had been at arm's length, depend on the facts of the individual case. It should be noted that nothing in paragraph 2 prevents such secondary adjustments from being made where they are permitted under the domestic laws of Contracting States.

> 10. The paragraph also leaves open the question whether there should be a period of time after the expiration of which State B would not be obliged to make an appropriate adjustment to the profits of enterprise Y following an upward revision of the profits of enterprise X in State A. Some States consider that State B's commitment should be open-ended – in other words, that however many years State A goes back to revise assessments, enterprise Y should in equity be assured of an appropriate adjustment in State B. Other States consider that an open-ended commitment of this sort is unreasonable as a matter of practical administration. In the circumstances, therefore, this problem has not been dealt with in the text of the Article; but Contracting States are left free in bilateral conventions to include, if they wish, provisions dealing with the length of time during which State B is to be under obligation to make an appropriate adjustment *[…]*.
>
> 11. If there is a dispute between the parties concerned over the amount and character of the appropriate adjustment, the mutual agreement procedure provided for under Article 25 should be implemented; the Commentary on that Article contains a number of considerations applicable to adjustments of the profits of associated enterprises carried out on the basis of the present Article (following, in particular, adjustment of transfer prices) and to the corresponding adjustments which must then be made in pursuance of paragraph 2 thereof *[…]*.

8. The view has been expressed that a correlative adjustment under paragraph 2 could be very costly to a developing country which may therefore consider not including paragraph 2 in its treaties. However, paragraph 2 is an essential aspect of Article 9 and failure to provide a correlative adjustment will result in double taxation, which is contrary to the purpose of the Convention. A country should closely examine the primary adjustment under paragraph 1 before deciding what correlative adjustment is appropriate to reflect the primary adjustment. Some countries take the view that it may be desirable to eliminate the obligation that a State may have to make a correlative adjustment when the other Contracting State has previously adjusted the transfer prices. This approach can be achieved by changing the word "shall" to "may" in paragraph 2. Contracting States may, during bilateral negotiations, use the word that is convenient. However, there is no consensus on this point and the language of paragraph 2 remains unchanged.

Paragraph 3

9. The UN Model was amended in 1999 by the insertion of paragraph 3. Paragraph 2 of Article 9 requires a country to make an "appropriate adjustment" (a correlative adjustment) to reflect a change in the transfer price made by a country under paragraph 1 of Article 9. Paragraph 3 provides that the provisions of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that, by actions giving rise to an adjustment of profits under paragraph 1, one of the associated enterprises concerned is liable to penalty with respect to fraud, gross negligence or wilful default. In other words, in case a final order has been passed in a judicial, administrative or other legal proceeding pointing out that in relation to the adjustment of profits under paragraph 1 one of the associated enterprises is subject to a penalty for fraud, gross negligence or wilful default, there is no obligation to make the correlative adjustment under paragraph 2. This approach means that a taxpayer may be subject to non-tax and tax penalties. Some countries may consider such double penalties as too harsh, but it should be borne in mind that cases involving the levy of such penalties are likely to be exceptional and there would be no application of this provision in a routine manner.

Article 10

DIVIDENDS

A. General considerations

1. Article 10 of the UN Model reproduces the provisions of Article 10 of the OECD Model with the exception of paragraph 2, which contains substantive differences. Article 10 deals with the taxation of dividends received by a resident of a Contracting State from sources in the other Contracting State. Paragraph 1 provides that dividends may be taxed in the country of residence and paragraph 2 provides that dividends may be taxed in the country of source, but at a limited tax rate. The term "dividends" is defined in paragraph 3 as generally including distributions of corporate profits to shareholders. As observed in paragraph 3 of the Commentary on Article 10 of the 2017 OECD Model, "[f]rom the shareholders' standpoint, dividends are income from the capital which they have made available to the company as its shareholders." Paragraph 4 provides that paragraphs 1 and 2 do not apply to dividends that are attributable to a permanent establishment of the recipient in the source country, and paragraph 5 generally precludes a Contracting State from taxing dividends paid by a company resident in the other State unless the shareholder is a resident of the taxing State or the dividends are attributable to a permanent establishment of the recipient in that State.

B. Commentary on the paragraphs of Article 10

Paragraph 1

2. This paragraph, which reproduces paragraph 1 of Article 10 of the OECD Model, provides that dividends may be taxed in the State of the beneficiary's residence. It does not, however, provide that dividends may be taxed exclusively in that State and therefore leaves open the possibility of taxation by the State of which the company paying the dividends is a resident, that is, the State in which the dividends originate (source country). When the UN Model was first developed, many members of the former Group of Experts from developing countries felt that as a matter of principle dividends should be taxed only by the source

country. According to them, if both the country of residence and the source country were given the right to tax, the country of residence should grant a full tax credit regardless of the amount of foreign tax to be absorbed and, in appropriate cases, a tax-sparing credit. One of those members emphasized that there was no necessity for a developing country to waive or reduce its withholding tax on dividends, especially if it offered tax incentives and other concessions. However, the former Group of Experts reached a consensus that dividends may be taxed by the State of the beneficiary's residence. Current practice in developing/developed country treaties generally reflects this consensus. Double taxation is eliminated or reduced through a combination of exemption or tax credit in the residence country and reduced rates of tax in the source country.

3. The Committee considers that the following part of the Commentary on Article 10 of the 2017 OECD Model, which provides additional explanations on paragraph 1 of the Article, is applicable to paragraph 1 of Article 10 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 7. *[…]* The term "paid" has a very wide meaning, since the concept of payment means the fulfilment of the obligation to put funds at the disposal of the shareholder in the manner required by contract or by custom.
>
> 8. The Article deals only with dividends paid by a company which is a resident of a Contracting State and does not, therefore, apply to dividends paid by a company which is a resident of a third State. Dividends paid by a company which is a resident of a Contracting State which are attributable to a permanent establishment which an enterprise of that State has in the other Contracting State may be taxed by the first-mentioned State under paragraph 2 but may also be taxed by the other State under paragraph 1 of Article 7 (see paragraphs 9 and 9.1 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]* concerning relief of double taxation in such cases).

Paragraph 2

4. This paragraph reproduces paragraph 2 of Article 10 of the OECD Model with certain changes which are explained below.

5. Paragraph 2*a*) of the OECD Model restricts the tax in the source country to 5 per cent for direct investment dividends and paragraph 2*b*) restricts the tax in the source country to 15 per cent for portfolio investment dividends, but the UN Model leaves these percentages to be established through bilateral negotiations.

6. Prior to 2017, the minimum ownership necessary for direct investment dividends treatment under paragraph 2(*a*) of this Model was 10 per cent, as opposed to 25 per cent under the corresponding provision of the OECD Model. The 10 per cent threshold which determined the level of shareholding qualifying as a direct investment before 2017 was intended to be illustrative only. The former Group of Experts decided to use "10 per cent" in subparagraph (*a*) as the minimum capital required for direct investment dividend status because in some developing countries, non-residents were limited to a 50 per cent share ownership, and 10 per cent represented a significant portion of such permitted ownership. However, as part of the 2017 update, the Committee considered that 25 per cent was a more appropriate threshold for direct investment, in line with the position adopted in the OECD Model.

7. Also, in line with a recommendation included in the final report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[61] of the OECD/G20 BEPS Project, the Committee decided in 2017 that, in order to prevent abuse of the lower withholding rate for direct investment dividends, a 365-day holding period should be inserted into subparagraph (*a*). This 365-day holding requirement may be met either at the time of the payment of the dividend or after the time the dividend is paid. That change mirrored a similar change made to the OECD Model and the Committee therefore considers that the following part of the Commentary on Article 10 of the 2017 OECD Model, which explains the change, is applicable to paragraph 2(*a*) of Article 10 of this Model:

61 See footnote 9 above.

> 16. Before 2017, paragraph 17 of the Commentary on the Article provided that "[t]he reduction envisaged in subparagraph *a*) of paragraph 2 should not be granted in cases of abuse of this provision, for example, where a company with a holding of less than 25 per cent has, shortly before the dividends become payable, increased its holding primarily for the purpose of securing the benefits of the above-mentioned provision, or otherwise, where the qualifying holding was arranged primarily in order to obtain the reduction." Such abuses were addressed by the final report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project. As a result of that report, subparagraph *a*) was modified in order to restrict its application to situations where the company that receives the dividend holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend. The subparagraph also provides, however, that in computing that period, changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, should not be taken into account. Also, the addition of Article 29 will address other abusive arrangements aimed at obtaining the benefits of subparagraph *a*).

8. Treaties entered into prior to the 2017 update will typically not include this new time threshold until they are renegotiated bilaterally or amended through the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*.[62] Accordingly, the following part of the Commentary on Article 10 of the 2014 OECD Model remains relevant for these treaties:

> 16. Subparagraph *a)* of paragraph 2 does not require that the company receiving the dividends must have owned at least 25 per cent of the capital for a relatively long time before the date of the distribution. This means that all that counts regarding the holding is the situation prevailing at the time material for the coming into existence of the liability to the tax to which paragraph 2 applies, that is, in most cases the situation existing at the time when the dividends become legally available to the shareholders. The primary reason for this resides in the desire to have a provision which is applicable as broadly as possible. To require the parent company to have possessed the minimum holding

62 See https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm, accessed on 10 May 2021.

for a certain time before the distribution of the profits could involve extensive inquiries. Internal laws of certain OECD member countries provide for a minimum period during which the recipient company must have held the shares to qualify for exemption or relief in respect of dividends received. In view of this, Contracting States may include a similar condition in their conventions.

17. The reduction envisaged in subparagraph *a)* of paragraph 2 should not be granted in cases of abuse of this provision, for example, where a company with a holding of less than 25 per cent has, shortly before the dividends become payable, increased its holding primarily for the purpose of securing the benefits of the above-mentioned provision, or otherwise, where the qualifying holding was arranged primarily in order to obtain the reduction. To counteract such manoeuvres Contracting States may find it appropriate to add to subparagraph *a)* a provision along the following lines:

provided that this holding was not acquired primarily for the purpose of taking advantage of this provision.

9. The former Group of Experts was unable to reach a consensus on the maximum tax rates to be permitted in the source country. Members from the developing countries, who basically preferred the principle of the taxation of dividends exclusively in the source country, considered that the rates prescribed by the OECD Model would entail too large a loss of revenue for the source country. Also, although they accepted the principle of taxation in the beneficiary's country of residence, they believed that any reduction of the tax rate in the source country should benefit the foreign investor rather than the treasury of the beneficiary's country of residence, as may happen under the traditional tax-credit method if the reduction lowers the cumulative tax rate of the source country below the rate of the beneficiary's country of residence.

10. The former Group of Experts suggested some considerations that might guide countries in negotiations on the rates for source country taxation of direct investment dividends. If the developed (residence) country uses a credit system, treaty negotiations could appropriately seek a tax rate at source that would, in combination with the basic corporate tax rate of the source country, produce a combined effective rate not exceeding the tax rate in the residence country. The parties' negotiating positions may also be affected by whether the residence country allows credit for taxes spared by the source country under tax

incentive programmes. If the developed country uses an exemption system for double taxation relief, it could, in bilateral negotiations, seek a limitation on source taxation rates on the grounds that (*a*) the exemption itself stresses the concept of not taxing inter-corporate dividends, and a limitation of the rate of tax at source would be in keeping with that concept, and (*b*) the exemption and resulting departure from tax neutrality with domestic investment are of benefit to the international investor, and a limitation of the rate of tax at source, which would also benefit the investor, would be in keeping with this aspect of the exemption.

11. Both the source country and the country of residence should be able to tax dividends on portfolio investment shares, although the relatively small amount of portfolio investment and its distinctly lesser importance compared with direct investment might make the issues concerning its tax treatment less intense in some cases. The former Group of Experts decided not to recommend a maximum rate because source countries may have varying views on the importance of portfolio investment and on the figures to be inserted.

12. During the 1999 revision of the UN Model, it was noted that recent developed/developing country treaty practice indicated a range of maximum direct investment and portfolio investment rates of tax at source. Traditionally, maximum rates of source tax on dividends in the developed/developing country treaties have been higher than those in treaties between developed countries. Thus, while the OECD direct and portfolio investment rates are 5 per cent and 15 per cent, developed/developing country treaty rates have traditionally ranged between 5 per cent and 15 per cent for direct investment dividends and 15 per cent and 25 per cent for portfolio dividends. Some developing countries have taken the position that short-term loss of revenue occasioned by low rates of source tax is justified by the increased foreign investment in the medium and long terms. Thus, several modern developed/developing country treaties contain the rates of the OECD Model for direct investment, and a few treaties provide for even lower rates.

13. Also, several special features in developed/developing country treaties have appeared: (a) the tax rates may not be the same for both countries, with higher rates allowed to the developing country; (b) tax rates may not be limited at all; (c) reduced rates may apply only to income

from new investment; (d) the lowest rates or exemption may apply only to preferred types of investments (e.g. "industrial undertakings" or "pioneer investments"); and (e) dividends may qualify for reduced rates only if the shares have been held for a specified period (even before the addition of the 365-day holding period being included in paragraph 2(a) in the Model's Article 10 in 2017). In treaties of countries that have adopted an imputation system of corporation taxation (i.e. integration of company tax into the shareholder's company tax or individual income tax) instead of the classical system of taxation (i.e. separate taxation of shareholder and corporation), specific provisions may ensure that the advanced credits and exemptions granted to domestic shareholders are extended to shareholders resident in the other Contracting State.

14. Although the rates are fixed either partly or wholly for reasons connected with the general balance of the particular bilateral tax treaty, the following technical factors are often considered in fixing the rates:

a) the corporate tax system of the country of source (e.g. the extent to which the country follows an integrated or classical system) and the total burden of tax on distributed corporate profits resulting from the system;

b) the extent to which the country of residence can credit the tax on the dividends and the underlying profits against its own tax and the total tax burden imposed on the taxpayer, after relief in both countries;

c) the extent to which matching credit is given in the country of residence for tax spared in the country of source;

d) the achievement from the source country's point of view of a satisfactory balance between raising revenue and attracting foreign investment.

15. Changes made in 2014 to the Commentary on Article 10 of the OECD Model made it clear, as regards paragraph 2 of Article 3, that the concept of beneficial owner used in paragraph 2 of Article 10 was intended to be interpreted in the context in which it appears and not with reference to the domestic law of the Contracting States. In 2021, the Committee agreed with this application of paragraph 2 of Article 3 to the concept of beneficial owner. The Committee therefore considers that the following part of the Commentary on Article 10 of the 2017 OECD Model, which deals with the interpretation of the concept of beneficial

owner, is applicable to paragraph 2 of Article 10 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 12. The requirement of beneficial owner*[…]* was introduced in paragraph 2 of Article 10 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention.
>
> 12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid … to a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context, in particular in relation to the words "paid … to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.
>
> 1 For example, where the trustees of a discretionary trust do not distribute interest earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 11 even if they are not the beneficial owners under the relevant trust law.
>
> 12.2 Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the *[OECD]* Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[1] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

1 Reproduced *[at page R(6)-1 of]* Volume II of the *[full-length]* version of the *[2017]* OECD Model Tax Convention*[, available at* https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833*, accessed on 10 May 2021.]*

12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the "beneficial owner" because that recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs *[29 to 49 of the Commentary on Article 1 of this Model]*. Where the recipient of dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that dividend. It should also be noted that Article 10 refers to the beneficial owner of dividend as opposed to the owner of the shares, which may be different in some cases.

12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 22 *[of the Commentary on Article 10 of the 2017 OECD Model, as quoted below]*). The provisions of Article 29 and the principles put forward in the section on "Improper use of the Convention" in the Commentary on Article 1 will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of the dividends. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 *a*), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10 *[, 11, 12, 12AA, 12B and 12C]*, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends*[, interest, royalties, fees for services, income from automated digital services and insurance premiums]* rather than difficulties related to the ownership of the *[underlying property or rights in respect of which the amounts are paid]*. For that reason, it would be inappropriate, in the context of *[these articles]*, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]

1 See, for example, *Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard

and which includes the following definition of beneficial owner (at page 110): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

> In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2 See the Financial Action Task Force's definition quoted in the previous note.

12.7 Subject to other conditions imposed by the Article and the other provisions of the Convention, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the *[UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014]*).

16. Also, the Committee considers that the following part of the Commentary on Article 10 of the 2017 OECD Model, which provides additional explanations on paragraph 2 of Article 10, is applicable to paragraph 2 of Article 10 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 11. Before 2017, subparagraph *a*) of paragraph 2 referred to a company "other than a partnership". That exception was deleted in recognition of the fact that if a partnership is treated as a company for tax purposes by the Contracting State in which it is established, it is appropriate for the other State to grant the benefits of subparagraph *a*) to that partnership. Indeed, an entity or arrangement (e.g. a partnership) that is treated as a

company for tax purposes qualifies as a company under the definition in subparagraph *b*) of paragraph 1 of Article 3 and, to the extent that it is a resident of a Contracting State, is therefore entitled to the benefits of subparagraph *a*) of paragraph 2 with respect to dividends paid by a company resident of the other State, as long as it holds directly at least 25 per cent of the capital of that company. This conclusion holds true regardless of the fact that the State of source of the dividends may regard that entity or arrangement as fiscally transparent. That conclusion is confirmed by the provision on fiscally transparent entities in paragraph 2 of Article 1.

11.1 That provision also ensures that the part of the dividend received by a fiscally transparent entity or arrangement that is treated as the income of a member of that entity or arrangement for purposes of taxation by the State of residence of that member will be considered as a dividend paid to that member for the purposes of Article 10 (see paragraph 12 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 7 of the Commentary on Article 1 of this Model]*). Where, for example, a company resident of State A pays a dividend to a partnership that State B treats as a transparent entity, the part of that dividend that State B treats as the income of a partner resident of State B, will, for the purposes of paragraph 2 of the convention between States A and B, be treated as a dividend paid to a resident of State B. Also, for the purposes of the application of subparagraph *a*) of paragraph 2 in such a case, a member that is a company should be considered to hold directly, in proportion to its interest in the fiscally transparent entity or arrangement, the part of the capital of the company paying the dividend that is held through that entity or arrangement and, in order to determine whether the member holds directly at least 25 per cent of the capital of the company paying the dividends, that part of the capital will be added to other parts of that capital that the member may otherwise hold directly. In that case, for the purposes of the application of the requirement that at least 25 per cent of the capital of the company paying the dividends be held throughout a 365-day period, it will be necessary to take account of both the period during which the member held the relevant interest in the fiscally transparent entity or arrangement and the period during which the part of the capital of the company paying the dividend was held through that entity or arrangement: if either period does not satisfy the 365-day requirement, subparagraph *a*) will not apply and subparagraph *b*) will therefore apply to the relevant part of the dividend. States are free to clarify the application of subparagraph *a*) in these circumstances by adding a provision drafted along the following lines:

> To the extent that a dividend paid by a company which is a resident of a Contracting State is, under paragraph 2 of Article 1, considered to be income of another company resident of the other Contracting State because that other company is a member of a fiscally transparent entity or arrangement referred to in that paragraph, that other company shall be deemed, for the purposes of the application of subparagraph *a*) of paragraph 2 of Article 10, to hold directly that part of the capital of the company paying the dividend that is held by the transparent entity or arrangement which corresponds to the proportion of the capital of that fiscally transparent entity or arrangement that is held by that other company.

[…]

13. The tax rates fixed by the Article for the tax in the State of source are maximum rates. The States may agree, in bilateral negotiations, on lower rates or even on taxation exclusively in the State of the beneficiary's residence. The reduction of rates provided for in paragraph 2 refers solely to the taxation of dividends and not to the taxation of the profits of the company paying the dividends.

13.1 Under the domestic laws of many States, pension funds and similar entities are generally exempt from tax on their investment income. In order to achieve neutrality of treatment as regards domestic and foreign investments by these entities, some States provide bilaterally that income, including dividends, derived by such an entity resident of the other State shall be exempt from source taxation. States wishing to do so may agree bilaterally on a provision drafted along the lines of the provision found in paragraph 69 of the Commentary on Article 18 *[of the 2017 OECD Model, as quoted in paragraph 18 of the Commentary on Article 18 of this Model]*.

13.2 Similarly, some States refrain from levying tax on dividends paid to other States and some of their wholly-owned entities, at least to the extent that such dividends are derived from activities of a governmental nature. Some States are able to grant such an exemption under their interpretation of the sovereign immunity principle (see paragraphs 52 and 53 of the Commentary on Article 1 *[of the 2017 OECD Model]*); others may do it pursuant to provisions of their domestic law. States wishing to do so may confirm or clarify, in their bilateral conventions, the scope of these exemptions or grant such an exemption in cases where it would not otherwise be available. This may be done by adding to the Article an additional paragraph drafted along the following lines:

Notwithstanding the provisions of paragraph 2, dividends paid by a company which is a resident of a Contracting State shall be taxable only in the other Contracting State if the beneficial owner of the dividends is that State or a political subdivision or local authority thereof.

14. The two Contracting States may also, during bilateral negotiations, agree to *[lower the holding percentage required for direct investment dividends]*. A lower percentage is, for instance, justified in cases where the State of residence of the parent company, in accordance with its domestic law, grants exemption to such a company for dividends derived from a holding of less than 25 per cent in a non-resident subsidiary.

15. In subparagraph *a*) of paragraph 2, the term "capital" is used in *[…] [defining the minimum ownership required for direct investment dividends]*. The use of this term in this context implies that, for the purposes of subparagraph *a*), it should be used in the sense in which it is used for the purposes of distribution to the shareholder (in the particular case, the parent company).

a) As a general rule, therefore, the term "capital" in subparagraph *a*) should be understood as it is understood in company law. Other elements, in particular the reserves, are not to be taken into account.

b) Capital, as understood in company law, should be indicated in terms of par value of all shares which in the majority of cases will be shown as capital in the company's balance sheet.

c) No account need be taken of differences due to the different classes of shares issued (ordinary shares, preference shares, plural voting shares, non-voting shares, bearer shares, registered shares etc.), as such differences relate more to the nature of the shareholder's right than to the extent of his ownership of the capital.

d) When a loan or other contribution to the company does not, strictly speaking, come as capital under company law but when on the basis of internal law or practice ("thin capitalisation", or assimilation of a loan to share capital), the income derived in respect thereof is treated as dividend under Article 10, the value of such loan or contribution is also to be taken as "capital" within the meaning of subparagraph *a*).

e) In the case of bodies which do not have a capital within the meaning of company law, capital for the purpose of subparagraph *a*) is to be taken as meaning the total of all contributions to the body which are taken into account for the purpose of distributing profits.

In bilateral negotiations, Contracting States may depart from the criterion of "capital" used in subparagraph *a*) of paragraph 2 and use instead the criterion of "voting power".

[…]

18. Paragraph 2 lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment.

19. The paragraph does not settle procedural questions. Each State should be able to use the procedure provided in its own laws. It can either forthwith limit its tax to the rates given in the Article or tax in full and make a refund (see, however, paragraph 109 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 166 of the Commentary on Article 1 of this Model]*). Potential abuses arising from situations where dividends paid by a company resident of a Contracting State are attributable to a permanent establishment which an enterprise of the other State has in a third State are dealt with in paragraph 8 of Article 29. Other questions arise with triangular cases (see paragraph 71 of the Commentary on Article 24 *[of the 2017 OECD Model, as quoted in paragraph 2 of the Commentary on Article 24 of this Model]*).

[…]

21. The Article contains no provisions as to how the State of the beneficiary's residence should make allowance for the taxation in the State of source of the dividends. This question is dealt with in Articles 23 A and 23 B.

22. The OECD/G20 Base Erosion and Profit Shifting (BEPS) Project and, in particular, the final report on Action 6 produced as part of that project, have addressed a number of abuses related to cases such as the following one: the beneficial owner of the dividends arising in a Contracting State is a company resident of the other Contracting State; all or part of its capital is held by shareholders resident outside that other State; its practice is not to distribute its profits in the form of dividends; and it enjoys preferential taxation treatment (private investment company, base company). *[*The *subject-to-tax rule set out in paragraph 3 of Article 1 of this Model would in many cases address this situation. In addition…]* Article 29, which was included in the Convention as a result of the final report on Action 6, addresses the treaty-shopping aspects of that case*[…]*.

17. The application of paragraph 2 to distributions made by a Real Estate Investment Trust (REIT) raises policy issues which are discussed in paragraph 31 of the Commentary on Article 1.

Paragraph 3

18. This paragraph reproduces paragraph 3 of Article 10 of the OECD Model. The Committee considers that the following part of the Commentary on Article 10 of the 2017 OECD Model is applicable to paragraph 3 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 23. In view of the great differences between the laws of OECD member countries, it is impossible to define "dividends" fully and exhaustively. Consequently, the definition merely mentions examples which are to be found in the majority of the member countries' laws and which, in any case, are not treated differently in them. The enumeration is followed up by a general formula. In the course of the revision of the 1963 *[OECD]* Draft Convention, a thorough study has been undertaken to find a solution that does not refer to domestic laws. This study has led to the conclusion that, in view of the still remaining dissimilarities between member countries in the field of company law and taxation law, it did not appear to be possible to work out a definition of the concept of dividends that would be independent of domestic laws. It is open to the Contracting States, through bilateral negotiations, to make allowance for peculiarities of their laws and to agree to bring under the definition of "dividends" other payments by companies falling under the Article.
>
> 24. The notion of dividends basically concerns distributions by companies within the meaning of subparagraph *b)* of paragraph 1 of Article 3. Therefore the definition relates, in the first instance, to distributions of profits the title to which is constituted by shares, that is holdings in a company limited by shares (joint stock company). The definition assimilates to shares all securities issued by companies which carry a right to participate in the companies' profits without being debt claims; such are, for example, "jouissance" shares or "jouissance" rights, founders' shares or other rights participating in profits. In bilateral conventions, of course, this enumeration may be adapted to the legal

situation in the Contracting States concerned. This may be necessary, in particular, as regards income from "jouissance" shares and founders' shares. On the other hand, debt claims participating in profits do not come into this category (see paragraph 19 of the Commentary on Article 11 *[of the 2017 OECD Model, as quoted in paragraph 19 of the Commentary on Article 11 of this Model]*); likewise interest on convertible debentures is not a dividend.

25. Article 10 deals not only with dividends as such but also with interest on loans insofar as the lender effectively shares the risks run by the company, that is, when repayment depends largely on the success or otherwise of the enterprise's business. Articles 10 and 11 do not therefore prevent the treatment of this type of interest as dividends under the national rules on thin capitalisation applied in the borrower's country. The question whether the contributor of the loan shares the risks run by the enterprise must be determined in each individual case in the light of all the circumstances, as for example the following:

— the loan very heavily outweighs any other contribution to the enterprise's capital (or was taken out to replace a substantial proportion of capital which has been lost) and is substantially unmatched by redeemable assets;

— the creditor will share in any profits of the company;

— the repayment of the loan is subordinated to claims of other creditors or to the payment of dividends;

— the level or payment of interest would depend on the profits of the company;

— the loan contract contains no fixed provisions for repayment by a definite date.

26. The laws of many of the States put participations in a *société à responsabilité limitée* (limited liability company) on the same footing as shares. Likewise, distributions of profits by co-operative societies are generally regarded as dividends.

27. Distributions of profits by partnerships are not dividends within the meaning of the definition, unless the partnerships are subject, in the State where their place of effective management is situated, to a fiscal treatment substantially similar to that applied to companies limited by shares (for instance, in Belgium, Portugal and Spain, also in France as regards distributions to *commanditaires* in the *sociétés en commandite simple*). On the other hand, clarification in bilateral conventions may be necessary in cases where the taxation law of a Contracting State

gives the owner of holdings in a company a right to opt, under certain conditions, for being taxed as a partner of a partnership, or, vice versa, gives the partner of a partnership the right to opt for taxation as the owner of holdings in a company.

28. Payments regarded as dividends may include not only distributions of profits decided by annual general meetings of shareholders, but also other benefits in money or money's worth, such as bonus shares, bonuses, profits on a liquidation or redemption of shares (see paragraph 31 of the Commentary on Article 13 *[of the 2017 OECD Model, as quoted in paragraph 44 of the Commentary on Article 13 of this Model]*) and disguised distributions of profits. The reliefs provided in the Article apply so long as the State of which the paying company is a resident taxes such benefits as dividends. It is immaterial whether any such benefits are paid out of current profits made by the company or are derived, for example, from reserves, that is, profits of previous financial years. Normally, distributions by a company which have the effect of reducing the membership rights, for instance, payments constituting a reimbursement of capital in any form whatever, are not regarded as dividends.

29. The benefits to which a holding in a company confer entitlement are, as a general rule, available solely to the shareholders themselves. Should, however, certain of such benefits be made available to persons who are not shareholders within the meaning of company law, they may constitute dividends if:

— the legal relations between such persons and the company are assimilated to a holding in a company ("concealed holdings") and

— the persons receiving such benefits are closely connected with a shareholder; this is the case, for example, where the recipient is a relative of the shareholder or is a company belonging to the same group as the company owning the shares.

30. When the shareholder and the person receiving such benefits are residents of two different States with which the State of source has concluded conventions, differences of views may arise as to which of these conventions is applicable. A similar problem may arise when the State of source has concluded a convention with one of the States but not with the other. This, however, is a conflict which may affect other types of income and the solution to it can be found only through an arrangement under the mutual agreement procedure.

Paragraph 4

19. This paragraph, which makes paragraphs 1 and 2 inapplicable to dividends on shares that are effectively connected with a permanent establishment of the recipient in the source country, reproduces paragraph 4 of Article 10 of the OECD Model.

20. As noted in paragraph 31 of the Commentary on Article 10 of the 2017 OECD Model, paragraph 4 does not adopt a force-of-attraction approach that would allow dividends to be taxed as business profits if the recipient had a permanent establishment in the source country regardless of whether the shareholding is connected with the permanent establishment. Rather, the paragraph only permits dividends to be taxed as business profits if these dividends are paid in respect of holdings effectively connected with a permanent establishment in the source country.

21. The Committee considers that the following part of the Commentary on Article 10 of the 2017 OECD Model, which includes additional observations related to paragraph 4 of Article 10, is applicable to paragraph 4 of Article 10 of this Model:

> 32. It has been suggested that the paragraph could give rise to abuses through the transfer of shares to permanent establishments set up solely for that purpose in countries that offer preferential treatment to dividend income. Apart from the fact that the provisions of Article 29 (and, in particular, paragraph 8 of that Article) and the principles put forward in the section on "Improper use of the Convention" in the Commentary on Article 1 will typically prevent such abusive transactions, it must be recognised that a particular location can only constitute a permanent establishment if a business is carried on therein and*[…]* that the requirement that a shareholding be "effectively connected" to such a location requires more than merely recording the shareholding in the books of the permanent establishment for accounting purposes.

Paragraph 5

22. This paragraph, which bars a Contracting State from taxing dividends paid by a company resident in the other State merely because the company derives income or profits in the taxing State, reproduces paragraph 5 of Article 10 of the OECD Model. The Committee considers

that the following part of the Commentary on Article 10 of the 2017 OECD Model, which includes additional explanations on paragraph 5 of Article 10, is applicable to paragraph 5 of Article 10 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 33. The Article deals only with dividends paid by a company which is a resident of a Contracting State to a resident of the other State. Certain States, however, tax not only dividends paid by companies resident therein but even distributions by non-resident companies of profits arising within their territory. Each State, of course, is entitled to tax profits arising in its territory which are made by non-resident companies, to the extent provided in the Convention (in particular in Article 7). The shareholders of such companies should not be taxed as well at any rate, unless they are residents of the State and so naturally subject to its fiscal sovereignty.
>
> 34. Paragraph 5 rules out the extraterritorial taxation of dividends, that is, the practice by which States tax dividends distributed by a non-resident company solely because the corporate profits from which the distributions are made originated in their territory (for example, realised through a permanent establishment situated therein). There is, of course, no question of extraterritorial taxation when the country of source of the corporate profits taxes the dividends because they are paid to a shareholder who is a resident of that State or to a permanent establishment situated in that State.
>
> 35. Moreover, it can be argued that such a provision does not aim at, or cannot result in, preventing a State from subjecting the dividends to a withholding tax when distributed by foreign companies if they are cashed in its territory. Indeed, in such a case, the criterion for tax liability is the fact of the payment of the dividends, and not the origin of the corporate profits allotted for distribution. But if the person cashing the dividends in a Contracting State is a resident of the other Contracting State (of which the distributing company is a resident), he may under Article 21 obtain exemption from, or refund of, the withholding tax of the first-mentioned State. Similarly, if the beneficiary of the dividends is a resident of a third State which had concluded a double taxation convention with the State where the dividends are cashed, he may, under Article 21 of that convention, obtain exemption from, or refund of, the withholding tax of the last-mentioned State.

36. Paragraph 5 further provides that non-resident companies are not to be subjected to special taxes on undistributed profits.

37. As confirmed by paragraph 3 of Article 1, paragraph 5 cannot be interpreted as preventing the State of residence of a taxpayer from taxing that taxpayer, pursuant to its controlled foreign companies legislation or other rules with similar effect, on profits which have not been distributed by a foreign company. Moreover, it should be noted that the paragraph is confined to taxation at source and, thus, has no bearing on the taxation at residence under such legislation or rules. In addition, the paragraph concerns only the taxation of the company and not that of the shareholder.

38. The application of such legislation or rules may, however, complicate the application of Article 23. If the income were attributed to the taxpayer then each item of the income would have to be treated under the relevant provisions of the Convention (business profits, interest, royalties). If the amount is treated as a deemed dividend then it is clearly derived from the base company thus constituting income from that company's country. Even then, it is by no means clear whether the taxable amount is to be regarded as a dividend within the meaning of Article 10 or as "other income" within the meaning of Article 21. Under some of these legislation or rules the taxable amount is treated as a dividend with the result that an exemption provided for by a tax convention, for example, an affiliation exemption is also extended to it. It is doubtful whether the Convention requires this to be done. If the country of residence considers that this is not the case it may face the allegation that it is obstructing the normal operation of the affiliation exemption by taxing the dividend (in the form of "deemed dividend") in advance.

39. Where dividends are actually distributed by the base company, the provisions of a bilateral convention regarding dividends have to be applied in the normal way because there is dividend income within the meaning of the convention. Thus, the country of the base company may subject the dividend to a withholding tax. The country of residence of the shareholder will apply the normal methods for the elimination of double taxation (i.e. tax credit or tax exemption is granted). This implies that the withholding tax on the dividend should be credited in the shareholder's country of residence, even if the distributed profit (the dividend) has been taxed years before under controlled foreign companies legislation or other rules with similar effect. However, the obligation to give credit in that case remains doubtful. Generally the dividend as such is exempted from tax (as it was already taxed under the relevant legislation or rules and one might argue that there is no

basis for a tax credit. On the other hand, the purpose of the treaty would be frustrated if the crediting of taxes could be avoided by simply anticipating the dividend taxation under counteracting legislation. The general principle set out above would suggest that the credit should be granted, though the details may depend on the technicalities of the relevant legislation or rules and the system for crediting foreign taxes against domestic tax, as well as on the particularities of the case (e.g. time lapsed since the taxation of the "deemed dividend"). However, taxpayers who have recourse to artificial arrangements are taking risks against which they cannot fully be safeguarded by tax authorities.

23. It may be relevant to point out that certain countries' laws seek to avoid or mitigate economic double taxation, that is, the simultaneous taxation of the company's profits at the level of the company and of dividends at the level of the shareholder. For a detailed consideration of this matter, it may be instructive to refer to paragraphs 40 to 67 of the Commentary on Article 10 of the 2017 OECD Model.

Branch profits taxes

24. The inclusion of a branch profits tax provision in a revised U N Model was discussed at the 1987 and 1991 meetings of the former Group of Experts. The issue was further discussed in the 1997 meeting (eighth meeting) of the former Group of Experts and it was considered that because only a few countries had a branch tax, the paragraph might be better placed in the Commentary and not in the main text. It would be left to the Contracting States, if they so desire, during the course of bilateral negotiations to incorporate the provisions relating to the branch profits tax in their bilateral tax treaties. Developing countries were generally not opposed to the principle of branch profits taxation, even if they did not impose a branch profits tax.

25. Some members, while citing the justification of branch profits taxation as a means of achieving rough parity in source country taxation whether business in that country is conducted through a subsidiary company or a branch, maintained that the principle should be followed logically throughout the Convention. Thus, in this view, contrary to paragraph 3 of Article 7 of the UN Model, all expenses of the permanent establishment must be deductible as if the permanent establishment were a distinct and separate enterprise dealing wholly independently with the head office.

26. Another member from a developed country noted that his country imposed the tax in two separate parts: (i) a tax analogous to a dividend withholding tax was imposed on the "dividend equivalent amount" of a branch that was approximately the amount that would likely have been distributed as dividends if the branch were a subsidiary; and (ii) a second tax, analogous to a withholding tax on interest paid by a subsidiary resident in that country to its foreign parent, was imposed on the excess of the amount of interest deducted by the branch in computing its taxable income over the amount of interest actually paid by the branch. The principal purpose of that system was to minimize the effect of tax considerations on the foreign investor's decision whether to operate in the country in branch or subsidiary form.

27. If one or both of the Contracting States impose branch profits taxes, they may include in the Convention a provision such as the following:

> Notwithstanding any other provision of this Convention, where a company which is a resident of a Contracting State has a permanent establishment in the other Contracting State, the profits taxable under paragraph 1 of Article 7 may be subject to an additional tax in that other State, in accordance with its laws, but the additional charge shall not exceed ___ per cent of the amount of those profits.

28. The suggested provision does not recommend a maximum branch profits rate. The most common practice is to use the direct investment dividend rate (e.g. the tax rate in paragraph 2(*a*)). At the 1991 meeting of the former Group of Experts, there was agreement among the supporters of branch profits taxation that, in view of the principles enunciated in support of the system, the rate of tax on branch profits should be the same as that on dividends from direct investments. However, in several treaties the branch profits tax rate was the rate for portfolio investment dividends (typically a higher rate) and in some treaties the branch tax rate was lower than the direct investment dividend rate. Although a branch profits tax is on business profits, the provision may be included in Article 10, rather than in Article 7, because the tax is intended to be analogous to a tax on dividends.

29. The suggested provision allows the branch profits tax to be imposed only on profits taxable under paragraph 1 of Article 7 on

account of the permanent establishment. Many treaties further limit the tax base to such profits "after deducting therefrom income tax and other taxes on income imposed thereon in that other State". Other treaties do not contain this clause because the concept is included under domestic law.

30. At the 1991 meeting of the former Group of Experts, attention was drawn to the fact that a branch profits tax provision could potentially conflict with a treaty's non-discrimination clause. Since a branch profits tax is usually a second level of tax on profits of foreign corporations that is not imposed on domestic corporations carrying on the same activities, it could be viewed, as a technical matter, as prohibited by Article 24 (Non-discrimination). However, countries imposing the tax do so as an analogue to the dividend withholding tax paid on dividends from a subsidiary to its foreign parent, and they therefore consider it appropriate to include in the non-discrimination Article an explicit exception allowing imposition of the branch tax. The non-discrimination Article in several treaties with branch profits tax provisions contains the following paragraph:

> Nothing in this Article shall be construed as preventing either Contracting State from imposing a tax as described in paragraph ___ *[branch profits tax provision]* of Article 10 (Dividends).

However, the branch profits tax provision suggested above makes this provision unnecessary because it applies "notwithstanding any other provision of this Convention" and thus takes precedence over other treaty provisions, including Article 24 (Non-discrimination).

31. When the scope of Article 10 was discussed by the former Group of Experts, some members pointed out that there are many artificial devices entered into by persons to take advantage of the provisions of Article 10 through, inter alia, creation or assignment of shares or other rights in respect of which a dividend is paid. While it was then noted that substance over form rules, the abuse of rights principle or any similar doctrine could be used to counter such arrangements, the subsequent addition, in 2017, of paragraph 9 of Article 29 provided another way of addressing these concerns.

Article 11

INTEREST

A. General considerations

1. Article 11 of the UN Model reproduces the provisions of Article 11 of the OECD Model with the exception of paragraphs 2 and 4, in which substantive changes have been made.

2. Interest, which, like dividends, constitutes income from movable capital, may be paid to individual savers who have deposits with banks or hold savings certificates, to individual investors who have purchased bonds, to individual suppliers or trading companies selling on a deferred payment basis, to financial institutions which have granted loans or to institutional investors which hold bonds or debentures. Interest may also be paid on loans between associated enterprises.

3. At the domestic level, interest is usually deductible in calculating profits. Any tax on interest is paid by the beneficiary unless a special contract provides that it should be paid by the payer of the interest. Contrary to what occurs in the case of dividends, interest is not liable to taxation in the hands of both the beneficiary and the payer. If the latter is obliged to withhold a certain portion of the interest as a tax, the amount withheld represents an advance on the tax to which the beneficiary will be liable on his aggregate income or profits for the fiscal year, and the beneficiary can deduct this amount from the tax due from him and obtain reimbursement of any sum by which the amount withheld exceeds the tax finally payable. This mechanism prevents the beneficiary from being taxed twice on the same interest.

4. At the international level, when the beneficiary of the interest is a resident of one State and the payer of the interest is a resident of another, the interest is subject to taxation in both countries. This double taxation may considerably reduce the net amount of interest received by the beneficiary or, if the payer has agreed to bear the cost of the tax deductible at the source, increase the financial burden on the payer.

5. The following part of the Commentary on Article 11 of the Commentary on the 2017 OECD Model explains that, although this

double taxation could be eliminated by barring the source country or the residence country from taxing the interest, this approach would have been unlikely to receive general approval, which led to the compromise solution reflected in Article 11. It also explains that domestic law restrictions on the deduction of interest applicable where the recipient is not a resident of the State of source and is not taxable in that State are dealt with in paragraph 4 of Article 24 (Non-discrimination):

> 3. A formula reserving the exclusive taxation of interest to one State, whether the State of the beneficiary's residence or the State of source, could not be sure of receiving general approval. Therefore a compromise solution was adopted. It provides that interest may be taxed in the State of residence, but leaves to the State of source the right to impose a tax if its laws so provide, it being implicit in this right that the State of source is free to give up all taxation on interest paid to non-residents. Its exercise of this right will however be limited by a ceiling which its tax cannot exceed *[…]*. The sacrifice that the latter would accept in such conditions will be matched by a relief to be given by the State of residence, in order to take into account the tax levied in the State of source (see Article 23 A or 23 B).
>
> 4. Certain countries do not allow interest paid to be deducted for the purposes of the payer's tax unless the recipient also resides in the same State or is taxable in that State. Otherwise they forbid the deduction. The question whether the deduction should also be allowed in cases where the interest is paid by a resident of a Contracting State to a resident of the other State is dealt with in paragraph 4 of Article 24.

B. Commentary on the paragraphs of Article 11

Paragraph 1

6. This paragraph reproduces paragraph 1 of Article 11 of the 2017 OECD Model. The Committee considers that the following part of the Commentary on Article 11 of the 2017 OECD Model, which provides additional explanations on paragraph 1 of the Article, is applicable to paragraph 1 of Article 11 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

5. Paragraph 1 lays down the principle that interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in the latter. In doing so, it does not stipulate an exclusive right to tax in favour of the State of residence. The term "paid" has a very wide meaning, since the concept of payment means the fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom.

6. The Article deals only with interest arising in a Contracting State and does not, therefore, apply to interest arising in a third State. Interest arising in a Contracting State which is attributable to a permanent establishment which an enterprise of that State has in the other Contracting State may be taxed by the first-mentioned State under paragraph 2 but may also be taxed by the other State under paragraph 1 of Article 7 (see paragraphs 9 and 9.1 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23A and 23B of this Model,]* concerning relief of double taxation in such cases).

Paragraph 2

7. This paragraph reproduces paragraph 2 of Article 11 of the OECD Model with one substantive change. The OECD Model provides that the tax in the country of source "shall not exceed 10 per cent of the gross amount of the interest", but the UN Model leaves this percentage to be established through bilateral negotiations.

8. When this Article was considered by the former Group of Experts, members from developing countries took the view that the source country should have the exclusive, or at least the primary, right to tax interest. According to that view, it is incumbent on the residence country to prevent double taxation of that income through exemption, credit or other relief measures. These members reasoned that interest should be taxed where it was earned, that is, where the capital was put to use. Some members from developed countries felt that the home country of the investor should have the exclusive right to tax interest, since in their view that would promote the mobility of capital and give the right to tax to the country that is best equipped to consider the characteristics of the taxpayer. They also pointed out that an exemption of foreign interest from the tax of the investor's home country might not be in the best interests of the developing countries because it could

induce investors to place their capital in the developing country with the lowest tax rate.

9. The members from developing countries agreed to the solution of taxation by both the country of residence and the source country embodied in Article 11, paragraphs 1 and 2, of the OECD Model but found the ceiling of 10 per cent of the gross amount of the interest mentioned in paragraph 2 unacceptable. Since the former Group of Experts was unable to reach a consensus on an alternative ceiling, the matter was left to bilateral negotiations.

10. The decision not to recommend a maximum withholding rate can be justified under current treaty practice. The withholding rates for interest adopted in developed/developing country tax treaties range more widely than those for dividends – between complete exemption and 25 per cent. However, some developing countries have reduced the interest withholding rate to attract foreign investment; several of them have adopted rates at or below the OECD rate of 10 per cent.

11. A precise level of withholding tax for a source country should take into account several factors, including the following: the fact that the capital originated in the residence country; the possibility that a high source rate might cause lenders to pass the cost of the tax on to the borrowers, which would mean that the source country would increase its revenue at the expense of its own residents rather than the foreign lenders; the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment; the fact that a lowering of the withholding rate has revenue and foreign exchange consequences for the source country; and the main direction of interest flows (e.g. from developing to developed countries).

12. In negotiations on bilateral treaties with a general positive rate for interest withholding, a lower ceiling or even exemption has sometimes been agreed upon for one or more of the following categories of interest:

(*a*) Interest paid to Governments or government agencies;

(*b*) Interest guaranteed by Governments or government agencies;

(*c*) Interest paid to central banks;

(*d*) Interest paid to banks or other financial institutions;

(*e*) Interest on long-term loans;

(*f*) Interest on loans to finance special equipment or public works; or

(*g*) Interest on other government-approved types of investment (e.g. export finance).

With respect to bank loans and loans from financial institutions, a major justification for the reduced rate is the high costs associated with these loans, particularly the lender's cost of funds. The withholding tax, because it is a gross basis tax, has a high effective tax rate. If the effective rate is higher than the general tax rate in the lender's country of residence, the borrower is often required to bear the tax through a gross-up feature in the loan agreement. In that case, the withholding tax amounts to an additional tax on residents of the source State. One way to deal with this is to allow the lender to elect to treat such income as business profits under Article 7, but this approach raises computational and administrative issues for banks and tax administrators.

13. A similar justification exists for reduced rates on interest from credit sales. The supplier in such cases often merely passes on to the customer, without additional charge, the price he has had to pay to a bank or export finance agency to finance the credit. For a person selling equipment on credit, the interest is more an element of the sales price than income from invested capital.

14. In addition, long-term credits correspond to investments that should be profitable enough to be repaid in instalments over a period. In the latter case, interest must be paid out of earnings at the same time as instalments of credit are repaid out of capital. Consequently, any excessive fiscal burden on such interest must be passed on to the book value of the capital goods purchased on credit, with the result that the fiscal charge levied on the interest might, in the last analysis, diminish the amount of tax payable on the profits made by the user of the capital goods.

15. At the 1991 meeting of the former Group of Experts, some members argued that interest income received by government agencies should be exempted from source country taxation because exemption would facilitate the financing of development projects, especially in developing countries, by eliminating tax considerations from negotiations over interest rates. Some members from developing countries asserted that the financing of such projects would be enhanced even further if the

interest income was also exempt from tax in the lender's country of residence.

16. The predominant treaty practice is to exempt governmental interest from source country tax, but there is a wide range of practice on the details. In some instances interest income is exempted if paid by a Government or paid to a Government; in other instances only interest paid to a Government is exempt. Also, the definition of "Government" varies to include, for example, local authorities, agencies, instrumentalities, central banks, and financial institutions owned by the Government.

17. The former Group of Experts observed that long-term credits often call for special guarantees because of the difficulty of long-term political, economic and monetary forecasting. Moreover, most developed countries, in order to ensure full employment in their capital goods industries or public works enterprises, have adopted various measures to encourage long-term credits, including credit insurance or interest-rate reductions by government agencies. These measures may take the form of direct loans by government agencies tied to loans by private banks or private credit facilities or interest terms more favourable than those obtainable on the money market. These measures are not likely to persist if the preferences are effectively cancelled out or reduced by excessive taxation in the debtor's country. Thus, not only should interest on loans made by a government be exempted, but an argument exists for exempting interest on long-term loans made by private banks where such loans are guaranteed or refinanced by a government or a government agency.

18. Changes made in 2014 to the Commentary on Article 11 of the OECD Model made it clear, as regards paragraph 2 of Article 3, that the concept of beneficial owner used in paragraph 2 of Article 11 was intended to be interpreted in the context in which it appears and not with reference to the domestic law of the Contracting States. In 2021, the Committee agreed with this application of paragraph 2 of Article 3 to the concept of beneficial owner. The Committee therefore considers that the following part of the Commentary on Article 11 of the 2017 OECD Model, which deals with the interpretation of the concept of beneficial owner, is applicable to paragraph 2 of Article 11 of this Model (the modifications that appear in italics between square brackets, which are

not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 9. The requirement of beneficial owner was introduced in paragraph 2 of Article 11 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over interest income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention.
>
> 9.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

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1 For example, where the trustees of a discretionary trust do not distribute interest earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 11 even if they are not the beneficial owners under the relevant trust law.

> 10. Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

10.1 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the *[OECD]* Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[1] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

1 Reproduced *[at page R(6)-1 of]* Volume II of the *[full-length]* version of the *[2017]* OECD Model Tax Convention*[, available at* https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833*, accessed on 10 May 2021.]*

10.2 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the interest is not the "beneficial owner" because that recipient's right to use and enjoy the interest is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs *[29 to 49 of the Commentary on Article 1 of this Model]*. Where the recipient of interest does have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that interest. It should also be noted that Article 11 refers to the beneficial owner of interest as opposed to the owner of the debt claim with respect to which the interest is paid, which may be different in some cases.

10.3 The fact that the recipient of an interest payment is considered to be the beneficial owner of that interest does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 8 *[of the Commentary on Article 11 of the 2017 OECD Model). [The subject-to-tax rule of paragraph 3 of Article 1 of the UN Model addresses cases involving preferential tax treatment of the beneficial owner of interest (such as the case described in paragraph 8 of the Commentary on Article 11 of the 2017 OECD Model). In addition, t]*he provisions of Article 29 and the principles put forward in the section on "Improper use of the Convention" in the Commentary on Article 1 will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of interest. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the interest to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

10.4 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 *a*) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10*[, 11, 12, 12AA, 12B and 12C]*, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends*[, interest, royalties, fees for services, income from automated digital services and insurance premiums]* rather than difficulties related to the ownership of the *[underlying property or rights in respect of which the amounts are paid]*. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]

1 See, for example, *Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism &*

Proliferation – The FATF Recommendations (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 110): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

> In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2 See the Financial Action Task Force's definition quoted in the previous note.

11. Subject to other conditions imposed by the Article and the other provisions of the Convention, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the *[… UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014]*).

12. The paragraph lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment. Procedural questions are not dealt with in this Article. Each State should be able to apply the procedure provided in its own law *[…]*. Potential abuses arising from situations where interest arising in a Contracting State is attributable to a permanent establishment which an enterprise of the other State has in a third State are dealt with in paragraph 8 of Article 29. Other questions arise with triangular cases (see paragraph 71 of the Commentary on Article 24 *[of the 2017 OECD Model, as quoted in paragraph 2 of the Commentary on Article 24 of this Model]*).

[…]

14. The Article contains no provisions as to how the State of the beneficiary's residence should make allowance for the taxation in the State of source of the interest. This question is dealt with in Articles 23 A and 23 B.

Paragraph 3

19. This paragraph reproduces paragraph 3 of Article 11 of the OECD Model. The Committee considers that the following part of the Commentary on Article 11 of the 2017 OECD Model, which explains the definition of interest, is applicable to paragraph 3 of Article 11 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

18. Paragraph 3 specifies the meaning to be attached to the term "interest" for the application of the taxation treatment defined by the Article. The term designates, in general, income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in profits. The term "debt claims of every kind" obviously embraces cash deposits and security in the form of money, as well as government securities, and bonds and debentures, although the three latter are specially mentioned because of their importance and of certain peculiarities that they may present. It is recognised, on the one hand, that mortgage interest comes within the category of income from movable capital (*revenus de capitaux mobiliers*), even though certain countries assimilate it to income from immovable property. On the other hand, debt claims, and bonds and debentures in particular, which carry a right to participate in the debtor's profits are nonetheless regarded as loans if the contract by its general character clearly evidences a loan at interest.

19. Interest on participating bonds should not normally be considered as a dividend, and neither should interest on convertible bonds until such time as the bonds are actually converted into shares. However, the interest on such bonds should be considered as a dividend if the loan effectively shares the risks run by the debtor company *[…]*. In situations of presumed thin capitalisation, it is sometimes difficult to distinguish between dividends and interest and in order to avoid any possibility of overlap between the categories of income dealt with under Article 10 and Article 11 respectively, it should be noted that the

term "interest" as used in Article 11 does not include items of income which are dealt with in Article 10.

20. As regards, more particularly, government securities, and bonds and debentures, the text specifies that premiums or prizes attaching thereto constitute interest. Generally speaking, what constitutes interest yielded by a loan security, and may properly be taxed as such in the State of source, is all that the institution issuing the loan pays over and above the amount paid by the subscriber, that is to say, the interest accruing plus any premium paid at redemption or at issue. It follows that when a bond or debenture has been issued at a premium, the excess of the amount paid by the subscriber over that repaid to him may constitute negative interest which should be deducted from the stated interest in determining the interest that is taxable. On the other hand, *[any profit or loss which a holder of such a security realises by the sale thereof to another person does not enter into the concept of interest].* Such profit or loss may, depending on the case, constitute either a business profit or a loss, a capital gain or a loss, or income falling under Article 21.

[…]

21. Moreover, the definition of interest in the first sentence of paragraph 3 is, in principle, exhaustive. It has seemed preferable not to include a subsidiary reference to domestic laws in the text; this is justified by the following considerations:

a) the definition covers practically all the kinds of income which are regarded as interest in the various domestic laws;

b) the formula employed offers greater security from the legal point of view and ensures that conventions would be unaffected by future changes in any country's domestic laws;

c) in the Model Convention references to domestic laws should as far as possible be avoided.

It nevertheless remains understood that in a bilateral convention two Contracting States may widen the formula employed so as to include in it any income which is taxed as interest under either of their domestic laws but which is not covered by the definition and in these circumstances may find it preferable to make reference to their domestic laws.

21.1 The definition of interest in the first sentence of paragraph 3 does not normally apply to payments made under certain kinds of non*[-]* traditional financial instruments where there is no underlying debt

(for example, interest rate swaps). However, the definition will apply to the extent that a loan is considered to exist under a "substance over form" rule, an "abuse of rights" principle, or any similar doctrine.

20. Furthermore, in a number of countries, certain non-traditional financial arrangements are assimilated to debt relations under domestic tax law, although their legal form is not a loan. The definition of interest in paragraph 3 applies to payments made under such arrangements.

21. The definition applies, for instance, to Islamic financial instruments where the economic reality of the contract underlying the instrument is a loan (even if the legal form thereof is not). This may be the case, for example, of *murabaha, istisna'a*, certain forms of *mudaraba* and *musharaka* (i.e. profit-sharing deposits and diminishing *musharaka*) and *ijara* (where assimilated to finance lease), as well as *sukuk* based on such instruments.

22. Countries that do not deal specifically in their domestic law with the above-mentioned instruments and generally follow an economic-substance-based approach for tax purposes may, nevertheless, apply the definition of interest to payments made under those instruments. Alternatively, such countries, as well as those following a purely legal approach for tax purposes, may wish to refer expressly to such instruments in the definition of interest in the treaty. This may be done by inserting the following after the first sentence:

> The term also includes income from arrangements such as Islamic financial instruments where the substance of the underlying contract can be assimilated to a loan.

23. It is clear that the definition does not apply to Islamic financial instruments the economic substance of which cannot be considered as a loan.

24. The Committee considers that the following part of the Commentary on Article 11 of the 2017 OECD Model, which provides additional explanations on the definition of interest included in paragraph 3 of the Article, is also applicable to paragraph 3 of Article 11 of this Model:

> 22. The second sentence of paragraph 3 excludes from the definition of interest penalty charges for late payment but Contracting States

are free to omit this sentence and treat penalty charges as interest in their bilateral conventions. Penalty charges, which may be payable under the contract, or by customs or by virtue of a judgement, consist either of payments calculated *pro rata temporis* or else of fixed sums; in certain cases they may combine both forms of payment. Even if they are determined *pro rata temporis* they constitute not so much income from capital as a special form of compensation for the loss suffered by the creditor through the debtor's delay in meeting his obligations. Moreover, considerations of legal security and practical convenience make it advisable to place all penalty charges of this kind, in whatever form they be paid, on the same footing for the purposes of their taxation treatment. On the other hand, two Contracting States may exclude from the application of Article 11 any kinds of interest which they intend to be treated as dividends.

23. Finally, the question arises whether annuities ought to be assimilated to interest; it is considered that they ought not to be. On the one hand, annuities granted in consideration of past employment are referred to in Article 18 and are subject to the rules governing pensions. On the other hand, although it is true that instalments of purchased annuities include an interest element on the purchase capital as well as return of capital, such instalments thus constituting "*fruits civils*" which accrue from day to day, it would be difficult for many countries to make a distinction between the element representing income from capital and the element representing a return of capital in order merely to tax the income element under the same category as income from movable capital. Taxation laws often contain special provisions classifying annuities in the category of salaries, wages and pensions, and taxing them accordingly.

Paragraph 4

25. This paragraph, which provides that paragraphs 1 and 2 do not apply to some interest if the recipient has a permanent establishment, reproduces paragraph 4 of Article 11 of the OECD Model, with one modification. The OECD version only applies if the obligation on which the interest is paid is effectively connected with the permanent establishment. Since this Model, unlike the OECD Model, adopts a limited force of attraction rule in Article 7, defining the income that may be taxed as business profits, a conforming change is made in paragraph 4 of Article 11 of this Model. This modification makes paragraphs 1 and 2 of Article 11 inapplicable if the debt claim is effectively connected

with the permanent establishment or with business activities carried on in the source country which are of the same or similar kind as those effected through the permanent establishment.

Paragraph 5

26. This paragraph reproduces paragraph 5 of Article 11 of the OECD Model; the first sentence of paragraph 5 was amended in 1999 in line with the OECD Model. However, in the course of discussion, the former Group of Experts agreed that countries might substitute a rule that would identify the source of interest as the State in which the loan giving rise to the interest was used. Where, in bilateral negotiations, the two parties differ on the appropriate rule, a possible solution would be a rule which, in general, would accept the place of residence of the payer as the source of interest, but where the loan was used in the State having a "place of use" rule, the interest would be deemed to arise in that State.

27. The Committee considers that the following part of the Commentary on Article 11 of the 2017 OECD Model, which provides additional explanations on the source rule of paragraph 5, is applicable to paragraph 5 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 26. This paragraph lays down the principle that the State of source of the interest is the State of which the payer of the interest is a resident. It provides, however, for an exception to this rule in the case of interest-bearing loans which have an obvious economic link with a permanent establishment owned in the other Contracting State by the payer of the interest. If the loan was contracted for the requirements of that establishment and the interest is borne by the latter, the paragraph determines that the source of the interest is in the Contracting State in which the permanent establishment is situated, leaving aside the place of residence of the owner of the permanent establishment, even when he resides in a third State.
>
> 27. In the absence of an economic link between the loan on which the interest arises and the permanent establishment, the State where the latter is situated cannot on that account be regarded as the State where the interest arises; it is not entitled to tax such interest, not even

within the limits of a "taxable quota" proportional to the importance of the permanent establishment. Such a practice would be incompatible with paragraph 5. Moreover, any departure from the rule fixed in the first sentence of paragraph 5 is justified only where the economic link between the loan and the permanent establishment is sufficiently clear-cut. In this connection, a number of possible cases may be distinguished:

a) The management of the permanent establishment has contracted a loan which it uses for the specific requirements of the permanent establishment; it shows it among its liabilities and pays the interest thereon directly to the creditor.

b) The head office of the enterprise has contracted a loan the proceeds of which are used solely for the purposes of a permanent establishment situated in another country. The interest is serviced by the head office but is ultimately borne by the permanent establishment.

c) The loan is contracted by the head office of the enterprise and its proceeds are used for several permanent establishments situated in different countries.

In cases *a)* and *b)* the conditions laid down in the second sentence of paragraph 5 are fulfilled, and the State where the permanent establishment is situated is to be regarded as the State where the interest arises. Case *c),* however, falls outside the provisions of paragraph 5, the text of which precludes the attribution of more than one source to the same loan. Such a solution, moreover, would give rise to considerable administrative complications and make it impossible for lenders to calculate in advance the taxation that interest would attract. It is, however, open to two Contracting States to restrict the application of the final provision in paragraph 5 to case *a)* or to extend it to case *c).*

28. Paragraph 5 provides no solution for the case, which it excludes from its provisions, where both the beneficiary and the payer are indeed residents of the Contracting States, but the loan was borrowed for the requirements of a permanent establishment owned by the payer in a third State and the interest is borne by that establishment. As paragraph 5 now stands, therefore, only its first sentence will apply in such a case. The interest will be deemed to arise in the Contracting State of which the payer is a resident and not in the third State in whose territory is situated the permanent establishment for the account of which the loan was effected and by which the interest is payable. Thus the interest will be taxed both in the Contracting State of which the payer is a resident and in the Contracting State of which the beneficiary

is a resident. But, although double taxation will be avoided between these two States by the arrangements provided in the Article, it will not be avoided between them and the third State if the latter taxes the interest on the loan at the source when it is borne by the permanent establishment in its territory.

29. It has been decided not to deal with that case in the Convention. The Contracting State of the payer's residence does not, therefore, have to relinquish its tax at the source in favour of the third State in which is situated the permanent establishment for the account of which the loan was effected and by which the interest is borne. If this were not the case and the third State did not subject the interest borne by the permanent establishment to source taxation, there could be attempts to avoid source taxation in the Contracting State through the use of a permanent establishment situated in such a third State. States for which this is not a concern and that wish to address the issue described in the paragraph above may do so by agreeing to use, in their bilateral convention, the alternative formulation of paragraph 5 suggested in paragraph 30 *[of the Commentary on Article 11 of the 2017 OECD Model]* below. The risk of double taxation just referred to could also be avoided through a multilateral convention. Also, if in the case described in paragraph 28 *[of the Commentary on Article 11 of the 2017 OECD Model above]*, the State of the payer's residence and the third State in which is situated the permanent establishment for the account of which the loan is effected and by which the interest is borne, together claim the right to tax the interest at the source, there would be nothing to prevent those two States together with, where appropriate, the State of the beneficiary's residence, from concerting measures to avoid the double taxation that would result from such claims using, where necessary, the mutual agreement procedure (as envisaged in paragraph 3 of Article 25) *[…]*.

30. As mentioned in paragraph 29 *[of the Commentary on Article 11 of the 2017 OECD Model above]*, any such double taxation could be avoided either through a multilateral convention or if the State of the beneficiary's residence and the State of the payer's residence agreed to word the second sentence of paragraph 5 in the following way, which would have the effect of ensuring that paragraphs 1 and 2 of the Article did not apply to the interest, which would then typically fall under Article 7 or 21:

> Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident a permanent establishment in

connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.

31. If two Contracting States agree in bilateral negotiations to reserve to the State where the beneficiary of the income resides the exclusive right to tax such income, then *ipso facto* there is no value in inserting in the convention which fixes their relations that provision in paragraph 5 which defines the State of source of such income. But it is equally obvious that double taxation would not be fully avoided in such a case if the payer of the interest owned, in a third State which charged its tax at the source on the interest, a permanent establishment for the account of which the loan had been borrowed and which bore the interest payable on it. The case would then be just the same as is contemplated in paragraphs 28 to 30 *[of the Commentary on Article 11 of the 2017 OECD Model]* above.

Paragraph 6

28. This paragraph reproduces paragraph 6 of Article 11 of the OECD Model. The Committee considers that the following part of the Commentary on Article 11 of the 2017 OECD Model, which provides additional explanations on this paragraph, is applicable to paragraph 6 of Article 11 of this Model:

32. The purpose of this paragraph is to restrict the operation of the provisions concerning the taxation of interest in cases where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length. It provides that in such a case the provisions of the Article apply only to that last-mentioned amount and that the excess part of the interest shall remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

33. It is clear from the text that for this clause to apply the interest held excessive must be due to a special relationship between the payer and the beneficial owner or between both of them and some other person. There may be cited as examples cases where interest is paid to an individual or legal person who directly or indirectly controls the payer,

or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

34. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the interest.

35. With regard to the taxation treatment to be applied to the excess part of the interest, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income in which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. This paragraph permits only the adjustment of the rate at which interest is charged and not the reclassification of the loan in such a way as to give it the character of a contribution to equity capital. For such an adjustment to be possible under paragraph 6 of Article 11 it would be necessary as a minimum to remove the limiting phrase "having regard to the debt claim for which it is paid". If greater clarity of intent is felt appropriate, a phrase such as "for whatever reason" might be added after "exceeds". Either of these alternative versions would apply where some or all of an interest payment is excessive because the amount of the loan or the terms relating to it (including the rate of interest) are not what would have been agreed upon in the absence of the special relationship. Nevertheless, this paragraph can affect not only the recipient but also the payer of excessive interest and if the law of the State of source permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States should have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the interest, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 6, as long as they do not alter its general purport.

36. Should the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

29. When the scope of paragraph 6 was last considered by the former Group of Experts, some members pointed out that there are many artificial devices entered into by persons to take advantage of the provisions of Article 11 through, inter alia, the creation or assignment of debt claims in respect of which interest is charged. While it was then noted that substance over form rules, the abuse of rights principle or any similar doctrine could be used to counter such arrangements, the subsequent addition, in 2017, of paragraph 9 of Article 29 provided another way of addressing these concerns.

Article 12

ROYALTIES

A. General considerations

1. Article 12 of the UN Model reproduces Article 12 of the OECD Model with the following exceptions: first, substantive differences appear in paragraphs 1 and 3; second, paragraphs 2 and 5 do not appear in the OECD Model with the result that the paragraph numbers in the UN Model differ from those in the OECD Model; and third, a drafting adjustment is made in paragraph 4.

2. When the user of a patent or similar property is resident in one country and pays royalties to the owner of the property who is resident in another country, the amount paid by the user is generally subject to withholding tax in his country, the source country. The source country tax is imposed on the gross payments, with no allowance for any related expenses incurred by the owner. Without recognition of expenses, the owner's after-tax profit may in some cases be only a small percentage of gross royalties. Consequently, the owner may take the withholding tax in the source country into account in fixing the amount of the royalty, so that the user and the source country will pay more for the use of the patent or similar property than they would if the withholding tax levied by the source country were lower and took into account the expenses incurred by the owner. A manufacturing enterprise or an inventor may have spent substantial sums on the development of the property generating the royalties, because the work of research and testing involves considerable capital outlays and does not always yield successful results. The problem of determining the appropriate tax rate to be applied by the source country to gross royalty payments is therefore complex, especially since the user may make a lump sum payment for the use of the patent or similar property, in addition to regular royalty payments.

3. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model, which provides general remarks related to the tax treaty treatment of royalties, is applicable to Article 12 of this Model:

1. In principle, royalties in respect of licences to use patents and similar property and similar payments are income to the recipient from a letting. The letting may be granted in connection with an enterprise (e.g. the use of literary copyright granted by a publisher or the use of a patent granted by the inventor) or quite independently of any activity of the grantor (e.g. use of a patent granted by the inventor's heirs).

2. Certain countries do not allow royalties paid to be deducted for the purposes of the payer's tax unless the recipient also resides in the same State or is taxable in that State. Otherwise they forbid the deduction. The question whether the deduction should also be allowed in cases where the royalties are paid by a resident of a Contracting State to a resident of the other State is dealt with in paragraph 4 of Article 24.

B. Commentary on the paragraphs of Article 12

Paragraphs 1 and 2

4. Paragraph 1 omits the word "only" found in the corresponding provision of the OECD Model, which provides that "royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State". Paragraph 2 is an addition flowing logically from the premise underlying paragraph 1, which is that royalties may be taxable in the source country as well as the residence country. By providing for taxing rights in respect of royalties to be shared between the State of residence and the State of source, the UN Model departs from the principle of exclusive residence State's right to tax provided in the OECD Model. In this context, it should be noted that several member States of the OECD have recorded reservations to the exclusive residence State taxation of royalties provided by Article 12 of the OECD Model.

5. During discussion by the former Group of Experts in 1999, members from developing countries argued that, in order to facilitate the conclusion of tax treaties between those countries and developed countries, the primary right to tax royalties should be given to the country where the income arose, that is, the source country. Patents and processes might be licensed to developing countries after they had been fully exploited elsewhere and, according to these members, after the expenses incurred in connection with their development had already been largely recouped.

6. Members from developed countries responded that it would be unrealistic to assume that enterprises selected the oldest patents for licensing to developing countries. Normally, an enterprise would license its patents to foreign subsidiaries and therefore select the most up-to-date inventions, in the hope of expanding existing markets or opening up new ones. Patents are not merchandise but instruments for promoting industrial production. Several members from developed countries held as a matter of principle that the country of residence of the owner of a patent or similar property should have the exclusive or primary right to tax royalties paid thereon.

7. Since the former Group of Experts reached no consensus on a particular rate for the source tax to be charged on royalties on a gross basis, the rate should be established through bilateral negotiations. The following considerations might be taken into account in negotiations:

— First, the country of source should recognize both current expenses allocable to the royalty and expenditure incurred in the development of the property whose use gave rise to the royalty. It should be considered that the costs of developing the property are also allocable to profits derived from other royalties or activities, past or future, associated with these expenditures and that expenditure not directly incurred in the development of that property might nevertheless have contributed significantly to that development.

— Second, if an expense ratio is agreed upon in fixing a gross rate in the source country, the country of the recipient, if following a credit method, should also use that expense ratio in applying its credit, whenever feasible. Therefore, that matter should be considered under Article 23 A or 23 B.

8. Other factors might influence the determination of the source tax on gross royalties, including the developing countries' need to earn revenue and conserve foreign exchange; the fact that royalty payments flow almost entirely from developing countries to developed countries; the extent of assistance that developed countries should, for a variety of reasons, extend to developing countries; the special importance of providing such assistance in the context of royalty payments; the desirability of preventing a shift of the tax burden to the licensees in the licensing arrangement; the ability that taxation at source confers on

a developing country to make selective judgments by which, through reduced taxation or exemption, it could encourage those licensing arrangements if they were considered desirable for its development; the lessening of the risks of tax evasion resulting from taxation at the source; the fact that the country of the licensor supplies the facilities and activities necessary for the development of the patent and thus undertakes the risks associated with the patent; the desirability of obtaining and encouraging a flow of technology to developing countries; the desirability of expanding the field of activity of the licensor in the utilization of the research; the benefits that developed countries obtain from world development in general; the relative importance of revenue sacrifice; the relation of the royalty decision to other decisions in the negotiations.

9. Income from film rentals should not be treated as industrial and commercial profits but should be dealt with in the context of royalties. The tax would thus be levied on a gross basis but expenses would be taken into account in fixing the rate of the source tax. With regard to expenses, there are factors that could be regarded as peculiarly relevant to film rentals. As a general rule, the expenses of film producers might be much higher and the profits lower than in the case of industrial royalties. On the other hand, because a considerable part of film expenses represents high salaries paid to actors and other participants who may be taxed solely by the country of residence, and not by the source country, these expenses might not justify any great reduction of the source tax. However, it could be said that the amounts involved are nevertheless real costs for the producer and should be taken into account, while at the same time all countries involved should join in efforts to make sure that such income does not escape tax. Further, while the write-off of expenses in the country of residence does not mean that the expenses should not be taken into account at source, at some point old films could present a different expense situation.

10. Some members of the former Group of Experts expressed the view that because copyright royalties represent cultural efforts, they should be exempted from taxation by the source country. Other members, however, argued that tax would be levied by the residence country, and the reduction at source would not benefit the author. Other members favoured exempting copyright royalties at the source, not necessarily for cultural reasons, but because the country of residence is in a better position to evaluate the expenses and personal circumstances of the

creator of the royalties, including the period over which the books or other copyrighted items had been created; a reduction of the source country tax could be supported in some cases by the fact that the tax was too high to be absorbed by the tax credit of the residence country. However, source countries might not be willing to accept that approach to the problem. Furthermore, if the person dealing with the source country might be the publisher and not the author, arguments supporting the exemption of the author's income because of his personal situation obviously do not apply to the publisher.

11. Changes made in 2014 to the Commentary on Article 12 of the OECD Model made it clear, as regards paragraph 2 of Article 3, that the concept of beneficial owner used in paragraph 2 of Article 12 was intended to be interpreted in the context in which it appears and not with reference to the domestic law of the Contracting States. In 2021, the Committee agreed with this application of paragraph 2 of Article 3 to the concept of beneficial owner. It noted, however, that Article 12 of the UN Model, unlike Article 12 of the OECD Model, provides for the source taxation of royalties and that the term beneficial owner was also used in former Article 12A and Article 12B of this Model. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model, which deals with the interpretation of the concept of beneficial owner, is applicable to paragraph 2 of Article 12 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 4. The requirement of beneficial owner*[…]* was introduced in paragraph *[2]* of Article 12 to clarify *[the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article.]* It makes plain that the State of source is not obliged to give up taxing rights over royalty income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

1 For example, where the trustees of a discretionary trust do not distribute royalties earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 12 even if they are not the beneficial owners under the relevant trust law.

4.1 Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

4.2 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the *[OECD]* Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[1] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

1 Reproduced *[at page R(6)-1 of]* Volume II of the *[full-length]* version of the *[2017]* OECD Model Tax Convention*[, available at* https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833*, accessed on 10 May 2021.]*

4.3 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the royalties is not the "beneficial owner" because that recipient's right to use and enjoy the royalties is constrained by a contractual or legal

obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs *[29 to 49 of the Commentary on Article 1 of this Model].* Where the recipient of royalties does have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of these royalties. It should also be noted that Article 12 refers to the beneficial owner of royalties as opposed to the owner of the right or property in respect of which the royalties are paid, which may be different in some cases.

4.4 The fact that the recipient of royalties is considered to be the beneficial owner of these royalties does not mean, however, that the *[limitation of tax provided for by paragraph 2]* must automatically be granted. *[This limitation of tax should not be granted in cases of abuse of this provision. The subject-to-tax rule of paragraph 3 of Article 1 of the UN Model denies that limitation of tax in cases involving a low level of residence State taxation of the royalties. In addition, t]*he provisions of Article 29, and the principles put forward in the section on "Improper use of the Convention" in the Commentary on Article 1 will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of royalties. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the royalties to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

4.5 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that

concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 *a*) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. *[In the context of Articles 10, 11, 12, 12AA and 12C, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends interest, royalties, fees for services, income from automated digital services and insurance premiums rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid].* For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]

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1 See, for example, *Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 110): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

> In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2 See the Financial Action Task Force's definition quoted in the previous note.

4.6 Subject to other conditions imposed by the Article and the other provisions of the Convention, *[the limitation of tax]* in the State of source remains available when an intermediary, such as an agent or

nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer *[but]* the beneficial owner is a resident of the other Contracting State (the text of the *[UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014]*).

Paragraph 3

12. This paragraph corresponds to Article 12, paragraph 2, of the OECD Model but, as explained below, includes specific references to industrial, commercial or scientific equipment and to software, which are not referred to in the OECD definition. It therefore does not incorporate the 1992 amendment to the OECD definition that eliminates equipment rental from the definition. As described below, it expands the coverage of the definition with respect to software beyond payments for the use of, or the right to use, a copyright in software. Paragraph 3 of the UN Model also breaks out separate types of property referred to in the definition of "royalties" for purposes of this Model. This structure was viewed as making the definition easier to read and apply as well as accommodating the common practice of providing different withholding rates for different categories of royalties. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model Convention is applicable to Article 12 of this Model (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 8. Paragraph 2 contains a definition of the term "royalties". These relate, in general, to rights or property constituting the different forms of literary and artistic property, the elements of intellectual property specified in the text*[, industrial, commercial or scientific equipment]* and information concerning industrial, commercial or scientific experience. The definition applies *[for instance]* to payments for the use of, or the entitlement to use, rights *[or property]* of the kind mentioned, whether or not they have been, or are required to be, registered in a public register. The definition covers both payments made under a licence and compensation which a person would be obliged to pay for fraudulently copying or infringing the right.

[…]

8.4 As a guide, certain explanations are given below in order to define the scope of Article 12 in relation to that of other Articles of the Convention, as regards, in particular, *[equipment renting and]* the provision of information.

[…]

10. Rents in respect of cinematograph films are also treated as royalties, whether such films are exhibited in cinemas or on the television. It may, however, be agreed through bilateral negotiations that rents in respect of cinematograph films shall be treated as business profits and, in consequence, subjected to the provisions of Articles 7 and 9 *[or 12B]*.

[…]

11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 is referring to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how. The words "payments … for information concerning industrial, commercial or scientific experience" are used in the context of the transfer of certain information that has not been patented and does not generally fall within other categories of intellectual property rights. It generally corresponds to undivulged information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived. Since the definition relates to information concerning previous experience, the Article does not apply to payments for new information obtained as a result of performing services at the request of the payer. *[Some members of the Committee, however, were of the view that there is no ground to limit the scope of information of an industrial, commercial or scientific nature to that arising from previous experience].*

11.1 In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.

11.2 This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary

skills of his calling to execute work himself for the other party. Payments made under the latter contracts generally fall under Article 7 *[or 12AA]*.

11.3 The need to distinguish these two types of payments, that is, payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:

— Contracts for the supply of know-how concern information of the kind described in paragraph 11 *[of the Commentary on Article 12 of the 2017 OECD Model, as quoted above]* that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.

— In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.

— In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material. On the other hand, a contract for the performance of services would, in the majority of cases, involve a very much greater level of expenditure by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.

11.4 Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:

— payments obtained as consideration for after-sales service,

— payments for services rendered by a seller to the purchaser under a warranty,

— payments for pure technical assistance,

— payments for a list of potential customers, when such a list is developed specifically for the payer out of generally available information (a payment for the confidential list of customers

to which the payee has provided a particular product or service would, however, constitute a payment for know-how as it would relate to the commercial experience of the payee in dealing with these customers),

— payments for an opinion given by an engineer, an advocate or an accountant, and

— payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with non-confidential information in response to frequently asked questions or common problems that arise frequently.

11.5 In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.

11.6 In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then the treatment applicable to the principal part should generally be applied to the whole amount of the consideration.

[…]

15. Where consideration is paid for the transfer of the full ownership of the rights in the copyright, the payment cannot represent a royalty and the provisions of the Article are not applicable. Difficulties can arise where there is a transfer of rights involving:

— exclusive right of use of the copyright during a specific period or in a limited geographical area;

— additional consideration related to usage;

— consideration in the form of a substantial lump sum payment.

16. Each case will depend on its particular facts but in general if the payment is in consideration for the transfer of rights that constitute a distinct and specific property (which is more likely in the case of geographically-limited than time-limited rights), such payments are likely to be business profits within Article 7 or a capital gain within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.

13. In 2025, the Committee of Experts agreed to amend paragraph 3 to include specific references to software in new subparagraph (c), which does not require the payment to be in consideration for the use of copyright in such software. For example, subparagraph (c) would apply to payments made by a company that is a resident of State S for the use in its business of human resources software that is owned by a company that is a resident of State R. In the view of a majority of the Members of the Committee, the addition of subparagraph (c) was necessary because, in their view, Article 12 is intended to cover payments for the letting of property. Accordingly, subparagraph (c) allows payments for the use or right to use software to be taxed by a Contracting State on a gross basis and does not require any threshold, such as a permanent establishment, as a condition for the taxation of such payments. Subparagraph (c) therefore serves the same function with respect to software as subdivision (a)(iii) serves with respect to industrial, commercial or scientific equipment. In the view of that majority of Members, a person that is making payments for the use of, or the right to use, software described in subparagraph (c) is making a payment in consideration for the letting of that intangible property just

as a person that is making payments covered by subdivision (a)(iii) is making a payment in consideration for the letting of tangible property.

14. A large minority of the Committee opposed including in paragraph 3 an explicit reference to software that was not linked to the use of copyright. [63] In general, they believe that it is appropriate to focus on the business of the person allowing the use of the software or selling a copy of the software, and that person should not be taxable in the source State unless it has a permanent establishment in that State; in that case net taxation would be allowed under Article 7 rather than the gross basis taxation that usually applies under Article 12. Therefore, as a policy matter, they agree with the distinction made by Paragraphs 13.1 and 14 of the Commentary on Article 12 of the OECD Model (quoted in paragraph 24 below) between the use of a copyright right and the use of a copyrighted article, comparing the acquisition of standardized software to the purchase of a product such as a book and arguing that both should give rise to business profits, not royalties, and believe that it is appropriate to maintain that distinction. They also do not agree that it is appropriate to compare the use of software with the use of industrial, commercial or scientific equipment. Finally, they point to the arguments against the imposition of a gross basis withholding tax on royalties generally that are described in paragraphs 6 to 9 and 11 of the UN Commentary on Article 12 and conclude that they apply equally with respect to payments for software.

15. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable to subparagraph (3)(c) of Article 12 of this Model:

> 12.1 Software may be described as a program, or series of programs, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software). It can be transferred through a variety of media, for example in writing or electronically, on a magnetic tape or disk, or on a laser disk or CD-ROM. It may be standardised with a wide range of applications or be tailor-made for single users. It can be transferred as an integral

63 The decision to include that minority view in the Commentary was taken at the twenty-seventh session of the Committee held in October 2023.

part of computer hardware or in an independent form available for use on a variety of hardware.

16. However, the Committee notes that a significant amount of software forms part of embedded systems, consisting of software and hardware designed for a specific function, such as the system that controls a vending machine. Embedded systems may also function as part of a larger system, such as the various embedded systems that control functions in an automobile. The Committee also notes that, since the original adoption of paragraph 12.1 by the OECD, it has become quite common for copies of software to be delivered via digital download or to be accessed remotely.

17. The user may access software through a physical medium or by downloading it through the internet or an intranet. The method by which the software is transferred to the transferee is not relevant to the categorization for purposes of Article 12. Therefore, the definition ensures that Article 12 will apply whether a user downloads software under what is legally a "license" to use that software under domestic law, or "purchases" a copy of software which that user is entitled to use as the legal owner of that copy. In the latter case, any computer file, CD-ROM or other medium containing the copy of the software that is purchased is the means by which the owner of that copy can access the software, which is the object of the transaction. Because the domestic law can vary in how it treats these economically equivalent transactions, and in some countries it may not be clear whether software is transferred by sale or by license, subparagraph (c) refers not only to the use of software but also to an acquisition of software for the acquiror's own use so as to provide for consistent and reciprocal treatment.

18. Some countries may also be concerned about the effect of the revised definition on individuals. Article 12 has never excluded payments made by individuals from its application. However, the definition of royalties encompassed payments that were, in most cases, paid by businesses so, in practice, individuals seldom made payments that were subject to withholding under Article 12. The addition of subparagraph (c) of paragraph 3, which expands the scope of payments on which source State tax may be imposed, may also require more individuals to withhold tax with respect to such payments (unless the domestic law of the source State exempts those payments). The concern is that

individuals are ill-equipped to comply with withholding obligations that may apply with respect to a wide variety of transactions that are generally of low value. Those who share this concern may want to redraft subparagraph (c) to exclude payments for the personal use of software by individuals, as in the following:

(c) received as a consideration for the use of, or the right to use, any software, or paid as a consideration for the acquisition of any copy of software for the purposes of using it, unless the consideration is paid by an individual for the personal use of an individual.

19. The words "for the purposes of using it" at the end of subparagraph (c) are intended to prevent that subparagraph from applying to payments made for the right to distribute software when that right does not include the right to reproduce the software. A medium-sized minority of the members of the Committee disagreed with this approach because they believe that it inappropriately narrows the scope of the provision.[64] In their view, payments with respect to such distribution rights should be covered by Article 12 even in the absence of reproduction rights. In some countries, such distribution rights might be covered by subdivision (a)(i) as payment in consideration for the use of copyright in the software. However, countries that want to ensure that result should delete the words "for the purposes of using it" in subparagraph (c).

20. Application of subparagraph (c) will be straightforward in the case of separately-stated payments for software, as in the example provided in paragraph 13. The provision will apply to payments for both standardized software and to payments for software that has been customized to meet the needs of the client. However, it will not apply in cases where the entity using the software has hired another person to develop software that will be owned by the entity using the software, not by the developer; that contract relates to the provision of services by the developer and any payments made to the developer will be either fees for services, if the relevant treaty includes Article 12AA, or business profits under Article 7. Some Members feel that Article 12 should not apply to payments for the use of standardized software. Those who share this view may want to redraft subparagraph (c) to apply only to software that has been modified for the user thereof, as in the following:

64 The decision to include that minority view in the Commentary was taken at the twenty-seventh session of the Committee held in October 2023.

(c) received as a consideration for the use of, or the right to use, any software that is not standardized but that has been adapted in some way for the benefit of the user thereof, or paid as a consideration for the acquisition of any copy of such software, for the purposes of using it.

21. On the other hand, if software is embedded in physical goods or is bundled with the acquisition of other goods and services, the application of subparagraph (c) becomes more difficult. The guidance regarding mixed contracts in paragraph 12 (quoting paragraph 11.6 of the Commentary on Article 12 of the OECD Model) would apply. The Committee also considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable to Article 12 of this Model:

> 17. Software payments may be made under mixed contracts. Examples of such contracts include sales of computer hardware with built-in software and concessions of the right to use software combined with the provision of services. The methods set out in paragraph 11.6 *[of the Commentary on Article 12 of the 2017 OECD Model, as quoted above]* for dealing with similar problems in relation to patent royalties and know-how are equally applicable to *[…]* software. Where necessary the total amount of the consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part.

22. In general, therefore, the appropriate course is to break down the whole amount of the consideration among the various parts of what is being provided under the contract on the basis of information in the contract or a reasonable apportionment of that consideration. However, paragraph 11.6 of the Commentary on Article 12 of the OECD Model, quoted in paragraph 12 above, also notes that, "if…one part of what is being provided constitutes by far the principal purpose of the contract and the other parts… are only of ancillary and largely unimportant character" then the treatment applicable to the principal part should apply to the entire consideration under the contract. Accordingly, in most cases, the sale of a physical good that incorporates various intangibles need not be disaggregated into its component parts and the entire purchase price should be treated as giving rise to business profits, not royalties.

23. In light of these interpretative issues, some countries may want to exclude from the definition in paragraph 3 payments for software that is embedded in a physical product or part of a contract for services. A revised subparagraph to implement such an exclusion might read:

(c) received as a separately-stated consideration for the use of, or the right to use, any software, or paid as a separately-stated consideration for the acquisition of any copy of software for the purposes of using it.

Even if countries do not agree to include this provision, they may want to discuss the issues of interpretation described above during the negotiations to ensure that both parties have reached a common understanding regarding the manner in which the provision will be applied.

24. Payments in consideration for the use of, or the right to use, a copyright in software may also be covered by subdivision (a)(i). This subdivision will be particularly important with respect to payments for the right to distribute software. Accordingly, the Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable for purposes of interpreting subdivision (a)(i) of paragraph 3 of Article 12 of this Model with respect to software (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 12.2 The character of payments received in transactions involving the transfer of computer software *[under subdivision (a)(i) of paragraph 3]* depends on the nature of the rights that the transferee acquires under the particular arrangement regarding the use and exploitation of the program. The rights in computer programs are a form of intellectual property. Research into the practices of OECD member countries has established that all but one protect rights in computer programs either explicitly or implicitly under copyright law. Although the term "computer software" is commonly used to describe both the program – in which the intellectual property rights (copyright) subsist – and the medium on which it is embodied, the copyright law of most OECD member countries recognises a distinction between the copyright in the program and software which incorporates a copy of the copyrighted program. Transfers of rights in relation to software occur in many different ways ranging from the alienation of the entire rights

in the copyright in a program to the sale of a product which is subject to restrictions on the use to which it is put. The consideration paid can also take numerous forms. These factors may make it difficult to determine where the boundary lies between software payments that are properly to be regarded as royalties and other types of payment. The difficulty of determination is compounded by the ease of reproduction of computer software, and by the fact that acquisition of software frequently entails the making of a copy by the acquirer in order to make possible the operation of the software.

13. The transferee's rights will in most cases consist of partial rights or complete rights in the underlying copyright (see paragraphs 13.1 and 15 *[of the Commentary on Article 12 of the 2017 OECD Model, as quoted in this paragraph and paragraph 12, respectively, of the Commentary on Article 12 of this Model]*), or they may be (or be equivalent to) partial or complete rights in a copy of the program (the "program copy"), whether or not such copy is embodied in a material medium or provided electronically (see paragraphs 14 to 14.2 *[of the Commentary on Article 12 of the 2017 OECD Model, as quoted below]*). In unusual cases, the transaction may represent a transfer of "know-how" or secret formula (paragraph 14.3 *[of the Commentary on Article 12 of the 2017 OECD Model, as quoted below at paragraph 26 of the Commentary on Article 12 of this Model]*).

13.1 Payments made for the acquisition of partial rights in the copyright (without the transferor fully alienating the copyright rights) will represent a royalty *[in accordance with subdivision (a)(i) of paragraph 3 of Article 12 of this Model]* where the consideration is for granting of rights to use the program in a manner that would, without such license, constitute an infringement of copyright. Examples of such arrangements include licenses to reproduce and distribute to the public software incorporating the copyrighted program, or to modify and publicly display the program. In these circumstances, the payments are for the right to use the copyright in the program (i.e. to exploit the rights that would otherwise be the sole prerogative of the copyright holder). It should be noted that where a software payment is properly to be regarded as a royalty there may be difficulties in applying the copyright provisions of *[subdivision (a)(i) of paragraph 3 of Article 12 of this Model]* to software payments, since paragraph 2 requires that software be classified as a literary, artistic or scientific work. None of these categories seems entirely apt. The copyright laws of many countries deal with this problem by specifically classifying software as a literary or scientific work. For other countries treatment as a scientific

work might be the most realistic approach. Countries for which it is not possible to attach software to any of those categories might be justified in adopting in their bilateral treaties an amended version of paragraph *[3]* which either omits all references to the nature of the copyrights or refers specifically to software.

14. In other types of transactions, the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program, for example, where the transferee is granted limited rights to reproduce the program. This would be the common situation in transactions for the acquisition of a program copy. The rights transferred in these cases are specific to the nature of computer programs. They allow the user to copy the program, for example onto the user's computer hard drive or for archival purposes. In this context, it is important to note that the protection afforded in relation to computer programs under copyright law may differ from country to country. In some countries the act of copying the program onto the hard drive or random access memory of a computer would, without a license, constitute a breach of copyright. However, the copyright laws of many countries automatically grant this right to the owner of software which incorporates a computer program. Regardless of whether this right is granted under law or under a license agreement with the copyright holder, copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilising the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analysing the character of the transaction for tax purposes*[of subdivision (a)(i) of paragraph 3 of Article 12 of this Model]*...

14.1 The method of transferring the computer program to the transferee is not relevant. For example, it does not matter whether the transferee acquires a computer disk containing a copy of the program or directly receives a copy on the hard disk of her computer via a modem connection. It is also of no relevance that there may be restrictions on the use to which the transferee can put the software.

14.2 The ease of reproducing computer programs has resulted in distribution arrangements in which the transferee obtains rights to make multiple copies of the program for operation only within its own business. Such arrangements are commonly referred to as "site licences", "enterprise licenses", or "network licences". Although these arrangements permit the making of multiple copies of the program, such rights are generally limited to those necessary for the purpose

of enabling the operation of the program on the licensee's computers or network, and reproduction for any other purpose is not permitted under the license. Payments under such arrangements will in most cases be *[outside the scope of subdivision (a)(i) but could be covered by subparagraph (c) of the definition of royalties in paragraph 3 of Article 12 of this Model]*.

25. A medium-sized minority of the Committee did not oppose the amendment of paragraph 3 but did not agree with this interpretation of subdivision (a)(i).[65] They are of the view that the definition in paragraph 3 of Article 12 of the UN Model before the change made in 2025 already allowed a source country to tax payments for the use of software. This position is based on the copyright laws of their countries which either explicitly or implicitly classify software as a literary, artistic or scientific work. Therefore, in their view a payment for software will represent a royalty payment where the consideration is for granting of rights to use the program in a manner that would, without such a license, constitute an infringement of copyright, as in the situations described in paragraphs 14, 14.1 and 14.2 of the quoted OECD Commentary. For these purposes, they view the reliance placed in paragraphs 14 and 14.2 of the quoted OECD Commentary on the purpose for which the software is copied to be incorrect; they do not believe that commercial exploitation of a copyright by the user is necessary in order to characterize the payment as a royalty.[66]

26. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable for purposes of interpreting subdivision (a)(i) of paragraph 3 of Article 12 of this Model as it applies to computer software (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

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65 The decision to include that minority view in the Commentary was taken at the twenty-seventh session of the Committee held in October 2023.

66 This view, initially recorded at the seventh session of the Committee in October 2011, was elaborated upon by Members of the Committee in conjunction with the 2021 and 2025 updates of the UN Model.

> 14.3 Another type of transaction involving the transfer of computer software is the more unusual case where a software house or computer programmer agrees to supply information about the ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques. In these cases, the payments may be characterised as royalties to the extent that they represent consideration for the use of, or the right to use, secret formulas or for information concerning industrial, commercial or scientific experience which cannot be separately copyrighted. This contrasts with the ordinary case in which a program copy is acquired for operation by the end user.
>
> 14.4 Arrangements between a software copyright holder and a distribution intermediary frequently will grant to the distribution intermediary the right to distribute copies of the program without the right to reproduce that program. In these transactions, the rights acquired in relation to the copyright are limited to those necessary for the commercial intermediary to distribute copies of the software program. In such transactions, distributors are paying only for the acquisition of the software copies and not to exploit any right in the software copyrights. Thus, in a transaction where a distributor makes payments to acquire and distribute software copies (without the right to reproduce the software), the rights in relation to these acts of distribution should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business profits in accordance with Article 7. This would be the case regardless of whether the copies being distributed are delivered on tangible media or are distributed electronically (without the distributor having the right to reproduce the software), or whether the software is subject to minor customisation for the purposes of its installation.

27. A medium-sized minority of the Committee did not agree with this interpretation of subdivision (a)(i).[67] They view the payments described in paragraph 14.4 of the quoted OECD Commentary as in the nature of royalties because the right to distribute is a use of a copyright, which is a valuable economic right of the copyright owner which exists independently of other rights in the copyright, including the copying

67 This view, initially recorded at the seventh session (October 2011) of the Committee, was elaborated upon by Members of the Committee in conjunction with the 2021 and 2025 updates of the UN Model.

right and the exhibition right. They also view it as impracticable to disaggregate the payment towards consideration for various uses.

28. There are possible overlaps between the provisions of Articles 12, 12AA and 12B. For example, the downloading of software and some other digital content may be covered by the definition of "automated digital services" in paragraph 5 of Article 12B and the definition of "royalties" in paragraph 3 of Article 12. However, paragraph 7 of Article 12B provides that "income from automated digital services" does not include payments defined as "royalties". A payment in consideration for the online acquisition of a copy of standardized accounting software for use in a business would be within the scope of Article 12 because the purpose of the transaction was the acquisition of a copy of the software for the use of the payor. Such payment therefore would not be subject to Article 12B. However, Article 12 does not apply to the free downloading of software to facilitate what is fundamentally a different type of transaction, such as the acquisition of goods or the receipt of services. Thus, if a merchant provides free application software to facilitate the on-line purchase of goods, sales of such goods will give rise to business profits which are subject to Article 7 (see paragraph 59(iv) of the Commentary on Article 12B). Similarly, free downloads of application software to access online intermediation platform services or online gaming, which are intended to facilitate automated digital services, would not implicate Article 12, so that the entire profit would fall within the scope of Article 12B. However, if the user makes a separate payment in order to download the application software, that payment would be subject to Article 12.

29. In the case of digital content (other than software described in subparagraph (c) of paragraph 3 of Article 12), it is necessary to determine the extent to which the download of such digital content constitutes the use of a copyright, in which case a payment for such download would be covered by paragraph 3(a)(i) of Article 12. In other cases, as explained in the OECD Commentary quoted below, payments in consideration for the download of digital content (other than software) would not be covered by Article 12 but by Article 7, 12B or 13. The Committee considers that the part of the Commentary on Article 12 of the 2017 OECD Model Tax reproduced below, which provides additional explanations on the definition of royalties in the case of payments for digital content, is applicable to subdivision (a)

(i) of paragraph 3 of Article 12 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model Tax, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model Tax and those of this Model):

17.1 The principles expressed above as regards software payments are also applicable as regards transactions concerning other types of digital products such as images, sounds or text. The development of electronic commerce has multiplied the number of such transactions. In deciding whether or not payments arising in these transactions constitute royalties, the main question to be addressed is the identification of that for which the payment is essentially made.

17.2 Under the relevant legislation of some countries, transactions which permit the customer to electronically download digital products may give rise to use of copyright by the customer, for example, because a right to make one or more copies of the digital content is granted under the contract. Where the consideration is essentially for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services), and the use of copyright is limited to such rights as are required to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device, such use of copyright should not affect the analysis of the character of the payment for purposes of applying *[subdivision (a)(i) of]* the definition of "royalties".

17.3 This is the case for transactions that permit the customer (which may be an enterprise) to electronically download digital products (such as software, images, sounds or text) for that customer's own use or enjoyment. In these transactions, the payment is essentially for the acquisition of data transmitted in the form of a digital signal and therefore does not constitute royalties *[under subdivision (a)(i) of paragraph 3 of Article 12 of this Model]* but falls within Article 7*[, 12B or]* 13, as the case may be. To the extent that the act of copying the digital signal onto the customer's hard disk or other non-temporary media involves the use of a copyright by the customer under the relevant law and contractual arrangements, such copying is merely the means by which the digital signal is captured and stored. This use of copyright is not important for classification purposes because it does not correspond to what the payment is essentially in consideration for (i.e. to acquire data transmitted in the form of a digital signal), which

> is the determining factor for the purposes of the definition of royalties. There also would be no basis to classify such transactions as "royalties" *[under subdivision (a)(i)]* if, under the relevant law and contractual arrangements, the creation of a copy is regarded as a use of copyright by the provider rather than by the customer.
>
> 17.4 By contrast, transactions where the essential consideration for the payment is the granting of the right to use a copyright in a digital product that is electronically downloaded for that purpose will give rise to royalties. This would be the case, for example, of a book publisher who would pay to acquire the right to reproduce a copyrighted picture that it would electronically download for the purposes of including it on the cover of a book that it is producing. In this transaction, the essential consideration for the payment is the acquisition of rights to use the copyright in the digital product, that is, the right to reproduce and distribute the picture, and not merely for the acquisition of the digital content.

30. A medium-sized minority of the Committee is of the view that the payments referred to in paragraphs 17.2 and 17.3 of the OECD Commentary extracted above may constitute royalties, without regard to subparagraph (c).[68]

31. There is less risk of overlap between Article 12 and Article 12AA as regards payments for software, because Article 12AA applies to the provision of services, such as software consulting, that involve human input, while Article 12 relates to the use of property.

32. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model is applicable for purposes of interpreting paragraph 3 of Article 12 of this Model (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 18. The suggestions made above regarding mixed contracts could also be applied in regard to certain performances by artists and, in particular, in regard to an orchestral concert given by a conductor

68 The decision to include that minority view in the Commentary was taken at the twenty-seventh session of the Committee held in October 2023.

or a recital given by a musician. The fee for the musical performance, together with that paid for any simultaneous radio broadcasting thereof, seems to fall to be treated under Article 17*[, 7 or 12AA, as the case may be]*. Where, whether under the same contract or under a separate one, the musical performance is recorded and the artist has stipulated that he, on the basis of his copyright in the sound recording, be paid royalties on the sale or public playing of the records, then so much of the payment received by him as consists of such royalties falls to be treated under Article 12. Where, however, the copyright in a sound recording, because of either the relevant copyright law or the terms of contract, belongs to a person with whom the artist has contractually agreed to provide his services (i.e. a musical performance during the recording), or to a third party, the payments made under such a contract fall under Article 7*[*or *12AA, as the case may be]* (e.g. if the performance takes place outside the State of source of the payment) or 17 rather than under this Article, even if these payments are contingent on the sale of the recordings.

19. It is further pointed out that variable or fixed payments for the working of mineral deposits, sources or other natural resources are governed by Article 6 and do not, therefore, fall within the present Article.

33. The definition of royalties in paragraph 2 of Article 12 of the OECD Model (which corresponds to, but differs from, the definition in paragraph 3 of Article 12 of this Model) was amended in 1992 by deleting the words "for the use of, or the right to use, industrial, commercial or scientific equipment" as a result of the OECD report entitled *The Revision of the Model Convention* adopted by the Council of the OECD on 23 July 1992. However, a number of OECD member countries have entered reservations on this point.

34. The reference, in paragraph 3 of Article 12 of this Model, to payments received as consideration "for the use of, or the right to use, industrial, commercial or scientific equipment" addresses circumstances in which the owner of the equipment earns profits from letting another person use that equipment, without having the owner establish any presence in the State where it is used, or where the user resides, which would satisfy the requirements of Article 5 for the existence of a permanent establishment. For this kind of business the equipment itself, when used by another person, is treated in the UN Model as having significance similar to that of a permanent establishment.

35. The term "equipment" is not defined in this Model. Accordingly, the provisions of paragraph 2 of Article 3 apply, which means that the term may have different meanings in different States. However, a feature that is always present is that the equipment will be used in the performance of a task. It is a tool used by a business in the sense that it is not enjoyed for its own sake. Thus, for example, a car rented by a tourist will not be considered to be "equipment." Neither can equipment include intellectual property, immovable property covered by Article 6, or property covered by Article 8. Industrial, commercial or scientific equipment is clearly a subset of equipment and may, outside of a consumer context, include (this is not an exhaustive list) ships, aircraft, cars and other vehicles, cranes, containers, satellites, pipelines and cables etc.

36. A clear distinction must be made between royalties paid for the use of equipment, which fall under Article 12, and payments constituting consideration for the sale of equipment, some or all of which may, depending on the case, fall under Articles 7, 11, 13 or 21. Some contracts combine the lease element and the sale element, so that it sometimes proves difficult to determine their nature and economic substance. In the case of credit sale agreements, hire purchase agreements and other forms of finance leases, it seems clear that the sale element is paramount, because the parties have from the outset agreed that the ownership of the property in question shall be transferred from one to the other, although they have made this dependent upon the payment of the last instalment. Consequently, the instalments paid by the purchaser/hirer do not, in principle, constitute royalties. In the case, however, of an operating lease, the sole, or at least the principal, purpose of the contract is normally that of lease, even if the lessee has the right thereunder to opt during its term to purchase the equipment in question outright. Article 12 therefore applies in the normal case to the rentals paid by the lessee, including all rentals paid up to the date the lessee exercises any right to purchase. Indications for a finance lease rather than an operating lease might include, for example:

— the lease is long term and non-cancellable;
— the term of the lease is likely to cover a substantial part (or all) of the equipment's useful life;
— there is no other likely user of the equipment, or it is not feasible for the equipment to be leased to another lessee;

— the lessee of the equipment behaves as owner;
— the lessee carries positive and/or negative residual value risk or utility in respect of the equipment;
— the lease payments to use the equipment are high particularly at the beginning such that they constitute an inordinately large proportion of the amount needed to secure the acquisition;
— the lease payments materially exceed the current fair rental value and thus compensate for more than just the use of property; and
— some portion of the lease payments is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest.

37. With regard to satellite operators and their customers, the characterization of a payment by the customer to the satellite operator as a royalty will depend to a large extent on the specific contractual arrangements. If the owner of the satellite leases it to another person and that person operates it, the payment for the lease would be a royalty payment for the use of industrial, commercial or scientific equipment. However, in many cases the customer does not acquire the possession or control of the satellite, but makes use of part or all of its transmission capacity. The satellite would continue to be operated by the lessor. In such cases, members were of the opinion that the payments made would be in the nature of transmission services to which Article 7, 12AA or 12B, as the case may be, applies. Other members were of the opinion that a payment for the use of the transmission capacity (or transport or transmission capacity in the case of pipelines or cables) could be regarded as payments made for the leasing of industrial, commercial or scientific equipment.

38. When the former Group of Experts considered the part of the definition of royalties dealing with payments received as consideration for "information concerning industrial, commercial or scientific experience", it addressed the problems of distinguishing royalties from types of income properly subject to other Articles of the Convention. A member from a developed country asserted that the problem was that the "royalties" definition makes an imperfect distinction between revenues that constituted royalties in the strict sense and payments received for brain-work and technical services, such as surveys of any kind (engineering, geological research etc.). The member also mentioned the problem of distinguishing between royalties akin to income from

capital and payments received for services. Given the broad definition of "information concerning industrial, commercial or scientific experience", some countries tend to regard the provision of brain-work and technical services as the provision of "information concerning industrial, commercial or scientific experience" and to regard payment for such information as royalties.

39. In order to avoid those difficulties, this member proposed that the definition of royalties be restricted by excluding payments received for "information concerning industrial, commercial or scientific experience". The member also suggested that a protocol should be annexed to the treaty making it clear that such payments should be deemed to be profits of an enterprise to which Article 7 would apply and that payments received for studies or surveys of a scientific or technical nature, such as geological surveys, or for consultant or supervisory services, should also be deemed to be business profits subject to Article 7. The effect of these provisions would be that the source country could not tax such payments unless the enterprise had a permanent establishment in that country and that taxes should only be imposed on the net income element of such payments attributable to that permanent establishment.

40. Some members from developing countries interpreted the phrase "information concerning industrial, commercial or scientific experience" to mean specialized knowledge, having intrinsic property value relating to industrial, commercial, or managerial processes, conveyed in the form of instructions, advice, teaching or formulas, plans or models, permitting the use or application of experience gathered on a particular subject. They also pointed out that the definition of the term royalties could be broadened through bilateral negotiations to include gains derived from the alienation of any such right or property that were contingent on the productivity, use or disposition thereof.

41. Also, the former Group of Experts agreed that the reference to "copyright of literary… work" found in the definition of royalties could be interpreted to include copyrights relating to international news.

Paragraph 4

42. This paragraph reproduces, with modifications, paragraph 3 of Article 12 of the OECD Model, which states that paragraph 1

does not apply to royalties beneficially owned by a person having a permanent establishment in the source country if the right or property from which the royalties derive is effectively connected with the permanent establishment. The former Group of Experts decided to modify paragraph 3 of the OECD Model by introducing a limited force-of-attraction principle. In addition to royalties excluded from the application of paragraph 1 by paragraph 3 of the OECD Article, paragraph 4 of the UN Model excludes royalties which are received in connection with business activities described in subparagraph (*c*) of paragraph 1 of Article 7 (business activities of the same or similar kind as those of a permanent establishment in the source country), even if the business activities are not carried on through a permanent establishment. This Model also modifies the paragraph to refer to paragraph 2 as well as paragraph 1.

Paragraph 5

43. This paragraph, which provides that royalties are considered income from sources in the residence country of the payer of the royalties, is an innovation of this Model not found in Article 12 of the OECD Model.

44. As in the case of interest, some members suggested that some countries may wish to substitute a rule that would identify the source of a royalty as the State in which the property or right giving rise to the royalty (the patent etc.) is used. Where, in bilateral negotiations, the two parties differ on the appropriate rule, a possible solution would be a rule which, in general, would accept the payer's place of residence as the source of royalty but, where the right or property for which the royalty was paid was used in the State having a place of use rule, the royalty would be deemed to arise in that State.

Paragraph 6

45. This paragraph reproduces, with one adjustment, paragraph 4 of Article 12 of the OECD Model. The Committee considers that the following part of the Commentary on Article 12 of the 2017 OECD Model which deals with that paragraph is applicable to paragraph 6 of Article 12 of this Model (the modifications that appear in square brackets, which are not part of the Commentary on the OECD Model, have been

inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 22. The purpose of this paragraph is to restrict the operation of the provisions concerning the taxation of royalties in cases where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length. It provides that in such a case the provisions of the Article apply only to that last-mentioned amount and that the excess part of the royalty shall remain taxable according to the laws of the two Contracting States due regard being had to the other provisions of the Convention. The paragraph permits only the adjustment of the amount of royalties and not the reclassification of the royalties in such a way as to give it a different character, for example, a contribution to equity capital. For such an adjustment to be possible under paragraph *[6]* of Article 12 it would be necessary as a minimum to remove the limiting phrase "having regard to the use, right, or information for which they are paid". If greater clarity of intent is felt appropriate, a phrase such as "for whatever reason" might be added after "exceeds".
>
> 23. It is clear from the text that for this clause to apply the payment held excessive must be due to a special relationship between the payer and the beneficial owner or between both of them and some other person. There may be cited as examples cases where royalties are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.
>
> 24. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the royalty.
>
> 25. With regard to the taxation treatment to be applied to the excess part of the royalty, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income in which it should be classified for the purpose of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. If two Contracting States should have difficulty in determining the other provisions of the Convention applicable, as cases required, to the excess part of the

royalties there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph *[6]*, as long as they do not alter its general purport.

26. Should the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

46. When the scope of paragraph 6 was last considered by the former Group of Experts, some members pointed out that there are many artificial devices entered into by persons to take advantage of the provisions of Article 12 through, inter alia, creation or assignment of agreements for the use, right or information with respect to intangible assets for which royalties are charged. While it was then noted that substance over form rules, the abuse of rights principle or any similar doctrine could be used to counter such arrangements, the subsequent addition, in 2017, of paragraph 9 of Article 29 provided another way of addressing these concerns.

Fees for included services

47. When former Article 12A was included in this Model in 2017, a minority of the members of the Committee were opposed to the inclusion of the Article. Those members considered that it would be preferable for countries that wish to have greater taxing rights with respect to fees for technical services to include in their treaties an alternative version of Article 12 of the UN Model that would allow Contracting States to impose tax on fees for services that are closely connected to the transfer of the use of, or the right to use, property producing royalties. This alternative version of Article 12 is set out and discussed in paragraphs 49 to 77 below.

48. However, a majority of the members of the Committee were of the view that the alternative version of Article 12 is inappropriate for most developing countries because of its limited scope and difficult and complex application. Instead, the majority of the members of the Committee suggested that countries that wish to consider an alternative to the former Article 12A or Article 12AA of this Model should consider the alternative provision set out in paragraphs 26 to 31

of the Commentary on former Article 12A[69] under which a Contracting State would be entitled to tax any income from services provided in that State and any fees for any services paid by payers in that State to closely related persons outside that State irrespective of whether those services are provided inside or outside that State.

Alternative version of Article 12 covering fees for included services

49. Countries taking the position described in paragraph 47 may consider the following alternative version of Article 12. Under this alternative version, the definition of "royalties" in paragraph 3 of Article 12 would be amended to include "fees for included services" and two new paragraphs would be added to Article 12. Paragraph 3 of Article 12 would therefore read as follows:

> 3. The term "royalties" as used in this Article means payments of any kind:
>
> (*a*) received as a consideration for the use of, or the right to use:
>
> i) any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting;
>
> ii) any patent, trademark, design or model, plan, or secret formula or process; or
>
> iii) industrial, commercial or scientific equipment; or
>
> (*b*) received as a consideration for information concerning industrial, commercial or scientific experience; or
>
> (*c*) received as a consideration for the use of, or the right to use, any software, or paid as a consideration for the acquisition of any copy of software for the purposes of using it; or
>
> (*d*) fees for included services as defined in paragraphs 4 and 5.

50. Paragraphs 4, 5 and 6 of Article 12 would then be renumbered as paragraphs 6, 7, and 8 respectively and the following new paragraphs 4 and 5 would be added to Article 12:

69 The text of former Article 12A and its Commentary can be found in the Annex to this Model.

4. For the purposes of this Article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of technical or other personnel) if such services:

(*a*) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

(*b*) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design.

5. Notwithstanding paragraph 4, "fees for included services" donot include payments:

(*a*) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property;

(*b*) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;

(*c*) for teaching in an educational institution or for teaching by an educational institution;

(*d*) by an individual for services for the personal use of an individual;

(*e*) to an employee of the person making the payments or to any individual or individuals for professional services.[70]

51. This alternative version of Article 12 includes only certain technical and consultancy services. The term "technical services" in this context means services requiring expertise in a technology. Consultancy services in this context means advisory services. The categories of technical and consultancy services are to some extent overlapping because a consultancy service could also be a technical service. However, the category of consultancy services also includes an advisory service, whether or not expertise in a technology is required to perform it.

70 The term "professional services" should be interpreted in accordance with the use of that term in former Article 14, which can be found in the Annex to this Model.

52. Under paragraph 4 of the alternative version of Article 12, technical and consultancy services are considered included services only to the extent that: (1) as described in paragraph 4(*a*), they are ancillary and subsidiary to the application or enjoyment of a right, property or information for which a royalty payment is made; or (2) as described in paragraph 4(*b*), they make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design. Thus, consultancy services which are not of a technical nature cannot be included services under paragraph 4(*b*).

53. Paragraph 4(*a*) of the alternative version of Article 12 refers to technical or consultancy services that are ancillary and subsidiary to the application or enjoyment of any right, property, or information for which a payment described in paragraph 3 is received. Thus, paragraph 4(*a*) includes technical and consultancy services that are ancillary and subsidiary to the application or enjoyment of intangible property for which a royalty is received under a license or sale as described in paragraph 3, as well as those ancillary and subsidiary to the application or enjoyment of industrial, commercial, or scientific equipment or information concerning industrial, commercial, or scientific experience for which a royalty is received under a lease as described in paragraph 3.

54. Paragraph 4(*a*) is consistent with the interpretation of the definition of "royalty" that is set forth in paragraph 11.6 of the Commentary on Article 12 of the 2017 OECD Model quoted in paragraph 12 above. The inclusion of paragraph 4(*a*) in the text of a bilateral treaty is particularly beneficial to countries that have concerns about relying only on the interpretation in paragraph 11.6 of the Commentary on Article 12 of the 2017 OECD Model quoted in paragraph 12 above. Provisions identical or substantially similar to paragraph 4(*a*) are found in several existing bilateral tax treaties concluded by developing countries.

55. In order for a service fee to be considered "ancillary and subsidiary" to the application or enjoyment of some right, property, or information for which a payment described in paragraph 3 is received, the service must be related to the application or enjoyment of the right, property, or information. In addition, the predominant purpose of the arrangement under which the payment of the service fee and such other payment are

made must clearly be the application or enjoyment of the right, property, or information described in paragraph 3. The question of whether the services are related to the application or enjoyment of the right, property, or information described in paragraph 3 and whether the predominant purpose of the arrangement is such application or enjoyment must be determined by reference to the facts and circumstances of each case. Factors which may be relevant to such determination (although not necessarily controlling) include:

- the extent to which the services in question facilitate the effective application or enjoyment of the right, property, or information described in paragraph 3;
- the extent to which such services are customarily provided in the ordinary course of business arrangements involving royalties described in paragraph 3;
- whether the amount paid for the services (or the amount which would be paid by parties operating at arm's length) is an insubstantial portion of the combined payments for the services and the right, property, or information described in paragraph 3;
- whether the payment made for the services and the royalty described in paragraph 3 are made under a single contract (or a set of related contracts); and
- whether the person providing the services is the same person as, or related to, the person receiving the royalties described in paragraph 3 (for this purpose, persons are considered related if their relationship is described in Article 9 (Associated enterprises) or if the person providing the services is doing so in connection with an overall arrangement which includes the payer and recipient of the royalties).

56. To the extent that services are not considered ancillary and subsidiary to the application or enjoyment of some right, property, or information for which a royalty payment under paragraph 3 is made, the fees for such services shall be considered "fees for included services" only to the extent that they are described in paragraph 4(*b*) of the alternative version of Article 12.

57. The following paragraphs provide examples to clarify the types of services intended to be included within the scope of the provision

on "fees for included services" and the types of services that are not intended to be included in that provision. These examples are intended to be illustrative rather than exhaustive.

58. *Example 1:* A manufacturing company resident in State R grants rights to a company resident in State S to use manufacturing processes in which the manufacturer has exclusive rights by virtue of process patents or the protection otherwise extended by the law of State R to the owner of a process. As part of the contractual arrangement, the manufacturer agrees to provide certain consultancy services to the State S company in order to improve the effectiveness of the latter's use of the process. For example, such services include the provision of information and advice on sources of supply for materials needed in the manufacturing process, and on the development of sales and service literature for the manufactured product. The payments for these services do not form a substantial part of the total consideration payable under the contractual arrangement.

59. The payments described in Example 1 are fees for included services. They are ancillary and subsidiary to the use of a manufacturing process protected by law as described in paragraph 3 of the alternative version of Article 12, because the services are related to the application or enjoyment of the protected process and the granting of the right to use the process is clearly the predominant purpose of the arrangement. Because the services are ancillary and subsidiary to the use of the manufacturing process, the fees for these services are considered fees for included services under paragraph 4(*a*) regardless of whether they are covered in paragraph 4(*b*). As explained in paragraph 54 above, while this result is consistent with the interpretation of the definition of "royalty" that is set forth in paragraph 11.6 of the Commentary on Article 12 of the 2017 OECD Model quoted in paragraph 12 above, countries can make this result explicit by including paragraph 4(*a*) in the text of the treaty provision.

60. *Example 2:* A manufacturing company resident in State S produces a product that must be manufactured under sterile conditions using machinery that must be kept completely free of bacterial and other harmful deposits. A company resident in State R has developed a special cleaning process for removing such deposits from this type of machinery. The State R company enters into a contract with the State S

manufacturing company under which the former will clean the latter's machinery on a regular basis. As part of the arrangement, the State R company leases to the State S company a piece of equipment which allows the State S company to measure the level of bacterial deposits on its machinery in order for it to know when cleaning is required.

61. In Example 2, the provision of cleaning services by the State R company and the lease of the monitoring equipment are related to each other. However, the predominant purpose of the arrangement is clearly the provision of cleaning services. Thus, although the cleaning services might be considered technical services, they are not "ancillary and subsidiary" to the rental of the monitoring equipment. Accordingly, the cleaning services are not "included services" within the meaning of paragraph 4(*a*) of the alternative version of Article 12.

62. Paragraph 4(*b*) of the alternative version of Article 12 refers to technical or consultancy services that make available to the recipient technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design to such person. The services described in paragraph 4(*b*) differ from the services described in paragraph 4(*a*) of the alternative version of Article 12 in that any service that does not make technology available to the person acquiring the service is excluded. Generally speaking, technology will be considered "made available" to a person if that person is enabled to apply the technology through the provision of the services. The fact that the provision of the service may require technical input by the person providing the service does not mean, by itself, that technical knowledge, skills, etc., are made available to the person purchasing the service. Similarly, the use of a product that embodies technology does not mean, by itself, that technology is made available to the recipient of the services.

63. Categories of services that typically involve either the development and transfer of technical plans or technical designs, or making technology available as described in paragraph 4(*b*) of the alternative version of Article 12, include:

— engineering services (including the subcategories of bioengineering and aeronautical, agricultural, ceramics, chemical, civil, electrical, mechanical, metallurgical, and industrial engineering);

— architectural services; and
— computer software development.

The manner through which the services are provided is irrelevant to the characterization of the payments as fees for included services.

64. Under paragraph 4(*b*) of the alternative version of Article 12, technical and consultancy services could make technology available in a variety of settings, activities and industries. Such services may, for example, relate to any of the following areas:

— bio-technical services;
— food processing;
— environmental and ecological services;
— communication through satellite or otherwise;
— digital networking;
— energy conservation;
— exploration or exploitation of mineral oil or natural gas;
— geological surveys;
— scientific services; and
— technical training.

65. *Example 3:* A manufacturing company resident in State R has experience in the use of a process for manufacturing wallboard for interior walls of houses which is more durable than standard wallboard products. A company resident in State S wishes to produce this product for its own use. It rents a plant in State S and contracts with the State R company for the use of the process and for sending experts to State S to show engineers employed by the State S company how to produce the more durable wallboard. The experts supplied by the State R manufacturer work with the employees of the State S firm for a few months.

66. According to the principles set out in paragraphs 11.1, 11.3 and 11.4 of the Commentary on Article 12 of the 2017 OECD Model quoted in paragraph 12 above, in Example 3, payments for the use of the wallboard manufacturing process would be characterized as payments for "know-how," and thus are taxed as royalties, while the payments by the State S company to show its engineers how to produce the more durable

wallboard would be characterized as business profits. However, under paragraph 4(*b*) of the alternative version of Article 12, the payments for the services of the experts supplied by the State R manufacturer would be fees for included services. The services are of a technical or consultancy nature; they have elements of both types of services. The services make available to the State S company technical knowledge, skill, and processes. Therefore, the payments are fees for included services under paragraph 4(*b*) of the alternative version of Article 12.

67. *Example 4:* A manufacturing company resident in State R operates a wallboard fabrication plant outside State R. A company resident in State S enters into a contract with the State R company to produce wallboard for the State S company at that plant for a fee. The State S company provides the raw materials, and the State R manufacturer fabricates the wallboard in its plant, using advanced technology.

68. In Example 4, the payments under the contract to the State R manufacturer would not be fees for included services under the alternative version of Article 12. Although the State R company is performing a technical service, no technical knowledge, skill etc. is made available to the State S company, nor is there any development and transfer of a technical plan or design. The State R company is merely performing contract manufacturing services for the State S company.

69. *Example 5:* A firm resident in State S owns inventory control software for use in its chain of retail outlets throughout State S. It expands its sales operation by employing a team of employees to travel around the countryside selling the company's wares. The company wants to modify its software to permit the sales force to access the company's central computers for information on what products are available in inventory and when they can be delivered. The State S firm enters into a contract with a State R computer programming firm resident in State R to modify its software for this purpose. In fulfilling the terms of the contract, the State R firm transfers the modified software to the State S firm.

70. According to the principles set out in paragraph 14.3 of the Commentary on Article 12 of the 2017 OECD Model quoted in paragraph 26 above, in Example 5, the payments by the State S firm for the modification of computer software would be characterized as business profits. However, under paragraph 4(*b*) of the alternative

version of Article 12, the payments are fees for included services. The State R company provides a technical service to the State S company, and it transfers to the State S company the technical plan (i.e. the computer program) that it develops.

71. *Example 6:* A vegetable oil manufacturing company resident in State S wants to produce a cholesterol-free oil from a plant which produces oil containing cholesterol. A company resident in State R has developed a process for refining cholesterol out of the oil. The State S company contracts with the State R company to modify the extraction formulas which it owns and uses to eliminate the cholesterol, and to train the employees of the State S company in applying the new formulas.

72. According to the principles set out in paragraphs 11.1, 11.3 and 11.4 of the Commentary on Article 12 of the 2017 OECD Model quoted in paragraph 12 above, in Example 6, payments for the modification of the cholesterol extraction formula as well as the payments for the training in the use of the new formulas would be characterized as business profits. However, under paragraph 4(*b*) of the alternative version of Article 12, both payments by the company resident in State S are fees for included services. The services are technical, and the technical knowledge is made available by the State R company to the State S company through the training of its employees to apply the modified formulas.

73. *Example 7:* A company resident in State R engaged in manufacturing vegetable oil has mastered the science of producing cholesterol-free oil and wishes to market the product worldwide. It enters into a contract with a marketing consulting firm resident in State S to do a computer simulation of the world market for such oil and to advise it on marketing strategies.

74. The payments in Example 7 would not be fees for included services under the alternative version of Article 12. The State S company is providing a consultancy service to the manufacturing enterprise in State R, which involves the use of substantial technical skill and expertise. It is not, however, making available to the State R company any technical experience, knowledge or skill, etc.; nor is it transferring a technical plan or design. The State S consulting firm is providing commercial information to the State R manufacturing company through the service contract. The fact that the consulting firm used technical skills and

expertise in order to perform the services and provide the commercial information to the State R manufacturing company does not make the service a technical service within the meaning of paragraph 4(*b*) of the alternative version of Article 12.

75. *Example 8:* A hospital established in State S purchases an X-ray machine from a manufacturer resident in State R. As part of the purchase agreement, the manufacturer agrees to install the machine, to perform an initial inspection of the machine in the hospital, to train hospital staff in the use of the machine, and to service the machine periodically during the usual warranty period (2 years). Under an optional service contract purchased by the hospital, the manufacturer also agrees to perform certain other services throughout the life of the machine, including periodic inspections and repair services, advising the hospital about developments in X-ray technology, which could improve the effectiveness of the machine, and training hospital staff in the application of these new developments. The cost of the initial installation, inspection, training, and warranty service is relatively minor as compared with the cost of the X-ray machine.

76. In Example 8, the initial installation, inspection, and training services performed for the hospital in State S and the periodic services provided during the warranty period are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of the X-ray machine because the usefulness of the machine to the hospital depends on this service, the manufacturer has responsibility to service the machine during the warranty period, and the cost of the services is a relatively minor component of the contract. Therefore, under subparagraph 5(*a*) of the alternative version of Article 12 the payments received by the manufacturer are excluded from the definition of fees for included services, regardless of whether they would otherwise be covered by paragraph 4(*b*). However, neither the post-warranty period inspection and repair services, nor the advisory and training services relating to new developments are "inextricably and essentially linked" to the initial sale of the X-ray machine. Absent the alternative version of Article 12, these payments would constitute business profits. However, under the alternative version of Article 12, the payments for the training of the hospital staff on the application of new developments in X-ray technology are covered by paragraph 4(*b*) and as such, may be taxed as fees for included services.

Article 12A

FEES FOR TECHNICAL SERVICES
[Deleted 2025]

Article 12AA

FEES FOR SERVICES

A. General considerations

1. A new Article 12AA was added to the Model Tax Convention in 2025 to replace the former Article 12A and Article 14.

2. Article 12AA is intended to remove some of the limitations on a country's right to tax income from cross-border services under the provisions of the Model Tax Convention as it read before the 2025 update. Article 12AA allows a country to tax payments for cross-border services irrespective of where the services are performed and without any minimum threshold requirement such as a permanent establishment or fixed base in the country or the physical presence of the service provider in the country for a minimum number of days. The previous requirements for a country to tax income from services performed by residents of the other Contracting State placed limits on a country's right to tax the income from those services that are no longer appropriate.

3. Article 12AA is also intended to make the taxation of fees for cross-border services by source countries more consistent. Under the former Article 14, a resident of one Contracting State providing professional or other independent services in the other Contracting State was subject to tax by the other Contracting State only if the service provider had a fixed base in the other State that was regularly available to the service provider or was present in the other State for 183 days or more in any twelve-month period. Under the former Article 12A, fees for consulting, management and technical services provided by a resident of one Contracting State to a resident of the other Contracting State (or to a non-resident with a permanent establishment in the other Contracting State that bears those fees) were taxable by the other State; however, the scope of the meaning of "fees for technical services" was far from

clear. In contrast, under paragraph 2 of Article 12AA, a Contracting State is allowed to tax payments for services from payers resident in that Contracting State (and from non-residents with a permanent establishment in that State that bears those fees) irrespective of the nature of those services (whether independent personal services or technical services) or the place where services are performed, unless those services are provided through a permanent establishment in the other Contracting State.

4. The digitalisation of the economy has enabled residents of one state to provide substantial business services in other states without establishing any taxable presence in those states. Physical presence has increasingly been questioned as an appropriate basis for the allocation of taxing rights pursuant to bilateral tax treaties. An alternative basis for the taxation of income from services is to allocate taxing rights to the country in which the services are used or consumed rather than the country in which the services are performed. The country in which services are used or consumed is generally the country where the person paying for the services is resident or has a permanent establishment, and where that person is carrying on business, the fees paid for services to non-resident service providers are usually deductible in computing that payer's income for purposes of that country's tax. The reduction of a country's tax base by the deduction of fees for services paid to non-residents can be seen as sufficient justification for that country to impose tax on the fees derived by those non-residents. For example, Article 16 allows the taxation of directors' fees and the remuneration of top-level managerial officials by the country in which the company paying such fees and remuneration is resident. Similarly, Article 12 of the Convention allows the taxation of rent paid by a resident of one Contracting State to a resident of the other State and arising in the first State for the use of commercial, industrial or scientific equipment.

5. In response to the increasing ability of multinational enterprises to provide a wide range of cross-border services remotely, the Model Tax Convention was amended in 2017 to add a new article on fees for technical services (former Article 12A) allowing a Contracting State to impose tax up to an agreed rate on the gross amount of fees for consultancy, management and technical services paid to a resident of the other Contracting State. The Convention was amended again in 2021 to add Article 12B (Income from automated digital services), allowing

a State to impose tax up to an agreed rate on payments for automated digital services paid to a resident of the other State. These changes, as well as other changes made in the 2025 update of the Convention, mark a shift away from reliance on physical presence as a condition for source country taxation of income from cross-border services.

6. In many circumstances, fees for cross-border services are deductible against a country's tax base, where the payer is a resident of the country or a non-resident with a permanent establishment in the country, and the deduction results in the reduction of the country's tax base. Nevertheless, the provisions of the Model Tax Convention, as it read before the 2025 update, often prevented countries from taxing such deductible fees for services. The reduction of a country's tax base by deductible fees for services is not, in principle, objectionable. If the payer is an enterprise, the payments represent legitimate expenses incurred by the payer for the purpose of earning income and should be deductible (assuming, of course, that the amount of the payments is reasonable and subject to anti-abuse provisions to deal with double non-taxation). If the country is entitled to tax the non-resident service provider with respect to the fees earned from providing the services, the reduction of the country's tax base by the deductible payments would be offset by the tax imposed by that country on those fees.

7. As a result of these considerations, the Committee identified fees for cross-border services as a matter of priority to be dealt with as part of its project on the taxation of income from services under the Model Tax Convention. After considerable debate, having due regard to all the arguments for and against the limitations on source countries' taxing rights with regard to fees for services, in 2025 the Committee decided to add Article 12AA to the Convention and to delete the former Article 12A and Article 14 in order to further reduce the reliance on physical presence as a condition for source country taxation of income from cross-border services.

8. In effect, new Article 12AA replaces former Articles 12A and 14, with the result that fees for services previously taxable under those provisions are usually taxable in accordance with the provisions of new Article 12AA by the Contracting State in which the fees arise up to the rate agreed through the negotiations of the Contracting States applied to the gross amount of the fees. If, however, a resident of one

Contracting State who provides services to customers in the other State has a permanent establishment in that other State in which the fees for services arise and the fees are effectively connected with that permanent establishment, the fees are taxable in accordance with Article 7 of the Convention. Under paragraph 5 of Article 12AA, fees for services arise in a Contracting State where the payer of the fees for services is a resident of that State or where a non-resident payer has a permanent establishment in that State that bears the fees. The term "fees for services" is broadly defined in paragraph 3 to mean any payments in consideration for services of any type without any exclusions.

9. The adoption of Article 12AA is consistent with a shift away from threshold and physical presence requirements for source country taxation of income from cross-border services (other than technical services and automated digital services). Previously, a source country was entitled to tax income from such cross-border services only where the service provider had a permanent establishment or a fixed base in the source country through which the services were provided (or where the service provider stayed in the source country for 183 days or more in a twelve-month period under subparagraph (b) of paragraph 1 of the former Article 14). The Committee has decided that these threshold and physical presence requirements are inappropriate conditions for source country taxation of income from cross-border services in light of new business models for delivering services. As a result, these threshold requirements are not included in Article 12AA under which most fees for cross-border services are taxable by a country if the fees are paid by a resident of that country or by a non-resident with a permanent establishment in that country that bears those fees.

10. The elimination of threshold requirements based on physical presence for source country taxation of certain cross-border services is the fundamental goal of Article 12AA. That goal incorporates two distinct but complementary objectives: to make the provisions of the Convention dealing with those services more consistent and to expand source country taxing rights with respect to income from such services by removing some of the limits on those taxing rights imposed by the former Article 12A and Article 14.

11. Replacing the former Articles 12A and 14 by new Article 12AA simplifies the Convention significantly. It is no longer necessary for

taxpayers and tax officials to distinguish between fees for technical services taxable in accordance with the former 12A and certain other services, or between professional and other independent services taxable in accordance with former Article 14 and certain other services. The difficulties caused by the concept of a fixed base are eliminated completely. However, it remains necessary to distinguish between services covered by Article 12AA and services also covered by either subparagraph (a) or (b) of paragraph 3 of Article 5 and in this regard to determine the days during which a non-resident service provider furnishes construction or other services in a country. Some source countries may not be able to impose tax in accordance with Article 12AA unless they amend their domestic law to impose tax on non-residents deriving income from services provided to residents of their country (and to non-resident payers with a permanent establishment in the country) and also impose an obligation on those payers to withhold tax from the payments. The obligation to withhold from payments to non-resident service providers may be simplified for some payers because they are no longer required to determine whether their payments are for technical services, professional or other independent services, or other services. Payments for many services may be subject to tax at the same rate.

12. Article 12AA allows fees for services to be taxed by a Contracting State on a gross basis at a limited rate, which provides a simple, reliable and efficient method to enforce tax imposed on income from cross-border services derived by non-residents.

13. Article 12AA may result in residents of some Contracting States providing services to residents of other Contracting States requiring the grossing-up of the cost of those services to offset the tax imposed on the fees for services by the source country. However, such grossing up may not happen if it would make the non-resident service provider uncompetitive. On the argument that the tax may be passed on to the service recipient, the Committee noted that this may not be the case. The actual (economic) incidence of the tax as distinct from its legal incidence, as in case of any tax, may fall on labour, consumers or capital depending on supply and demand and market conditions. Countries should consider all these aspects in assessing the possibility that some fees for services may be grossed up, in the same way that they would assess the possibility of similar grossing-up with respect to interest and royalties under Article 11 and Article 12 of the Convention, respectively.

The possibility of grossing up is also a factor to be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for services under paragraph 2 of Article 12AA, as discussed in paragraph 31.

14. The taxation of fees for services, on a gross basis without any deductions, under Article 12AA should not result in double taxation, as that would be reduced or eliminated under Article 23 (Methods for the elimination of double taxation). The taxation of fees for services on a gross basis under Article 12AA should also not result in excessive taxation. The possibility of excessive taxation can be taken into account when negotiating the maximum rate of tax, under paragraph 2 of Article 12AA, that can be imposed by a Contracting State on fees for services and, depending on the maximum rate negotiated, the risk of excessive taxation may be reduced or completely eliminated. While Article 12AA allows for gross taxation of fees for services, where service providers qualify under paragraph 4 of Article 12AA, Article 7 (and, generally, net taxation) will apply.

15. Despite the inclusion of Article 12AA in the Model Tax Convention, a large minority of the members of the Committee did not agree with the policy justifications set forth above for Article 12AA.[71] Fundamentally, these members did not agree that changes in modern economies, particularly with respect to cross-border services which have enabled some non-resident service providers to be substantially involved in another State's economy without any physical presence in that State, justify the introduction of this Article. Rather, these members were of the view that in cases of payments for services that are not provided in the payer's State, there is not a sufficient nexus to that State that warrants taxation by that State of the payments. It was the view of these members that, as a policy matter, the taxation of fees for services by a State is justified only when a service provider has a sufficient nexus to the payer's State and that such a sufficient nexus generally means the services must be physically performed in that State. In other words, they believed that, to justify taxation of services by a State, the services must be physically provided in that State with the degree of nexus required by Article 7 and the former Article 14.

71 The decision to include that minority view in the Commentary was taken at the thirtieth session of the Committee held in March 2025.

16. However, in the opinion of those members, some countries might be willing to agree to include Article 12AA in their bilateral treaties if Article 12AA were limited to fees for services performed in a Contracting State. Accordingly, Article 12AA would apply to fees for services paid by a resident of one Contracting State to a resident of the other Contracting State under paragraph 2 of Article 12AA without any threshold requirement, such as a permanent establishment or fixed base in the first State, but the Article would apply only to fees for services performed in a Contracting State. Such an alternative, along with others, is described in paragraphs 108 and 109 below.

17. In addition, they were of the opinion that the reduction of the tax base of a Contracting State by the deduction of commercially justified payments for services is not a justification for that State to impose tax on those payments.

18. These members also disagreed with the argument that the introduction of Article 12AA can be justified because the uncertainty concerning the treatment of fees for cross-border services under prior versions of the Model Tax Convention may have resulted in difficult disputes, consuming scarce resources.

19. These members of the Committee were also concerned that the taxation of fees for services on a gross basis under Article 12AA can lead to excessive or double taxation. Article 12AA allows the taxation of certain fees for services to be shifted from net to gross taxation. These members considered that the imposition of tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection with the provision of the services, which would have been deductible if tax was imposed on a net basis. Thus, it is possible that the residence State's remedies with a view to relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State. Taxation on a gross basis is especially problematic because different types of service providers have different levels of expenses and the Article does not distinguish between high- and low-margin/loss-making businesses; gross-based taxation could exceed the profit margin and make the provision of the service unprofitable. For example, it could have unintended impacts on countries that export services such as low-value-added services. In practice, it will be very difficult to set the maximum rate of the taxation under this Article that will achieve

a fair level of taxation for a wide variety of service providers across all industry sectors. Further, the imposition of a gross-basis withholding tax (applied solely on payments before expense deductions) could hamper cross-border-trade in services, increase compliance costs and impede the growth of start-up businesses, important in an increasingly digitalized economy, and which often have losses in the early years.

20. As a matter of broader economic policy, these members were also concerned that, as a result of a gross-based tax on fees for services, consumers of services in the source State may encounter higher prices for services, including all financial services, because foreign service providers could pass added tax costs on to the consumer through means such as "gross-up" clauses in contracts. Typically, a gross-up clause will specify a net amount that the provider will receive, effectively passing the burden of any withholding tax on to the consumer of the services. The use of gross-up clauses could result in the tax being shifted to the consumer, making it more expensive to purchase the services. This can put a foreign service provider at a competitive disadvantage, effectively foreclosing access to a market that imposes such a withholding tax and restricting the consumer's legitimate choice of suppliers.

21. In the opinion of these members, countries sharing these concerns about the negative economic impact of taxation on a gross basis may wish to consider including an option for taxation on a net basis or an option similar to what is provided for in paragraph 3 of Article 12B.

22. These members were also concerned that certain design choices (such as retaining subparagraph (b) of paragraph 3 of Article 5, applying Article 12AA to small payments, and payments by individuals acquiring services for personal use, even if the service is provided, paid for and consumed outside the individual's state of residence) are inconsistent with the stated arguments for the policy objective and may significantly increase the administrative burden of the Article's application by some developing countries that have limited administrative capacity, without a clear indication that such choices will increase potential revenues to outweigh the cost of such choices. For example, the interaction of Article 12AA with subparagraph (b) of paragraph 3 of Article 5 will create administrative challenges both for the taxpayer and the tax administration resulting in tax withheld on a gross basis in accordance with Article 12AA having to be refunded and offset against the net

taxation on a permanent establishment under subparagraph (b) of paragraph 3 of Article 5. Further, introducing withholding obligations on individuals acquiring services for personal use will impose a significant administrative burden on individuals and be very difficult to control by the tax administration. Countries sharing these concerns may wish to consider not including subparagraph (b) of paragraph 3 of Article 5, including a threshold and/or excluding payments by individuals acquiring services for personal use from the application of Article 12AA, similar to the exclusion that was provided for in subparagraph (c) of paragraph 3 of the former Article 12A (Fees for technical services). Such simplifications and other alternatives proposed by these members are set out in paragraphs 16, 21 and this paragraph of this Commentary.

23. In summary, these members did not accept the arguments in paragraphs 9 to 14 above and regarded any expanded taxing jurisdiction on payments for services as an unjustified shift in the balance of taxation from the place where the services are provided to the residence of the payer. In their opinion, countries sharing these concerns may wish not to include Article 12AA in their bilateral tax treaties.

B. Commentary on the Paragraphs of Article 12AA

Paragraph 1

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

25. In most cases, the person who provides services receives fees for those services. If the person who receives fees for services is not the person who provides those services, it is a matter for the domestic law of the country in which the recipient of the fees is resident as to who is the proper taxpayer with respect to those fees. If fees for services are paid to a person, other than the person who provides the services, paragraph 1 of Article 12AA applies to the fees as long as the recipient is a resident of the other Contracting State.

26. The expression "fees for services" is defined in paragraph 3 of Article 12AA to mean any "payment" for any services. The term

"payment" has a broad meaning consistent with the meaning of the related term "paid" in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 and paragraph 6 of the Commentary on Article 11, the concept of payment means the fulfilment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

27. Article 12AA deals only with fees for services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to fees for services arising in a third State. Paragraph 5 and paragraph 6 of Article 12AA specify when fees for services are deemed to arise in a Contracting State and are deemed not to arise in a Contracting State, respectively. Under paragraph 5, fees for services are considered to arise in a Contracting State if they are paid by a resident of that State or if they are borne by a permanent establishment in that State of a person resident in another State. However, paragraph 5 is subject to paragraph 6, under which fees for services paid by a resident of a Contracting State are deemed not to arise in that State if they are borne by a permanent establishment that the resident has in the other Contracting State.

Paragraph 2

28. This paragraph lays down the principle that the Contracting State in which fees for services arise may tax those payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the fees is a resident of the other Contracting State, the amount of tax imposed by the State in which the fees for services arise may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the fees.

29. When considered in conjunction with Article 23 (Methods for the elimination of double taxation), paragraph 2 establishes the primary right of the country in which fees for services arise to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the fees is a resident of the other Contracting State). Accordingly, the country in which the recipient of the fees is resident is obligated to prevent double taxation of those fees. Under Article 23 A or Article 23 B, the residence country is required to provide relief from double taxation through the exemption

from tax of the fees for services or through the granting of a credit against tax payable to the residence country on the fees for services for any tax imposed on those fees by the other Contracting State in accordance with Article 12AA. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under paragraph 2 of Article 23 A with respect to items of income taxable under Article 10, 11, 12, 12AA, 12B, or 12C.

30. The decision not to recommend a maximum rate of tax on fees for services is consistent with Articles 8 (Alternative A), 10, 11, 12, 12B, and 12C of the Convention dealing with income from shipping or air transport in international traffic, dividends, interest, royalties, income from automated digital services, and insurance premiums, respectively, as well as the former Article 12A dealing with fees for technical services. This decision can be justified under current treaty practice. The tax rates on fees for services adopted in bilateral tax treaties between developed and developing countries may vary widely. Thus, the maximum rate of tax on fees for services is to be established through the bilateral negotiations of the Contracting States. As a result, for example, countries may consider adopting a lower maximum rate of tax on services that generate relatively low profit margins.

31. In determining the maximum rate of tax on fees for cross-border services, countries should take into account several factors, including the following:

— The possibility that a high rate of tax imposed by a Contracting State might cause residents of the other State providing services to pass on the cost of the tax to customers in the first State, which would mean that the first State would increase its tax revenue at the expense of its own residents rather than the residents of the other State. However, as discussed in paragraph 13, such an eventuality is not inevitable and would depend on supply and demand and the market conditions.

— The possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter some residents of that country from carrying on their business of providing services in the other country.

— The possibility that some persons providing services may incur high costs in providing services, so that a high rate of tax on

the gross fees may result in an excessive effective tax rate on the net income derived from the services. There is also the possibility that a very low tax rate on the gross fees may result in an inappropriately low effective tax rate for the source country on the net income from high margin services. The countries should therefore consider both these competing scenarios and agree to a tax rate that works in most situations for both countries.

— The potential benefit of applying the same rate of tax both to royalties under Article 12, payments for automated digital services under Article 12B, and fees for services under Article 12AA (see example 6 in paragraphs 76 to 78 below).

— The fact that a reduction of the rate of tax has revenue and foreign-exchange consequences for the country imposing withholding tax.

— The relative flows of fees for cross-border services between countries.

32. Paragraph 2 of Article 12AA applies in priority to Article 7 as a result of paragraph 6 of Article 7. Thus, the conditions for the taxation of the business profits of an enterprise under Article 7 do not apply to fees for services covered by paragraph 2. Fees for services are taxable by a Contracting State under paragraph 2 if the fees arise in that State. This is the case irrespective of whether the enterprise providing the services has a permanent establishment in that State, provides services that are similar to those effected through the permanent establishment or provides the services in that State. However, by virtue of paragraph 4 of Article 12AA, if an enterprise of a Contracting State provides services that are effectively connected with a permanent establishment in the other Contracting State and receives fees for those services within the meaning of paragraph 3, Article 7 applies to those payments instead of paragraph 2 of Article 12AA.

33. Paragraph 2 is expressly subject to the provisions of Articles 8, 12B, 12C, 15, 16, 17, 18, and 19. As a result, where fees for services are within the scope of the provisions of one of those listed Articles, that Article applies to those services instead of Article 12AA. Where, however, fees for services are outside the scope of those Articles, the fees are potentially taxable under Article 12AA. For example, where an individual resident in one Contracting State receives directors' fees

or remuneration as a top-level managerial official paid by a company resident in the other Contracting State, Article 12AA does not apply to the fees or remuneration because paragraph 2 is expressly subject to the provisions of Article 16. If, however, the payments are not within the scope of Article 16 (because, for example, the payments are made with respect to services provided by the individual in a capacity other than that of a director or top-level managerial official of the company), the other State is entitled to tax those payments in accordance with paragraph 2 of Article 12AA.

34. Where one of the provisions to which paragraph 2 of Article 12AA is subject is not included in a bilateral tax treaty, paragraph 2 of Article 12AA applies to the services that would have been covered by that article. For example, where a bilateral treaty includes Article 12AA but does not include Article 12B or Article 12C, paragraph 2 of Article 12AA will not refer to Article 12B or Article 12C and as a result, any payments underlying income from automated digital services or any insurance premiums that would have been covered by Article 12B or by Article 12C will be within the scope of Article 12AA.

35. The beneficial owner requirement is included in paragraph 2 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over fees for services merely because those fees were paid directly to a resident of another State with which the first State had concluded a convention.

36. Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

37. For example, where the trustees of a discretionary trust do not distribute fees for services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such fees for the purposes of Article 12AA even if they are not the beneficial owners under the relevant trust law.

38. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

39. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

40. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the fees for services is not the "beneficial owner" because that recipient's right to use and enjoy the fees is constrained by a contractual or legal obligation to pass on the fees received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to

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

41. The fact that the recipient of fees for services is considered to be the beneficial owner of those fees does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of that benefit, such as those addressed by the general anti-abuse rule of paragraph 9 of Article 29. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on fees for services to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

42. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph (*a*) of

paragraph 2 of Article 10 which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, 12AA, 12B, and 12C, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends, interest, royalties, fees for services, income from automated digital services, and insurance premiums, rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".

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

44. The following examples illustrate the application of paragraph 2 of Article 12AA.

45. *Example 1:* X is a resident of State R and a heart surgeon. X's practice is carried on primarily in State R, although X occasionally travels to other countries to perform heart surgery. X performs surgery in State R on an individual resident in State S. The tax treaty between State R and State S contains a provision identical to Article 12AA. The payments made by the patient, a resident of State S, to X would be considered to be "fees for services" as defined in paragraph 3 that arise in State S. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article 12AA.

46. The result in Example 1 would be the same if X travelled to State S and performed the surgery in State S unless the services provided by X were effectively connected with a permanent establishment in State S through which X carried on business, in which case Article 7 would apply by virtue of paragraph 4 of Article 12AA.

47. *Example 2:* X is a resident of State R and a heart surgeon. X's practice is carried on primarily in State R, although X occasionally

travels to other countries to perform heart surgery. X enters into a contract with a health services company resident of State S under which X agrees to perform heart surgery on patients referred to her by the health services corporation. X is not an employee of the health services company. The surgeries are performed both in State S and in State R. The tax treaty between State R and State S contains a provision identical to Article 12AA. Under paragraph 3 of Article 12AA, the payments made by the health services company, a resident of State S, to X would be considered to be fees for services that arise in State S under paragraph 5, irrespective of whether the surgery is provided in State S, State R or a third State. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article 12AA. If, however, X were an employee of the health services company, the payments to X would not be taxable by State S under Article 12AA because the application of paragraph 2 is expressly subject to Article 15.

48. *Example 3:* R Company is a resident of State R. R Company's business is the collection, organization and maintenance of various databases. R Company sells access to these databases to its clients. One of R Company's clients is S Company, a resident of State S. State R and State S have entered into a tax treaty that contains a provision identical to Article 12AA. The payments that R Company receives from S Company for access to its databases would be fees for services within the meaning of paragraph 3. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article 12AA (assuming that the services are not automated digital services within the meaning of Article 12B). Article 12AA would also apply to the fees payable by S Company to R Company for the services performed by R Company in creating and providing access to a specialized database customized for S Company. It would not matter whether R Company performed all or any part of the work involved in creating the database in State S.

Paragraph 3

49. This paragraph specifies the meaning of the phrase "fees for services" for purposes of Article 12AA. The definition of "fees for services" in paragraph 3 is intended to be exhaustive. However, the application of paragraph 2 of Article 12AA to fees for services is limited to the payments described in paragraph 3 of Article 12AA that are not within the scope of other specific Articles of the Convention, namely,

Article 8, 12B, 12C, 15, 16, 17, 18, or 19 because paragraph 2 is expressly stated to be subject to the application of those other Articles; (see the examples in paragraphs 73 to 82 below).

50. Paragraph 3 defines "fees for services" broadly as "any payment in consideration for any service." However, fees for services that are within the scope of Article 8, 12B, 12C, 15, 16, 17, 18, or 19 of the Model are not within the scope of Article 12AA because paragraph 2 is subject to those Articles.

51. The definition of "fees for services" does not include a reference to the domestic law of a Contracting State. The lack of any reference to domestic law is justified because:

(*a*) the definition in paragraph 3 generally covers most payments that are regarded as payments for services under the domestic law of most countries;

(*b*) such a reference could introduce a large element of uncertainty;

(*c*) future changes in a country's domestic law with respect to the taxation of fees for services could otherwise have an effect on the Convention; and

(*d*) in the Model, reference to domestic laws should be avoided as far as possible.

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

53. Although paragraph 2 of Article 3 of the Model provides that, as regards the application of the Convention at any time, the meaning of an undefined term in the Convention should be the meaning at that time under the domestic law of the Contracting State applying the Convention, that rule is expressly subject to the caveat "unless the context requires otherwise." A state may choose not to impose tax on

certain fees for services under its domestic law because the definition of "services" under its domestic law is narrower than the definition in paragraph 3 of Article 12AA of the Convention without creating any conflict between its domestic law and the Convention. However, if the Contracting State in which the recipient of fees for services is resident applies a narrow domestic law meaning, it would nevertheless be required to provide relief from double taxation under Article 23 for the tax imposed by the other State on the fees; the context of the treaty would require a broader meaning of services for purposes of the treaty. Thus, a domestic law meaning of services that is limited to certain types of services would be inconsistent with the purpose of Article 12AA, and the context of Article 12AA and the Convention as a whole would require a broader meaning. Conversely, it would be similarly inconsistent with the treaty for a Contracting State to apply a domestic law meaning of "services" which includes sources of income that are not within the ordinary meaning of services.

54. Although the term "services" is intended to have a broad meaning, it is not intended to include activities where one person provides the use of immovable, tangible or intangible property, or lends money, to another person. The activity of leasing or licencing the use of property does not usually involve the furnishing of services by the owner of the property or, where the owner of the property does provide services, those services are usually ancillary to the use of the property. Where the owner of property provides extensive services to the lessee that go beyond ancillary services, it may be necessary to apportion the payments by the lessee between the consideration for the use of the property and the consideration for the services. See paragraph 12 of the Commentary on Article 12 for more guidance on such mixed contracts.

55. Similarly, the lending of money does not involve the lender providing services to the borrower; the lender simply provides the use of the funds to the borrower for a period of time. However, other financial services, such as the provision of a guarantee, may be services subject to Article 12AA.

56. Although the provision of insurance by an insurer to a person is within the broad meaning of services for purposes of Article 12AA, insurance premiums within the scope of Article 12C are effectively excluded from paragraph 2 of Article 12AA because paragraph 2 is

subject to Article 12C. However, fees for insurance services that are not covered by Article 12C are potentially within the scope of paragraph 2 of Article 12AA. For example, Article 12C applies only to insurance premiums paid to an "insurer", defined in paragraph 3(b) of Article 12C as a person or arrangement that derives the majority of its income from insurance premiums, reinsurance, and annuity contracts and investment income related thereto. As a result, fees for insurance paid by a resident of a Contracting State to a person resident in the other Contracting State, other than such an insurer, may be taxed in the first State in accordance with Article 12AA. The definition of "insurance premiums" in subparagraph (*a*) of paragraph 3 of Article 12C excludes amounts paid for an annuity or insurance contract that has a substantial investment component. Although such amounts are excluded from Article 12C and, as a result, are not covered by the wording of paragraph 2 of Article 12AA, which makes that paragraph subject to Article 12C, such amounts would not be covered by Article 12AA because they represent acquisitions of property rather than fees for services.

57. By reason of the broad definition of "fees for services" in paragraph 3, Article 12AA applies to all payments for services, including payments by individuals for services for the personal use of an individual. The inclusion of payments by individuals for services for the personal use of an individual within the scope of Article 12AA is consistent with Article 12B, which applies to payments by individuals for automated digital services. Many countries are unlikely to impose tax under their domestic law on payments by individuals for personal services provided outside their territory by non-residents. However, Article 12AA does not prevent countries from doing so.

58. Countries that wish to exclude payments by individuals for services used or consumed by an individual or other payments from Article 12AA could do so by adding the words "unless the payments are" or "except for" at the end of paragraph 3 and then listing the payments for services to be excluded in a general manner. For example, countries that prefer not to tax fees paid by an individual for services for the personal use of an individual could revise paragraph 3 to read as follows:

> 3. The term "fees for services" as used in this Article means any payment in consideration for any service, unless the payment is made by an individual in consideration for services for the personal use of an individual.

The meaning of the phrase "services for the personal use of an individual" is not defined. Such services would include services related to a person's health, education, maintenance, and entertainment. The exclusion is not limited to services provided to the individual who pays for them but includes payments for the benefit of other individuals, such as family members.

59. Some members of the Committee were concerned that the different sourcing rules of Article 12AA and Article 8 (Alternative A) may create the possibility of multiple source taxation with respect to the income from the operation of ships or aircraft in international traffic. In their bilateral treaties that include Article 8 (Alternative A), countries that share this concern could delete the reference to Article 8 in paragraph 2 of Article 12AA, and revise paragraph 3 to exclude such income from the definition of "fees for services" by adding the following wording at the end of paragraph 3: "unless the payment is made in respect of income from the operation of ships or aircraft in international traffic as defined in paragraph 3 of Article 8." With this exclusion, income as defined in paragraph 3 of Article 8 (Alternative A) would not be subject to different sourcing rules, thus avoiding multiple source taxation.

60. The definition of "fees for services" does not exclude payments for teaching in an educational institution or teaching by an educational institution, although the definition of "fees for technical services" in paragraph 3 of the former Article 12A excluded such services. Thus, if an educational institution established in one Contracting State pays for teaching services provided by an individual, (other than as an employee,) or by an enterprise resident in the other Contracting State, the payments made by the educational institution for those teaching services are taxable by the first State in accordance with paragraph 2. Similarly, if an educational institution established in one Contracting State receives payments from an enterprise resident in the other Contracting State for teaching services provided by that institution to some of the enterprise's employees, the payments received by the educational institution for those teaching services are fees for services taxable under paragraph 2 of Article 12AA. Payments (such as tuition fees) by an individual to an educational institution for services provided by that institution to an individual are also subject to Article 12AA because payments by individuals for services, even services of a personal nature, are not excluded from the definition of "fees for services" in paragraph 3.

61. Some countries may be concerned about taxing educational institutions on fees for teaching services provided by such institutions or about taxing fees for teaching services paid by such institutions. These countries may wish to include a provision in paragraph 3 to exclude payments made "by an educational institution for teaching in an educational institution or received for teaching by an educational institution," similar to the exclusion in paragraph 3 of the former Article 12A.

62. The treatment of reimbursements of expenses for purposes of the definition of "fees for services" in paragraph 3 of Article 12AA poses special difficulties. As an initial matter, it is important to distinguish between an allowance for expenses and the reimbursement of expenses. An allowance is an amount usually established in advance for which the recipient of the allowance is not obligated to account; a per diem allowance for meals and accommodation is an example of a typical allowance. Since the recipient of an allowance does not have to account for the actual expenses incurred, any allowance received by a person for services performed by that person is included within the meaning of "fees for services" under paragraph 3.

63. The reimbursement of expenses is different from an allowance because the person must account for the actual expenses incurred, and only those actual expenses qualify for reimbursement. The issue is whether payments received in reimbursement of actual expenses incurred in connection with the provision of services are included in the definition of "fees for services" for purposes of Article 12AA.

64. First, a person may be reimbursed for expenses incurred in connection with providing services, but may not receive any other compensation for those services. For example, an individual resident in one Contracting State might be invited to speak at a conference or participate in a meeting in the other Contracting State and might be reimbursed for his or her travel expenses, but not receive any other compensation. In these circumstances, it seems difficult to justify imposing tax on a person who receives only the reimbursement of actual expenses incurred. However, unless reimbursements are explicitly excluded from the definition of "fees for services", paragraph 2 would permit the State in which the reimbursement arises to impose tax on the reimbursement at the rate specified in the treaty.

65. Second, a resident of one Contracting State may be paid a fee and separately reimbursed for all the expenses incurred in providing services to a resident of the other Contracting State. In these circumstances, if reimbursements are excluded from the definition of "fees for services", the tax imposed by the State in which the fees arise would be limited to the amount of the fee. On these facts, the fee represents the entire net profit of the taxpayer performing the services. However, the maximum limit on the tax imposed under paragraph 2 is based on the gross amount of the payments, and the rate of tax specified in Article 12AA may have been established on the assumption that the fees represent the non-resident's gross revenue. As a result, if reimbursements are excluded from the definition of "fees for services", the maximum rate of tax agreed to by the Contracting States may be too low. Moreover, the exclusion of reimbursements from the definition of "fees for services" might lead to abuses. For example, in order to reduce the source country's tax, a taxpayer providing services might receive payments labelled as reimbursements that are actually fees or might be reimbursed for expenses for which they would not ordinarily be reimbursed. Preventing these types of abuses would impose a significant administrative burden on the tax authorities.

66. Third, a resident of one State providing services to a resident of the other Contracting State might not be reimbursed for any of the expenses incurred in providing the services. In this case, the amount of the payment received by the resident providing the services may be greater than the amount of that resident's net profit. The maximum rate of withholding tax in paragraph 2 may have been agreed to on the assumption that some of the expenses incurred by the person providing the services would be reimbursed. On this assumption, the maximum rate of withholding tax may be established at a higher rate than it otherwise would be in order to approximate the amount of tax on the person's net profit. Therefore, if reimbursements are excluded from the definition of "fees for services", the rate established in the treaty might be too high for a person providing services that receives no reimbursement for expenses.

67. The issues discussed in paragraphs 63 to 66 above are illustrated in the example in paragraph 68 below, which shows that the effect of a gross-based tax on fees for services depends, in part, on whether payments in reimbursement of expenses are subject to tax and the extent to which service providers are reimbursed for their expenses.

68. *Example 4:* X, a resident of State A, is a management consultant, who provides advice to companies concerning best practices for corporate governance. X enters into a contract to provide services to BCo, a public company resident in State B, for a period of 60 days for fees of 5,000 per day plus the reimbursement of all reasonable expenses incurred in providing the services. X receives fees of 300,000 from BCo and a payment of 250,000 in reimbursement for expenses. As a result, in this situation, X's net profit from the services provided to BCo is 300,000. Assume that State A and State B have entered into a tax treaty with provisions identical to those of Article 12AA, which allows the imposition of tax on fees for services at a maximum rate of 5 per cent. On these facts, assuming that the payment in reimbursement for X's expenses is not considered to be fees for services, State B would be entitled to impose tax of 15,000 of the fees received by X, which represents a tax rate of 5 percent on X's net profit earned in State B. State A would be entitled to impose tax on X's fees for services subject to an obligation to provide a credit for the tax imposed by State B on those fees. Alternatively, assuming that the payment of 250,000 in reimbursement of X's expenses is also considered to be part of X's fees for services subject to tax under Article 12AA, State B would be entitled to impose tax of 27,500, which represents a tax rate of over 9 per cent on X's net profit. If X did not receive any reimbursement for expenses, State B's tax would be 15,000, representing a tax rate of 30 percent on X's net profit of 50,000 irrespective of whether payments in reimbursement of expenses are subject to tax under Article 12AA as fees for services.

69. It appears to be extremely difficult to predict to what extent, on average, persons providing services are expressly and separately reimbursed for their expenses. As a result, any single rule for the treatment of reimbursements will operate improperly in some situations. On the one hand, if reimbursements are excluded from the definition of "fees for services", the rate of tax agreed to in the treaty might be too low where most or all of a taxpayer's expenses are reimbursed, but too high where none of the expenses are reimbursed. Also, if reimbursements are excluded, taxpayers might try to disguise part of their fees as reimbursements of expenses, and it might be difficult for the tax authorities to detect such abuses. On the other hand, if reimbursements are not excluded, the rate of tax agreed to in the treaty might be too high where a taxpayer's expenses are reimbursed, but too low where they are not reimbursed.

70. As a result of the difficulties described in the foregoing paragraphs, the solution that has been adopted is to omit any reference to the reimbursement of expenses in the definition of "fees for services" in paragraph 3 of Article 12AA. However, countries are encouraged to consider adopting a common approach for the treatment of reimbursements in their bilateral treaties and to take the issue into account in establishing the maximum rate of tax under paragraph 2 of Article 12AA.

71. It is sometimes necessary to distinguish between fees for services and royalties in order to determine whether Article 12 or Article 12AA of the Convention is applicable. The distinction between fees for services and royalties is clear in principle. Under paragraph 3 of Article 12, royalties are payments for the use, or the right to use, certain types of property or for information concerning industrial, commercial or scientific experience (so-called know-how). In contrast, the performance of services does not involve one person allowing another person to use property or any transfer of the right to use property to another person. However, in practice, it is often difficult to distinguish between royalties and fees for services, especially with respect to so-called mixed contracts. Guidance with respect to the distinction between fees for services and royalties is provided in paragraph 12 of the Commentary on Article 12 of this Model, which reproduces paragraphs 11.2 – 11.6 of the Commentary on Article 12 of the 2017 OECD Model (see also Examples 6 and 7 below).

72. The following examples illustrate the application of the definition of "fees for services" in paragraph 3.

73. *Example 5:* R Company is a financial institution resident of State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, credit and debit cards, payment and transmission services, banker's drafts, guarantees, foreign exchange, negotiable instruments, derivative products, investment research and advisory services. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty that includes Article 12AA.

74. The payments received for services provided by a financial institution are clearly fees for services within the meaning of paragraph 3

of Article 12AA. Note, however, that if R Company provides the services through a permanent establishment located in State S, the fees received for those services would be taxable by State S in accordance with Article 7 rather than Article 12AA by virtue of paragraph 4 of Article 12AA.

75. Where a financial institution receives interest in consideration for lending funds to a client for a period, the interest is not considered to be fees for services because, as explained in paragraph 55, the financial institution has simply allowed its client to use its property for a period; it has not performed any services for the client. This result would also apply where an enterprise resident of one State receives rent for allowing a client resident in another State to use property owned or leased by the enterprise for a period.

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

— provide the production procedures and assist S Company in carrying out those procedures and

— provide specifications concerning the necessary materials, tools, and containers used in the production process.

77. R Company also agrees to use its best efforts to ensure that S Company is able to produce the industrial substance in the quantities and with the characteristics that S Company expects. State S and State R have entered into a tax treaty with a provision identical to Article 12AA.

78. In Example 6, the payments by S Company to R Company for the right to use the patented formula would be royalties within the meaning of paragraph 3 of Article 12, and not fees for services. However, the payments for the services provided by R Company to S Company would not be royalties assuming that R Company is not transferring any property or right to use property to S Company. On the facts of Example 6, R Company is using its specialized knowledge, skill and experience on behalf of S Company and guaranteeing the result of S

Company's use of the patented chemical formula. Consequently, the payments made by S Company to R Company for the services are fees for services within the meaning of paragraph 3 and State S would be entitled to impose tax on those fees under paragraph 2 of Article 12AA.

79. The addition of Article 12AA to the Model in 2025 not only eliminates the necessity to distinguish between fees for consulting, technical, and management and certain other services but may also reduce the significance of the distinction between royalties and fees for services. If the limits on the rate of tax in paragraph 2 of Article 12 and in paragraph 2 of Article 12AA are the same, it does not matter whether a particular payment is characterized as a royalty or as fees for services. However, where the limits on the rates of tax in paragraph 2 of Article 12 and in paragraph 2 of Article 12AA are not the same, it is important to determine whether a particular payment is a royalty or fees for services,

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

81. *Example 7:* S Company, a resident of State S, enters into a contractual arrangement with R Company, a resident of State R, to acquire the use of a secret formula or process developed by R Company. The contract requires R Company to provide the information to S Company subject to strict confidentiality conditions and to use its specialized knowledge and expertise to train employees of S Company with respect to the use of the secret formula or process. State R and State S have entered into a tax treaty with provisions identical to those of the Model, including those of Article 12 and Article 12AA.

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

be payments for "information concerning industrial, commercial or scientific experience" within the meaning of the definition of "royalty" in paragraph 3 of Article 12, since the training is necessary to transfer R Company's know-how to S Company. Therefore, irrespective of whether the payments for the training are provided separately from the payments for the secret formula or process or whether the contract provides for a single payment for both, the payments for the training would be considered to be royalties under Article 12 rather than fees for services under Article 12AA. However, if the training provided by R Company was not necessary to transfer the secret formula or process to S Company and S Company could obtain such training from other sources, the training would not be considered to be a transfer of know-how and the payments for the services would be considered fees for services within the definition in paragraph 3 of Article 12AA.

Paragraph 4

83. This paragraph provides that paragraphs 1 and 2 do not apply to fees for services if the person who provides the services has a permanent establishment in the State in which the fees arise and the fees are effectively connected with that permanent establishment. In this regard, paragraph 4 of Article 12AA is similar to paragraph 4 of Articles 10, 11 and 12, paragraph 8 of Article 12B, and paragraph 4 of Article 12C. Thus, if a resident of one Contracting State provides services through a permanent establishment located in the other Contracting State, the fees received for those services are taxable by the State in which the permanent establishment is located in accordance with Article 7, rather than in accordance with Article 12AA.

84. Since Article 7 of the Model adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 4 also makes paragraphs 1 and 2 of Article 12AA inapplicable if the fees for services are effectively connected with business activities in the State in which the fees arise that are of the same or similar kind as those effected through the permanent establishment.

85. The paragraph does not define the meaning of the expression "effectively connected". As a result, whether fees for services are effectively connected with a permanent establishment or business activities similar to those carried on through a permanent establishment must

be determined on the basis of all the relevant facts and circumstances of each case. In general, fees for services would be considered to be effectively connected with a permanent establishment if the services are closely related to or connected with the permanent establishment. Also, fees for services would be effectively connected with business activities referred to in subparagraph (c) of paragraph 1 of Article 7 where the services are provided by an enterprise as part of that enterprise's business activities carried on in a Contracting State where a permanent establishment of that enterprise is situated, and these activities are of the same or similar kind as the business activities performed through that permanent establishment.

86. Where paragraph 4 applies, fees for services are taxable by the State in which the fees arise as part of the profits attributable to the permanent establishment in accordance with Article 7. Thus, paragraph 4 relieves the Contracting State in which the fees for services arise from the limitations on its taxing rights imposed by Article 12AA. Where Article 7 applies as a result of the application of paragraph 4, most countries consider that the State in which the permanent establishment is located is allowed to tax only the profits from the services attributable to the permanent establishment determined on a net basis, although the rate of tax is not limited. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis, but a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination).

87. Construction activities provided by a resident of one Contracting State in the other Contracting State to a resident of that State or a non-resident with a permanent establishment in that State in connection with a construction, assembly or installation project or supervisory activities connected with such a project for more than six months are considered to be a permanent establishment under subparagraph (a) of paragraph 3 of Article 5 of the Model. In this situation, any profits attributable to the permanent establishment are taxable in accordance with Article 7, instead of Article 12AA, as a result of paragraph 4 of Article 12AA. However, where the construction activities are not performed in the other State for more than six months, the conditions of subparagraph (a) of paragraph 3 of Article 5 are not met and paragraph 4 of Article 12AA would not apply. As a result, paragraph 2 of Article 12AA would apply to allow the Contracting State in which

the payer is resident or has a permanent establishment that bears the fees for the construction services to tax those fees at the applicable rate on the gross amount of the fees irrespective of whether the services are performed inside or outside that State. Article 12AA does not apply to construction activities by a resident of one Contracting State in the other State where the activities involve property owned by that resident since in this situation no services are provided by one person to another person as required by Article 12AA.

88. Countries may wish to impose tax on fees for construction services paid to a resident of the other Contracting State from the first day on which such fees are payable, on the basis that the construction project may not last for more than six months. Accordingly, they may impose an obligation on the payer to withhold the required amount of tax from the fees. However, if the construction project lasts for more than six months, as explained above, the fees attributable to the permanent establishment are taxable on a net basis under Article 7 and the permanent establishment is considered to exist from the start of the construction project (see paragraph 44 of the Commentary on Article 5 of the OECD Model, as quoted in paragraph 15 of the Commentary on Article 5). As a result, the amounts collected by those countries through withholding at source during the first six months would have to be applied to the tax payable by the service provider under Article 7 and any excess would have to be refunded to the service provider.

89. On one hand, to avoid the obligation to refund withholding taxes, states might consider not imposing any obligation to withhold from fees for construction services for the first six months of any construction project. On the other hand, states should be aware of the risk that if there is no obligation to withhold tax and a construction project does not last for six months, it may be difficult to collect the tax from non-resident persons providing the construction services after it is determined that the project has not resulted in a permanent establishment.

90. Similar issues are more likely to arise in connection with permanent establishments under subparagraph (b) of paragraph 3 of Article 5 because subparagraph (b) of paragraph 3 of Article 5 applies to all types of services unlike subparagraph (a) of paragraph 3 of Article 5 which is limited to construction and related activities. Whether subparagraph (b) of paragraph 3 of Article 5 applies to consider

a resident of one Contracting State providing services in the other Contracting State to have a permanent establishment in that other State depends solely on the number of days that the services are furnished in the other State. As a result, Article 12AA applies where a resident of one Contracting State provides services to a resident of the other State (or to a non-resident with a permanent establishment in the other State that bears the fees) if the services are provided:

(a) outside the other State, or

(b) inside the other State for 183 days or less in any twelve-month period.

91. To effectively collect tax imposed in accordance with Article 12AA, countries may consider imposing an obligation on the payer to withhold tax from all payments for services made to non-residents (other than payments for any services expressly excluded from the scope of Article 12AA). However, the services may have been provided in a Contracting State for more than 183 days in which case the resident of the other Contracting State providing the services would be deemed to have a permanent establishment in that country (assuming that the treaty contains a provision comparable to subparagraph (b) of paragraph 3 of Article 5). Since the person providing the services has a permanent establishment in the other State in this situation, the fees for services are taxable by that other State under Article 7 to the extent they are attributable to the permanent establishment (which may include fees for services performed in that other State). Once the 183-day threshold in subparagraph (b) of paragraph 3 of Article 5 is met, the permanent establishment is deemed to have existed from the first day during which services were performed by the service provider in that State (paragraph 44 of the Commentary on Article 5 of the OECD Model, as quoted in paragraph 15 of the Commentary on Article 5). Ordinarily, the non-resident person providing the services would be required to file a tax return to determine the amount of tax payable on the profits attributable to the permanent establishment under the domestic law of the country in which the permanent establishment is located. Any tax withheld on the basis that Article 12AA applied to the fees for services would normally be treated as a payment on account of the tax payable. The non-resident person providing the services would be required to pay the amount of any shortfall or would be entitled to a refund with respect to any excess tax withheld.

92. Any tax imposed by a State in accordance with Article 12AA on fees for services performed by a resident of the other Contracting State with a permanent establishment in the first State is not pre-empted by Article 7 where the fees are not attributable to the permanent establishment. This may be the case where the services are performed outside the State in which the permanent establishment is located (for example, where the services are performed in the State where the person providing the services is resident). Withholding agents in one Contracting State cannot reasonably be expected to know whether or to what extent fees for services paid to a resident of another Contracting State are attributable to that resident's permanent establishment in the first state; as a result, countries may wish to impose an obligation on payers to withhold from all payments for services made to non-residents. However, such countries would need to establish an administrative system to refund taxes withheld inappropriately where it is established subsequently that the non-resident providing the services has a permanent establishment in their country, to the extent that the amount withheld exceeds the tax payable on the profits attributable to the permanent establishment.

Paragraphs 5 and 6

93. Paragraph 5 lays down the principle that the State in which fees for services arise for purposes of Article 12AA is the State of which the payer of the fees is a resident or the State in which the payer has a permanent establishment if the fees for services are borne by the permanent establishment. It is not necessary under paragraph 2 for the services to be provided in the Contracting State in which the payer is resident or has a permanent establishment. Whether a person is a resident of a Contracting State for purposes of Article 12AA is determined in accordance with the provisions of Article 4 of the Convention.

94. Where there is an obvious economic link between services being provided and the permanent establishment of the payer to which the services are provided, the fees for services are considered to arise in the Contracting State in which the permanent establishment is situated. This result applies irrespective of the residence of the person to which the permanent establishment belongs, even where that person resides in a third State.

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

96. Paragraph 5 is subject to paragraph 6, which provides an exception to the source rule in paragraph 5. Paragraph 6 deems fees for services paid by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State and the fees for services are borne by that permanent establishment. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for services under paragraph 2 of Article 12AA.

97. The phrase "borne by" must be interpreted in the light of the underlying purpose of paragraphs 5 and 6, which is to provide source rules for fees for services. A Contracting State is entitled to tax fees for services under paragraph 2 only if the fees arise in that State. The basic source rule in paragraph 5 is that fees for services arise in a Contracting State where the payer is a resident of that State or the payer has a permanent establishment in that State and the fees for services are borne by that permanent establishment. However, the basic rule is limited by the deeming rule in paragraph 6 where the payer is a resident of a Contracting State but the fees for services are borne by a permanent establishment that the payer has in the other Contracting State.

98. Where fees for services are incurred for the purpose of a business carried on through a permanent establishment, those fees usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7. The deductibility of the fees for services provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment is situated.

99. The fact that the payer has, or has not, actually claimed a deduction for the fees for services in computing the profits of the permanent establishment is not necessarily conclusive, since the proper test is whether any deduction available for those fees should be taken into account in determining the profits attributable to the permanent establishment. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the fees for services are not deductible for some reason other than the fact that the fees for services should not be allocated to the permanent establishment.

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

101. *Example 8:* R Enterprise is carried on by a resident of State R. R Enterprise provides services to S Company, a resident of State S. The tax treaty between State R and State S is identical to the Model, including Article 12AA. S Company carries on business in State S and in State R through a permanent establishment situated in State R. However, the services provided by R Enterprise to S Company are related to S Company's business carried on in State S, not to the business carried on through S Company's permanent establishment in State R.

102. In Example 8, since the payments are made by S Company, a resident of State S, and are not borne by a permanent establishment of S Company in State R, the fees for services would be considered to arise in State S in accordance with paragraph 5. Therefore, State S would be entitled to tax the fees for services under paragraph 2 of Article 12AA.

103. *Example 9:* The facts are the same as in Example 8, except that the fees for services are borne by S Company's permanent establishment in State R.

104. In Example 9, since the fees for services are borne by a permanent establishment of S Company situated in State R, paragraph 6 of Article 12AA applies to deem the fees for services not to arise in State S. Consequently, the fees for services are not taxable by State S under paragraph 2 of Article 12AA but are taxable exclusively by State R under paragraph 1 of Article 12AA.

105. In Example 9, Article 12AA of the Convention denies State S the right to tax the fees for services although the fees are paid by a resident of State S. This result is justified because the fees relate to a business carried on by a resident of State S through a permanent establishment in State R. In such a situation, where fees for services are deductible in computing the profits of a business attributable to a permanent establishment situated in State R, those payments have a closer economic connection to the activities carried on in State R than to State S.

106. *Example 10:* T Enterprise is carried on by a resident of State T. T Enterprise carries on business through a permanent establishment situated in State S. T Enterprise pays R Company, a resident of State R, for services provided by R Company for T Enterprise in connection with its income-earning activities carried on in State S. The payments made by T Enterprise to R Company for the services are deductible in computing the profits attributable to the permanent establishment of T Enterprise in State S. The tax treaty between State S and State T includes a provision identical to Article 12AA.

107. In Example 10, although the fees for services are not paid by a resident of State S, the fees are borne by the permanent establishment that T Enterprise has in State S. In these circumstances, the fees for services have a close economic connection to the income-earning activities of T Enterprise carried on in State S. Thus, the fees are deemed to arise in State S in accordance with paragraph 5 and State S is entitled to tax the payments in accordance with paragraph 2 of Article 12AA.

108. In the case of interest and royalties, paragraph 26 of the Commentary on Article 11 and paragraph 44 of the Commentary on Article 12 of the Model indicate that countries might substitute a rule that would identify the source of interest or royalties as the State in which the loan giving rise to the interest or the property or right giving rise to the royalties was used. An equivalent source rule might be substituted for purposes of Article 12AA. Similarly, as suggested in the Commentary on Articles 11 and 12, where, in bilateral negotiations, the parties differ on the appropriate rule, a possible solution would be a rule that, in general, would accept the payer's place of residence as the source of fees for services, but where the services are used or consumed in a State having a place-of-use rule, the payment would be deemed to arise in that State.

109. Other alternative source rules for fees for services are possible. Such alternatives include:

— The Contracting States might decide not to include paragraph 6. If paragraph 6 were omitted from Article 12AA, fees for services would be considered to arise in the State in which the payer is resident, even where those fees are incurred for purposes of a permanent establishment of the payer in the other Contracting State.

— The Contracting States might decide not to include paragraph 6 and to revise paragraph 5 so that fees for services would be considered to arise in a Contracting State only if the payer is a resident of that State and the services are used or consumed by the payer in that State; or if the payer is not a resident of a Contracting State, the payer has a permanent establishment situated in a Contracting State and the fees for services are borne by that permanent establishment. In this case, services used or consumed by a resident of a Contracting State outside that State would not be considered to arise in that State, and that State would not be entitled to tax fees for such services under Article 12AA. Paragraph 6 would be unnecessary because services used or consumed outside a Contracting State would include any services incurred for the purposes of a resident's permanent establishment situated in the other Contracting State.

— Fees for services could be considered to arise in a Contracting State only if the payer is a resident of that State and the services are provided in that State or if the payer, not being a resident of a Contracting State, has a permanent establishment situated in a Contracting State, the fees for services are borne by that permanent establishment, and the services are provided in that State. In this case, a Contracting State would be entitled to tax fees for services paid by its residents to residents of the other Contracting State if the services are provided in the State. In this situation, paragraph 6 would be unnecessary.

110. Paragraph 6 provides no solution for the case where the beneficiary and the payer are residents of the Contracting States, but the fees for services were incurred for the benefit of a permanent establishment of the payer situated in a third State and the fees for services are borne by that permanent establishment. In such a case, the fees for services are

deemed to arise in the Contracting State of which the payer is a resident under paragraph 5 and not in the third State in which the permanent establishment is situated. Thus, the fees for services may be taxed both in the Contracting State of which the payer is a resident and in the Contracting State of which the beneficiary is a resident. Although double taxation will be avoided between these two States, it will not be avoided between them and the third State if the third State taxes the fees for services because they are borne by the permanent establishment in its territory. Paragraph 6 is consistent in this regard with paragraph 5 of Article 11 and paragraph 5 of Article 12.

111. As explained in paragraph 27 of the Commentary on Article 11, if the third State did not subject the fees for services to tax, there could be attempts to avoid taxation in the Contracting State of which the payer is a resident through the use of a permanent establishment situated in such a third State. States for which this is not a concern and that wish to address the issue described in paragraph 110 above may do so by agreeing, in their bilateral conventions, to the alternative formulation of paragraph 6 suggested in paragraph 112 below.

112. As mentioned in paragraph 111, the State of which the beneficiary is a resident and the State of which the payer of fees for services is a resident may avoid the double taxation described in paragraph 110 above by agreeing to the following wording of paragraph 6:

> 6. For the purposes of this Article, fees for services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State or a third State through a permanent establishment situated in that other State or the third State and such fees are borne by that permanent establishment.

113. This wording would have the effect of ensuring that paragraphs 1 and 2 would not apply to such fees for services because they would not arise in a Contracting State. As a result, such fees for services would typically fall under Article 7.

Paragraph 7

114. The purpose of paragraph 7 is to restrict the operation of Article 12AA concerning the taxation of fees for services in cases where,

by reason of a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person, the amount of the fees paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length. Paragraph 7 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the fees for services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

115. It is clear from the text of paragraph 7 that in order for this paragraph to apply, the fees for services held to be excessive must be due to a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person. There may be cited as examples of such a special relationship cases where fees for services are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the payer or is subordinate to a group having common interest with the payer. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

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

117. With regard to the taxation treatment to be applied to the excess part of the fees for services, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike paragraph 6 of Article 11, which, because of the limiting phrase "having regard to the debt claim for which it is paid", permits only the adjustment of the rate at which interest is charged, paragraph 7 permits the reclassification of the excess part of the fees for services in such a way as to give them a different character. This paragraph can affect not only the recipient of the fees, but also the payer of excessive fees for services; if the law of the State where the payer is resident or has a permanent establishment permits, the excess amount can be disallowed as a deduction, due regard

being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the fees for services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 7, as long as they do not alter its general purport.

118. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of fees for services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

Article 12B

INCOME FROM AUTOMATED DIGITAL SERVICES

A. General considerations

1. Digital technology has had a very significant impact on how cross-border business activities can be carried out at a very large scale, with high speed and without necessarily having a physical presence in the market jurisdiction (source jurisdiction). The question has arisen whether the existing rules under tax treaties allocating taxing rights amongst countries based on permanent establishment criteria are any longer appropriate in respect of the new business models based on digital technologies. The concept of permanent establishment effectively acts as a threshold and only where this threshold is met, is any taxation in the market jurisdiction possible under most of the existing tax treaty rules. The concept of permanent establishment in Article 5 is essentially based on a fixed place of business, and also includes service or construction activities carried on for a specific duration and the existence of a dependent agent. In addition, Article 5A deems the carrying on of a business through a permanent establishment to include exploration or exploitation activity in relation to natural resources that is carried on for a specific duration. However, with the advent of modern means of telecommunications and the spread of digitalization, enterprises have the ability to effectively engage in substantial business activities in the market country without a fixed place of business there, or to conclude contracts remotely through technological means with no involvement of individual employees or dependent agents.

2. Tax consequences of digitalized economies, especially from the point of view of developing countries were therefore recognized as a matter of importance by the Committee, which first engaged itself in this work during its fifteenth session (October 2017). The Committee identified income from automated digital services as a matter of priority to be dealt with and decided to focus on a tax treaty provision for the UN Model that would enable jurisdictions to apply their domestic legislation levying taxes on income derived from digital business models. The Committee's approach has been to find a solution which is relatively simple to comply with by business as well as tax administrations and, at the same time, results in a definite share for market jurisdictions. As a

result of these considerations, Article 12B was added to the UN Model in 2021 to preserve the domestic law taxing rights for States from which payments for automated digital services are made.

3. Article 12B allows a Contracting State to tax income from certain digital services paid to a resident of the other Contracting State on a gross basis at the rate negotiated bilaterally and specified in paragraph 2 of the Article, with an option for the taxpayer to pay tax on a net profit basis for the whole year under paragraph 3 of the Article. Under Article 12B, a Contracting State is entitled to tax payments for automated digital services if the income is paid by a resident of that State or by a non-resident with a permanent establishment in that State and the payments are borne by the permanent establishment. Automated digital services are defined to mean services provided on the Internet or digital or other electronic network requiring minimal human involvement from the service provider. Until the addition of Article 12B in 2021, income from automated digital services derived by an enterprise of a Contracting State (unless it also fell within the scope of Article 12 or former Article 12A) was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a permanent establishment in the other State (the source State) or, under former Article 14, provided professional or independent personal services in the source State (either for more than 183 days or through a fixed base therein) and the income from automated digital services was effectively connected with such permanent establishment or activities.

4. The taxation of income from automated digital services on a gross basis under Article 12B may result in double or other excessive taxation. Although the rate is to be bilaterally negotiated, the possibility of double or excessive taxation can be taken into account by having a modest rate (i.e. three or four per cent) of tax on the income from automated digital services under paragraph 2 of Article 12B. Moreover, paragraph 3 allows the non-resident provider to require taxation on a net basis by following the global profitability ratio of the beneficial owner or the multinational enterprise group to which it belongs. Where the enterprise belongs to a multinational enterprise group, the option for net basis taxation is subject to the availability of information to the source jurisdiction about the profitability ratio of the automated digital services business segment or of the group as a whole. The possibility that payments in consideration for automated digital services may be

subject to double or excessive taxation is also reduced or eliminated under Article 23 (Methods for the elimination of double taxation).

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

6. While paragraph 5 above notes the possibility of implementing this tax by way of a withholding tax, the Article itself lays down nothing about the mode of taxation in the State in which the income from automated digital services arises. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or individual assessment. As with other provisions of the UN Model, procedural questions are not dealt with in this Article. Each State is able to apply the procedure provided in domestic law.

7. Article 12B does not require any particular threshold, such as a permanent establishment, fixed base, or minimum period of presence, in a Contracting State as a condition for the taxation of income from automated digital services. In this regard, modern methods for the delivery of services allow non-residents to render substantial services for customers in the other country with little or no presence in that country. This ability to derive income from a country with little or no physical presence in that country is considered by the Committee to justify source taxation of income from automated digital services.

8. A large minority of the members of the Committee did not agree[72] with the argument set forth in paragraph 1 of the Commentary

72 The decision to include that minority view in the Commentary was taken at the twenty-second session of the Committee held in April 2021.

to Article 12B that the advent of modern means of telecommunications and the ability to conclude contracts remotely without the involvement of individual employees or dependent agents, on its own, justifies the allocation of taxing rights over the revenue of the enterprises, in particular multinational enterprise groups, to the source jurisdiction (sometimes referred to as "market jurisdiction") in the manner provided for in Article 12B. These members did not agree that taxing rights should be allocated to the source jurisdiction based on mere sales. Further, these members did not agree that the market, on its own, generates profits from activities under the scope of Article 12B such that the market jurisdiction should be allocated taxing rights.

9. Those members recognized that the digitalization of the economy and, in particular, certain highly digitalized business models have caused tax challenges and accentuated the question of whether traditional concepts of nexus and income allocation lead to appropriate results in light of such business models. However, these members considered the reallocation of profits of a multinational enterprise group to the market jurisdiction to be a multilateral issue which is best suited for a comprehensive multilateral solution, not a bilateral approach. In their view, it is not clear that the entity within the multinational enterprise group that ultimately provides the automated digital service has earned that part of the worldwide profit of the multinational enterprise group that should be reallocated to the market jurisdiction. These members supported continued work on a comprehensive multilateral solution. Further, those members considered that if a multilateral solution is reached and widely adopted, the interaction of Article 12B with such multilateral solution will need to be considered, especially to ensure that concerns regarding double and multiple taxation are not exacerbated.

10. Those members were also concerned that Article 12B does not comprehensively address the tax challenges related to the digitalization of the economy. For example, the sourcing rule in paragraph 9 of Article 12B, deeming the payment to arise in the State in which the payer is resident, in their view unduly limits the scope of the Article as it does not fully address the value generated by data collected in relation to users of free digital services (e.g. search engines and social media platforms). Further, these members questioned the rationale for the allocation of taxing rights in the case of "online advertising services", which is one of the biggest sources of income from automated digital services.

In many cases, the entity paying for the advertisement and the target of the advertising (the user of automated digital services) are located in different States. In such a situation, Article 12B would not convey any taxing right to the market State where the user is located. Rather than reallocating taxing rights to the market jurisdiction, Article 12B would allocate taxing rights based on the location of the entity paying for the advertisement.

11. Further, a source right to tax the payment may allow digital companies to structure their business models to avoid making the payment in a particular country that has such source taxing rights. It was also noted by those members that the exclusion for permanent establishments in paragraph 10 of the Article will limit the application of Article 12B. Further, those members were of the view that given the scope limitations of Article 12B, it is not clear that the "definite share for market jurisdictions" referred to in paragraph 2 of this Commentary will be significant, especially for small developing countries.

12. These members were concerned that the term "income from automated digital services" as used in the Article is not clear. These members also considered that several terms and concepts used in paragraph 3 of the Article, in the related Commentary or otherwise relevant to the application of the net basis taxation option (for example, "automated digital services business segment", "segmental accounts", "segmental profitability ratio", the need to determine an allocation of indirect costs to the automated digital services business segment, the need to determine the profit before tax and the need to address situations where consolidated accounts do not exist and different accounting standards are used for different entities within the multinational enterprise group) were insufficiently defined or explained in the Commentary and too much flexibility was left to individual countries to define the terms in their domestic law. These members were therefore concerned that the application of the Article would result in increased uncertainty, inconsistent treatment, and lengthy disputes between taxpayers and tax authorities. Further, they considered that information to justify the profitability ratio of the multinational enterprise group, as required for paragraph 3 of the Article to apply, may not be in the taxpayer's possession or control. In order for this net taxation option to work in a consistent manner, those members regarded it as critically important that a model of the domestic law framework be developed

and followed by States implementing such a tax and that more guidance on the required information to justify the segmentation and required profitability ratios be provided by tax administrations. These members were also concerned that the complexity and administrative burden required for an entity to justify the required profitability ratios would make the net option unadministrable in practice or the option would be denied by the tax administration in the source State on the basis that insufficient information was provided.

13. In the view of these members, a further problem with the taxation of income from automated digital services on a gross basis – and even on a net basis given the reliance on the profitability ratio of the multinational enterprise group – is that it can lead to excessive or double taxation noting also the arguments raised in paragraph 9 of this Commentary concerning the multilateral character of the taxation of multinational enterprises. They considered that imposition of a tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection with the provision of the services, which would be deductible if tax were imposed on a net basis. Thus, it is possible that the residence State's remedies with a view to relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State. The imposition of tax on a net basis, which relies on the greater of the profitability ratio of the taxpayer and the multinational enterprise group, means that the service provider may be subject to tax even if the service provider is in a loss position.

14. These members were concerned that certain design choices (such as applying Article 12B to small payments and payments by individuals acquiring services for personal use) may significantly increase the administrative burden of the Article's application by some developing countries that have limited administrative capacity, without a clear indication that such choices will increase potential revenues to outweigh the cost of such choices. Countries sharing these concerns may wish to consider including a threshold (for example, a threshold based on the size of the taxpayer or the multinational enterprise group and a threshold based on the revenue arising in the source jurisdiction) and excluding payments by individuals acquiring services for personal use from the application of Article 12B, similar to the exclusion from the application of former Article 12A (Fees for technical services) provided for individuals acquiring services for personal use (see paragraph 3(*c*)

of former Article 12A).[73] Such simplifications and other alternatives for simplification proposed by these members are set out in paragraphs 24, 25, 42, 47 and 64 of this Commentary.

15. As a matter of broader economic policy, these members were concerned that, as a result of the Article, consumers of automated digital services in the source State may encounter higher prices for those services, because foreign service providers could pass added tax costs on to the consumer through means such as so-called "gross-up" clauses in contracts. Typically, a gross-up clause will specify a net amount that the provider will receive, effectively passing the burden of any withholding tax on the consumer of the services. The use of gross-up clauses could result in the tax being shifted to the consumer and make it more expensive to purchase the services. This can, in the view of those members, put a foreign service provider at a competitive disadvantage, effectively foreclosing access to a market that imposes such a withholding tax and restricting the consumer's legitimate choice of suppliers.

16. In summary, countries sharing these concerns may wish not to include Article 12B in their bilateral tax treaties.

17. In case income from automated digital service falls within the purview of both Article 12B and Article 7, the provisions of Article 12B prevail pursuant to paragraph 6 of Article 7. However, this priority given to Article 12B does not apply if the beneficial owner of the income from automated digital services carries on business through a permanent establishment in the Contracting State in which the income arises and the income from those services is effectively connected with the permanent establishment or business activities referred to in paragraph 1(*c*) of Article 7. In this situation, paragraph 8 of Article 12B provides that the provisions of Article 7 apply instead of Article 12B.

18. In order to reduce uncertainty and inconsistencies, paragraph 7 also explicitly clarifies that the Article does not apply to income from automated digital services where such income also qualifies as a "royalty" or as "insurance premiums" falling under Article 12 or 12C, as the case may be.

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73 The text of former Article 12A can be found in the Annex to this Model.

19. Paragraph 6 of the Article lists examples of services that will often constitute automated digital services. However, the provision is not self-standing: in any particular case a service also has to meet the requirements of paragraph 5 for it to be an automated digital service for the purposes of the Article. The relationship between those paragraphs is addressed further in paragraph 56 of this Commentary.

B. Commentary on the paragraphs of Article 12B

Paragraph 1

20. This paragraph establishes that the income from automated digital services arising in a Contracting State, underlying payments for which are made to a resident of the other Contracting State, may be taxed in the other Contracting State. It does not, however, provide that such income is taxable exclusively by the State of residence.

21. The term "payment" has a broad meaning consistent with the meaning of the related term "paid" in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the 2017 OECD Model) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the 2017 OECD Model), the concept of payment means the fulfilment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom. The expression "automated digital services" is defined in paragraph 5 to mean any service provided on the Internet or digital or other electronic network requiring minimal human involvement from the service provider.

22. Article 12B deals only with income from automated digital services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to income from services arising in a third State. Paragraph 9 and paragraph 10 of Article 12B specify when income from automated digital services is deemed to arise in a Contracting State and when it is deemed not to arise in a Contracting State, respectively. Under paragraph 9, income from automated digital services is considered to arise in a Contracting State if the underlying payments for that income are made by a resident of that State or if they are borne by a permanent establishment

in that State of a person resident of another State. However, under paragraph 10 income from automated digital services is deemed not to arise in that State if the underlying payments for that income are borne by a permanent establishment that the resident has in the other Contracting State.

Paragraph 2

23. This paragraph lays down the principle that the Contracting State in which income from automated digital services arises may tax the underlying payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the income is a resident of the other Contracting State, the amount of tax imposed by the State in which the income from automated digital services arises may not exceed a maximum percentage of the gross amount of the underlying payments, as may be negotiated by the Contracting States.

24. A large minority of members were of the view[74] that it would be desirable to include thresholds for the application of Article 12B to reduce the population of taxpayers that would be subject to possible excessive taxation as a result of applying source taxation on a gross basis to automated digital services. Such thresholds could be, for example, a threshold based on the worldwide revenue of the taxpayer for the purpose of protecting small-size taxpayers which may find the harsh result more difficult to bear than larger taxpayers, and a threshold based on the revenue from automated digital services derived from the source State for the purpose of protecting taxpayers that have just entered a particular market, since they would more often be operating at a loss during the start-up stage.

25. States seeking a result in line with the minority view expressed in the preceding paragraph may wish to agree bilaterally to replace paragraph 2 of the Article by the following:

> 2. However, subject to the provisions of Article 8, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according

74 The decision to include that minority view in the Commentary was taken at the twenty-second session of the Committee held in April 2021.

to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the income from automated digital services arising in a Contracting State may be taxed in the Contracting State in which it arises only if:

(*a*) the worldwide revenue derived by the beneficial owner of the income during the fiscal year concerned is an amount exceeding ____ ; and

(*b*) the revenue from automated digital services derived by the beneficial owner from the Contracting State during the fiscal year concerned is an amount exceeding ____ ;

and the tax so charged shall not exceed ____ per cent of the gross amount of the income from automated digital services arising in the first-mentioned State.

26. When considered in conjunction with Article 23 (Methods for the elimination of double taxation), paragraph 2 establishes the primary right of the Contracting State in which income from automated digital services arises to tax it in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the income is a resident of the other Contracting State). Accordingly, the country in which the recipient of the income is resident is obligated to eliminate double taxation of those payments. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption from tax of the income from automated digital services or the granting of a credit against tax payable to the residence country on the income from automated digital services for any tax imposed on such income by the other Contracting State in accordance with Article 12B. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under paragraph 2 of Article 23 A with respect to items of income taxable under Article 10, 11, 12, 12AA, 12B or 12C. A resident of State R, deriving income from State S, may have a loss in State R, in State S or in a third State. For purposes of the tax credit, in general, a loss in a given State will be set off against other income from the same State. When the total income is derived from abroad, and no income but a loss not exceeding the income from abroad arises in State R, then the total tax charged in State R will be appropriate to the income from State S, and the maximum deduction which State R is to allow will consequently be

the tax charged in State R. Other solutions are possible. As indicated in paragraph 66 of the Commentary on Article 23 B of the 2017 OECD Model quoted in paragraph 25 of the Commentary on Article 23 of the UN Model, some States are very liberal in applying the credit method. Some States are also considering or have already adopted the possibility of carrying over unused tax credits. Contracting States are, of course, free in bilateral negotiations to amend the Article to deal with any of the aforementioned issues. Consequently, whether the tax paid in the source State according to Article 12B is relieved in the State of residence in the same year or in subsequent years would depend on the domestic laws and practice of each State.

27. The maximum rate of tax on income from automated digital services is to be established through the bilateral negotiations between the Contracting States. Although, the rate is to be bilaterally negotiated, it is recommended to be set at a modest value, that is, three or four per cent.

28. A precise level of taxation at source on payments in consideration for automated digital services should take into account several factors, including the following:

— the possibility that a high rate of tax imposed by a country might cause non-resident service providers to pass on the cost of the tax to customers in the country, which would mean that the country would increase its revenue at the expense of its own residents rather than the non-resident service providers;

— the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter the provision of cross-border services;

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

— the fact that a reduction of the tax rate has revenue and foreign exchange consequences for the country imposing tax at source; and

— the relative flows of payments in consideration for automated digital services (e.g. from developing to developed countries).

29. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words "payments made to a resident" as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over income from automated digital services merely because such payments underlying such income were made directly to a resident of another State with which the first State had concluded a convention.

30. Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "underlying payments for which are made to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[75]), rather, it should be understood in its context, in particular in relation to the words "payments … made to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

31. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

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75 For example, where the trustees of a discretionary trust do not distribute income from automated digital services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognized as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 12B even if they are not the beneficial owners under the relevant trust law.

32. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person which in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[76] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

33. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the payments in consideration for automated digital services is not the "beneficial owner" because that recipient's right to use and enjoy the income is constrained by a contractual or legal obligation to pass on the income received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the income received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payments by the direct recipient such as an obligation that is not dependent on the receipt of the income and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of payments in consideration for automated digital services does have the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the income received to another person, the recipient is the "beneficial owner" of such income.

34. The fact that the recipient of payments in consideration for automated digital services is considered to be the beneficial owner

76 Reproduced at page R(6)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833, accessed on 10 May 2021. See footnote 25.

of such income does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. While the subject-to-tax rule of paragraph 3 of Article 1 of this Model would deny the limitation of tax in cases involving a low level of residence State taxation of payments in consideration of automatic digital services, the limitation of tax should also not be granted in cases of abuse of this provision, such as those addressed by the general anti-abuse rule of paragraph 9 of Article 29. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient which is obliged to pass on payment in consideration for automated digital services to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

35. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[77] that

77 See, for example, Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012, updated in 2020), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 117): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of paragraph 2(*a*) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, 12AA, 12B and 12C, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends, interest, royalties, fees for services and insurance premiums as well as the words "payments … made to" in relation to income from automated digital services, rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[78]

36. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State.

37. To avoid uncertainty, it is stated explicitly in paragraphs 2 and 3 that the provisions of these paragraphs apply subject to the provisions of Article 8. Under Article 8, profits from the operation of ships or aircraft in international traffic derived by an enterprise of a Contracting

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In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

78 See the Financial Action Task Force's definition quoted in the previous footnote.

State are taxable only in that State.[79] However, due to the nature of automated digital services, it is unlikely that income from automated digital services would be dealt with under Article 8.

Paragraphs 3 and 4

38. Paragraph 3 gives the beneficial owner of the income from automated digital services, being a resident of a Contracting State, the option to be taxed on a net basis for the whole year in the other Contracting State where the income arises, as an alternative to the taxation provided for in paragraph 2. According to this paragraph, the beneficial owner of the income may request the Contracting State where the income arises to be subject to taxation on its qualified profits, as defined in the paragraph. This option would provide relief in those cases where the taxpayer may have a lower tax liability than the liability determined under the provisions of paragraph 2 and also in cases where it has a global business loss or a loss in the relevant business segment during the taxable year.

39. Paragraph 3 defines the qualified profits to be 30 per cent of the amount arrived at by applying the profitability ratio of the beneficial owner's automated digital services business segment to the gross annual revenue derived from such services in the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine the qualified profits. Gross annual revenue from automated digital services derived from the Contracting State where the income from automated digital services arises would be the sum total of payments underlying the income from automated digital services arising in that Contracting State, in accordance with the sourcing rules in paragraphs 9 and 10 of Article, during the fiscal year.

40. A large minority of members were of the view[80] that 30 per cent of group consolidated profits for net taxation may be too high and that consideration should be given to bilaterally negotiating a rate that more accurately reflects the particular facts and circumstances.

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79 Subject to the exception provided in paragraph 2 of Article 8 (Alternative A).

80 The decision to include that minority view in the Commentary was taken at the twenty-second session of the Committee held in April 2021.

41. Where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be the profitability ratio of the group's automated digital services segment or the profitability ratio of the group itself if segmental accounts are not maintained by the group, provided the profitability ratio of the multinational enterprise group is higher than the profitability ratio of the beneficial owner at entity level. This is with a view to neutralizing the possible reduction of the profitability due to tax-driven related party transactions in the multinational enterprise group. The application of paragraph 3 in cases where the beneficial owner belongs to a multinational enterprise group is contingent on the availability of information about the profitability of the multinational enterprise group to the Contracting State where the income from automated digital services arises. In certain situations, this information may be available through country-by-country reports exchanged. Exchange of information mechanisms may be utilized to obtain this information in certain situations. The beneficial owner itself may also be able to obtain such information and provide the same to the tax authorities while opting for net basis taxation under paragraph 3. Where such information is still not available to the tax authority, paragraph 2 shall prevail and the option given by paragraph 3 will not be applicable for an enterprise that belongs to the multinational enterprise group.

42. A large minority of members were concerned[81] that requiring a beneficial owner forming part of a multinational enterprise group to use the higher of its profitability ratio and the profitability ratio of the multinational enterprise group will add significant complexity, increases the risk that, even under a net basis option, tax could be imposed when the beneficial owner is in a loss situation and increases the risk of excessive and double or multiple taxation. An alternative to address the risk identified by these members is to amend paragraph 3 to require reference to only the profitability ratio of the beneficial owner, with the possible inclusion of an anti-abuse rule to address the majority's concern that the profitability of the beneficial owner may be reduced due to tax-driven related party transactions in the multinational enterprise group.

81 The decision to include that minority view in the Commentary was taken at the twenty-second session of the Committee held in April 2021.

43. According to the international standards on transfer pricing,[82] a multinational enterprise group is a group of associated enterprises with business establishments in two or more countries. Multinational groups of companies generally operate worldwide through locally incorporated subsidiaries or permanent establishments. For the purposes of paragraph 3, paragraph 4 provides a clear definition of "multinational enterprise group" as any "group" that includes two or more enterprises, the tax residence for which is in different jurisdictions. Further, the term "group" is defined as a collection of enterprises related through ownership or control such that it is either required to prepare consolidated financial statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public stock exchange.

44. A large minority of members believe[83] that where the taxpayer has no presence and thus no functions performed in the source State, it should not be subject to taxation in the source State on its routine profits which are based on functions. Without any carve-out for routine profits from the profitability ratio, the source State could apply taxation on routine profits which have been taxed by States where routine functions are performed. This would give rise to double taxation and the residence State may find it unfair (e.g. in situations where the routine functions are performed in the residence State) or may be unable to provide a relief (e.g. in situations where the routine functions are performed in a third State).

45. It is also possible that the routine functions are performed in the source State itself. To give an example, a taxpayer derives income from automated digital services from a source State and at the same time has a permanent establishment in that State which undertakes routine functions supporting the activities of providing automated digital services undertaken by the taxpayer. In such a case the permanent establishment would have already been taxed in the source State on

82 See United Nations, *Practical Manual on Transfer Pricing for Developing Countries*, footnote 23 above, and OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, footnote 29 above.

83 The decision to include that minority view in the Commentary was taken at the twenty-second session of the Committee held in April 2021.

the routine profits it derives from undertaking the routine functions, which form part of the profits the taxpayer derives for providing the activities in the source State. If no carve-out from the profitability ratio is provided for such routine profits, the source State would tax the same routine profits twice. These members support having a carve-out from the profitability ratio to reflect the routine profits attributed to the functions performed, risks assumed and assets employed.

46. The profitability ratio of the beneficial owner or the multinational enterprise group to which the beneficial owner belongs is understood to be the annual profits divided by the annual revenue, as revealed by the consolidated financial statements of the automated digital services business segment of the beneficial owner or of the group it belongs to, or of the beneficial owner or the group as a whole, as the case may be. Unless bilaterally agreed otherwise between the Contracting States, the profit to be used for calculating profitability would be the profit before tax as shown in the accounts of the beneficial owner, or as shown in the consolidated accounts of the multinational enterprise group,[84] as the case may be, with adjustments such as, for example, exclusion of income tax expenses, exclusion of dividend income, exclusion of gains or losses in connection with shares, adding back expenses not deductible for corporate income tax purpose due to public policy reasons, etc.

47. States sharing the concerns set out in the minority views expressed in paragraphs 40, 42 and 44 above, and wishing to refer only to the profitability ratio of the beneficial owner, set a carve-out for routine profits from the profitability ratio and leave the share of qualified profits to be taxed in the source State to bilateral negotiations, may agree bilaterally to replace paragraph 3 of the Article by the following:

> 3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises to subject its qualified profits from automated digital services for the fiscal year concerned to

84 The relevant financial accounting standards for the multinational enterprise group would be the financial accounting standards used by the ultimate parent entity in the preparation of its consolidated financial statements.

taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article 8, the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be ___ per cent of the amount resulting from applying to the gross annual revenue from automated digital services derived from the Contracting State where such income arises:

(*a*) the automated digital services business segment profitability ratio of the beneficial owner where segmental accounts are maintained;

(*b*) the overall profitability ratio of the beneficial owner where segmental accounts are not maintained;

deducted by ___ per cent deemed return on routine functions for providing the automated digital services.

48. In order to avoid disputes and to provide certainty, not many adjustments are envisaged to be made to the profits shown in the accounts when determining the profits to calculate the profitability for purposes of this paragraph. The profitability of the multinational enterprise group to be used for the purposes of paragraph 3 would be for the same fiscal year. The information concerning the profitability ratio of the multinational enterprise group may be furnished by the taxpayer along with supporting evidence. The tax administration of the Contracting State where the income from automated digital services arises may in appropriate cases make a cross-verification of the correctness of a taxpayer declaration through various available exchange of information mechanisms.

49. Qualified profits have been deemed to be 30 per cent of the amount arrived at by applying the profitability ratio to the local revenue in recognition of the fact that the entire profits arising from the market jurisdiction cannot be attributed to it. The specific figure of 30 per cent was adopted by the Committee to achieve certainty on the one hand and to provide a fair and reasonable share to both jurisdictions on the other, keeping in mind the special role markets play in the generation of profits from the activities within the scope of the Article. In arriving at a figure of 30 per cent, the respective roles of assets, employees and revenue in the generation of profits were assigned equal weight. Finally,

in the view of the Committee, the figure of 30 per cent constitutes a balanced compromise as regards the allocation of profits between source and residence countries.

50. Qualified profits shall be taxable at the tax rate provided in the Contracting State's domestic law. The domestic law may have a procedure for the registration of providers of automated digital services as well as necessary forms to be filed for facilitating taxation of income from automated digital services in accordance with paragraph 3. Similarly, any taxation at source that may have been levied pursuant to paragraph 2 should be taken into account against the tax liability determined at a later stage pursuant to paragraph 3.

Paragraphs 5 and 6

51. Paragraph 5 defines "automated digital services" for the purposes of Article 12B as any service provided on the Internet or digital or other electronic network requiring minimal human involvement from the service provider. Paragraph 6 lists examples of services that may constitute automated digital services.

52. A service is regarded as automated when the user is able to make use of the service because of equipment and systems being in place, which allow the user to obtain the service automatically, as opposed to requiring a bespoke interaction with the supplier to provide the service. In determining whether a service requires minimal human involvement, the test only looks to the supplier of the service, without regard to any human involvement on the side of the user, for example where the user may input certain parameters into an automated system to obtain a customized result. Furthermore, the definition focuses on the provision of services and therefore does not include human involvement in creating or supporting or maintaining the system needed for the provision of services, maintaining and updating the system environment, dealing with system errors, or making other generic, non-specific adjustments unrelated to individual user requests. The threshold of minimal human intervention would not be crossed where the provision of services to new users involves very limited human response to individual user requests/input at the service delivery point or where, in individual cases involving particular, more complex problems, the programmes running the system direct the customer to a staff member.

53. An important indicator of the concept of automated services is whether there is ability to scale up and provide the same type of services to new users with minimal human involvement. This feature aims to identify automated digital service businesses that benefit from significant economies of scale, rather than to suggest that there is no human involvement required in the business. For many automated digital service businesses, developing the system that delivers the offered services may require a large degree of upfront human involvement and capital inputs such as creating algorithms to deliver the automated services including such features as tailoring the offering to user's preferences. It distinguishes automated digital service businesses by looking at whether the marginal cost in terms of additional human involvement of providing the same services to additional users is nil or almost nil. In other words, once the service offering of an automated digital service business is developed (such as a music catalogue or a social media platform), then the business can provide that service to one user, or to many more, on an automated basis with the same basic business processes. On the other hand, a non-automated digital service business would see a proportionate increase in the costs per unit in connection with providing the services to new customers.

54. The aspect of providing a service over the Internet or digital or other electronic network distinguishes it from other service provision methods, such as the on-site physical performance of a service. No distinction is made between different Internet or electronic network transmission methods for the purposes of determining whether a service is an automated digital service. That determination is also not affected by whether or not the service provider owns, leases or otherwise controls the transmission equipment.

55. The general definition of "automated digital services" in paragraph 5 of Article 12B is exhaustive and when read together with the specific services listed in paragraph 6 that will often constitute automated digital services, provides certainty combined with flexibility. The benefit of using a general definition supported by a list of specific types of services is that this approach will be capable of accommodating rapid changes in technology that may give rise to new types of automated digital services not so far included or excluded in the specific lists that appear in paragraphs 56 and 58 below respectively. If there are multiple

supplies that are identifiable and substantive in their own right, then each individual supply is to be tested against the definition.

56. Paragraph 6 of the Article lists examples of services that will often constitute automated digital services. However, the provision is not self-standing. While paragraph 6 notes that online advertising services, supply of user data, etc., are common types of automated digital services, when one is looking at the operations of a particular beneficial owner or multinational enterprise group, the requirements of paragraph 5 must also be met. Paragraph 6 therefore simply provides an indication that an activity may constitute an automated digital service; it does not provide that an activity listed therein necessarily is an automated digital service. The following services are expressly mentioned in paragraph 6:

(*a*) online advertising services;

(*b*) supply of user data;

(*c*) online search engines;

(*d*) online intermediation platform services;

(*e*) social media platforms;

(*f*) digital content services;

(*g*) online gaming;

(*h*) cloud computing services; and

(*i*) standardized online teaching services.

The categories are not mutually exclusive; for example, a digital content service could be funded in whole or in part by online advertising.

57. The following describes the services listed in paragraph 56 above:

(*a*) Online advertising services are understood as online services aimed at placing advertisements on a digital interface, including services for the purchase, storage and distribution of advertising messages, and for monitoring of advertising and measurement of its performance. It includes related systems for attracting potential viewers of the advertisements and collecting content contributions from them and data regarding them, including via the provision of services such as access to the digital interface. Online advertising services include direct advertising services, such as where social media platforms, online search engines, online intermediation platforms and digital content providers

directly sell advertising inventory for display on the digital interfaces they operate. It also extends to automated systems and processes for the purchase and sale of advertising inventory (such as demand-side platforms, supply-side platforms, advertisement exchanges, advertisement verification services, etc.). Given the broad definition of "digital interface" it also includes online advertising displayed on an Internet-connected good ("Internet of things") provided that there is an identifiable revenue stream from that advertising.

(*b*) Supply of data means the provision of data to a third-party customer in respect of users of a digital interface, which is collected, compiled, aggregated or otherwise processed into data through an automated algorithm. Data in respect of users here refers to all directly or indirectly identifiable personal data, such as a user's habits, spending, location, environment, usage of services, hobbies, or personal interests or preferences, including anonymized and aggregated data (such as geo-location information and user traffic levels). The source of data may be collected as raw data by the enterprise itself (e.g. the manufacturer/seller of a home heating system collecting data about energy use, or a social media company collecting data about its users) or it may be acquired from another business. The source of the data would not be relevant, provided that it is generated by a user through a digital interface.

(*c*) Online search engines imply making a digital interface available to users for the purpose of allowing them to search across the Internet for webpages or information hosted on digital interfaces. Many online search engines are monetized through online advertising services and/or services transmitting data about users, which may constitute automated digital services under other subparagraphs of paragraph 6, that is, subparagraphs (*a*) and (*b*) respectively. The category of "online search engines" extends to instances where an online search engine charges users for access, for example under a subscription model, or where online search engine technologies are provided for incorporation into a third-party host website (e.g. a "search box"). This category does not include services such as online databases or "internal" website search functions that are not monetized, where the search results are limited to data hosted on that same digital interface (or

related digital interfaces). However, if an online database or an "internal" website search function service involves monetization of services and meets the general definition of automated digital service, it will be within the scope of Article 12B.

(*d*) Online intermediation platform services involve a digital interface available to users for the purpose of enabling interaction among themselves, including for the sale, hire, advertisement, display or other offer by users of particular goods, services, user-generated content or other property to other users. It does not include the online sale of goods and services of the platform's own inventory. This category applies where the service enables the interaction between third party users, irrespective of the nature of the interaction, the characteristics of the users involved, whether an underlying transaction is itself an automated digital service, or the extent of the service provider's activities in facilitating the interaction. This category covers instances where the online intermediation platform charges users for its online intermediation services, for example through commission, listing or subscription fees. The intermediation service may at times be funded via online advertising or the sale of data, which constitute automated digital services under other subparagraphs of paragraph 6, (i.e. subparagraphs (*a*) and (*b*) respectively).

(*e*) Social media platforms involve making a platform available on a digital interface to facilitate the interaction between users or between users and user-generated content. This category includes a range of activities such as social and professional networking websites, micro-blogging platforms, video or image sharing platforms, online dating websites, platforms dedicated to sharing user reviews, as well as online call and messaging platforms, some of which could overlap with online intermediation platforms. This category covers instances where the social media platform charges users for access, for example under a subscription model. These services may be funded via online advertising, the sale of data, or different subscription models such as for digital content services. Such services of online advertising etc. constitute automated digital services under other subparagraphs of paragraph 6. This category does not extend to instances where user interaction is merely incidental to the core purpose of the digital interface, for example where a company sells its own inventory online and

the website allows users to post comments or reviews or where a website allows a user to engage in an online chat with a sales representative.

(*f*) Digital content services implies the automated provision of content in digital form, such as computer programs, applications, music, videos, books, other texts, games, online newspapers, online libraries, online databases and software, in each case other than the data represented by a digital interface, whether by way of online streaming, accessing or downloading digital content, whether for access one time, for a limited period or in perpetuity. This category captures the different forms which digital content can take when accessed by a user, but it does not include simply making a digital interface available to users. The purpose from a user's perspective in a digital service transaction is the ability to access the digital content. By way of background, the streaming and downloading consists of the same process of transmitting data, either as a continuous flow similar in effect to a temporary download or as a file saved to the user's device available for later use. A number of streaming services allow both temporary streaming and downloading, but from the perspective of the automated digital service provider, the process is essentially the same. Downloading of or access to software over the Internet also meets the general definition of automated digital service where it is automated requiring minimal human involvement to make the software available to users over the Internet. As such, the provision of software that is accessed or downloaded over the Internet would therefore qualify as automated digital services under the "digital content services" category, or it may also qualify under the "cloud computing" category ("Software-as-a-service"). Paragraph 61 below clarifies the interaction with other Articles in cases where elements of income could be regarded as being covered by both Article 12B and either Article 12 or 12C. Accordingly, Article 12B does not apply to the provision of software provided via streaming or downloading as digital content if the associated payment qualifies as a royalty under Article 12.

(*g*) Online gaming means making a digital interface available for the purposes of allowing users to interact with one another

in the same game environment. This category applies to all multiplayer gaming enabled by the Internet, such as massively multiplayer online games, or other games that enable multiplayer functionalities, and regardless of the device or platform through which the game is accessed. The provision of in-game purchases, or any other online purchases within the game also falls within this category. This category does not include single-player games (which if streamed, accessed or downloaded over the Internet would be within the category of digital content services) or the purchase of a game sold on tangible media such as a DVD.

(*h*) Cloud computing services are those providing standardized on-demand network access to information technology resources, including infrastructure as a service, platforms as a service, or software as a service (such as computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software). The network access to on-demand standardized information technology resources includes all types of standardized cloud computing services, including computing services, storage services, database services, migration services, networking and content delivery services, webhosting, and end-user applications and software. Cloud computing services are typically provided in a standardized and highly automated way. Standardized cloud computing services may be "assembled" or configured together for a particular customer (whether by the service provider or by the customer on a self-serve basis). Some cloud computing services, however, involve a high degree of human involvement to customize the service to the needs of a particular client. Such services are not automated digital services and are, therefore, outside the purview of Article 12B. A bespoke cloud solution involving more than minimal human involvement on behalf of the provider or provider's staff (e.g. engineers or consultants) to create a new computing solution (as opposed to configuring existing solutions) is not considered to be included. To the extent that the human involvement relates only to the configuration of standardized cloud computing products, the integration of standardized cloud computing products into a customer's existing information technology architecture, or ancillary customer support, the human involvement will be

considered ancillary to the cloud computing service, which would be covered by this category.

(*i*) Finally, standardized online teaching services are those involving the provision of an online education programme provided to an unlimited number of users, which does not require: (a) the live presence of an instructor; or (b) significant customization on behalf of an instructor to a particular user or limited group of users, whether with respect to the curriculum, teaching materials, or feedback provided. This category includes pre-packaged, non-customized education products such as a pre-recorded series of lectures, the content of which is not customized to each individual user (e.g. massive open online courses). Although these services may allow users to discuss the course content with each other on discussion forums within the platform, there is no or only limited interaction with instructors. Another key feature of standardized teaching services is that course work completed by the user is generally not marked by the instructors, but either marked automatically, or by other users. This category does not cover online education products that are customized to a student, or to a limited group of students, and may incorporate certain ancillary elements that are automated (e.g. a prerecorded lecture offered as part of a customized education package; automatically graded assignments accompanying a live-streamed lecture). Such services do not also meet the general definitions of automated digital services, and as such are included in paragraph 58 under the category of customized online teaching services.

58. Based on the general principles in paragraphs 51 to 55 above and to avoid uncertainty, the expression "automated digital services" does not include:

(i) customized professional services;

(ii) customized online teaching services;

(iii) services providing access to the Internet or to another electronic network;

(iv) online sale of goods and services other than automated digital services; and

(v) revenue from the sale of a physical good, irrespective of network connectivity ("internet of things").

59. The following describes the services and types of activities listed in paragraph 58 above:

(i) The expression "customized professional services" includes services whether provided individually or by a firm, such as legal, accounting, architecture, engineering, medical professional or financial or other specialized expert consultancy services. Customized professional services are not within the general definition of automated digital services. Although such services may be delivered online (e.g. legal advice sent by email, an architect sending drawings; or an accountant sending calculations on a spreadsheet), they require customization to each client, through the tailored exercise of professional judgment and bespoke interactions. These services are not automated and require more than minimal human involvement on behalf of the professional individual or firm. They would also not be scalable without additional human involvement.

(ii) Customized online teaching services means live or recorded teaching services delivered online, where the teacher customizes the service (such as by providing individualized, non-automated feedback and support) to the needs of a student or a limited group of students and the Internet or another electronic network is used as a tool simply for communication between the teacher and the student. This category confirms that customized teaching services delivered online are not within the general definition of automated digital services where the Internet or electronic network is used as a tool simply for communication between the teacher and student. This includes online education packages that are significantly customized to a student, or to a limited group of students, even where certain ancillary elements of the product are automated (e.g. a prerecorded lecture offered as part of a customized education package; automatically graded assignments accompanying a live-streamed, customized lecture). However, a standardized online teaching service with ancillary interaction with an instructor is described in paragraph 58(*i*) above as an automated digital service.

(iii) The expression "services providing access to the Internet or to another electronic network" applies to the provision of access (i.e. connection, subscription, installation) to the Internet or another electronic network, irrespective of the delivery method, namely over wire, lines, cable, fibre optics, satellite transmission or other means, although there may be change in situation as technology advances. Internet Service Packages in which the Internet access component is an ancillary and subordinate part (i.e. a package that goes beyond mere Internet access comprising various elements – such as content pages containing news, weather or travel information; games fora; web-hosting; access to chat-lines etc.) are not covered by this category. In such cases, the guidance provided in this Commentary for dual category automated digital services and bundled packages would be relevant.

(iv) Online sales of goods and services other than automated digital services involve the sale of a good or service completed through a digital interface where: the digital interface is operated by the provider of the good or service; the main substance of the transaction is the provision of the good or service; and the good or service does not otherwise qualify as an automated digital service. This category applies to sellers that use a digital platform to sell their own non-digital goods and services to customers. While the sale can be transacted over the Internet, these businesses are sellers of non-digital goods and non-digital services, rather than offering a digital service per se. This is the case of online selling of tickets for international transport, profits in respect of which are covered by Article 8, as clarified in paragraph 2 of Article 12B. Applying the general definition of automated digital service, the provision of the intended good/service is not of a type that is automated but requires additional human intervention to make that service available to additional users.

(v) Irrespective of the network connectivity of a physical good, payment for the sale of that physical good is not considered to be covered by Article 12B provided there is

no separate identifiable payment for the automated digital service attached to that physical good (either at the time of purchase or a later date). Increasingly, physical goods may be connected to the Internet, or bundled with an online service. Beyond the sale of the physical good, such goods can be additionally monetized with a customer beyond the purchase of the physical good through different payment streams (whether at the outset at the time of purchase or at a later date), and those payment streams are captured by existing categories of automated digital services included in paragraph 6 of Article 12B and paragraph 57 above. Common examples include: (a) the monetization of data collected from the connected object; (b) online advertising revenue relating to advertisements displayed on the connected object; and (c) the user of the connected object may pay for different types of automated digital services relating to, and/or to be accessed through the connected object. To the extent that these payment streams are separately identifiable from the sale price of the physical good, the payment for the automated digital service would be captured by Article 12B. Further deliberation is required to address cases where a separate payment stream can be inferred even if not explicitly identified as such. There are certain types of machinery and industrial products that may contain a digital component. For example, monitoring the performance of an engine and providing remote technical support. This will typically require significant human involvement to provide the core function, which is using that information to conduct maintenance and repairs on the machinery. This is related to the operation of the machinery, rather than the service provider separately monetizing that data in an automated way with a third party. This means that the Internet-enabled functionality of the machinery would not meet the general definition of automated digital service in paragraph 5 or any subparagraph of paragraph 6 of Article 12B. There are certain products, known as the "Internet of things", that provide a network of everyday devices, appliances, and other objects equipped with computer chips and sensors that can collect and transmit

data through the Internet, which enables additional features of the product to be used. It may be that many consumer goods now contain some software and may in the future be Internet-enabled, and bringing all such items into the scope of automated digital services would be overbroad having regard to the general definition of paragraph 5, given that the sale of a physical good is not an automated digital service because it is not a service, nor is it provided over the Internet or through another electronic network. Treating a portion of Internet-of-things goods as within the scope of Article 12B may be difficult in practice as it would require trying to separate out the value of the digital component of the service. Based on the guidance above, the scope of Article 12B would include the revenue from the Internet of things to the extent separately identifiable as being in respect of another automated digital service.

60. There may be situations where a particular kind of payment for automated digital service may wholly or partly fall within the scope of Article 12 (Royalties) or Article 12C (Insurance premiums). Paragraph 7 of Article 12B provides that Article 12B does not apply to any amounts falling within the definition of "royalties" in Article 12 or "insurance premiums" in Article 12C. Where, however, some part of the services amongst a bundle of automated digital services fall within the definition of royalties or of insurance premiums in Article 12 or 12C respectively, taxation of such part only would be governed by Article 12 or 12C, as the case may be, and Article 12B would apply to the remaining parts.

61. There may be activities which are not clearly severable. Where a substantial part of the overall activity fulfils the criteria under paragraph 5 of Article 12B and the remaining elements derive significant benefits from their connection to the elements having characteristics under paragraph 5, then the overall service may be regarded as covered by Article 12B. By contrast, where the elements fulfilling the criteria or matching the characteristics under paragraph 5 of Article 12B are merely ancillary or a technical support feature for the rest of the service (for example an automated chat function to screen a user's request as an entry point to the service), and the rest of the service requires human involvement, the overall service shall not be considered as covered by Article 12B.

62. It should be noted that while the former Article 12A excluded payments by individuals for services for personal use from the definition of "fees for technical services", paragraph 5 of Article 12B does not make a similar exclusion. Consequently, Article 12B also applies to automated digital services provided to individuals for their personal use. Even though such payments would not normally be deductible by those individuals for tax purposes, it cannot be disregarded that many multinational enterprise groups that rely on digital business models derive a very significant portion of their income from the provision of automated digital services generally to individual consumers. Since the imposition of tax obligations at source on such payments by individuals under domestic law may be difficult to enforce and might cause compliance problems for individuals consuming automated digital services supplied remotely by non-residents, other mechanisms for collection may be required. Such mechanisms are already in place in some countries.

63. In this regard, the domestic legislation in some jurisdictions levying taxes on automated digital services requires non-resident providers to present a tax return where the tax obligation has been self-assessed and subject to examination by the tax administration. Other jurisdictions, instead, impose the obligation to determine and pay the tax due by the non-resident provider, on the financial intermediary that individual consumers access to make the payments for the automated digital services involved. Jurisdictions may also apply both mechanisms, triggering the obligation of the financial intermediary only in cases the self-assessment return is not submitted.

64. A large minority of members were of the view that payments by individuals for automated digital services for personal use should be specifically excluded from the definition of "income from automated digital services".[85] Such an exclusion was provided for under the former Article 12A (Fees for technical services). Moreover, the imposition of withholding tax obligations on such payments by individuals under domestic law would be difficult to enforce and might cause serious compliance problems for individuals utilizing automated digital services

85 The decision to include that minority view in the Commentary was taken at the twenty-second session of the Committee held in April 2021.

supplied remotely by non-residents. This could be achieved by including the following sentence at the end of paragraph 5:

> However, the term "income from automated digital services" does not include payments made by an individual for services for the personal use of the individual.

Paragraph 7

65. Paragraph 7 of Article 12B provides that the provisions of Article 12B shall not apply if the payments underlying the income from automated digital services qualify as "royalties" or "insurance premiums" under Article 12 or Article 12C, as the case may be. It may sometimes be necessary to distinguish between payments for automated digital services and payments that constitute royalties so as to determine whether Article 12B or Article 12 is applicable. For this purpose, the principles in the respective Articles, that is, paragraph 5 of Article 12B and paragraph 3 of Article 12, together with the Commentary on the Articles, need to be carefully applied to determine the character of the payment. Thereafter the particular Article will take precedence over the other. With respect to a so-called mixed contract, the appropriate course would be to break down, on the basis of information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to various parts of what is being provided under the contract, and then to apply to each part of it, as so determined, the proper tax treatment.

Paragraph 8

66. Paragraph 8 provides that the provisions of paragraphs 1, 2 and 3 of Article 12B do not apply to income from automated digital services if the person which provides the services has a permanent establishment in the State in which the income arises and the income is effectively connected with that permanent establishment. In this regard, paragraph 8 is similar to paragraph 4 of each of Articles 10, 11, 12, 12AA and 12C. Thus, if a resident of one Contracting State provides automated digital services through a permanent establishment located in the other Contracting State, the payment received for those services will be taxable by the State in which the permanent establishment is located in accordance with Article 7 rather than in accordance with Article 12B.

67. Since Article 7 of the UN Model adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 8 also makes paragraphs 1, 2 and 3 inapplicable if the income from automated digital services is effectively connected with business activities in the State in which the income arises that are of the same or similar kind as those effected through the permanent establishment

68. Like paragraph 4 of Articles 10, 11, 12, 12AA and 12C where the expression "effectively connected" is used, paragraph 7 of Article 12B does not define the meaning of the expression "effectively connected." As a result, whether income from automated digital services is effectively connected with a permanent establishment or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, income from automated digital services would be considered to be effectively connected with a permanent establishment if the automated digital services are closely related to or connected with the permanent establishment or if the business activities are similar to those carried out through the permanent establishment. Also, income from automated digital services would be effectively connected with business activities referred to in paragraph 1(*c*) of Article 7 where the automated digital services are provided by an enterprise as part of that enterprise's business activities carried on in a Contracting State where a permanent establishment of that enterprise is situated and these activities are of the same or similar kind as the business activities performed through that permanent establishment.

69. Where paragraph 8 applies, payments in consideration for automated digital services are taxable by the State in which the income arises as part of the profits attributable to the permanent establishment in accordance with Article 7. Thus, paragraph 8 relieves the State in which the income from automated digital services arises from the limitations on its taxing rights imposed by Article 12B. Where Article 7 applies as a result of the application of paragraph 8, most countries consider that the State in which the permanent establishment is located is allowed to tax only the net profits from the automated digital services attributable to the permanent establishment. Article 7 does not preclude taxation of business profits attributable to a permanent establishment

on a gross basis, but a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination). However, it may be useful for Contracting States to clarify these issues during their bilateral negotiations.

Paragraphs 9 and 10

70. Paragraph 9 lays down the principle that income from automated digital services arises in a Contracting State if the underlying payments for such income are made by a resident of that State or if the person making the underlying payments for the automated digital services has in the Contracting State a permanent establishment in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment. It is not necessary for the services to be provided in the Contracting State of which the payer is a resident or in which it has a permanent establishment. Whether a person is a resident of a Contracting State for purposes of Article 12B is determined in accordance with the provisions of Article 4.

71. Where there is an obvious economic link between automated digital services being provided and the permanent establishment of the payer to which the services are provided, the income from automated digital services is considered to arise in the State in which the permanent establishment is situated. This result applies irrespective of the residence of the person to whom the permanent establishment belongs, even where that person is a resident of a third State.

72. Where there is no economic link between the automated digital services and the permanent establishment, the income from automated digital services is considered to arise in the Contracting State of which the payer of the consideration for the automated digital services is a resident. If the payer of the consideration for automated digital services is not a resident of either Contracting State, Article 12B does not apply to the income from automated digital services unless the payer has a permanent establishment in the Contracting State and there is a clear economic link between the automated digital services and the permanent establishment. Otherwise, there would be, in effect, a force-of-attraction principle for payments in consideration for automated digital services, which would be inconsistent with other provisions of this Model.

73. Even where a service is covered by the definition of "automated digital services" in paragraph 5, the income from such automated digital service has to arise in a Contracting State according to paragraph 9 for Article 12B to apply, that is, a payment has to be made in consideration for such automated digital service by a resident of that Contracting State or the payment has to be incurred in connection with, and borne by, a permanent establishment in that Contracting State. There may be cases where an automated digital service, for instance a search engine or a social platform service, is provided to users for free. In such situation, no taxing right is allocated to jurisdictions where automated digital services are provided to users located therein who do not make payments in consideration for such services. Also, it cannot be argued that the voluntary or involuntary provision of data by users as a condition to access a social platform or search engine, or any other automated digital service, should be considered as a type of payment made in consideration for the automated digital service.

74. The sourcing rule in paragraph 9 of Article 12B operates on the basis of "payment" and not on the basis of the location of users. For example, where an enterprise of State A provides search engine services to users that are located in State B without requiring any payment in consideration for such services, it collects data regarding those users' profiles. Such information allows that enterprise to provide online advertising services to a person resident of State C that is interested in reaching potential consumers of its own services and products in State B. Therefore, the enterprise of State A receives payments made by the person resident of State C to target advertisements to specific potential consumers among the users of the search engine services that the enterprise in State A provides for free to residents of State B. By virtue of Article 12B of the tax treaty between State A and State C, State C may tax the income derived by the enterprise of State A from the provision of the online advertising services, that is the payments received from the resident of State C. However, Article 12B of the tax treaty between State A and State B does not allocate any taxing right to State B merely due to the location of users therein, unless payments are made by such users, who are residents of State B, to the provider of automated digital services which is a resident of State A.

75. Paragraph 9 is subject to paragraph 10, which provides an exception to the source rule in paragraph 9. Paragraph 10 deems payments in

consideration for automated digital services made by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State and the underlying payments for automated digital services are borne by that permanent establishment. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for automated digital services under paragraphs 2 or 3.

76. The phrase "borne by" must be interpreted in the light of the underlying purpose of paragraphs 9 and 10, which is to provide source rules for income from automated digital services. A Contracting State is entitled to tax income from automated digital services under paragraph 2 or 3 only if the income arises in that State. The basic source rule in paragraph 9 is that income from automated digital services arises in a Contracting State if the payer is a resident of that State or the payer has a permanent establishment in that Contracting State and the payments in consideration for automated digital services are borne by that permanent establishment. However, the basic rule is limited by the deeming rule in paragraph 10 which applies where the payer is a resident of a Contracting State but the payments in consideration for automated digital services are borne by a permanent establishment that the payer has in the other Contracting State.

77. Where underlying payments in consideration for automated digital services are incurred for the purpose of a business carried on through a permanent establishment, those payments will usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7. The deductibility of the automated digital service payments provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment is situated.

78. The fact that the payer has, or has not, actually claimed a deduction for the payments for automated digital services in computing the profits of the permanent establishment is not necessarily conclusive, since the proper test is whether any deduction available for those payments should be taken into account in determining the profits attributable to the permanent establishment. For example, that test would be met even if no amount were actually deducted as a result of the permanent

establishment being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the payments for automated digital services are not deductible for some reason other than the fact that such expenses should not be allocated to the permanent establishment.

Paragraph 11

79. The purpose of paragraph 11 is to restrict the operation of the provisions concerning the taxation of income from automated digital services in cases where, by reason of a special relationship between the payer and the beneficial owner of the income or between both of them and some other person, the amount of the payments underlying such income exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length. Paragraph 11 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the payments underlying the income from automated digital services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

80. It is clear from the text that in order for this paragraph to apply, the underlying payments in consideration for automated digital services held to be excessive must be due to a special relationship between the payer and the beneficial owner of the income or between both of them and some other person. There may be cited as examples of such a special relationship cases where remuneration for automated digital services is paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the payer or is subordinate to a group having common interest with the payer. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

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

82. With regard to the taxation treatment to be applied to the excess part of the underlying payments for automated digital services, the

exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike paragraph 6 of Article 11, which, because of the limiting phrase "having regard to the debt claim for which it is paid," permits only the adjustment of the rate at which interest is charged, paragraph 11 permits the reclassification of the underlying payments for the automated digital services in such a way as to give them a different character. This paragraph can affect not only the recipient of the payments, but also the payer of excessive remuneration for automated digital services; if the law of the State where the payer is resident or has a permanent establishment permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the underlying payments for the automated digital services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 11, as long as they do not alter its general purport.

83. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of payments in consideration for automated digital services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

Article 12C

INSURANCE PREMIUMS

A. General considerations

1. This article was added to the Model in 2025 to replace paragraph 6 of Article 5 of previous versions of the Model. That paragraph, which has been deleted from the 2025 Model, had provided an expanded definition of permanent establishment that would have allowed taxation of certain profits from insurance activities in the host State even in the absence of a fixed place of business or a dependent agent. A special provision addressing the taxation of insurance premiums was included because of concerns that insurance companies could do large-scale business in a State without being taxed in that State on their profits arising from such business. Paragraph 6 of Article 5 did not, however, apply to reinsurance premiums.

2. Over the years, the Committee had discussed various problems with paragraph 6 of Article 5.[86] Because paragraph 6 of Article 5 created a deemed permanent establishment, it generally required taxation of the relevant insurance company on a net basis (if such net basis taxation was available to domestic insurance companies). Determining those taxable profits could be difficult. The Commentary to Article 7 of the Model does not provide guidance regarding the determination of the profits of a permanent establishment that is deemed to exist by reason of paragraph 6. The Model retains Article 7(4), allowing for an apportionment of the total profits of an enterprise, a provision that may be used to determine the taxable profits of a deemed permanent establishment of an insurance company if the conditions of paragraph 7(4) are met. Members also noted that, if a resident insurance company reinsures its risk with a reinsurance company in the other country, the profits of that insurance company will be reduced by the premiums paid to the reinsurance company, but under the prior paragraph 6, the source country would not have been able to tax the reinsurance company on those premiums. This would also be true with respect to reinsurance premiums paid by a branch of the insurance company located in the source State. Therefore,

86 See E/C.18/2025/CRP.19 for the history of those discussions.

depending on their domestic law, some countries could find that the inclusion of the prior paragraph 6 of Article 5 in their bilateral treaties did not result in retention of significant tax revenues. The difficulties in determining the taxable profits of the deemed permanent establishment reinforced, in the case of insurance premiums, the general preference expressed by many developing countries for the simplicity of treaty provisions that allow them to continue collecting tax on non-residents through their domestic withholding taxes.

3. For these reasons, the Committee decided to replace paragraph 6 of Article 5 with Article 12C to avoid the need to determine the profits of a deemed permanent establishment in those circumstances. Article 12C allows certain premium payments paid to insurance or reinsurance companies to be taxed by a Contracting State on a gross basis and does not require any threshold, such as a permanent establishment or fixed base, as a condition for the taxation of such payments. Article 12C therefore serves the same function with respect to insurance and reinsurance premiums as other articles do with respect to payments underlying income from shipping or air transport in international traffic, dividends, interest, royalties, fees for services and payments underlying income from automated digital services.

4. A medium-sized minority of the Committee did not support the adoption of Article 12C.[87] In general, those Members prefer taxation on a net basis to taxation on a gross basis. Several expressed concerns about the potential tax burden if tax is imposed each time that the same risk is reinsured.

B. Commentary on the Paragraphs of Article 12C

Paragraph 1

5. This paragraph establishes that premiums arising in a Contracting State for insurance or reinsurance and paid to a resident of the other Contracting State may be taxed in the latter State. It does not, however, provide that such premiums are taxable exclusively by that State. Such premiums may also be taxed in the State in which such premiums arise.

87 The decision to include that minority view in the Commentary was taken at the thirtieth session of the Committee held in March 2025.

6. The article applies if the insurance premiums arising in a Contracting State are "paid" to a resident of the other Contracting State. The term "paid" has a broad meaning. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the 2017 OECD Model) and paragraph 6 of the Commentary on Article 11(quoting paragraph 5 of the Commentary on Article 11 of the 2017 OECD Model), the concept of payment means the fulfilment of the obligation to put funds at the disposal of the insurer in the manner required by contract or custom.

7. Article 12C deals only with insurance premiums arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to insurance premiums arising in a third State. Paragraphs 5 and 6 specify when insurance premiums are deemed to arise in a Contracting State.

Paragraph 2

8. This paragraph establishes the principle that the Contracting State in which the insurance premiums arise may tax such premiums in accordance with the provisions of its domestic law. However, if the beneficial owner of the premiums is an enterprise of the other Contracting State, the amount of tax imposed by the other State may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the premiums.

9. When considered in conjunction with Article 23 (Methods for the elimination of double taxation), Article 12C establishes the primary right of the country in which the premiums arise to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the premiums is a resident of the other Contracting State). Accordingly, the country in which the recipient of those premiums is resident is obligated to prevent double taxation of those premiums. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption of the income or the granting of a credit against any tax payable to the residence country on the income concerned, for any tax imposed on that income by the other Contracting State in accordance with the convention. In this regard, where a country generally applies the exemption method under Article 23 A, it is nevertheless entitled to

apply the credit method under paragraph 2 of Article 23 A with respect to items of income taxable under Article 12C.

10. The decision not to recommend a maximum rate of tax on insurance premiums is consistent with Articles 8, 10, 11, 12, 12AA and 12B of the UN Model dealing with payments underlying income from shipping or air transport in international traffic, dividends, interest, royalties, fees for services and income from automated digital services, respectively. Thus, the maximum rate of tax on insurance premiums is to be established through the bilateral negotiations of the Contracting States. This decision can be justified under current treaty practice. The source State tax treatment of insurance premiums allowed in bilateral tax treaties varies although the maximum rate that can be applied by the source State frequently is set at a rate lower than that applicable to dividends and interest to reflect the fact that an insurer will pay out a significant amount of its premium income to cover losses of those that are insured. However, it is natural for an insurer's underwriting losses to be cyclical. An insurer may collect premiums for a number of years before suffering large underwriting losses in a later year. Many, but not all, countries allow deductions for additions to reserves so that the entity's results show a more realistic and steady profit. It is therefore appropriate to consider the industry's profits over a number of years in setting an appropriate rate. Another factor favouring a low rate is the possibility that the same risk will be reinsured multiple times, with a withholding tax imposed on each reinsurance premium.

11. Paragraph 2 will restrict the source State's right to tax only in cases where the tax imposed with respect to the premiums is a covered tax under Article 2. This is likely to be the case if a Contracting State imposes taxes on insurance premiums in the form of an income tax, such as a gross-basis withholding tax. However, many countries impose excise taxes or other indirect taxes on insurance premiums or policies. In the case of a bilateral tax treaty entered into between two countries with different domestic law systems for taxing insurance premiums, it is possible that the taxing rights of a country that imposes a withholding tax could be limited while those of a country that imposes an excise tax would not be. Countries may want to consider these differences while drafting Article 2 in order to avoid inadvertent asymmetric treatment under their treaties.

12. For example, if State W imposes an income tax, in the form of a withholding tax, on insurance premiums and State X an excise tax, then one option is to include both taxes as covered taxes in Article 2. In that case, under paragraph 2 of Article 12C, the negotiated rate would apply to premiums arising in each Contracting State. Alternatively, if the treaty excluded both taxes from Article 2, then each of State W and State X could apply its domestic law without limit.

13. Paragraph 2 applies in priority to Article 7 as a result of paragraph 6 of Article 7. Thus, the conditions for the taxation of the business profits of an enterprise under Article 7 do not apply to insurance premiums covered by paragraph 2. Insurance premiums are taxable by a Contracting State under paragraph 2 if the premiums arise in that State irrespective of whether the relevant insurer has a permanent establishment in that State or conducts business activities in that State that are similar to those effected through the permanent establishment. However, by virtue of paragraph 4, if an insurer that is a resident of a Contracting State carries on business in the other Contracting State through a permanent establishment in that other State and receives insurance premiums in connection with those business activities, Article 7 will apply to those payments in priority to paragraph 2 of Article 12C.

14. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over insurance premiums merely because those premiums were paid directly to a resident of another State with which the first State had concluded a convention.

15. Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[88]), rather,

88 For example, where the trustees of a discretionary trust do not distribute insurance premiums earned during a given period, these trustees,

it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

16. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

17. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[89] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

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acting in their capacity as such (or the trust, if recognized as a separate taxpayer) could constitute the beneficial owners of such premiums for the purposes of Article 12C even if they are not the beneficial owners under the relevant trust law.

89 Reproduced at page R(6)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833, accessed on 10 May 2021. See footnote 25 above.

18. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the insurance premiums is not the "beneficial owner" because that recipient's right to use and enjoy the premiums is constrained by a contractual or legal obligation to pass on the premiums received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the insurance premiums unconstrained by a contractual or legal obligation to pass on the premiums received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the premiums by the direct recipient such as an obligation that is not dependent on the receipt of the premiums and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of insurance premiums does have the right to use and enjoy the premiums unconstrained by a contractual or legal obligation to pass on the premiums received to another person, the recipient is the "beneficial owner" of those premiums.

19. Whether entering into a reinsurance contract affects the insurer's status as a beneficial owner of the insurance premiums it receives depends on the terms of that contract. For example, in a fronting arrangement, an insurance company may identify a customer and price a risk in a jurisdiction in which it is not licensed to write such insurance. It then enters into an arrangement with an insurer that is so licensed under which the licensed insurer will write the direct insurance and then immediately reinsure the risk with the unlicensed company. The fronting company receives a commission in return for participating in the transaction. Cases involving a "fronting" company should be closely analysed to determine whether, under the facts and circumstances, the fronting company is acting as a mere nominee or agent or whether it has the right to use and enjoy the premiums within the meaning of paragraph 18 so that it should be recognized as the beneficial owner of such premiums.

20. For example, assume that a group of doctors located in State S, bands together to establish a captive insurance company, Captive, in State R to insure the doctors against medical malpractice risk. Captive is not licensed to provide insurance in State S. Accordingly,

Insurer T, a resident of Country T that is licensed to provide malpractice insurance in State S, agrees to "front" the insurance coverage by issuing insurance policies to the doctors on the condition that Captive will immediately reinsure the policies and pay a commission to Insurer T for its participation in the transaction. There is a treaty between State T and State S that includes Article 12C. However, in this case, Insurer T should not be treated as the beneficial owner of the premiums received from the doctors.

21. In most cases, however, an insurance company enters into a reinsurance contract for the business purpose of further shifting and distributing risks. This reinsurance can take several forms. A reinsurer may take on only specific risks (or a block of risks) from an insurer, through what is called "facultative" reinsurance, or may take on all risks incurred by the insurer during a specified period of time, pursuant to a "reinsurance treaty". In either case, the coverage may be "proportional" or "non-proportional". In the case of proportional reinsurance, the reinsurer may accept a certain percentage of all losses incurred by the insurance company. For example, a quota share treaty is a form of pro-rata reinsurance contract in which the insurer and reinsurer share premiums and losses according to a fixed percentage. In the case of non-proportional reinsurance, the reinsurer will only be liable if the insurance company's losses exceed a certain amount. One common form of non-proportional insurance is "excess-of-loss" insurance, in which the reinsurer will pay the entire amount of the insurer's loss in excess of the agreed threshold. However, it is also possible for a reinsurer to take only a specific "slice" of losses or for different reinsurers to take different slices.

22. In all of these cases, the company ceding risks to the reinsurance companies performs significant functions in terms of acquiring and administering the business. If there is a claim under the original contract of insurance, that claim is made against the ceding insurance company, not the reinsurance company. Under some quota share contracts, the reinsurance company is required to pay a ceding commission to compensate the insurance company for these functions. In these cases, the ceding company is not acting as a mere conduit or agent.

23. This argues in favour of generally treating the ceding company as the beneficial owner of the insurance premiums it receives, even

when it reinsures a part of the related risks with a reinsurance company, except in the case of fronting companies or other similar intermediary entities. Such an approach would also be administratively simple, as trying to "look-through" various layers of reinsurance could become very complicated in light of the various kinds of proportional and non-proportional reinsurance described in paragraph 21.

24. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of paragraph 2(a) of Article 10 which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, 12AA, 12B and 12C, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends, interest, royalties, fees for services, income from automated digital services and insurance premiums rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".

25. The fact that the recipient of insurance premiums is considered to be the beneficial owner of those premiums does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision, such as those addressed by the general anti-abuse rule of paragraph 9 of Article 29. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic

substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on insurance premiums to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

26. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State. Accordingly, in the example in paragraph 20, if there is a treaty between State S and State R that includes Article 12C, the imposition of the fronting company between the insured doctors and the captive insurance company would not prevent the captive insurance company from claiming a reduced rate under Article 12C.

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

Paragraph 3

28. Paragraph 3 defines certain terms used in Article 12C.

29. Paragraph 3(a) defines the term "insurance premiums" for the application of the taxation treatment specified by the Article. The term means amounts paid to an insurer pursuant to a contract (policy) in which the insurer indemnifies another person against losses from specific contingencies or perils (risks). Thus, for example, the definition would apply to premiums paid by a corporation to insure the life of a senior executive ("key person" insurance).

30. Insurance generally involves both "risk shifting" and "risk distribution". Risk shifting is transferring the risk of loss from one party to another, such as from the insured to the insurer, and is sometimes an

issue when considering captive insurance companies. Risk distribution is the pooling of independent risks of unrelated parties. An insurer can further reduce its overall risks by diversification, such as by writing homeowners' insurance in multiple markets. An insurer can also shift part of its risk through reinsurance, which effectively is insurance for insurers. Reinsurance therefore performs an important business function by further shifting and distributing risk, allowing insurance companies to underwrite more risks and reducing costs.

31. The definition in paragraph 3 also includes payments made by an insurer to secure reinsurance from another insurer. Some Members of the Committee were concerned that including reinsurance in the definition could result in tax being imposed multiple times with respect to the same risks. Other Members did not view such a result as multiple taxation as they viewed each reinsurance policy as a separate transaction giving rise to independent tax consequences. In their bilateral negotiations, countries might want to set a relatively low rate in paragraph 2 to take into account the common practice of entering into reinsurance contracts or provide for different rates for direct insurance and reinsurance.

32. Another Member was concerned that imposing a tax on reinsurance premiums paid to an unrelated third-party reinsurer could impact the local market and increase the cost of insurance. Reinsurance companies are located in very few countries and payments to a non-resident third party reinsurer represent a real shifting of the risk. This Member was of the view that the gross tax should only apply to reinsurance premiums paid to related non-residents, including back-to-back arrangements. Countries sharing these concerns could redraft the definition to include such a limitation.

33. The definition excludes amounts paid to acquire or maintain an annuity contract or an insurance contract that includes a substantial investment component. The investment component of an insurance contract consists of amounts that the insurer is required to pay to a policyholder even if an insured event does not occur. The concept of an investment component is derived from International Financial Reporting Standards on insurance products. The determination of whether or not the insurance contract includes a substantial investment component should be made when the contract is entered into.

34. The purpose of the exclusion is to prevent the imposition of a tax on certain life insurance contracts which are essentially savings products as, in those cases, the premium represents a capital investment by the owner of the insurance contract, not income to the recipient. Accordingly, the exclusion does not apply to term life contracts, where the owner of the insurance contract will receive nothing if the person who is the subject of the contract does not die during the contract's term.

35. Such contracts frequently allow the owner of the product to access the cash value in advance of the insured event taking place. For example, Individual X, a resident of Country A, has purchased a life insurance contract from InsureCo, a mutual life insurance company that is a resident of Country B. Individual X pays premiums of 10,000 annually for 30 years, starting at age 28, when the cost of insuring Individual X would be a fraction of 10,000. InsureCo invests the excess of the premiums paid by Individual X and the cash value of the insurance contract increases each year. The face amount of the contract (the amount that would be paid upon Individual X's death) may or may not increase, depending on whether Individual X has decided to use his dividends to buy additional paid-up insurance. Individual X has borrowed a portion of the cash value of the contract to make a down payment on a house (such borrowing would reduce the amount of the death benefit to the beneficiary if not repaid before Individual X dies). The insurance contract entered into by Individual X and InsureCo includes a substantial investment component, so that the premiums paid by Individual X are not subject to Article 12C.

36. Some members of the Committee noted that the provision, although based on a regulatory standard, might not provide sufficient certainty to taxpayers regarding whether premiums on a contract were subject to Article 12C. Accordingly, Contracting States are encouraged to discuss the types of insurance products that are available in each of the Contracting States and describe or identify, to the extent possible, the products with respect to which premiums are excluded from Article 12C.

37. A small minority of the Committee prefer that the provision itself be more specific and reference the investment component as a

percentage of the value of the insurance contract.[90] Countries sharing this preference could use this alternative formulation:

(a) the term "insurance premiums" means amounts paid to an insurer pursuant to a contract (policy) in which the insurer indemnifies another person against losses from specific contingencies, perils or risks; the term includes amounts paid to secure reinsurance but does not include amounts paid to acquire or maintain an annuity contract or an insurance contract if more than ___ per cent [*the percentage is to be established through bilateral negotiations*] of the value of such insurance contract consists of an investment component;

38. The definition of "insurance premiums" is restricted to payments made to an "insurer" as defined in subparagraph (b). An "insurer" is a company, any other person, or an arrangement, the majority of the income of which (i.e. more than 50% of the enterprise's gross income) consists of premiums and other amounts received in consideration for the issuance of insurance, reinsurance and annuity contracts and investment income related thereto. This includes investment income received from the investment of a company's reserves and a reasonable amount of "surplus assets" that are intended to provide protection against unexpected occurrences. This limitation is included to help distinguish insurance contracts from certain financial instruments such as credit default swaps and catastrophe bonds. A country that wished to cover all such instruments in their bilateral agreements could do so by deleting references to "insurer" in paragraph 3.

39. Country practice differs with respect to "captive insurance." In a captive insurance transaction, an entity or small group of taxpayers creates an affiliated entity (frequently in a no- or low-tax jurisdiction) in order to "insure" their risks. Some countries may take the position that the "insurance policies" entered into by such captive companies do not provide the risk shifting and/or risk distribution that are hallmarks of insurance. The transaction therefore may be seen as essentially establishing a reserve for future contingent liabilities, contributions to which would not be deductible under that country's domestic

90 The decision to include that minority view in the Commentary was taken at the thirtieth session of the Committee held in March 2025.

law. Because those countries would not view the captive company as providing insurance, amounts paid to the captive would not be paid to an "insurer" and therefore would not be subject to Article 12C.

40. Other countries may recognize the transactions entered into by the captive insurance company as insurance but use transfer pricing rules to ensure that any profits from the transaction are reflected in the accounts of the company being insured, not the captive insurance company. If a payment made to a captive insurance company is respected as an insurance premium, then Article 12C generally will apply to the payment.

41. Countries may also decide, in their bilateral agreements, to treat as "insurers" all enterprises that are regulated as such under the domestic laws of one of the Contracting States. Such an approach would require countries to become familiar with their own insurance regulatory structure, and that of their treaty partners, in order to ensure that those standards are consistent, including with respect to captive insurers. If that is the case, they could use the following alternative definition of "insurer" if they so choose:

(b) the term "insurer" means a person or arrangement:

(i) the majority of the income of which consists of premiums and other amounts received in consideration for the issuance of insurance, reinsurance and annuity contracts and investment income related thereto; or

(ii) that is regulated as an insurance or reinsurance enterprise in a Contracting State.

Paragraph 4

42. This paragraph provides that paragraphs 1 and 2 do not apply to insurance premiums if the beneficial owner has a permanent establishment in the State in which the premiums arise and the premiums are effectively connected with that permanent establishment. In this regard, paragraph 4 is similar to paragraph 4 of Articles 10, 11, 12, 12AA and 12C as well as paragraph 8 of Article 12B. Thus, if an insurer of one Contracting State enters into insurance policies through a permanent establishment located in the other Contracting State, the premiums received with respect to those policies will be taxable by the

State in which the permanent establishment is located in accordance with Article 7, rather than in accordance with Article 12C.

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

44. The paragraph does not define the meaning of the expression "effectively connected." As a result, whether insurance premiums are effectively connected with a permanent establishment or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, insurance premiums would be considered to be effectively connected with a permanent establishment if the insurance premiums are closely related to or connected with the business activities carried on through the permanent establishment. Also, insurance premiums would be effectively connected with business activities referred to in paragraph 1(c) of Article 7 where the insurance policies are entered into by an enterprise as part of that enterprise's business activities carried on in a Contracting State where a permanent establishment of that enterprise is situated and these activities are of the same or similar kind as the business activities performed through that permanent establishment.

45. Where paragraph 4 applies, insurance premiums are taxable by the State in which the premiums arise as part of the profits of the permanent establishment in accordance with Article 7. Thus, paragraph 4 relieves the State in which the insurance premiums arise from the limitations on its taxing rights imposed by paragraph 2 of Article 12C. Where Article 7 applies as a result of the application of paragraph 4, most countries consider that the State in which the permanent establishment is located is allowed to tax only the net profits from the insurance activities. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis, but a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination).

Paragraphs 5 and 6

46. Paragraph 5 lays down the principle that insurance premiums arise in a Contracting State when the payer is a resident of that State or if the person paying the insurance premiums has in the Contracting State a permanent establishment in connection with which the obligation to make the payment was incurred, and such payments are borne by the permanent establishment. This rule is consistent with the domestic law rules of many developing countries, which impose a withholding tax on all payments made from their country.

47. Under paragraph 5, where there is an obvious economic link between an insurance policy and the activities or assets of the permanent establishment of the policyholder in a Contracting State, the insurance premiums are considered to arise in the State in which the permanent establishment is situated. This result applies irrespective of whether the person that is carrying on the business through the permanent establishment is a resident of a Contracting State or a third State.

48. Paragraph 6 provides, however, for an exception from the rule of paragraph 5 in the case of insurance policies which have an obvious economic link with a permanent establishment maintained in the other Contracting State by the payer of the insurance premiums. If the policy was acquired for the requirements of that establishment and the premiums are borne by it, paragraph 6 provides that the source of the insurance premiums is in the Contracting State in which the permanent establishment is situated, rather than the Contracting State of which the payer is a resident.

49. Where there is no economic link between the insurance policy and a permanent establishment, the insurance premiums are considered to arise in the Contracting State of which the payer of the insurance premiums is a resident. If the payer of the insurance premiums is not a resident of either Contracting State, Article 12C does not apply to the insurance premiums unless the payer has a permanent establishment in one of the Contracting States and there is a clear economic link between the insurance policy and the permanent establishment. Otherwise, there would be, in effect, a force-of-attraction principle for insurance premiums, which would be inconsistent with other provisions of this Model.

50. Where insurance premiums are incurred for the purpose of a business carried on through a permanent establishment, those payments will usually qualify for deduction in computing the profits of the permanent establishment under Article 7. The deductibility of the insurance premiums provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment is situated.

51. The fact that the payer has, or has not, actually claimed a deduction for the insurance premiums in computing the profits of the permanent establishment is not necessarily conclusive, since the proper test is whether any deduction available for those payments should be taken into account in determining the profits of the permanent. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the insurance premiums are not deductible for some reason other than the fact that such expenses should not be allocated to the permanent establishment.

52. Before 2025, paragraph 6 of Article 5 provided that an insurance enterprise of a Contracting State would be deemed to have a permanent establishment in the other Contracting State if it collected premiums in that other State or insured risks situated in that State. This provision did not, however, apply to reinsurance.

53. The scope of the provision in Article 12C will be narrower than that of the former paragraph 6 of Article 5 because the source rule looks only to place of payment, not to the location of the risk that is being insured. The two will not always coincide. For example, a resident of State R may own ships that are berthed in State S and engaged in international traffic between State S and State T. If the resident of State R pays to insure those ships against loss, the premium payment will be treated as arising in State R, even though the property being insured is located in State S.

54. Those countries that are concerned about the narrower scope described in paragraph 53 may renumber the current source rule in paragraph 5 as subparagraph (a) and include the following new subparagraph 5(b) in their bilateral treaties:

(b) Where subparagraph (a) does not operate to treat insurance premiums as arising in either Contracting State and the insurance premiums are paid to insure risks situated in a Contracting State, then such premiums shall be deemed to arise in that State to the extent that they relate to such risks.

55. If subparagraph 5(b) is included, insurance premiums also will be deemed to arise in a Contracting State if the underlying risk is located in that State and the general rule of subparagraph (a) does not result in the premium payment being treated as arising in one of the Contracting States. For example, an insurance company resident in State I issues a property and casualty policy to another resident of State I, insuring its manufacturing facility located in State I against all perils. The State I insurance company then enters into an excess-of-loss reinsurance treaty with a reinsurance company resident in State R. That reinsurance company itself enters into a proportional reinsurance treaty with a resident of State T. Under Article 12C of the State I-State R tax treaty, the reinsurance premium paid by the State I insurer to the State R reinsurance company is treated as arising in State I. The reinsurance premium paid by the State R reinsurer to the State T reinsurer is treated as arising in State R because it is paid by a State R resident. It is not treated as arising in State I, even though the risk is located in State I, because the rule of alternative subparagraph 5(b) applies only in cases where the payment rule of subparagraph 5(a) does not treat the premiums as arising in one of the Contracting States.

56. However, alternative subparagraph 5(b) of the State I-State R treaty could be relevant in other circumstances involving the same parties. For example, assume that, in the circumstances described in paragraph 55, the State I insurance company enters into the excess-of-loss reinsurance treaty with the State T reinsurer, and the State T reinsurer enters into the proportional reinsurance treaty with the State R reinsurer. In that case, paragraph 5(b) of the State I-State R treaty would treat the payment made by the State T reinsurer to the State R reinsurer as arising in State I because the risk is located in State I and the payment rule of paragraph 5(a) is inapplicable to the payment made by the State T reinsurance company.

57. Although the prior rule of paragraph 6 of Article 5 included a reference to risk, it is unclear how that rule was applied in practice. Some

Members believe that risk should be located in the jurisdiction where the cost of an uninsured loss would have been borne. However, rules regarding the location of risk are far from uniform across countries and may not look to the entity that would incur the loss. For example, the location of the risk for immovable property such as a building may be where the property is located, not the residence of the owner of the property who would suffer a loss if there were damage to a building. In the case of vehicles, such as ships, aircraft and motor vehicles, the location of the risk may be the physical location of the vehicle, the jurisdiction in which the vehicle is registered or the place of residence or establishment of the insured. If there is no agreement on location of risk, there is a possibility that a single premium could be subject to tax in multiple jurisdictions under the rule of Article 12C, which allows gross basis taxation.

58. Some Members of the Committee believe that the location rule of subparagraph 5(b) would introduce substantial complexity to a rule that was intended to simplify taxation. In that regard, they are particularly concerned about how the rule would apply in the case of reinsurance or direct insurance that covers multiple entities and/or countries. Some also argue that it is inappropriate to look through the reinsurance contract to the underlying risk, as a reinsurer relies on the underwriting prowess of the ceding insurer rather than conducting its own analysis of the underlying risks. Moreover, the withholding tax systems of many developing countries are based on place of payment, so that those countries would have difficulty applying the rule of subparagraph 5(b). Countries may want to consider these points before deciding to include subparagraph 5(b). They may also want to discuss and agree with their treaty partners on rules regarding the location of risk in order to avoid double or multiple taxation.

Paragraph 7

59. The purpose of paragraph 7 is to restrict the operation of the provisions concerning the taxation of insurance premiums in cases where, by reason of a special relationship between the payer and the beneficial owner of the income or between both of them and some other person, the amount of the premiums exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they

had stipulated at arm's length. Paragraph 7 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the insurance premiums would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

60. It is clear from the text that in order for this paragraph to apply, the insurance premiums held to be excessive must be due to a special relationship between the payer and the beneficial owner of the income or between both of them and some other person. There may be cited, as examples of such a special relationship, cases where the insurance premiums are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the payer or is subordinate to a group having common interest with the payer. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

61. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationships created through the insurance policy.

62. With regard to the taxation treatment to be applied to the excess part of the insurance premium, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike paragraph 6 of Article 11, which, because of the limiting phrase "having regard to the debt claim for which it is paid," permits only the adjustment of the rate at which interest is charged, paragraph 6 permits the reclassification of the insurance premiums in such a way as to give them a different character. This paragraph can affect not only the recipient of the payments, but also the payer of excessive insurance premiums; if the law of the State where the payer is resident or has a permanent establishment permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the insurance premiums, there would be nothing to prevent them from introducing additional

clarifications in the last sentence of paragraph 7, as long as they do not alter its general purport.

63. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of insurance premiums, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

Article 13

CAPITAL GAINS

A. General considerations

1. Article 13 of the UN Model consists of the first four paragraphs of Article 13 of the OECD Model. Paragraphs 5, 6 and 7 of the UN Model include additional provisions. Paragraph 8 is the same as paragraph 5 of the OECD Model but adjusted to take into account the insertion of the additional paragraphs.

2. The text of this Article resulted from a compromise which the former Group of Experts felt would be most acceptable to both developed and developing countries. Some members from developed countries advocated the use of Article 13 of the OECD Model, which (1) allows the source country to tax capital gains from the alienation of immovable property and from movable property that is a part of a permanent establishment, (2) permits gains from the alienation of ships and aircraft in international traffic to be taxed only in the State of the relevant enterprise, and (3) reserves to the residence country the right to tax gains on the alienation of other types of property. Most members from developing countries advocated the right of the source country to levy a tax in situations in which the OECD reserves that right to the country of residence.

3. The Committee considers that the following preliminary remarks in the Commentary on Article 13 of the 2017 OECD Model are relevant to the taxation of capital gains in both developed and developing countries and are therefore applicable to Article 13 of this Model:

> 1. A comparison of the tax laws of the OECD member countries shows that the taxation of capital gains varies considerably from country to country:
>
> — in some countries capital gains are not deemed to be taxable income;
>
> — in other countries capital gains accrued to an enterprise are taxed, but capital gains made by an individual outside the course of his trade or business are not taxed;

— even where capital gains made by an individual outside the course of his trade or business are taxed, such taxation often applies only in specified cases, for example, profits from the sale of immovable property or speculative gains (where an asset was bought to be resold).

2. Moreover, the taxes on capital gains vary from country to country. In some OECD member countries, capital gains are taxed as ordinary income and therefore added to the income from other sources. This applies especially to the capital gains made by the alienation of assets of an enterprise. In a number of OECD member countries, however, capital gains are subjected to special taxes, such as taxes on profits from the alienation of immovable property, or general capital gains taxes, or taxes on capital appreciation (increment taxes). Such taxes are levied on each capital gain or on the sum of the capital gains accrued during a year, mostly at special rates, which do not take into account the other income (or losses) of the taxpayer. It does not seem necessary to describe all those taxes.

3. The Article does not deal with the above-mentioned questions. It is left to the domestic law of each Contracting State to decide whether capital gains should be taxed and, if they are taxable, how they are to be taxed. The Article can in no way be construed as giving a State the right to tax capital gains if such right is not provided for in its domestic law.

3.1 The Article does not specify to what kind of tax it applies. It is understood that the Article must apply to all kinds of taxes levied by a Contracting State on capital gains. The wording of Article 2 is large enough to achieve this aim and to include also special taxes on capital gains. Also, where the Article allows a Contracting State to tax a capital gain, this right applies to the entire gain and not only to the part thereof that has accrued after the entry into force of a treaty (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.

4. The Committee also considers that the following general remarks found in the Commentary on Article 13 of the 2017 OECD Model are applicable to Article 13 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

4. It is normal to give the right to tax capital gains on a property of a given kind to the State which under the Convention is entitled to tax both the property and the income derived therefrom. The right to tax a gain from the alienation of a business asset must be given to the same State without regard to the question whether such gain is a capital gain or a business profit. Accordingly, no distinction between capital gains and commercial profits is made nor is it necessary to have special provisions as to whether the Article on capital gains or Article 7 on the taxation of business profits should apply. It is however left to the domestic law of the taxing State to decide whether a tax on capital gains or on ordinary income must be levied. The Convention does not prejudge this question.

5. The Article does not give a detailed definition of capital gains. This is not necessary for the reasons mentioned above. The words "alienation of property" are used to cover in particular capital gains resulting from the sale or exchange of property and also from a partial alienation, the expropriation, the transfer to a company in exchange for stock, the sale of a right, the gift and even the passing of property on death.

6. Most States taxing capital gains do so when an alienation of capital assets takes place. Some of them, however, tax only so-called realised capital gains. Under certain circumstances, though there is an alienation no realised capital gain is recognised for tax purposes (e.g. when the alienation proceeds are used for acquiring new assets). Whether or not there is a realisation has to be determined according to the applicable domestic tax law. No particular problems arise when the State which has the right to tax does not exercise it at the time the alienation takes place.

7. As a rule, appreciation in value not associated with the alienation of a capital asset is not taxed, since, as long as the owner still holds the asset in question, the capital gain exists only on paper. There are, however, tax laws under which capital appreciation and revaluation of business assets are taxed even if there is no alienation.

8. Special circumstances may lead to the taxation of the capital appreciation of an asset that has not been alienated. This may be the case if the value of a capital asset has increased in such a manner that the owner proceeds to the revaluation of this asset in his books. Such revaluation of assets in the books may also occur in the case of a depreciation of the national currency. A number of States levy special taxes on such book profits, amounts put into reserve, an increase in the

paid-up capital and other revaluations resulting from the adjustment of the book-value to the intrinsic value of a capital asset. These taxes on capital appreciation (increment taxes) are covered by the Convention according to Article 2.

9. Where capital appreciation and revaluation of business assets are taxed, the same principle should, as a rule, apply as in the case of the alienation of such assets. It has not been found necessary to mention such cases expressly in the Article or to lay down special rules. The provisions of the Article as well as those of Articles 6, 7 and 21, seem to be sufficient. As a rule, the right to tax is conferred by the above-mentioned provisions on the State of which the alienator is a resident, except that in the cases of immovable property or of movable property forming part of the business property of a permanent establishment, the prior right to tax belongs to the State where such property is situated. Special attention must be drawn, however, to the cases dealt with in paragraphs 13 to 17 below.

10. In some States the transfer of an asset from a permanent establishment situated in the territory of such State to a permanent establishment or the head office of the same enterprise situated in another State is assimilated to an alienation of property. The Article does not prevent these States from taxing profits or gains deemed to arise in connection with such a transfer, provided, however, that such taxation is in accordance with Article 7.

11. The Article does not distinguish as to the origin of the capital gain. Therefore all capital gains, those accruing over a long term, parallel to a steady improvement in economic conditions, as well as those accruing in a very short period (speculative gains) are covered. Also capital gains which are due to depreciation of the national currency are covered. It is, of course, left to each State to decide whether or not such gains should be taxed.

12. The Article does not specify how to compute a capital gain, this being left to the domestic law applicable. As a rule, capital gains are calculated by deducting the cost from the selling price. To arrive at cost all expenses incidental to the purchase and all expenditure for improvements are added to the purchase price. In some cases the cost after deduction of the depreciation allowances already given is taken into account. Some tax laws prescribe another base instead of cost, for example, the value previously reported by the alienator of the asset for capital tax purposes.

13. Special problems may arise when the basis for the taxation of capital gains is not uniform in the two Contracting States. The capital gain from the alienation of an asset computed in one State according to the rules mentioned in paragraph 12 above, may not necessarily coincide with the capital gain computed in the other State under the accounting rules used there. This may occur when one State has the right to tax capital gains because it is the State of situs while the other State has the right to tax because the enterprise is a resident of that other State.

14. The following example may illustrate this problem: an enterprise of State A bought immovable property situated in State B. The enterprise may have entered depreciation allowances in the books kept in State A. If such immovable property is sold at a price which is above cost, a capital gain may be realised and, in addition, the depreciation allowances granted earlier may be recovered. State B, in which the immovable property is situated and where no books are kept, does not have to take into account, when taxing the income from the immovable property, the depreciation allowances booked in State A. Neither can State B substitute the value of the immovable property shown in the books kept in State A for the cost at the time of the alienation. State B cannot, therefore, tax the depreciation allowances realised in addition to the capital gain as mentioned in paragraph 12 above.

15. On the other hand, State A of which the alienator is a resident, cannot be obliged in all cases to exempt such book profits fully from its taxes under paragraph 1 of the Article and Article 23 A (there will be hardly any problems for States applying the tax credit method). To the extent that such book profits are due to the realisation of the depreciation allowances previously claimed in State A and which had reduced the income or profits taxable in such State A, that State cannot be prevented from taxing such book profits *[…]*.

16. Further problems may arise in connection with profits due to changes of the rate of exchange between the currencies of State A and State B. After the devaluation of the currency of State A, enterprises of such State A may, or may have to, increase the book value of the assets situated outside the territory of State A. Apart from any devaluation of the currency of a State, the usual fluctuations of the rate of exchange may give rise to so-called currency gains or losses. Take for example an enterprise of State A having bought and sold immovable property situated in State B. If the cost and the selling price, both expressed in the currency of State B, are equal, there will be no capital gain in State B. When the value of the currency of State B has risen between the

purchase and the sale of the asset in relation to the currency of State A, in the currency of that State a profit will accrue to such enterprise. If the value of the currency of State B has fallen in the meantime, the alienator will sustain a loss which will not be recognised in State B. Such currency gains or losses may also arise in connection with claims and debts contracted in a foreign currency. If the balance sheet of a permanent establishment situated in State B of an enterprise of State A shows claims and debts expressed in the currency of State B, the books of the permanent establishment do not show any gain or loss when repayments are made. Changes of the rate of exchange may be reflected, however, in the accounts of the head office. If the value of the currency of State B has risen (fallen) between the time the claim has originated and its repayment, the enterprise, as a whole, will realise a gain (sustain a loss). This is true also with respect to debts if between the time they have originated and their repayment, the currency of State B has fallen (risen) in value.

17. The provisions of the Article do not settle all questions regarding the taxation of such currency gains. Such gains are in most cases not connected with an alienation of the asset; they may often not even be determined in the State on which the right to tax capital gains is conferred by the Article. Accordingly, the question, as a rule, is not whether the State in which a permanent establishment is situated has a right to tax, but whether the State of which the taxpayer is a resident must, if applying the exemption method, refrain from taxing such currency gains which, in many cases, cannot be shown but in the books kept in the head office. The answer to that latter question depends not only on the Article but also on Article 7 and on Article 23 A. If in a given case differing opinions of two States should result in an actual double taxation, the case should be settled under the mutual agreement procedure provided for by Article 25.

18. Moreover, the question arises which Article should apply when there is paid for property sold an annuity during the lifetime of the alienator and not a fixed price. Are such annuity payments, as far as they exceed costs, to be dealt with as a gain from the alienation of the property or as "income not dealt with" according to Article 21? Both opinions may be supported by arguments of equivalent weight, and it seems difficult to give one rule on the matter. In addition such problems are rare in practice, so it therefore seems unnecessary to establish a rule for insertion in the Convention. It may be left to Contracting States who may be involved in such a question to adopt a solution in the mutual agreement procedure provided for by Article 25.

19. The Article is not intended to apply to prizes in a lottery or to premiums and prizes attaching to bonds or debentures.

20. Paragraphs 1 to *[7]* of the Article deal first with gains from the alienation of specific categories of property. For all other capital gains, paragraph *[8]* gives the right to tax to the State of which the alienator is a resident.

21. As capital gains are not taxed by all States, it may be considered reasonable to avoid only actual double taxation of capital gains. *[Paragraph 3 of Article 1 would address many such situations. If that paragraph does not address a specific type of situation in relation to capital gains that has been identified by the]* Contracting States*[, they]* are free to supplement their bilateral convention in such a way that a State has to forego its right to tax conferred on it by the domestic laws only if the other State on which the right to tax is conferred by the Convention makes use thereof. In such a case, paragraph *[8]* of the Article should be supplemented accordingly. Besides, *[Contracting States may also wish to consider]* a modification of Article 23 A as suggested in paragraph 35 of the Commentary on Article 23 A *[of the OECD Model, as quoted at paragraph 15 of the Commentary on Article 23A of this model…]*.

B. Commentary on the paragraphs of Article 13

Paragraph 1

5. This paragraph reproduces paragraph 1 of Article 13 of the OECD Model. The Committee considers that the following part of the Commentary on Article 13 of the 2017 OECD Model is applicable to paragraph 1 of Article 13 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

22. Paragraph 1 states that gains from the alienation of immovable property may be taxed in the State in which it is situated. This rule corresponds to the provisions of Article 6 and of paragraph 1 of Article 22. It applies also to immovable property forming part of the assets of an enterprise. For the definition of immovable property paragraph 1 refers to Article 6. Paragraph 1 of Article 13 deals only with gains which a resident of a Contracting State derives from the

alienation of immovable property situated in the other Contracting State. It does not, therefore, apply to gains derived from the alienation of immovable property situated in the Contracting State of which the alienator is a resident in the meaning of Article 4 or situated in a third State; the provisions of paragraph *[8]* shall apply to such gains (and not, as was mentioned in this Commentary before 2002, those of paragraph 1 of Article 21).

23. The rules of paragraph 1 are supplemented by those of paragraph 4, which applies to gains from the alienation of all or part of the shares in a company holding immovable property *[…]*.

Paragraph 2

6. This paragraph reproduces paragraph 2 of Article 13 of the OECD Model. The Committee considers that the following part of the Commentary on Article 13 of the 2017 OECD Model is applicable to paragraph 2 of Article 13 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

24. Paragraph 2 deals with movable property forming part of the business property of a permanent establishment of an enterprise. The term "movable property" means all property other than immovable property which is dealt with in paragraph 1. It includes also incorporeal property, such as goodwill, licences, etc. Gains from the alienation of such assets may be taxed in the State in which the permanent establishment is situated, which corresponds to the rules for business profits (Article 7).

25. The paragraph makes clear that its rules apply when movable property of a permanent establishment is alienated as well as when the permanent establishment as such (alone or with the whole enterprise) is alienated. If the whole enterprise is alienated, then the rule applies to such gains which are deemed to result from the alienation of movable property forming part of the business property of the permanent establishment. The rules of Article 7 should then apply mutatis mutandis without express reference thereto. For the transfer of an asset from a permanent establishment in one State to a permanent establishment (or the head office) in another State, see paragraph 10 *[of the Commentary on Article 13 of the 2017 OECD Model, as quoted in paragraph 4 above]*.

26. On the other hand, paragraph 2 may not always be applicable to capital gains from the alienation of a participation in an enterprise. Where the enterprise performs its activities in the form of an entity or arrangement that is treated as fiscally transparent under the tax law of a Contracting State, that State will, under paragraph 2 of Article 13, be allowed to tax in the hands of the non-resident partners or members of the entity or arrangement the gains derived from the alienation of the movable property forming part of the business property of a permanent establishment of the enterprise that is situated in that State even where the gains arise from the alienation of the enterprise as a whole (see also paragraph 2 of Article 1 and paragraphs 2 to 16 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 7 of the Commentary on Article 1 of this Model]*). Where, however, an enterprise performs its activities in the form of an entity or arrangement that a State treats as a separate taxpayer resident of one of the Contracting States, that State should treat the alienation of a participation in such an entity or arrangement in the same way as shares in a company to which paragraphs 4 or 5 of the Article apply. Paragraphs 32.4 to 32.7 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]* address situations where the domestic laws of the two Contracting States differ in this regard.

27. Certain States consider that all capital gains arising from sources in their territory should be subject to their taxes according to their domestic laws, if the alienator has a permanent establishment within their territory. Paragraph 2 is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". The paragraph merely provides that gains from the alienation of movable property forming part of the business property of a permanent establishment may be taxed in the State where the permanent establishment is situated. The gains from the alienation of all other movable property are taxable only in the State of residence of the alienator as provided in paragraph *[8]*. The foregoing explanations accord with those in the Commentary on Article 7.

Paragraph 3

7. This paragraph reproduces paragraph 3 of Article 13 of the OECD Model. The Committee considers that the following part of the Commentary on Article 13 of the 2017 OECD Model is applicable to paragraph 3 of Article 13 of the UN Model (the modifications that

appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 28. An exception from the rule of paragraph 2 is provided for ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft. Normally, gains from the alienation of such assets are taxable only in the State of the enterprise operating such ships and aircraft. This rule corresponds to the provisions of Article 8 and of paragraph 3 of Article 22. Contracting States which would prefer to confer the exclusive taxing right on the State in which the place of effective management of the enterprise is situated are free, in bilateral conventions, to substitute for paragraph 3 a provision corresponding to that proposed in paragraph 2 of the Commentary on Article 8 *[of the 2017 OECD Model and in paragraph 9 of the Commentary on Article 8 of this Model].*

Paragraph 4

8. This paragraph corresponds to paragraph 4 of the OECD Model. Until the 2017 update, paragraph 4 of the UN Model read as follows:

> 4. Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:
>
> (*a*) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.
>
> (*b*) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.

Both this previous formulation and the current one are designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the use of a company incorporated for the purpose of holding such property, it is necessary to tax the sale of shares in such a company. This is especially so where ownership of the shares carries the right to occupy the property. In order to achieve its objective, paragraph 4 applies regardless of whether the company is a resident of the Contracting State in which the immovable property is situated or a resident of another State.

9. In 1999, the former Group of Experts decided to amend paragraph 4 to expand its scope to include interests in partnerships, trusts and estates which own immovable property. In 2017, the Committee decided to adopt the updated provision from the OECD Model, as the concept of a "comparable interests" is broadly equivalent to what was previously covered by paragraph 4 of the UN Model. At the same time, paragraph 4 was expanded to cover situations where assets are contributed to an entity shortly before the sale of the shares (or comparable interests) in that entity in order to dilute the proportion of the value of these shares (or comparable interests) that is derived from immovable property situated in that other Contracting State. It achieves this by looking at whether the shares (or comparable interests) derived their value primarily from immovable property at any time during the 365 days preceding the alienation, as opposed to the time of alienation only.

10. By providing that gains from the alienation of shares or comparable interests which, at any time during the 365 days preceding the alienation, derived more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State, paragraph 4 provides that gains from the alienation of such shares or comparable interests and gains from the alienation of the underlying immovable property, which are covered by paragraph 1, are equally taxable in that State.

11. Paragraph 4 allows the taxation of the entire gain attributable to the shares or comparable interests to which it applies even where part of the value of these shares or comparable interests is derived from property other than immovable property located in the source State. The determination of whether shares of a company or comparable interests

derive, at any time during the 365 days preceding the alienation, more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company, entity or arrangement without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property).

12. When adopting the updated wording from the OECD Model in 2017, the Committee decided to delete the previous paragraph 4(*a*) from the UN Model as it did not reflect common practice. It was found that the provision was very rarely used and was difficult to apply. However, States may agree during bilateral negotiations to include, at the end of paragraph 4, the wording of paragraph 4(*a*) as it appeared prior to the 2017 update. In that case, paragraph 4 would read as follows:

> 4. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State. Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.

13. Countries may also agree during bilateral negotiations to restrict the scope of paragraph 4, as is done in the case of paragraph 7, to situations where the alienator holds directly or indirectly at least a certain percentage, to be established through bilateral negotiations, of the capital of the company or entity of which it alienates shares or comparable interests. This possibility is recognized as follows in paragraph 28.6 of the Commentary on Article 13 of the 2017 OECD: "Another change that some States may agree to make is to restrict the application of the provision to cases where the alienator holds a certain level of participation in the company."

14. Additionally, as is the case with paragraphs 5 and 7 (see paragraphs 30 and 43 below), States could choose to add an exception for gains derived in the course of corporate reorganizations.

15. The application of paragraph 4 to the alienation of shares and comparable interests in a Real Estate Investment Trust (REIT) raises policy issues which are discussed in paragraph 49 of the Commentary on Article 1.

Paragraph 5

16. Some countries hold the view that a Contracting State should be able to tax a gain on the alienation of shares of a company resident of that State, whether the alienation occurs within or outside that State. However, it is recognized that for administrative reasons the right to tax should be limited to the alienation of shares of a company in the capital of which the alienator at any time during the 365 days preceding the alienation, held, directly or indirectly, a substantial participation. The determination of what is a substantial participation is left to bilateral negotiations, in the course of which an agreed percentage can be determined.

17. In 2017, the Committee decided to include a reference to "comparable interests" in paragraph 5 in order to mirror the similar change made to paragraph 4.

18. Paragraph 5 provides for taxation of a gain on the alienation of shares and comparable interests but excludes gains from the alienation of shares to which paragraph 4 applies. The wording clearly stipulates that a gain on the alienation of any number of shares may be taxed in the State in which the company is a resident as long as the shareholding is substantial at any time during the 365-day period preceding the alienation. A substantial shareholding is determined according to the percentage shareholding decided during the relevant bilateral negotiations. Consequently, even if a substantial shareholding is alienated through a number of transfers of smaller shareholdings, the taxing right granted by the paragraph will still apply if the shares transferred were alienated at any time during the 365-day period.

19. It will be up to the law of the State imposing the tax to determine which transactions give rise to a gain on the alienation of shares and how to determine the percentage held by the alienator, in particular in

the case of an indirect holding. An indirect holding in this context may include ownership by related persons that is imputed to the alienator. Anti-avoidance rules of the law of the State imposing the tax may also be relevant in determining the percentage held directly or indirectly by the alienator. The treaty text itself or associated documents could alternatively expand on the meaning of these concepts.

20. The question of laying down a concessionary rate of tax (compared with the normal domestic rate) on gains arising from the alienation of shares, other than the shares referred to in paragraph 4 (that is, shares that do not derive more than 50 per cent of their value from immovable property), has also been considered. Since the gains arising on alienation of shares being taxed in a concessionary manner is likely to encourage investment in shares, promote foreign direct investment and portfolio investment, and thereby give impetus to the industrialization of the country, countries may consider discussing this matter during bilateral negotiations and making necessary provision in the bilateral tax treaties.

21. The right to tax under paragraph 5 depends on whether, at any time during the 365 days preceding the alienation, the alienator of the shares or comparable interests held directly or indirectly at least the specified percentage of the capital of the company or entity. In most situations, the "alienator" will be the resident who derives the gain, such as a parent company that alienates shares of its subsidiary.

22. In some cases, however, the alienator may be different from the resident who derives the gain. This would be the case, for instance, where the shares or comparable interests are alienated by a transparent entity.

23. Assume, for example, that RCo, a company resident of State R, holds a 50 per cent interest in RPSP, a partnership that is organized under State R law. RPSP in turn holds 25 per cent of the shares of SCo, a company resident of State S. Assume also that paragraph 5 of Article 13 of the R-S tax convention contains a 25 per cent ownership threshold and that, under State R law, RPSP is treated as fiscally transparent (see the explanation in paragraph 7 of the Commentary on Article 1 which quotes paragraph 9 of the Commentary on Article 1 of the 2017 OECD Model). RPSP alienates all its shares of SCo and realises a capital gain of 100. In that case, State R will tax the capital gain in the hands of its resident partners, thereby taxing RCo on 50.

24. In this example, for the purposes of applying paragraph 5, RCo is the resident of a Contracting State that has derived a gain from the alienation of the shares of SCo. However, RPSP, as the owner of the SCo shares, is the alienator of the shares, and as such, the relevant ownership threshold should be applied at the level of RPSP. In this example, State S may therefore tax the gain from the alienation of the shares of SCo.

25. In the different example where RCo held directly 20 per cent of the shares of SCo, in addition to the 12.5 per cent held through RPSP, and alienated this 20 per cent direct shareholding, thereby realising a capital gain of 80, RCo would be considered both as the resident who derived the capital gain of 80 and the alienator of the 20 per cent shareholding for the purposes of paragraph 5 (in that case, RCo's total holding of the shares of SCo would be 32.5 per cent, that is, 20 per cent plus 12.5 per cent held through RPSP). State S would therefore be allowed to tax the capital gain of 80 derived by RCo on the alienation of its 20 per cent shareholding.

26. A single member of the Committee did not agree with paragraphs 24 and 25 above.[91] That member held the view that the legal form of enterprises in bona fide transactions should be respected so as to provide legal certainty to the enterprises concerned, other than in cases of treaty abuse which are more appropriately addressed under paragraph 9 of Article 29. That member also noted that the approach in paragraphs 24 and 25 to treat a transparent entity as an "alienator" does not cohere with paragraph 8 of Article 13, which provides for taxing rights to be allocated to the Contracting State of which the alienator is resident and may lead to conflicting results under paragraphs 5 and 8 of Article 13 when applied to the same transparent entity. The mentioned approach may also result in fundamental mismatches with domestic tax laws, as transparent entities are not treated as legal persons in some States and would not be a resident of a Contracting State in any circumstances. As a consequence of this approach, there could also be uncertainty on how double taxation, if any, would be eliminated.

27. It is costly to tax gains from the alienation of quoted shares. In addition, developing countries may find it economically rewarding to

91 The decision to include that minority view in the Commentary was taken at the twenty-first session of the Committee held in October 2020.

boost their capital markets by not taxing gains from the alienation of quoted shares. Countries that wish to do so may include in their bilateral tax treaties the following:

> Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests, such as interests in a partnership or a trust, which is a resident of the other Contracting State, excluding shares in which there is substantial and regular trading on a recognized stock exchange, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ per cent *[the percentage is to be established through bilateral negotiations]* of the capital of that company.

The treaty text itself or associated documents could expand on the meaning of the phrases "substantial and regular trading" and "recognized stock exchange".

28. Some countries might consider that the Contracting State in which a company is resident should be allowed to tax the alienation of its shares only if a substantial portion of the company's assets are situated in that State and in bilateral negotiations might seek to include such a limitation.

29. Other countries engaged in bilateral negotiations might seek to have paragraph 5 omitted entirely, where they take the view that taxation in the source State of capital gains in these situations may create economic double taxation in the corporate chain, thus hampering foreign direct investment. This consideration is, in particular, relevant for countries that apply a participation exemption not only to dividends received from a substantial shareholding, but also to capital gains made on shares in relation to such substantial holdings.

30. If countries choose not to tax the gains derived in the course of corporate reorganizations, they are of course also free to do so.

Paragraph 6

31. The provisions of paragraph 6 allow a State to tax gains from the alienation of rights granted under the law of that State as long as these rights allow the use of resources that are naturally present in that

State and that are under the jurisdiction of that State. This would cover, for example, the alienation of rights such as fishing quotas granted by the State; the right to fell timber in a forest; the right to extract water; the right to explore part of a territory of the State for oil, gas or minerals; the right to install wind or tidal stream turbines in part of the territory of the State as well as the right to use all or part of the radiofrequency spectrum in the State, including for cell phone purposes. The common features of these rights are that they allow the commercial exploitation of resources that are inextricably linked to the territory of a State and that the value of these rights consists of what are recognizably location-specific rents deriving from some government-issued license.

32. The provision does not cover rights granted contractually between private parties even if these rights are protected under the law of a State. Thus, the alienation of the exclusive right to use know-how in a given State would not be covered by the provision as that right granted by the owner of the know-how is not granted under the law of the State. Also, rights allowing the use of property developed by private parties, such as a copyright or patent license, would not be covered by the provision because they do not relate to the use of resources that are naturally present in that other State and that are under the jurisdiction of that State.

33. The provision only applies where the right referred to therein is itself alienated. Subject to the possible application of anti-abuse rules such as those of paragraph 9 of Article 29, it would not apply in the case of an "indirect transfer" of such a right, for example, where the right is held by a company and the shares of that company are alienated. Depending on the circumstances, however, such indirect transfers could fall within the scope of paragraph 4, 5 or 7.

34. In many cases, the rights to which the provision applies will also constitute immovable property, as defined in paragraph 2 of Article 6, and the provisions of paragraph 1 of Article 13 will apply to the alienation of such rights. This would be the case, for example, of a mining license granted by a State that would constitute immovable property within the meaning of the term "immovable property" under the domestic law of that State or under the phrase "rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources" in paragraph 2

of Article 6. In such a case, nothing in the provision would prevent the application of paragraph 1 of Article 13 and vice-versa. In other situations, however, the provision will allow a State to tax rights that relate to the exploitation of its natural resources where these rights do not constitute immovable property under a proper construction of paragraph 2 of Article 6. This would be the case, for example, if exploration rights granted by a State do not fall within the meaning of "immovable property" under its domestic law.

35. Also, while paragraph 2 of Article 13 would cover cases where an enterprise of a Contracting State alienates rights granted under the law of the other Contracting State to which the provision applies to the extent that such rights form part of the movable property of a permanent establishment of the enterprise situated in that other State, the provision ensures the same treatment for cases where the right is not attributable to such a permanent establishment, for example where the right that is alienated does not belong to the enterprise that owns the permanent establishment but belongs to a closely related person.

Paragraph 7

36. Since the application of paragraph 5 is restricted to shares or comparable interests in resident companies or entities (subject to the possible application of anti-abuse rules such as paragraph 9 of Article 29), a Contracting State may not tax gains derived by a resident of the other Contracting State from the alienation of shares or comparable interests of a non-resident company or similar entity unless these shares or comparable interests derive more than 50 per cent of their value directly or indirectly from immovable property situated in the first-mentioned State so as to fall within the scope of paragraph 4. This means that for non-abusive cases, unless paragraph 4 applies, gains derived by a non-resident from the alienation of shares or similar interests of a non-resident company or entity would fall under paragraph 8, which provides for the exclusive taxation of the gains by the State of residence, even if such non-resident company or entity derives the majority of its value from other types of assets situated in the other State (such as shares of a manufacturing company that is resident of, and operated in, that other State). Many developing countries consider that they should have the right to tax gains from such transactions, which are sometimes referred to as "offshore indirect transfers" (OITs).

37. Paragraph 7 addresses that issue by allowing for the taxation of gains from certain OITs by the Contracting State in which the underlying assets are situated. According to that paragraph, gains derived by a non-resident from the alienation of shares or comparable interests in a local or offshore company or entity may be taxed by a State if these shares or comparable interests derive at least 50 per cent of their value from property with respect to which that State would, under the other provisions of Article 13, have had the right to tax the gain from a direct alienation. The policy rationale for that paragraph is analogous to the policy rationale for paragraph 4 regarding immovable property. The following example illustrates the application of paragraph 7:

> *Example*: Company A, a resident of State A, holds 30 per cent of the shares of company B, which is a resident of State B. The value of all the shares of company B is 100. Throughout all the relevant period, company B has no debt and the only assets owned by company B are a bank account worth 30, shares representing 30 per cent of the capital of company X, shares representing 25 per cent of the capital of company Y and shares representing 15 per cent of the capital of company Z. Companies X, Y and Z are all residents of State C and the value of all the shares of each company is 100. Paragraphs 5 and 7 of Article 13 of the tax treaty between States A and C are based on paragraphs 5 and 7 of Article 13 of the UN Model; the percentages specified in paragraph 5 and in subparagraph (*a*) of paragraph 7 are 20 per cent.
>
> Company A alienates part of the shares of company B that it owns. The condition in subparagraph *(a)* of paragraph 7 is met since company A held more than 20 per cent of the capital of company B at some point in time during the 365-day period preceding the alienation. The condition of subparagraph (*b*) is also met because, at some point in time during the 365-day period preceding the alienation, more than 50 per cent of the value of the shares of company B was derived from a combination of property (i.e. the 30 per cent of the shares of company X and the 25 per cent of the shares of company Y), which are property any gain from which would have been taxable in State C in accordance with paragraph 5 if that gain had been derived by a resident of State A from the alienation of these shares at that time. Since, throughout the relevant period, the value of the shares of company X owned by company B was

30 and the value of the shares of company Y owned by company B was 25, this meant that the shares of company B derived 55 per cent of their value from a combination of property referred to in subdivision (i) of paragraph (*b*) of paragraph 7, namely the shares in company X and Y, even though the other property owned by company B (i.e. the bank account worth 30 and the shareholding in company Z worth 15), did not constitute property referred to in subdivision (i). Since the conditions of subparagraphs (*a*) and (*b*) of paragraph 7 are both met, State C is entitled to tax the gain realised by company A on the alienation of the shares of company B.

38. As was stressed by the medium-sized minority of members of the Committee who opposed the inclusion of paragraph 7,[92] States should weigh a number of factors when considering whether to include paragraph 7 in their treaties. For instance, they should consider whether and to what extent their domestic law allows the taxation of such OITs, especially when the shares or comparable interests of the non-resident company or entity derive more than 50 per cent of their value from assets other than immovable property situated in their territory. Also, the practical application of the paragraph may raise important administrative and collection challenges, especially when the shares or comparable interests are alienated by one non-resident to another non-resident.[93]

39. In addition, there could be situations of unrelieved double taxation. Assume, for instance, that company A, a resident of State A, owns all the shares of company B, a resident of State B which carries on business in State C through a permanent establishment situated therein. Using the profits realised through the permanent establishment, which have been fully taxed in State C, company B acquired all the shares of company D, a resident of State D that carries on business in that State. The shares of company D have increased in value after being acquired by company B.

92 The view of these members was included in note E/C.18/2020/CRP.36, which was discussed at the twenty-first session of the Committee (October 2020).

93 Other factors that would be relevant would include a country's revenue needs and desire to attract foreign investment, see Platform for Collaboration on Tax, *The Taxation of Offshore Indirect Transfers – A Toolkit, 2020*, available at https://www.imf.org/~/media/Files/Miscellaneous/OIT.ashx?la=en, accessed on 10 May 2021, p. 54.

Assuming that the shares of companies A and B derive most of their value from the movable property of the permanent establishment in State C (even though there are no accrued gains on that property), paragraph 7 of the tax treaty between States A and C would allow both States to tax any gain realised by company A on the sale of the shares of company B even though the gain on these shares may be primarily attributable to the increase in value of the shares in company D. In addition, however, paragraph 5 of the tax treaty between States A and B would allow State B to tax the same gain since that gain arises from the sale of the shares of a company resident of that State. Since the tax treaty between States B and C is not applicable to the gain realised by company A, the double taxation resulting from the taxation of that gain by States B and C will not be eliminated. Also, the subsequent alienation by company B of the shares of company D would generate a gain taxable in States B and D under paragraph 5 of the tax treaty between States B and D even though that gain, or part thereof, will have already been taxed in States A and C as indicated above, which would result in further unrelieved double taxation.

40. One possible way to address such situations could be to resort to the mutual agreement procedure under the second sentence of paragraph 3 of Article 25 through discussion between the competent authorities of the States involved. For instance, in the situation described in paragraph 39 above where State C taxes company A under paragraph 7 of the treaty between States A and C while State B taxes company A under paragraph 5 of the treaty between States A and B, the competent authorities of States B and C might consult under paragraph 3 of Article 25 of the treaty between States B and C for the elimination of the resulting double taxation of company A, resident of State A. Since the outcome from such consultation would not address the problem that would subsequently arise as a result of the taxation by State D of the gain realised by company B on the alienation of the shares of company D, a similar consultation might be necessary under the treaty between States C and D upon the subsequent alienation by company B of the shares of company D.[94] It should be noted that the second sentence

94 See paragraphs 38.1, 38.2, 38.4, 55 and 55.1 of the Commentary on Article 25 of the 2017 OECD Model which describe how paragraph 3 of Article 25 might be used to consult to resolve double taxation in a multilateral situation.

of paragraph 3 of Article 25 does not, however, allow the Contracting States to eliminate double taxation where the provision of such relief would contravene their respective domestic laws or is not authorised by the provisions of other applicable tax treaties.[95] Alternatively, Contracting States may wish to make express provision for multilateral mutual agreement procedures covering such cases by using a different formulation of paragraph 2 of Article 25.

41. Since the paragraph applies with respect to the offshore indirect transfer of a property, or combination of property, to the extent that a State would have had the right to tax a direct alienation of such property in accordance with the preceding provisions of Article 13, the scope of these preceding provisions will indirectly impact the scope of the paragraph. Where, for instance, the provisions of paragraph 6 allow the source taxation of a gain on the direct alienation of the types of property referred to in that paragraph, the inclusion of that paragraph before paragraph 7 will allow the taxation of an indirect transfer of such property.

42. As indicated in paragraph 19 above with respect to paragraph 5, it will be up to the law of the State imposing the tax to determine the level of holdings of the alienator, in particular, how to determine an interest held indirectly. Anti-avoidance rules of the law of the State imposing the tax may also be relevant in determining the level of the alienator's direct or indirect holdings.

43. States may consider modifying the scope of paragraph 7 in their bilateral negotiations. For example, States could consider increasing or reducing the percentage of the value of the shares or comparable interests that must be derived directly or indirectly from the local asset for the provision to apply, which could be done by replacing "50 per cent" by the percentage that these States would agree to. Additionally, as is the case with paragraph 5 (see paragraph 30 above), States could choose to add an exception for gains derived in the course of corporate reorganizations. States could also consider amending subparagraph (*a*) of the paragraph in order to provide that the percentage of the capital

95 See paragraph 13 of the Commentary on paragraph 3 of Article 25 of the UN Model (quoting, inter alia, paragraph 55.1 of the Commentary on paragraph 3 of Article 25 of the 2017 OECD Model).

that is held directly or indirectly is determined by taking into account not only the shares or comparable interests held by the alienator but also any shares or comparable interests held by a closely related person or enterprise as defined in paragraph 9 of Article 5.

Paragraph 8

44. This paragraph reproduces paragraph 5 of Article 13 of the OECD Model with a drafting adjustment replacing the words "in paragraphs 1, 2, 3 and 4" with "in paragraphs 1 to 7". The Committee considers that the following part of the Commentary on paragraph 5 of the 2017 OECD Model is applicable to paragraph 8 of the UN Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 29. As regards gains from the alienation of any property other than that referred to in paragraphs 1 *[to 7]*, paragraph *[8]* provides that they are taxable only in the State of which the alienator is a resident *[…]*.
>
> 30. The Article does not contain special rules for gains from the alienation of shares in a company (other than shares of a company dealt with in paragraph 4*[, 5 or 7]*) or of securities, bonds, debentures and the like *[except to the extent that gains from the alienation of such property are otherwise covered by […] provisions of paragraphs 1 to 7]*. Such gains are, therefore, taxable only in the State of which the alienator is a resident.
>
> 31. If shares are alienated by a shareholder in connection with the liquidation of the issuing company or the redemption of shares or reduction of *[the]* paid-up capital of that company, the difference between the proceeds obtained by the shareholder and the par value of the shares may be treated in the State of which the company is a resident as a distribution of accumulated profits and not as a capital gain. The Article does not prevent the State of residence of the company from taxing such distributions at the rates provided for in Article 10: such taxation is permitted because such difference is covered by the definition of the term "dividends" contained in paragraph 3 of Article 10 and interpreted in paragraph 28 of the Commentary relating thereto, to the extent that the domestic law of that State treats that difference as income from shares. As explained in paragraphs 32.1 to 32.7 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD*

Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model], where the State of the issuing company treats the difference as a dividend, the State of residence of the shareholder is required to provide relief of double taxation even though such a difference constitutes a capital gain under its own domestic law. The same interpretation may apply if bonds or debentures are redeemed by the debtor at a price which is higher than the par value or the value at which the bonds or debentures have been issued; in such a case, the difference may represent interest and, therefore, be subjected to a limited tax in the State of source of the interest in accordance with Article 11 (see also paragraphs 20 and 21 of the Commentary on Article 11 *[of the OECD Model]*).

32. There is a need to distinguish the capital gain that may be derived from the alienation of shares acquired upon the exercise of a stock-option granted to an employee or member of a board of directors from the benefit derived from the stock-option that is covered by Articles 15 or 16. The principles on which that distinction is based are discussed in paragraphs 12.2 to 12.5 of the Commentary on Article 15 and paragraph 3.1 of the Commentary on Article 16 *[of the 2017 OECD Model]*.

45. However, as indicated in paragraph 2 above, most members from developing countries suggested the following alternative to paragraph 8 of Article 13 of the UN Model, which corresponds to paragraph 5 of the OECD Model:

> 8. Gains from the alienation of any property other than property mentioned in paragraphs 1 to 7 may also be taxed in the Contracting State in which they arise according to the law of that State.

46. This alternative is equivalent to saying that either or both States may tax gains from the alienation of property not mentioned in paragraphs 1 to 7 according to their own law and that the State of residence will eliminate double taxation under Article 23 A or 23 B. Th is alternative, unlike the alternative suggested in the version of this paragraph in the 2017 UN Model, refers to "property other than property mentioned" in the preceding paragraphs of Article 13 rather than to "gains … other than those gains mentioned" in these paragraphs. This means that where property that is mentioned in any of paragraphs 1 to 7 is alienated but the provisions of these paragraphs restrict the right of

the State of source to tax the gain from the alienation of that type of property to certain situations, gains from the alienation of such property in situations not covered by these paragraphs shall be taxable only in the Contracting State of which the alienator is a resident. One example would be a gain from the alienation of immovable property situated in the State of residence of the alienator: since immovable property is mentioned in paragraph 1 but that paragraph only indicates that the other State may tax gains from the alienation of immovable property situated in that other State, the gain from the alienation of immovable property situated in the State of residence of the alienator would only be taxable in that State.

47. Countries choosing the alternative in paragraph 45 may wish through bilateral negotiations to clarify which particular source rules will apply to establish where a gain shall be considered to arise. If they do not do so, the domestic laws of each Contracting State will determine the source of the gain. However, the domestic laws of the Contracting States may differ and this may lead to double taxation (or non-taxation where the State of residence of the beneficiary applies Article 23 A to eliminate double taxation). Countries that want to address the issue may wish to replace the phrase "according to the law of that State" at the end of the alternative provision by a rule that would provide expressly when a gain would be deemed to arise in a Contracting State. The following is an example of such a rule which is based on the approach used in paragraph 5 of Articles 11 and 12:

> For the purposes of this paragraph, a gain shall be deemed to arise in a Contracting State when the acquiror of the property is a resident of that State. Where, however, the person acquiring the property, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to acquire the property was incurred, and the consideration for the acquisition is borne by such permanent establishment, then such gain shall be deemed to arise in the State in which the permanent establishment is situated.

Article 14

INDEPENDENT PERSONAL SERVICES
[Deleted 2025]

Article 15

DEPENDENT PERSONAL SERVICES

1. Article 15 of this Model reproduces Article 15 of the OECD Model. The only difference is that the heading of the OECD Article was changed to "INCOME FROM EMPLOYMENT" when Article 14 was deleted from that Model in 2000.

Paragraph 1

2. The Committee considers that the following part of the Commentary on Article 15 of the 2017 OECD Model, which provides additional explanations on the provisions of paragraph 1 of the Article, is applicable to Article 15 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 1. Paragraph 1 establishes the general rule as to the taxation of income from employment (other than pensions), namely, that such income is taxable in the State where the employment is actually exercised. The issue of whether or not services are provided in the exercise of an employment may sometimes give rise to difficulties which are discussed in paragraphs 8.1 ff *[of the Commentary on Article 15 of the 2017 OECD Model, as quoted in paragraph 5 below]*. Employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid. One consequence of this would be that a resident of a Contracting State who derived remuneration, in respect of an employment, from sources in the other State could not be taxed in that other State in respect of that remuneration merely because the results of this work were exploited in that other State.

2. The general rule is subject to exception only in the case of the remuneration of crews of ships or aircraft operated in international traffic (paragraph 3 of Article 15), *[the remuneration of top-level managerial officials (paragraph 2 of Article 16)]*, pensions (Article 18) and of remuneration and pensions in respect of government service (Article 19). Non-employment remuneration of members of boards of directors of companies is the subject of *[paragraph 1 of]* Article 16.

2.1 Member countries have generally understood the term "salaries, wages and other similar remuneration" to include benefits in kind received in respect of an employment (e.g. stock-options, the use of a residence or automobile, health or life insurance coverage and club memberships).

2.2 The condition provided by the Article for taxation by the State of source is that the salaries, wages or other similar remuneration be derived from the exercise of employment in that State. This applies regardless of when that income may be paid to, credited to or otherwise definitively acquired by the employee.

Paragraph 2

3. This paragraph reproduces paragraph 2 of Article 15 of the OECD Model. The Committee considers that the following part of the Commentary on Article 15 of the 2017 OECD Model, which provides additional explanations on paragraph 2 of the Article, is applicable to paragraph 2 of Article 15 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

3. Paragraph 2 contains a general exception to the rule in paragraph 1. This exception covers all individuals rendering *[dependent personal]* services in the course of an employment (sales representatives, construction workers, engineers, etc.), to the extent that their remuneration does not fall under the provisions of other Articles, such as those applying to government services or entertainers and sportspersons.

4. The three conditions prescribed in this paragraph must be satisfied for the remuneration to qualify for the exemption. The first condition is that the exemption is limited to the 183 day period.

It is further stipulated that this time period may not be exceeded "in any twelve-month period commencing or ending in the fiscal year concerned". This contrasts with the 1963 *[OECD]* Draft Convention and the 1977 *[OECD]* Model Convention which provided that the 183 day period[96] should not be exceeded "in the fiscal year concerned", a formulation that created difficulties where the fiscal years of the Contracting States did not coincide and which opened up opportunities in the sense that operations were sometimes organised in such a way that, for example, workers stayed in the State concerned for the last 5 ½ months of one year and the first 5 ½ months of the following year. The present wording of subparagraph 2 *a*) does away with such opportunities for tax avoidance. In applying that wording, all possible periods of twelve consecutive months must be considered, even periods which overlap others to a certain extent. For instance, if an employee is present in a State during 150 days between 1 April 01 and 31 March 02 but is present there during 210 days between 1 August 01 and 31 July 02, the employee will have been present for a period exceeding 183 days during the second twelve-month period identified above even though he did not meet the minimum presence test during the first period considered and that first period partly overlaps the second.

4.1 The reference to the "fiscal year concerned" must be interpreted as a reference to a fiscal year of the Contracting State in which a resident of the other Contracting State has exercised his employment and during which the relevant employment services have been rendered. Assume, for example, that the fiscal year of State S runs from 1 January to 31 December and that a resident of State R is present and performs employment services in State S between 1 August 00 and 28 February 01. For the purposes of subparagraph 2 *a*), any twelve month period that begins between 1 January and 31 December 00 or ends between 1 January and 31 December 01 and that includes any part of the period of employment services would be relevant. For instance, the twelve month period of 1 August 00 to 31 July 01, which begins in the fiscal year 00 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 August and 31 December 00; similarly, the twelve month period of 1 March 00 to 28 February 01, which ends in the fiscal year 01 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 January and 28 February 01. The taxation of

96 *[The same change was made to the UN Model in 1999.]*

the remuneration for the relevant services need not take place in the fiscal year concerned: as explained in paragraphs 2.2 above and 12.1 *[of the Commentary on Article 15 of the 2017 OECD Model, as quoted in paragraph 8 below]*, the Article allows a State to tax the remuneration derived from employment exercised in that State in a particular year even if the remuneration for these employment services is acquired, or the tax is levied, in a different year.

5. Although various formulas have been used by member countries to calculate the 183 day period, there is only one way which is consistent with the wording of this paragraph: the "days of physical presence" method. The application of this method is straightforward as the individual is either present in a country or he is not. The presence could also relatively easily be documented by the taxpayer when evidence is required by the tax authorities. Under this method the following days are included in the calculation: part of a day, day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before, during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption) and death or sickness in the family. However, days spent in the State of activity in transit in the course of a trip between two points outside the State of activity should be excluded from the computation. It follows from these principles that any entire day spent outside the State of activity, whether for holidays, business trips, or any other reason, should not be taken into account. A day during any part of which, however brief, the taxpayer is present in a State counts as a day of presence in that State for purposes of computing the 183 day period.

5.1 Days during which the taxpayer is a resident of the source State should not, however, be taken into account in the calculation. Subparagraph *a*) has to be read in the context of the first part of paragraph 2, which refers to "remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State", which does not apply to a person who resides and works in the same State. The words "the recipient is present", found in subparagraph *a*), refer to the recipient of such remuneration and, during a period of residence in the source State, a person cannot be said to be the recipient of remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State. The following examples illustrate this conclusion:

— *Example 1:* From January 01 to December 01, X lives in, and is a resident of, State S. On 1 January 02, X is hired by an employer who is a resident of State R and moves to State R where he becomes a resident. X is subsequently sent to State S by his employer from 15 to 31 March 02. In that case, X is present in State S for 292 days between 1 April 01 and 31 March 02 but since he is a resident of State S between 1 April 01 and 31 December 01, this first period is not taken into account for purposes of the calculation of the periods referred to in subparagraph *a*).

— *Example 2:* From 15 to 31 October 01, Y, a resident of State R, is present in State S to prepare the expansion in that country of the business of ACO, also a resident of State R. On 1 May 02, Y moves to State S where she becomes a resident and works as the manager of a newly created subsidiary of ACO resident of State S. In that case, Y is present in State S for 184 days between 15 October 01 and 14 October 02 but since she is a resident of State S between 1 May and 14 October 02, this last period is not taken into account for purposes of the calculation of the periods referred to in subparagraph *a*).

6. The second condition is that the employer paying the remuneration must not be a resident of the State in which the employment is exercised. Some member countries may, however, consider that it is inappropriate to extend the exception of paragraph 2 to cases where the employer is not a resident of the State of residence of the employee, as there might then be administrative difficulties in determining the employment income of the employee or in enforcing withholding obligations on the employer. Contracting States that share this view are free to adopt bilaterally the following alternative wording of subparagraph 2 *b*):

b) the remuneration is paid by, or on behalf of, an employer who is a resident of the first-mentioned State, and

6.1 The application of the second condition in the case of fiscally transparent partnerships presents difficulties since such partnerships cannot qualify as a resident of a Contracting State under Article 4 (see paragraph *[8.13]* of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 4 of this Model]*). While it is clear that such a partnership could qualify as an "employer" (especially under the domestic law definitions of the term in some countries, for example, where an employer is defined as a person liable for a wage tax), the application of the condition at the level of the partnership regardless of the situation of the partners would therefore render the condition totally meaningless.

> 6.2 The object and purpose of subparagraphs *b*) and *c*) of paragraph 2 are to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the State of source because the employer is not taxable in that State as it neither is a resident nor has a permanent establishment therein. These subparagraphs can also be justified by the fact that imposing source deduction requirements with respect to short-term employments in a given State may be considered to constitute an excessive administrative burden where the employer neither resides nor has a permanent establishment in that State. In order to achieve a meaningful interpretation of subparagraph *b*) that would accord with its context and its object, it should therefore be considered that, in the case of fiscally transparent entities or arrangements such as partnerships, that subparagraph applies at the level of the partners or members. Thus, the concepts of "employer" and "resident", as found in subparagraph *b*), are applied at the level of the partners or members rather than at the level of a fiscally transparent entity or arrangement. This approach is consistent with the approach under paragraph 2 of Article 1 under which the benefit of other provisions of tax conventions must be granted with respect to income that is taxed at the partners' or members' level rather than at the level of an entity or arrangement that is treated as fiscally transparent. While this interpretation could create difficulties where the partners or members reside in different States, such difficulties could be addressed through the mutual agreement procedure by determining, for example, the State in which the partners or members who own the majority of the interests in the entity or arrangement reside (i.e. the State in which the greatest part of the deduction will be claimed).

4. Some members of the Committee disagree with the proposition, in paragraph 6.2 of the Commentary on Article 15 of the 2017 OECD Model quoted in paragraph 3 above, that the concepts of "employer" and "resident" in subparagraph (*b*) are applied at the level of partners. They dispute the stated rationale for this approach, that is, that in cases of fiscally transparent partnerships, provisions of tax conventions must be applied at the partners' level. They are of the view that a special rule is required in a convention to provide such a result.

5. The Committee considers that the following part of the Commentary on Article 15 of the 2017 OECD Model, which provides additional explanations with respect to paragraph 2 of the Article, is applicable to Article 15 of this Model (the modifications that appear in

italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 7. Under the third condition, if the employer has a permanent establishment in the State in which the employment is exercised, the exemption is given on condition that the remuneration is not borne by that permanent establishment. The phrase "borne by" must be interpreted in the light of the underlying purpose of subparagraph *c)* of the Article, which is to ensure that the exception provided for in paragraph 2 does not apply to remuneration that could give rise to a deduction, having regard to the principles of Article 7 and the nature of the remuneration, in computing the profits of a permanent establishment situated in the State in which the employment is exercised.
>
> 7.1 The fact that the employer has, or has not, actually claimed a deduction for the remuneration in computing the profits attributable to the permanent establishment is not necessarily conclusive since the proper test is whether any deduction otherwise available with respect to that remuneration should be taken into account in determining the profits attributable to the permanent establishment. That test would be met, for instance, even if no amount were actually deducted as a result of the permanent establishment being exempt from tax in the source country or of the employer simply deciding not to claim a deduction to which he was entitled. The test would also be met where the remuneration is not deductible merely because of its nature (e.g. where the State takes the view that the issuing of shares pursuant to an employee stock-option does not give rise to a deduction) rather than because it should not be allocated to the permanent establishment.
>
> *[…]*
>
> 8. There is a direct relationship between the principles underlying the exception of paragraph 2 and Article 7. Article 7 is based on the principle that an enterprise of a Contracting State should not be subjected to tax in the other State unless its business presence in that other State has reached a level sufficient to constitute a permanent establishment. The exception of paragraph 2 of Article 15 extends that principle to the taxation of the employees of such an enterprise where the activities of these employees are carried on in the other State for a relatively short period. Subparagraphs *b*) and *c*) make it clear that the exception is not intended to apply where the employment services are rendered to

an enterprise the profits of which are subjected to tax in a State either because it is carried on by a resident of that State or because it has a permanent establishment therein to which the services are attributable.

8.1 It may be difficult, in certain cases, to determine whether the services rendered in a State by an individual resident of another State, and provided to an enterprise of the first State (or that has a permanent establishment in that State), constitute employment services, to which Article 15 applies, or services rendered by a separate enterprise, to which Article 7 applies or, more generally, whether the exception applies. While the Commentary previously dealt with cases where arrangements were structured for the main purpose of obtaining the benefits of the exception of paragraph 2 of Article 15, it was found that similar issues could arise in many other cases that did not involve tax-motivated transactions and the Commentary was amended to provide a more comprehensive discussion of these questions.

8.2 In some States, a formal contractual relationship would not be questioned for tax purposes unless there were some evidence of manipulation and these States, as a matter of domestic law, would consider that employment services are only rendered where there is a formal employment relationship.

8.3 If States where this is the case are concerned that such approach could result in granting the benefits of the exception provided for in paragraph 2 in unintended situations (e.g. in so-called "hiring-out of labour" cases), they are free to adopt bilaterally a provision drafted along the following lines:

> Paragraph 2 of this Article shall not apply to remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and paid by, or on behalf of, an employer who is not a resident of that other State if:
>
> *a)* the recipient renders services in the course of that employment to a person other than the employer and that person, directly or indirectly, supervises, directs or controls the manner in which those services are performed; and
>
> *b)* those services constitute an integral part of the business activities carried on by that person.

8.4 In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed

for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services). That distinction keeps its importance when applying the provisions of Article 15, in particular those of subparagraphs 2 *b*) and *c*). Subject to the limit described in paragraph 8.11 *[below of the Commentary on Article 15 of the 2017 OECD Model]* and unless the context of a particular convention requires otherwise, it is a matter of domestic law of the State of source to determine whether services rendered by an individual in that State are provided in an employment relationship and that determination will govern how that State applies the Convention.

8.5 In some cases, services rendered by an individual to an enterprise may be considered to be employment services for purposes of domestic tax law even though these services are provided under a formal contract for services between, on the one hand, the enterprise that acquires the services, and, on the other hand, either the individual himself or another enterprise by which the individual is formally employed or with which the individual has concluded another formal contract for services.

8.6 In such cases, the relevant domestic law may ignore the way in which the services are characterised in the formal contracts. It may prefer to focus primarily on the nature of the services rendered by the individual and their integration into the business carried on by the enterprise that acquires the services to conclude that there is an employment relationship between the individual and that enterprise.

8.7 Since the concept of employment to which Article 15 refers is to be determined according to the domestic law of the State that applies the Convention (subject to the limit described in paragraph 8.11 *[below of the Commentary on Article 15 of the OECD Model]* and unless the context of a particular convention requires otherwise), it follows that a State which considers such services to be employment services will apply Article 15 accordingly. It will, therefore, logically conclude that the enterprise to which the services are rendered is in an employment relationship with the individual so as to constitute his employer for purposes of subparagraph 2 *b*) and *c*). That conclusion is consistent with the object and purpose of paragraph 2 of Article 15 since, in that case, the employment services may be said to be rendered to a resident of the State where the services are performed.

8.8 As mentioned in paragraph 8.2, even where the domestic law of the State that applies the Convention does not offer the possibility of questioning a formal contractual relationship and therefore does not allow the State to consider that services rendered to a local enterprise by an individual who is formally employed by a non-resident are rendered in an employment relationship (contract of service) with that local enterprise, that State may deny the application of the exception of paragraph 2 in abusive cases *[falling within the general anti-abuse rule of paragraph 9 of Article 29]* (see also paragraphs 54 to 80 of the Commentary on Article 1 *[of the 2017 OECD Model]*).

8.9 [Deleted]

8.10 The approach described in the previous paragraphs therefore allows the State in which the activities are exercised to reject the application of paragraph 2 in abusive cases and in cases where, under that State's domestic law concept of employment, services rendered to a local enterprise by an individual who is formally employed by a non-resident are rendered in an employment relationship (contract of service) with that local enterprise. This approach ensures that relief of double taxation will be provided in the State of residence of the individual even if that State does not, under its own domestic law, consider that there is an employment relationship between the individual and the enterprise to which the services are provided. Indeed, as long as the State of residence acknowledges that the concept of employment in the domestic tax law of the State of source or the existence of arrangements that constitute an abuse of the Convention allows that State to tax the employment income of an individual in accordance with the Convention, it must grant relief for double taxation pursuant to the obligations incorporated in Articles 23 A and 23 B (see paragraphs 32.1 to 32.7 of the Commentary on *[Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*). The mutual agreement procedure provided by paragraph 1 of Article 25 will be available to address cases where the State of residence does not agree that the other State has correctly applied the approach described above and, therefore, does not consider that the other State has taxed the relevant income in accordance with the Convention.

8.11 The conclusion that, under domestic law, a formal contractual relationship should be disregarded must, however, be arrived at on the basis of objective criteria. For instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly

appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises. The relief provided under paragraph 2 of Article 15 would be rendered meaningless if States were allowed to deem services to constitute employment services in cases where there is clearly no employment relationship or to deny the quality of employer to an enterprise carried on by a non-resident where it is clear that that enterprise provides services, through its own personnel, to an enterprise carried on by a resident. Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer; this could be relevant, for example, for purposes of determining whether that enterprise has a permanent establishment at the place where the individual performs his activities.

8.12 It will not always be clear, however, whether services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises. Any disagreement between States as to whether this is the case should be solved having regard to the following principles and examples (using, where appropriate, the mutual agreement procedure).

8.13 The nature of the services rendered by the individual will be an important factor since it is logical to assume that an employee provides services which are an integral part of the business activities carried on by his employer. It will therefore be important to determine whether the services rendered by the individual constitute an integral part of the business of the enterprise to which these services are provided. For that purpose, a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual's work. Clearly, however, this analysis will only be relevant if the services of an individual are rendered directly to an enterprise. Where, for example, an individual provides services to a contract manufacturer or to an enterprise to which business is outsourced, the services of that individual are not rendered to enterprises that will obtain the products or services in question.

8.14 Where a comparison of the nature of the services rendered by the individual with the business activities carried on by his formal employer and by the enterprise to which the services are provided

points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:

— who has the authority to instruct the individual regarding the manner in which the work has to be performed;

— who controls and has responsibility for the place at which the work is performed;

— the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below);

— who puts the tools and materials necessary for the work at the individual's disposal;

— who determines the number and qualifications of the individuals performing the work;

— who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;

— who has the right to impose disciplinary sanctions related to the work of that individual;

— who determines the holidays and work schedule of that individual.

8.15 Where an individual who is formally an employee of one enterprise provides services to another enterprise, the financial arrangements made between the two enterprises will clearly be relevant, although not necessarily conclusive, for the purposes of determining whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. For instance, if the fees charged by the enterprise that formally employs the individual represent the remuneration, employment benefits and other employment costs of that individual for the services that he provided to the other enterprise, with no profit element or with a profit element that is computed as a percentage of that remuneration, benefits and other employment costs, this would be indicative that the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. That should not be considered to be the case, however, if the fee charged for the services bears no relationship to the remuneration of the individual or if that remuneration is only one of many factors taken into account in the fee charged for what is really a contract for services (e.g. where a consulting firm charges a client on the basis of an hourly fee for the

time spent by one of its employees to perform a particular contract and that fee takes account of the various costs of the enterprise), provided that this is in conformity with the arm's length principle if the two enterprises are associated. It is important to note, however, that the question of whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided is only one of the subsidiary factors that are relevant in determining whether services rendered by that individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises.

8.16 *Example 1:* Aco, a company resident of State A, concludes a contract with Bco, a company resident of State B, for the provision of training services. Aco is specialised in training people in the use of various computer software and Bco wishes to train its personnel to use recently acquired software. X, an employee of Aco who is a resident of State A, is sent to Bco's offices in State B to provide training courses as part of the contract.

8.17 In that case, State B could not argue that X is in an employment relationship with Bco or that Aco is not the employer of X for purposes of the convention between States A and B. X is formally an employee of Aco whose own services, when viewed in light of the factors in paragraphs 8.13 and 8.14 *[above of the Commentary on Article 15 of the 2017 OECD Model]*, form an integral part of the business activities of Aco. The services that he renders to Bco are rendered on behalf of Aco under the contract concluded between the two enterprises. Thus, provided that X is not present in State B for more than 183 days during any relevant twelve month period and that Aco does not have in State B a permanent establishment which bears the cost of X's remuneration, the exception of paragraph 2 of Article 15 will apply to X's remuneration.

8.18 *Example 2:* Cco, a company resident of State C, is the parent company of a group of companies that includes Dco, a company resident of State D. Cco has developed a new worldwide marketing strategy for the products of the group. In order to ensure that the strategy is well understood and followed by Dco, which sells the group's products, Cco sends X, one of its employees who has worked on the development of the strategy, to work in Dco's headquarters for four months in order to advise Dco with respect to its marketing and to ensure that Dco's communications department understands and complies with the worldwide marketing strategy.

8.19 In that case, Cco's business includes the management of the worldwide marketing activities of the group and X's own services are an integral part of that business activity. While it could be argued that an employee could have been easily hired by Dco to perform the function of advising the company with respect to its marketing, it is clear that such function is frequently performed by a consultant, especially where specialised knowledge is required for a relatively short period of time. Also, the function of monitoring the compliance with the group's worldwide marketing strategy belongs to the business of Cco rather than to that of Dco. The exception of paragraph 2 of Article 15 should therefore apply provided that the other conditions for that exception are satisfied.

8.20 *Example 3:* A multinational owns and operates hotels worldwide through a number of subsidiaries. Eco, one of these subsidiaries, is a resident of State E where it owns and operates a hotel. X is an employee of Eco who works in this hotel. Fco, another subsidiary of the group, owns and operates a hotel in State F where there is a shortage of employees with foreign language skills. For that reason, X is sent to work for five months at the reception desk of Fco's hotel. Fco pays the travel expenses of X, who remains formally employed and paid by Eco, and pays Eco a management fee based on X's remuneration, social contributions and other employment benefits for the relevant period.

8.21 In that case, working at the reception desk of the hotel in State F, when examined in light of the factors in paragraphs 8.13 and 8.14 *[above of the Commentary on Article 15 of the 2017 OECD Model]*, may be viewed as forming an integral part of Fco's business of operating that hotel rather than of Eco's business. Under the approach described above, if, under the domestic law of State F, the services of X are considered to have been rendered to Fco in an employment relationship, State F could then logically consider that Fco is the employer of X and the exception of paragraph 2 of Article 15 would not apply.

8.22 *Example 4:* Gco is a company resident of State G. It carries on the business of filling temporary business needs for highly specialised personnel. Hco is a company resident of State H which provides engineering services on building sites. In order to complete one of its contracts in State H, Hco needs an engineer for a period of five months. It contacts Gco for that purpose. Gco recruits X, an engineer resident of State X, and hires him under a five month employment contract. Under a separate contract between Gco and Hco, Gco agrees to provide the services of X to Hco during that period. Under these contracts, Gco will pay X's remuneration, social contributions, travel expenses and other employment benefits and charges.

8.23 In that case, X provides engineering services while Gco is in the business of filling short-term business needs. By their nature the services rendered by X are not an integral part of the business activities of his formal employer. These services are, however, an integral part of the business activities of Hco, an engineering firm. In light of the factors in paragraphs 8.13 and 8.14 *[above of the Commentary on Article 15 of the 2017 OECD Model]*, State H could therefore consider that, under the approach described above, the exception of paragraph 2 of Article 15 would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.

8.24 *Example 5:* Ico is a company resident of State I specialised in providing engineering services. Ico employs a number of engineers on a full time basis. Jco, a smaller engineering firm resident of State J, needs the temporary services of an engineer to complete a contract on a construction site in State J. Ico agrees with Jco that one of Ico's engineers, who is a resident of State I momentarily not assigned to any contract concluded by Ico, will work for four months on Jco's contract under the direct supervision and control of one of Jco's senior engineers. Jco will pay Ico an amount equal to the remuneration, social contributions, travel expenses and other employment benefits of that engineer for the relevant period, together with a 5 per cent commission. Jco also agrees to indemnify Ico for any eventual claims related to the engineer's work during that period of time.

8.25 In that case, even if Ico is in the business of providing engineering services, it is clear that the work performed by the engineer on the construction site in State J is performed on behalf of Jco rather than Ico. The direct supervision and control exercised by Jco over the work of the engineer, the fact that Jco takes over the responsibility for that work and that it bears the cost of the remuneration of the engineer for the relevant period are factors that could support the conclusion that the engineer is in an employment relationship with Jco. Under the approach described above, State J could therefore consider that the exception of paragraph 2 of Article 15 would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.

8.26 *Example 6:* Kco, a company resident of State K, and Lco, a company resident of State L, are part of the same multinational group of companies. A large part of the activities of that group are structured along function lines, which requires employees of different companies of the group to work together under the supervision of managers who are located in different States and employed by other companies of

the group. X is a resident of State K employed by Kco; she is a senior manager in charge of supervising human resources functions within the multinational group. Since X is employed by Kco, Kco acts as a cost centre for the human resource costs of the group; periodically, these costs are charged out to each of the companies of the group on the basis of a formula that takes account of various factors such as the number of employees of each company. X is required to travel frequently to other States where other companies of the group have their offices. During the last year, X spent three months in State L in order to deal with human resources issues at Lco.

8.27 In that case, the work performed by X is part of the activities that Kco performs for its multinational group. These activities, like other activities such as corporate communication, strategy, finance and tax, treasury, information management and legal support, are often centralised within a large group of companies. The work that X performs is thus an integral part of the business of Kco. The exception of paragraph 2 of Article 15 should therefore apply to the remuneration derived by X for her work in State L provided that the other conditions for that exception are satisfied.

8.28 Where, in accordance with the above principles and examples, a State properly considers that the services rendered on its territory by an individual have been rendered in an employment relationship rather than under a contract for services concluded between two enterprises, there will be a risk that the enterprises would be required to withhold tax at source in two jurisdictions on the remuneration of that individual even though double taxation should ultimately be avoided (see paragraph 8.10 above *[of the Commentary on Article 15 of the 2017 OECD Model]*). This compliance difficulty may be partly reduced by tax administrations making sure that their domestic rules and practices applicable to employment are clear and well understood by employers and are easily accessible. Also, the problem can be alleviated if the State of residence allows enterprises to quickly adjust the amount of tax to be withheld to take account of any relief for double taxation that will likely be available to the employee.

Paragraph 3

6. Paragraph 3 of Article 15 reproduces paragraph 3 of Article 15 of the OECD Model as it was modified in 2017. The Committee considers that the following part of the Commentary on Article 15 of the 2017 OECD Model, which provides additional explanations on paragraph 3

of the Article and on certain issues that are not expressly dealt with in the Article, is applicable to Article 15 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 9. Paragraph 3 applies to the remuneration of crews of ships or aircraft operated in international traffic and provides that such remuneration shall be taxable only in the State of residence of the employee. The principle of exclusive taxation in the State of residence of the employee was incorporated in the paragraph through a change made in 2017. The purpose of that amendment was to provide a clearer and administratively simpler rule concerning the taxation of the remuneration of these crews.
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> 9.1 At the same time, the definition of international traffic was modified to ensure that it also applied to a transport by a ship or aircraft operated by an enterprise of a third State. As explained in paragraph 6.1 of the Commentary on Article 3 *[of the 2017 OECD Model, as quoted in paragraph 11 of the Commentary on Article 3 of this Model]*, this last change allows the application of paragraph 3 of Article 15 to a resident of a Contracting State who derives remuneration from employment exercised aboard a ship or aircraft operated by an enterprise of a third State.
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> 9.2 Where, however, the employment is exercised by a resident of a Contracting State aboard a ship or aircraft operated solely within the other State, it would clearly be inappropriate to grant an exclusive right to tax to the State of residence of the employee. The phrase "other than aboard a ship or aircraft operated solely within the other Contracting State" ensures that the paragraph does not apply to such an employee, which means that the taxation of the remuneration of that employee is covered by the provisions of paragraphs 1 and 2 of the Article.
>
> 9.3 As indicated in paragraph 9 above *[of the Commentary on Article 15 of the 2017 OECD Model]*, paragraph 3 applies to the crews of ships or aircraft. This is made clear by the reference to employment exercised "as a member of the regular complement of a ship or aircraft". These words are broad enough to cover any employment activities performed in the course of the usual operation of the ship or aircraft, including, for example, the activities of employees of restaurants aboard a cruise ship or the activities of a flight attendant who would only work on a single flight before leaving his employment; they would not

cover, however, employment activities that may be performed aboard a ship or aircraft but are unrelated to its operation (e.g. an employee of an insurance company that sells home and auto insurance to the passengers of a cruise ship).

9.4 As explained in *[… paragraph 41 of the Commentary on Article 8 of this Model]*, States wishing to apply the same treatment to transport on rivers, canals and lakes as to shipping and air transport in international traffic may extend the scope of Article 8 to cover profits from the operation of boats engaged in inland waterways transport. These States could then wish to apply paragraph 3 of Article 15 to the remuneration of employees working on these boats. In the case of the remuneration derived by an employee working aboard a boat engaged in inland waterways transport, however, paragraph 3 should only apply to the extent that the boat is operated by an enterprise of the State of residence of the employee. It would indeed be inappropriate for one Contracting State to be required to exempt remuneration derived by an employee who is a resident of the other State but is employed by an enterprise of the first-mentioned State (or of a third State with which the first-mentioned State did not agree to exempt profits derived from the operation of boats engaged in inland waterways transport) where that remuneration relates to activities exercised solely in that first-mentioned State. Contracting States wishing to address this issue could do so by including in their bilateral treaty a separate provision dealing with crews of boats engaged in inland waterways transport that would be drafted as follows:

> Notwithstanding the preceding provisions of this Article and of Article 1, remuneration derived by an individual, whether a resident of a Contracting State or not, in respect of an employment, as a member of the regular complement of a boat, that is exercised aboard a boat engaged in inland waterways transport in a Contracting State and operated by an enterprise of the other State shall be taxable only in that other State. However, such remuneration may also be taxed in the first-mentioned State if it is derived by a resident of that State.

9.5 As indicated in paragraph 2 of the Commentary on Article 8 *[of the 2017 OECD Model; see also paragraph 35 of the Commentary on Article 8 of this Model]*, some States may prefer to attribute the exclusive right to tax profits from shipping and air transport to the State in which the place of effective management of the enterprise is situated rather than the State of residence. Where the Contracting States follow that approach, a similar change should be made to the alternative provisions

included in paragraphs 9.4 above and 9.6 below *[of the Commentary on Article 15 of the 2017 OECD Model]* if these provisions are used.

9.6 Some States prefer to allow taxation of the remuneration of an employee who works aboard a ship or aircraft operated in international traffic both by the State of the enterprise that operates such ship or aircraft and the State of residence of the employee. States wishing to do so may draft paragraph 3 along the following lines:

> 3. Notwithstanding the preceding provisions of this Article and Article 1, remuneration derived by an individual, whether a resident of a Contracting State or not, in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic by an enterprise of a Contracting State shall be taxable only in that Contracting State. Where, however, such remuneration is derived by a resident of the other Contracting State, it may also be taxed in that other State.

9.7 Some States wishing to apply that approach may also wish to restrict the application of paragraph 3 to employees who are residents of one of the Contracting States, which could be done by using the following wording:

> 3. Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic shall be taxable only in that State. Where, however, the ship or aircraft is operated by an enterprise of the other Contracting State, such remuneration may also be taxed in the other State.

9.8 According to the alternative provision in paragraph 9.6 above *[of the Commentary on Article 15 of the 2017 OECD Model]*, the Contracting State of the enterprise has the primary right to tax the remuneration of the employee. Where the employee is a resident of the other Contracting State, the remuneration may also be taxed in that other State, subject to the obligation of that State to provide relief of double taxation under the provisions of Article 23 A or 23 B.

9.9 Since that alternative provision allows taxation in the State of the enterprise that operates the ship or aircraft, it may help to address the situation of employees who work extensively aboard ships or aircraft operated in international traffic and who may find it advantageous to establish their residence in States that levy no or little tax on the

employment income derived from such work performed outside their territory. The provision assumes, however, that the Contracting States have the possibility, under their domestic law, to tax the remuneration of employees working aboard ships or aircraft operated in international traffic solely because the enterprises that operate these ships or aircraft are enterprises of these States. Where this is not the case, the use of that provision in combination with the exemption method for the elimination of double taxation would create a risk of non-taxation. Assume, for instance, that the above provision has been included in a treaty between States R and S, that State R follows the exemption method and that an employee who is a resident of State R works on flights between State R and third States operated by an airline that is an enterprise of State S. In that case, if the domestic law of State S does not allow State S to tax the remuneration of employees of the airline who are not residents of, and do not work in, State S, State S will be unable to exercise the taxing right that has been allocated to it but State R will be required to exempt such remuneration because, under the provisions of the Convention, State S has the right to tax that remuneration.

9.10 As explained in paragraph 3 of the Commentary on Article 8 *[of the 2017 OECD Model; see also paragraph 36 of the Commentary on Article 8 of this Model]*, it may be provided that the reference to the "place of effective management" in the alternative provision in paragraph 2 *[of the Commentary on Article 8 of the 2017 OECD Model; see also paragraph 35 of the Commentary on Article 8 of this Model]* is applicable if the place of effective management of a shipping enterprise is aboard a ship. According to the domestic laws of some *[…]* countries, tax is levied on remuneration received by non-resident members of the crew in respect of employment aboard ships only if the ship has the nationality of such a State. For that reason conventions concluded between these States provide that the right to tax such remuneration is given to the State of the nationality of the ship. On the other hand many States cannot make use of such a taxation right and the provision could in such cases lead to a non-taxation situation similar to the one described in the preceding paragraph. However, States having that taxation principle in their domestic laws may agree bilaterally to confer the right to tax remuneration in respect of employment aboard ships on the State of the nationality of the ship.

10. It should be noted that no special rules regarding the taxation of income of frontier workers or of employees working on trucks and trains travelling between States are included as it would be more suitable for the problems created by local conditions to be solved directly between the States concerned.

> 11. No special provision has been made regarding remuneration derived by visiting professors or students employed with a view to their acquiring practical experience. Many conventions contain rules of some kind or other concerning such cases, the main purpose of which is to facilitate cultural relations by providing for a limited tax exemption. Sometimes, tax exemption is already provided under domestic taxation laws. The absence of specific rules should not be interpreted as constituting an obstacle to the inclusion of such rules in bilateral conventions whenever this is felt desirable.

7. As regards paragraph 11 of the Commentary on Article 15 of the 2017 OECD Model quoted immediately above, it should be noted that, although Articles 15, 19 and 23 may generally be adequate to prevent double taxation of visiting teachers, some countries may wish to include a visiting teachers Article in their treaties. Reference is made to paragraphs 11 to 13 of the Commentary on Article 20 for a comprehensive treatment of this subject.

The treatment of employee stock-options

8. The Committee considers that the following part of the Commentary on Article 15 of the 2017 OECD Model, which addresses the issue of the treatment of employee stock-options under the provisions of the OECD Model, is applicable to this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 12. The different country rules for taxing employee stock-options create particular problems which are discussed below. While many of these problems arise with respect to other forms of employee remuneration, particularly those that are based on the value of shares of the employer or a related company, they are particularly acute in the case of stock-options. This is largely due to the fact that stock-options are often taxed at a time (e.g. when the option is exercised or the shares sold) that is different from the time when the employment services that are remunerated through these options are rendered.
>
> 12.1 As noted in paragraph 2.2 *[of the Commentary on Article 15 of the 2017 OECD Model, as quoted in paragraph 2 above]*, the Article allows the State of source to tax the part of the stock-option benefit that constitutes remuneration derived from employment exercised in that

State even if the tax is levied at a later time when the employee is no longer employed in that State.

12.2 While the Article applies to the employment benefit derived from a stock-option granted to an employee regardless of when that benefit is taxed, there is a need to distinguish that employment benefit from the capital gain that may be derived from the alienation of shares acquired upon the exercise of the option. This Article, and not Article 13, will apply to any benefit derived from the option itself until it has been exercised, sold or otherwise alienated (e.g. upon cancellation or acquisition by the employer or issuer). Once the option is exercised or alienated, however, the employment benefit has been realised and any subsequent gain on the acquired shares (i.e. the value of the shares that accrues after exercise) will be derived by the employee in his capacity of investor-shareholder and will be covered by Article 13. Indeed, it is at the time of exercise that the option, which is what the employee obtained from his employment, disappears and the recipient obtains the status of shareholder (and usually invests money in order to do so). Where, however, the option that has been exercised entitles the employee to acquire shares that will not irrevocably vest until the end of a period of required employment, it will be appropriate to apply this Article to the increase in value, if any, until the end of the required period of employment that is subsequent to the exercise of the option.

12.3 The fact that the Article does not apply to a benefit derived after the exercise or alienation of the option does not imply in any way that taxation of the employment income under domestic law must occur at the time of that exercise or alienation. As already noted, the Article does not impose any restriction as to when the relevant income may be taxed by the State of source. Thus, the State of source could tax the relevant income at the time the option is granted, at the time the option is exercised (or alienated), at the time the share is sold or at any other time. The State of source, however, may only tax the benefits attributable to the option itself and not what is attributable to the subsequent holding of shares acquired upon the exercise of that option (except in the circumstances described in the last sentence of the preceding paragraph).

12.4 Since paragraph 1 must be interpreted to apply to any benefit derived from the option until it has been exercised, sold or otherwise alienated, it does not matter how such benefit, or any part thereof, is characterised for domestic tax purposes. As a result, whilst the Article will be interpreted to allow the State of source to tax the benefits accruing up to the time when the option has been exercised, sold or

otherwise alienated, it will be left to that State to decide how to tax such benefits, for example, as either employment income or capital gain. If the State of source decides, for example, to impose a capital gains tax on the option when the employee ceases to be a resident of that country, that tax will be allowed under the Article. The same will be true in the State of residence. For example, while that State will have sole taxation right on the increase of value of the share obtained after exercise since this will be considered to fall under Article 13 of the Convention, it may well decide to tax such increase as employment income rather than as a capital gain under its domestic law.

12.5 The benefits resulting from a stock-option granted to an employee will not, as a general rule, fall under either Article 21, which does not apply to income covered by other Articles, or Article 18, which only applies to pension and other similar remuneration, even if the option is exercised after termination of the employment or retirement.

12.6 Paragraph 1 allows the State of source to tax salaries, wages and other similar remuneration derived from employment exercised in that State. The determination of whether and to what extent an employee stock-option is derived from employment exercised in a particular State must be done in each case on the basis of all the relevant facts and circumstances, including the contractual conditions associated with that option (e.g. the conditions under which the option granted may be exercised or disposed of). The following general principles should be followed for that purpose.

12.7 The first principle is that, as a general rule, an employee stock-option should not be considered to relate to any services rendered after the period of employment that is required as a condition for the employee to acquire the right to exercise that option. Thus, where a stock-option is granted to an employee on the condition that he provides employment services to the same employer (or an associated enterprise) for a period of three years, the employment benefit derived from that option should generally not be attributed to services performed after that three-year period.

12.8 In applying the above principle, however, it is important to distinguish between a period of employment that is required to obtain the right to exercise an employee stock-option and a period of time that is merely a delay before such option may be exercised (a blocking period). Thus, for example, an option that is granted to an employee on the condition that he remains employed by the same employer (or an associated enterprise) during a period of three years can be considered

to be derived from the services performed during these three years while an option that is granted, without any condition of subsequent employment, to an employee on a given date but which, under its terms and conditions, can only be exercised after a delay of three years, should not be considered to relate to the employment performed during these years as the benefit of such an option would accrue to its recipient even if he were to leave his employment immediately after receiving it and waited the required three years before exercising it.

12.9 It is also important to distinguish between a situation where a period of employment is required as a condition for the acquisition of the right to exercise an option, that is, the vesting of the option, and a situation where an option that has already vested may be forfeited if it is not exercised before employment is terminated (or within a short period after). In the latter situation, the benefit of the option should not be considered to relate to services rendered after vesting since the employee has already obtained the benefit and could in fact realise it at any time. A condition under which the vested option may be forfeited if employment is terminated is not a condition for the acquisition of the benefit but, rather, one under which the benefit already acquired may subsequently be lost. The following examples illustrate this distinction:

— *Example 1:* On 1 January of year 1, a stock-option is granted to an employee. The acquisition of the option is conditional on the employee continuing to be employed by the same employer until 1 January of year 3. The option, once this condition is met, will be exercisable from 1 January of year 3 until 1 January of year 10 (a so-called "American" option[1]). It is further provided, however, that any option not previously exercised will be lost upon cessation of employment. In that example, the right to exercise that option has been acquired on 1 January of year 3 (i.e. the date of vesting) since no further period of employment is then required for the employee to obtain the right to exercise the option.

— E*xample 2:* On 1 January of year 1, a stock-option is granted to an employee. The option is exercisable on 1 January of year 5 (a so-called "European" option). The option has been granted subject to the condition that it can only be exercised on 1 January of year 5 if employment is not terminated before that date. In that example, the right to exercise that option is not acquired until 1 January of year 5, which is the date of exercise, since employment until that date is required to acquire the right to exercise the option (i.e. for the option to vest).

1 Under an "American" stock-option, the right to acquire a share may be exercised during a certain period (typically a number of years) whilst under a European stock-option, that right may only be exercised at a given moment (i.e. on a particular date).

12.10 There are cases where that first principle might not apply. One such case could be where the stock-option is granted without any condition to an employee at the time he either takes up an employment, is transferred to a new country or is given significant new responsibilities and, in each case, the option clearly relates to the new functions to be performed by the employee during a specific future period. In that case, it may be appropriate to consider that the option relates to these new functions even if the right to exercise the option is acquired before these are performed. There are also cases where an option vested technically but where that option entitles the employee to acquire shares which will not vest until the end of a period of required employment. In such cases, it may be appropriate to consider that the benefit of the option relates to the services rendered in the whole period between the grant of the option and the vesting of the shares.

12.11 The second principle is that an employee stock-option should only be considered to relate to services rendered before the time when it is granted to the extent that such grant is intended to reward the provision of such services by the recipient for a specific period. This would be the case, for example, where the remuneration is demonstrably based on the employee's past performance during a certain period or is based on the employer's past financial results and is conditional on the employee having been employed by the employer or an associated enterprise during a certain period to which these financial results relate. Also, in some cases, there may be objective evidence demonstrating that during a period of past employment, there was a well-founded expectation among participants to an employee stock-option plan that part of their remuneration for that period would be provided through the plan by having stock-options granted at a later date. This evidence might include, for example, the consistent practice of an employer that has granted similar levels of stock-options over a number of years, as long as there was no indication that this practice might be discontinued. Depending on other factors, such evidence may be highly relevant for purposes of determining if and to what extent the stock-option relates to such a period of past employment.

12.12 Where a period of employment is required to obtain the right to exercise an employee's stock-option but such requirement is not applied in certain circumstances, for example, where the employment is

terminated by the employer or where the employee reaches retirement age, the stock-option benefit should be considered to relate only to the period of services actually performed when these circumstances have in fact occurred.

12.13 Finally, there may be situations in which some factors may suggest that an employee stock-option is rewarding past services but other factors seem to indicate that it relates to future services. In cases of doubt, it should be recognised that employee stock-options are generally provided as an incentive to future performance or as a way to retain valuable employees. Thus, employee stock-options are primarily related to future services. However, all relevant facts and circumstances will need to be taken into account before such a determination can be made and there may be cases where it can be shown that a stock-option is related to combined specific periods of previous and future services (e.g. options are granted on the basis of the employee having achieved specific performance targets for the previous year, but they become exercisable only if the employee remains employed for another three years).

12.14 Where, based on the preceding principles, a stock-option is considered to be derived from employment exercised in more than one State, it will be necessary to determine which part of the stock-option benefit is derived from employment exercised in each State for purposes of the application of the Article and of Articles 23 A and 23 B. In such a case, the employment benefit attributable to the stock-option should be considered to be derived from a particular country in proportion of the number of days during which employment has been exercised in that country to the total number of days during which the employment services from which the stock-option is derived have been exercised. For that purpose, the only days of employment that should be taken into account are those that are relevant for the stock-option plan, for example, those during which services are rendered to the same employer or to other employers the employment by whom would be taken into account to satisfy a period of employment required to acquire the right to exercise the option.

12.15 It is possible for member countries to depart from the case-by-case application of the above principles (in paragraphs 12.7 to 12.14 *[above of the Commentary on Article 15 of the 2017 OECD Model]*) by agreeing to a specific approach in a bilateral context. For example, two countries that tax predominantly at exercise of an option may agree, as a general principle, to attribute the income from an option that relates

primarily to future services to the services performed by an employee in the two States between date of grant and date of exercise. Thus, in the case of options that do not become exercisable until the employee has performed services for the employer for a specific period of time, two States could agree to an approach that attributes the income from the option to each State based on the number of days worked in each State by the employee for the employer in the period between date of grant and date of exercise. Another example would be for two countries that have similar rules for the tax treatment of employee stock-options to adopt provisions that would give to one of the Contracting States exclusive taxation rights on the employment benefit even if a minor part of the employment services to which the option relates have been rendered in the other State. Of course, member countries should be careful in adopting such approaches because they may result in double taxation or double non-taxation if part of the employment is exercised in a third State that does not apply a similar approach.

Article 16

DIRECTORS' FEES AND REMUNERATION OF TOP-LEVEL MANAGERIAL OFFICIALS

1. Paragraph 1 of Article 16 of the UN Model reproduces the whole of Article 16 of the OECD Model.

2. For that reason, the Committee considers that the following part of the Commentary on Article 16 of the 2017 OECD Model is applicable to paragraph 1 of Article 16 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 1. This Article relates to remuneration received by a resident of a Contracting State, whether an individual or a legal person, in the capacity of a member of a board of directors of a company which is a resident of the other Contracting State. Since it might sometimes be difficult to ascertain where the services are performed, the provision treats the services as performed in the State of residence of the company.
>
> 1.1 Member countries have generally understood the term "fees and other similar payments" to include benefits in kind received by a person in that person's capacity as a member of the board of directors of a company (e.g. stock-options the use of a residence or automobile, health or life insurance coverage and club memberships).
>
> 2. A member of the board of directors of a company often also has other functions with the company, for example, as ordinary employee, adviser, consultant, etc. It is clear that the Article does not apply to remuneration paid to such a person on account of such other functions *[unless such remuneration falls within the scope of paragraph 2 of Article 16 of this Model].*
>
> 3. In some countries organs of companies exist which are similar in function to the board of directors. Contracting States are free to include in bilateral conventions such organs of companies under a provision corresponding to Article 16.
>
> 3.1 Many of the issues discussed under paragraphs 12 to 12.15 of the Commentary on Article *15 [of the 2017 OECD Model, as quoted in paragraph 8 of the Commentary on Article 15 of this Model]* in

relation to stock-options granted to employees will also arise in the case of stock-options granted to members of the board of directors of companies. To the extent that stock-options are granted to a resident of a Contracting State in that person's capacity as a member of the board of directors of a company which is a resident of the other State, that other State will have the right to tax the part of the stock-option benefit that constitutes director's fees or a similar payment (see paragraph 1.1 above *[of the Commentary on Article 16 of the 2017 OECD Model]*) even if the tax is levied at a later time when the person is no longer a member of that board. While the Article applies to the benefit derived from a stock-option granted to a member of the board of directors regardless of when that benefit is taxed, there is a need to distinguish that benefit from the capital gain that may be derived from the alienation of shares acquired upon the exercise of the option. This Article, and not Article 13, will apply to any benefit derived from the option itself until it has been exercised, sold or otherwise alienated (e.g. upon cancellation or acquisition by the company or issuer). Once the option is exercised or alienated, however, the benefit taxable under this Article has been realised and any subsequent gain on the acquired shares (i.e. the value of the shares that accrues after exercise) will be derived by the member of the board of directors in his capacity of investor-shareholder and will be covered by Article 13. Indeed, it is at the time of exercise that the option, which is what the director obtained in his capacity as such, disappears and the recipient obtains the status of shareholder (and usually invests money in order to do so).

3. Article 16 of the UN Model also includes a second paragraph, not found in the OECD Model, dealing with remuneration received by top-level managerial officials.

4. The former Group of Experts decided that where a top-level managerial position of a company resident of a Contracting State is occupied by a resident of the other Contracting State, the remuneration paid to that official should be subject to the same principle as directors' fees.

5. The term "top-level managerial position" refers to a limited group of positions that involve primary responsibility for the general direction of the affairs of the company, apart from the activities of the directors. The term covers a person acting as both a director and a top-level manager.

Article 17

ARTISTES AND SPORTSPERSONS

1. Article 17 of the UN Model reproduces Article 17 of the OECD Model. Unlike the term "entertainer", the term "sportspersons" is not followed in paragraph 1 by illustrative examples but is nevertheless likewise to be construed in a broad manner consistent with the spirit and purpose of the Article.

2. The Committee considers that the following part of the Commentary on Article 17 of the 2010[97] OECD Model is applicable to Article 17 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

Paragraph 1

1. Paragraph 1 provides that artistes and *[sportspersons]* who are residents of a Contracting State may be taxed in the other Contracting State in which their personal activities as such are performed, whether these are of a business *[nature or of the nature of dependent personal services]*. This provision is an exception to the rules in Article*[s]* 7 *[and 12AA]* and to that in paragraph 2 of Article 15, respectively.

2. This provision makes it possible to avoid the practical difficulties which often arise in taxing artistes and *[sportspersons]* performing abroad. Moreover, too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of paragraph 1 to business activities. To achieve this it would be sufficient to amend the text of the Article *[by replacing the words "notwithstanding the provisions of Article 15" by "subject to the provisions of Article 15" in paragraphs 1 and 2, the provisions of Article 17 prevailing over those*

97 Reference is made to the 2010 version of the Commentary on Article 17 of the OECD Model because the Committee did not examine in detail the large number of changes that were made to that Commentary in 2014.

of Article 7 by reason of paragraph 6 of that Article[98] *]*. In such a case, artistes and *[sportspersons]* performing in the course of an employment would automatically come within Article 15 and thus be entitled to the exemptions provided for in paragraph 2 of that Article.

3. Paragraph 1 refers to artistes and *[sportspersons]*. It is not possible to give a precise definition of "artiste", but paragraph 1 includes examples of persons who would be regarded as such. These examples should not be considered as exhaustive. On the one hand, the term "artiste" clearly includes the stage performer, film actor, actor (including for instance a former sportsman) in a television commercial. The Article may also apply to income received from activities which involve a political, social, religious or charitable nature, if an entertainment character is present. On the other hand, it does not extend to a visiting conference speaker or to administrative or support staff (e.g. cameramen for a film, producers, film directors, choreographers, technical staff, road crew for a pop group etc.). In between there is a grey area where it is necessary to review the overall balance of the activities of the person concerned.

4. An individual may both direct a show and act in it, or may direct and produce a television programme or film and take a role in it. In such cases it is necessary to look at what the individual actually does in the State where the performance takes place. If his activities in that State are predominantly of a performing nature, the Article will apply to all the resulting income he derives in that State. If, however, the performing element is a negligible part of what he does in that State, the whole of the income will fall outside the Article. In other cases an apportionment should be necessary.

5. Whilst no precise definition is given of the term "*[sportspersons]*", it is not restricted to participants in traditional athletic events (e.g. runners, jumpers, swimmers). It also covers, for example, golfers, jockeys, footballers, cricketers and tennis players, as well as racing drivers.

6. The Article also applies to income from other activities which are usually regarded as of an entertainment character, such as those deriving from billiards and snooker, chess and bridge tournaments.

7. Income received by impresarios, etc. for arranging the appearance of an artiste or sportsman is outside the scope of the Article, but any

98 *[Similarly, the provisions of Article 17 prevail over those of Article 12AA by virtue of paragraph 2 of the latter Article.]*

income they receive on behalf of the artiste or sportsman is of course covered by it.

8. Paragraph 1 applies to income derived directly and indirectly by an individual artiste or sportsman. In some cases the income will not be paid directly to the individual or his impresario or agent. For instance, a member of an orchestra may be paid a salary rather than receive payment for each separate performance: a Contracting State where a performance takes place is entitled, under paragraph 1, to tax the proportion of the musician's salary which corresponds to such a performance. Similarly, where an artiste or sportsman is employed by, for example, a one person company, the State where the performance takes place may tax an appropriate proportion of any remuneration paid to the individual. In addition, where its domestic laws "look through" such entities and treat the income as accruing directly to the individual, paragraph 1 enables that State to tax income derived from appearances in its territory and accruing in the entity for the individual's benefit, even if the income is not actually paid as remuneration to the individual.

9. Besides fees for their actual appearances, artistes and *[sportspersons]* often receive income in the form of royalties or of sponsorship or advertising fees. In general, other Articles would apply whenever there was no direct link between the income and a public exhibition by the performer in the country concerned. Royalties for intellectual property rights will normally be covered by Article 12 rather than Article 17 (see paragraph 18 of the Commentary on Article 12 *[of the 2017 OECD Model, as quoted in paragraph 32 of the Commentary on Article 12 of this Model]*), but in general advertising and sponsorship fees will fall outside the scope of Article 12. Article 17 will apply to advertising or sponsorship income, etc. which is related directly or indirectly to performances or appearances in a given State. Similar income which could not be attributed to such performances or appearances would fall under the standard rules of Article 7 or Article 15, as appropriate. Payments received in the event of the cancellation of a performance are also outside the scope of Article 17, and fall under Articles 7 or 15, as the case may be.

10. The Article says nothing about how the income in question is to be computed. It is for a Contracting State's domestic law to determine the extent of any deductions for expenses. Domestic laws differ in this area, and some provide for taxation at source, at a low rate based on the gross amount paid to artistes and *[sportspersons]*. Such rules may

also apply to income paid to groups or incorporated teams, troupes, etc. Some States, however, may consider that the taxation of the gross amount may be inappropriate in some circumstances even if the applicable rate is low. These States may want to give the option to the taxpayer to be taxed on a net basis. This could be done through the inclusion of a paragraph drafted along the following lines:

> Where a resident of a Contracting States derives income referred to in paragraph 1 or 2 and such income is taxable in the other Contracting State on a gross basis, that person may, within [period to be determined by the Contracting States] request the other State in writing that the income be taxable on a net basis in that other State. Such request shall be allowed by that other State. In determining the taxable income of such resident in the other State, there shall be allowed as deductions those expenses deductible under the domestic laws of the other State which are incurred for the purposes of the activities exercised in the other State and which are available to a resident of the other State exercising the same or similar activities under the same or similar conditions.

Paragraph 2

11. Paragraph 1 of the Article deals with income derived by individual artistes and *[sportspersons]* from their personal activities. Paragraph 2 deals with situations where income from their activities accrues to other persons. If the income of an entertainer or sportsman accrues to another person, and the State of source does not have the statutory right to look through the person receiving the income to tax it as income of the performer, paragraph 2 provides that the portion of the income which cannot be taxed in the hands of the performer may be taxed in the hands of the person receiving the remuneration. If the person receiving the income carries on business activities, tax may be applied by the source country even if the income is not attributable to a permanent establishment there. But it will not always be so. There are three main situations of this kind:

a) The first is the management company which receives income for the appearance of, for example, a group of *[sportspersons]* (which is not itself constituted as a legal entity).

b) The second is the team, troupe, orchestra, etc. which is constituted as a legal entity. Income for performances may be paid to the entity. Individual members of the team, orchestra, etc. will be liable to tax under paragraph 1, in the State in which a performance is

given, on any remuneration (or income accruing for their benefit) as a counterpart to the performance; however, if the members are paid a fixed periodic remuneration and it would be difficult to allocate a portion of that income to particular performances, member countries may decide, unilaterally or bilaterally, not to tax it. The profit element accruing from a performance to the legal entity would be liable to tax under paragraph 2.

c) The third situation involves certain tax avoidance devices in cases where remuneration for the performance of an artiste or sportsman is not paid to the artiste or sportsman himself but to another person, *for example,* a so-called artiste company, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the artiste or sportsman nor as profits of the enterprise, in the absence of a permanent establishment. Some countries "look through" such arrangements under their domestic law and deem the income to be derived by the artiste or sportsman; where this is so, paragraph 1 enables them to tax income resulting from activities in their territory. Other countries cannot do this. Where a performance takes place in such a country, paragraph 2 permits it to impose a tax on the profits diverted from the income of the artiste or sportsman to the enterprise. It may be, however, that the domestic laws of some States do not enable them to apply such a provision. Such States are free to agree to other solutions or to leave paragraph 2 out of their bilateral conventions.

11.1 The application of paragraph 2 is not restricted to situations where both the entertainer or sportsman and the other person to whom the income accrues, for example, a star-company, are residents of the same Contracting State. The paragraph allows the State in which the activities of an entertainer or sportsman are exercised to tax the income derived from these activities and accruing to another person regardless of other provisions of the Convention that may otherwise be applicable. Thus, notwithstanding the provisions of Article 7, the paragraph allows that State to tax the income derived by a star-company resident of the other Contracting State even where the entertainer or sportsman is not a resident of that other State. Conversely, where the income of an entertainer resident in one of the Contracting States accrues to a person, for example, a star-company, who is a resident of a third State with which the State of source does not have a tax convention, nothing will prevent the Contracting State from taxing that person in accordance with its domestic laws.

11.2 As a general rule it should be noted, however, that, regardless of Article 17, the Convention would not prevent the application of general anti-avoidance rules of the domestic law of the State of source which would allow that State to tax either the entertainer/sportsman or the star-company in abusive cases *[…]. [This would also be allowed under the provisions of paragraph 9 of Article 29.]*

Additional considerations relating to paragraphs 1 and 2

12. Where, in the cases dealt with in paragraphs 1 and 2, the exemption method for relieving double taxation is used by the State of residence of the person receiving the income, that State would be precluded from taxing such income even if the State where the activities were performed could not make use of its right to tax. It is therefore understood that the credit method should be used in such cases. The same result could be achieved by stipulating a subsidiary right to tax for the State of residence of the person receiving the income, if the State where the activities are performed cannot make use of the right conferred on it by paragraphs 1 and 2. Contracting States are free to choose any of these methods in order to ensure that the income does not escape taxation.

13. Article 17 will ordinarily apply when the artiste or sportsman is employed by a Government and derives income from that Government; see paragraph 6 of the Commentary on Article 19 *[of the 2017 OECD Model, as quoted in paragraph 2 of the Commentary on Article 19 of this Model]*. Certain conventions contain provisions excluding artistes and *[sportspersons]* employed in organisations which are subsidised out of public funds from the application of Article 17.

14. Some countries may consider it appropriate to exclude from the scope of the Article events supported from public funds. Such countries are free to include a provision to achieve this but the exemptions should be based on clearly definable and objective criteria to ensure that they are given only where intended. Such a provision might read as follows:

> The provisions of paragraphs 1 and 2 shall not apply to income derived from activities performed in a Contracting State by artistes or *[sportspersons]* if the visit to that State is wholly or mainly supported by public funds of one or both of the Contracting States or political subdivisions or local authorities thereof. In such a case, the income is taxable only in the Contracting State in which the artiste or the *[sportsperson]* is a resident.

3. When the examples given in the Commentary on paragraph 2 of Article 17 of the OECD Model quoted above were considered by the former Group of Experts, some members indicated that these examples should not be understood as limiting the field of application of taxation to the types of income mentioned in that Commentary. In fact, the wording of the Commentary would allow taxation of the enterprise in the other Contracting State, with the same limitations as those imposed for artistes or sportspersons resident of a Contracting State and carrying out activities in the other State.

4. On the other hand, members expressed the view that some countries might wish paragraph 2 to have a narrower scope.

Article 18

PENSIONS AND SOCIAL SECURITY PAYMENTS

A. General considerations

1. Two alternative versions are given for Article 18 of the UN Model, Article 18 (Alternative A) and Article 18 (Alternative B).

2. Article 18 (Alternative A), like Article 18 of the OECD Model, provides that the State of residence has an exclusive right to tax pensions and other similar remuneration. It departs, however, from the OECD Article by granting to the State of source an exclusive right to tax the payments made within the framework of a public scheme which is part of the social security system of that State or a political subdivision or a local authority thereof.

3. Under Article 18 (Alternative B), the State of source may tax pensions and other similar remuneration and the provisions of Article 23 A or 23 B will determine whether the State of residence shall exempt such income or shall allow, as a deduction from its own tax on such income, the tax paid in the State of source. Article 18 (Alternative B) allows, however, exclusive source taxation when the payments are made within the framework of a public scheme which is part of the social security system of a State or a political subdivision or a local authority thereof.

B. Commentary on the two alternative versions of Article 18

Commentary on the paragraphs of Article 18 (Alternative A)

Paragraph 1

4. According to this paragraph, pensions, and other similar remuneration, paid in respect of private employment are taxable only in the State of residence of the recipient. Since this paragraph reproduces the text of Article 18 of the OECD Model, the Committee considers that the following part of the Commentary on Article 18 of the 2017

OECD Model is applicable to paragraph 1 of Article 18 (Alternative A) of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 1. According to *[paragraph 1 of]* this Article, pensions paid in respect of private employment are taxable only in the State of residence of the recipient. Various policy and administrative considerations support the principle that the taxing right with respect to this type of pension, and other similar remuneration, should be left to the State of residence. For instance, the State of residence of the recipient of a pension is in a better position than any other State to take into account the recipient's overall ability to pay tax, which mostly depends on worldwide income and personal circumstances such as family responsibilities. This solution also avoids imposing on the recipient of this type of pension the administrative burden of having to comply with tax obligations in States other than that recipient's State of residence.
>
> *[…]*
>
> ***Scope of [paragraph 1]***
>
> 3. The types of payment that are covered by *[paragraph 1]* include not only pensions directly paid to former employees but also to other beneficiaries (e.g. surviving spouses, companions or children of the employees) and other similar payments, such as annuities, paid in respect of past employment. *[Paragraph 1]* also applies to pensions in respect of services rendered to a State or a political subdivision or local authority thereof which are not covered by the provisions of paragraph 2 of Article 19. *[Paragraph 1]* only applies, however, to payments that are in consideration of past employment; it would therefore not apply, for example, to an annuity acquired directly by the annuitant from capital that has not been funded from an employment pension scheme. *[Paragraph 1]* applies regardless of the tax treatment of the scheme under which the relevant payments are made; thus, a payment made under a pension plan that is not eligible for tax relief could nevertheless constitute a "pension or other similar remuneration" (the tax mismatch that could arise in such a situation is discussed below). Similarly, *[paragraph 1]* applies regardless of whether or not the relevant payments are made from a "recognised pension fund" as defined in subparagraph [(*i*)] of paragraph 1 of Article 3.

4. Various payments may be made to an employee following cessation of employment. Whether or not such payments fall under the Article will be determined by the nature of the payments, having regard to the facts and circumstances in which they are made, as explained in the following two paragraphs *[…]*.

5. While the word "pension", under the ordinary meaning of the word, covers only periodic payments, the words "other similar remuneration" are broad enough to cover non-periodic payments. For instance, a lump-sum payment in lieu of periodic pension payments that is made on or after cessation of employment may fall within *[paragraph 1]*.

6. Whether a particular payment is to be considered as other remuneration similar to a pension or as final remuneration for work performed falling under Article 15 is a question of fact. For example, if it is shown that the consideration for the payment is the commutation of the pension or the compensation for a reduced pension then the payment may be characterised as "other similar remuneration" falling under *[paragraph 1]*. This would be the case where a person was entitled to elect upon retirement between the payment of a pension or a lump-sum computed either by reference to the total amount of the contributions or to the amount of pension to which that person would otherwise be entitled under the rules in force for the pension scheme. The source of the payment is an important factor; payments made from a pension scheme would normally be covered by *[paragraph 1]*. Other factors which could assist in determining whether a payment or series of payments fall under *[paragraph 1]* include: whether a payment is made on or after the cessation of the employment giving rise to the payment, whether the recipient continues working, whether the recipient has reached the normal age of retirement with respect to that particular type of employment, the status of other recipients who qualify for the same type of lump-sum payment and whether the recipient is simultaneously eligible for other pension benefits. Reimbursement of pension contributions (e.g. after temporary employment) does not constitute "other similar remuneration" under *[paragraph 1]*. Where cases of difficulty arise in the taxation of such payments, the Contracting States should solve the matter by recourse to the provisions of Article 25.

7. Since *[paragraph 1]* applies only to pensions and other similar remuneration that are paid in consideration for past employment, it does not cover other pensions such as those that are paid with respect to previous independent personal services. Some States, however, extend

the scope of *[paragraph 1]* to cover all types of pensions, including Government pensions; States wishing to do so are free to agree bilaterally to include provisions to that effect.

Cross-border issues related to pensions

8. The globalisation of the economy and the development of international communications and transportation have considerably increased the international mobility of individuals, both for work-related and personal reasons. This has significantly increased the importance of cross-border issues arising from the interaction of the different pension arrangements which exist in various States and which were primarily designed on the basis of purely domestic policy considerations. As these issues often affect large numbers of individuals, it is desirable to address them in tax conventions so as to remove obstacles to the international movement of persons, and employees in particular.

9. Many such issues relate to mismatches resulting from differences in the general tax policy that States adopt with respect to retirement savings. In many States, tax incentives are provided for pension contributions. Such incentives frequently take the form of a tax deferral so that the part of the income of an individual that is contributed to a pension arrangement as well as the income earned in the scheme or any pension rights that accrue to the individual are exempt from tax. Conversely, the pension benefits from these arrangements are taxable upon receipt. Other States, however, treat pension contributions like other forms of savings and neither exempt these contributions nor the return thereon; logically, therefore, they do not tax pension benefits. Between these two approaches exist a variety of systems where contributions, the return thereon, the accrual of pension rights or pension benefits are partially taxed or exempt.

10. Other issues arise from the existence of very different arrangements to provide retirement benefits. These arrangements are often classified under the following three broad categories:

— statutory social security schemes;

— occupational pension schemes;

— individual retirement schemes.

The interaction between these three categories of arrangements presents particular difficulties. These difficulties are compounded by the fact that each State may have different tax rules for the arrangements falling in each of these categories as well as by the fact that there are

> considerable differences in the extent to which States rely on each of these categories to ensure retirement benefits to individuals (e.g. some States provide retirement benefits almost exclusively through their social security system while others rely primarily on occupational pension schemes or individual retirement schemes).
>
> 11. The issues arising from all these differences need to be fully considered in the course of bilateral negotiations, in particular to avoid double taxation or non-taxation, and, where appropriate, addressed through specific provisions *[…]*.

5. Many countries have adopted the approach under which, subject to specific conditions, tax on contributions to, and earnings in, pension schemes or on the accrual of pension rights is totally or partially deferred and is recovered when pension benefits are paid. Other countries, however, treat pension contributions, or some kind of them, like other forms of savings and neither exempt those contributions nor the return thereon. Those countries generally do not tax the corresponding pension benefits. Where an individual has been granted tax relief in a country that has adopted the first approach and, before the payment of all or part of the pension benefits, that individual becomes a resident of a country that has adopted the second approach, the mismatch in the approaches adopted by the two countries will result in a situation where no tax will ever be payable on the relevant income. In order to avoid such unintended result, countries could include in paragraph 1 an additional sentence along the following lines:

> However such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by or on behalf of a pension fund established in that other State or borne by a permanent establishment situated therein and the payment is not subject to tax in the first-mentioned State under the ordinary rules of its tax law.

6. The Committee considers that the following part of the Commentary on Article 18 of the 2017 OECD Model, which deals with exempt pensions, is also applicable to paragraph 1 of Article 18 (Alternative A) of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

22. As mentioned in paragraph 9 *[of the Commentary on Article 18 of the 2017 OECD Model, as quoted in paragraph 4 above of the Commentary on Article 18 of this Model]* some States do not tax pension payments generally or otherwise exempt particular categories or parts of pension payments. In these cases, the provisions of the Article, which provides for taxation of pensions in the State of residence, may result in taxation by that State of pensions which were designed not to be taxed and the amount of which may well have been determined having regard to that exemption. This may result in undue financial hardship for the recipient of the pension.

23. To avoid the problems resulting from this type of mismatch, some States include in their treaties provisions to preserve the exempt treatment of pensions when the recipient is a resident of the other Contracting State. These provisions may be restricted to specific categories of pensions or may address the issue in a more comprehensive way. An example of that latter approach would be a provision drafted along the following lines:

> Notwithstanding any provision of this Convention, any pension or other similar remuneration paid to a resident of a Contracting State in respect of past employment exercised in the other Contracting State shall be exempt from tax in the first-mentioned State if that pension or other remuneration would be exempt from tax in the other State if the recipient were a resident of that other State.

Paragraph 2

7. Under this paragraph the State of source has an exclusive right to tax pensions paid and other payments made within the framework of a public scheme which is part of the social security system of that State or a political subdivision or a local authority thereof. Countries using the credit method as the general method for relieving double taxation in their conventions are thus, as an exception to that method, obliged to exempt from tax such payments to their residents as are dealt with under paragraph 2. The exclusive right of the State of source to tax pensions paid and other payments made under a public scheme which is part of the social security system is predicated on the rationale that the payments involved are wholly or largely financed out of the tax revenues of the State of source. This is the case when there are no contributions by the prospective beneficiaries of the payments or when

the contractual savings contributed under the social security scheme have to be supplemented by the tax revenues of the State of source. Such may not always be the case, however, when the social security system functions on the basis of the capitalization principle rather than that of the distribution principle.

8. No consensus emerged within the OECD Committee on Fiscal Affairs on the inclusion in the text of Article 18 of the OECD Model of a provision allowing the State of source to tax payments made under its social security system. However, paragraph 27 of the Commentary on Article 18 of the 2017 OECD Model proposes an alternative paragraph providing for such right. The Committee considers that the following part of the Commentary on Article 18 of the 2017 OECD Model, which provides additional explanations on that alternative paragraph, is applicable to paragraph 2 of Article 18 (Alternatives A and B) of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 28. Although the *[…]* provision refers to the social security *[system]* of each Contracting State, there are limits to what it covers. "Social security" generally refers to a system of mandatory protection that a State puts in place in order to provide its population with a minimum level of income or retirement benefits or to mitigate the financial impact of events such as unemployment, employment-related injuries, sickness or death. A common feature of social security systems is that the level of benefits is determined by the State. Payments that may be covered by the provision include retirement pensions available to the general public under a public pension scheme, old age pension payments as well as unemployment, disability, maternity, survivorship, sickness, social assistance, and family protection payments that are made by the State or by public entities constituted to administer the funds to be distributed. As there may be substantial differences in the social security systems of the Contracting States, it is important for the States that intend to use the draft provision to verify, during the course of bilateral negotiations, that they have a common understanding of what will be covered by the provision.

9. Some countries using the credit method as the general method for the elimination of double taxation of income derived by their residents

may consider that the State of source should not have an exclusive right to tax social security payments. Those countries should then substitute the words "may be taxed" for the words "shall be taxable only" in paragraph 2 of their treaties.

10. The countries that wish to deal with the consequences of the privatisation of their social security system may propose to amend the provisions of paragraph 2 along the following lines in order to cover their privatised system:

> Notwithstanding the provisions of paragraph 1, pensions paid and other payments made under a public scheme or a mandatory private scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Commentary on the paragraphs of Article 18 (Alternative B)

11. Several countries consider that pensions paid in consideration of past employment should not be taxed exclusively in the beneficiary's State of residence. Various policy considerations support this rule. Since pensions are in substance a form of deferred compensation for services performed in the State of source, they should be taxed at source as normal employment income would be. When tax relief is granted for pension contributions, the tax on part of the employment income is deferred until retirement and the tax so deferred should be recovered even if the individual has ceased to be a resident before all or part of the pension benefits is paid. Pension flows between some developed and developing countries may not be reciprocal and in some cases represent a relatively substantial net outflow for the developing country.

12. If the State of source does not grant any personal allowances to non-residents, the source taxation of pensions may result in excessive taxation. This issue should be discussed during negotiations. The Contracting States may agree in those cases that the State of source shall grant to a resident of the other State any personal allowances, reliefs and reductions for taxation purposes granted to its own residents in the proportion which the pensions and other similar remunerations bear to world income of the resident of the other State. A sentence drafted along the following lines may be added in paragraph 2:

> The other State shall grant to a resident of the first-mentioned State any personal allowances, reliefs and reductions for taxation purposes which it grants to its own residents. Those allowances, reliefs and reductions shall be granted in the proportion which the pensions and other similar remunerations taxable in that State bear to the world income taxable in the first-mentioned State.

13. The State of source might be considered to be the State in which the fund is established, the State where the relevant work has been performed or the State where deductions have been claimed. It is fairly common for employees of transnational corporations to perform services consecutively in several different countries. In such case, taxation in the State where those services were performed or in which relief was granted would raise uncertainty and administrative difficulties for both taxpayers and tax authorities because it would create the possibility of different parts of the same pension being taxable in different States of source. It is generally agreed, therefore, that taxation of pension at source should be construed to mean taxation at the place in which the pension payments originate, not the place in which the services were performed or in which tax relief was granted.

Paragraph 1

14. This paragraph, although it recognizes the right of the State of residence of the recipient to tax pensions and other similar remuneration, leaves open the possibility that the State of source may also be given the right to tax in certain conditions which are defined in paragraph 2. Paragraph 4 of the Commentary on paragraph 1 of Article 18 (Alternative A) is applicable in order to determine the scope of Article 18 (Alternative B) and to consider the cross-border issues related to pensions.

Paragraph 2

15. As indicated above, the State of source may tax pensions and other similar remuneration paid in consideration of past employment if the payments involved are made by a resident of that State or are borne by a permanent establishment situated therein.

16. Some countries could, however, consider that the State which has given tax relief with regard to contributions to the pension scheme or to the accrual of pension rights should have the right to tax the resultant pension. This could be the case where countries grant also tax relief with respect to contributions to or pension rights within foreign pension funds. The following provision is an example of such a provision:

> However, such pensions and other similar remuneration may also be taxed in the other Contracting State to the extent that they arise from contributions that have qualified for tax relief in that other State.

As already explained in paragraph 13 above, this approach would raise administrative difficulties, especially in the case of individuals who have worked in more than one country during their career. Such difficulties should be addressed in order to avoid situations, for example, where two countries would claim to have source taxation rights on the same pension.

Paragraph 3

17. Since paragraph 3 of Article 18 (Alternative B) is identical to paragraph 2 of Article 18 (Alternative A), the Commentary on the latter paragraph (see above) is fully applicable to the former.

Other tax treaty issues related to pensions

18. Paragraphs 31 to 69 of the Commentary on Article 18 of the 2017 OECD Model deal with the question of tax treatment of contributions to foreign pension schemes, the question of tax obstacles to the portability of pension rights and the question of the tax-exempt treatment of investment income derived by pension funds established in the other Contracting State. The Committee considered that the incorporation of these paragraphs in the Commentary on Article 18 of the UN Model would send a strong positive signal to potential inward investors. Allowing recognition of cross-border pension contributions and facilitating cross-border transfer of pension rights from a pension scheme to another will also stimulate movement of personnel to foreign countries. The Committee therefore considers that the following part of the Commentary on Article 18 of the 2017 OECD Model is relevant to Article 18 (Alternative A) and Article 18 (Alternative B) of the United

Nations Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

The tax treatment of contributions to foreign pension schemes *[made by or for employees and individuals providing independent services]*

A. General comments

31. It is characteristic of multinational enterprises that their staff are expected to be willing to work outside their home country from time to time. The terms of service under which staff are sent to work in other countries are of keen interest and importance to both the employer and the employee. One consideration is the pension arrangements that are made for the employee in question. Similarly, individuals who move to other countries to provide independent services are often confronted with cross-border tax issues related to the pension arrangements that they have established in their home country.

32. Individuals working abroad will often wish to continue contributing to a pension scheme (including a social security scheme that provides pension benefits) in their home country during their absence abroad. This is both because switching schemes can lead to a loss of rights and benefits, and because many practical difficulties can arise from having pension arrangements in a number of countries.

33. The tax treatment accorded to pension contributions made by or for individuals working outside their home country varies both from country to country and depending on the circumstances of the individual case. Before taking up an overseas assignment or contract, pension contributions made by or for these individuals commonly qualify for tax relief in the home country. When the individual works abroad, the contributions in some cases continue to qualify for relief. Where the individual, for example, remains resident and fully taxable in the home country, pension contributions made to a pension scheme established in the home country will generally continue to qualify for relief there. But frequently, contributions paid in the home country by an individual working abroad do not qualify for relief under the domestic laws of either the home country or the host country. Where this is the case it can become expensive, if not prohibitive, to maintain

membership of a pension scheme in the home country during a foreign assignment or contract. Paragraph 37 below *[of the Commentary on Article 18 of the 2017 OECD Model]* suggests a provision which *[…]* countries can, if they wish, include in bilateral treaties to provide reliefs for the pension contributions made by or for individuals working outside their home country.

34. However, some *[…]* countries may not consider that the solution to the problem lies in a treaty provision, preferring, for example, the pension scheme to be amended to secure deductibility of contributions in the host State. Other countries may be opposed to including the provision below in treaties where domestic legislation allows relief only with respect to contributions paid to residents. In such cases it may be inappropriate to include the suggested provision in a bilateral treaty.

35. The suggested provision covers contributions made to all forms of pension schemes, including individual retirement schemes as well as social security schemes. Many Member countries have entered into bilateral social security totalisation agreements which may help to partially avoid the problem with respect to contributions to social security schemes; these agreements, however, usually do not deal with the tax treatment of cross-border contributions. In the case of an occupational scheme to which both the employer and the employees contribute, the provision covers both these contributions. Also, the provision is not restricted to the issue of the deductibility of the contributions as it deals with all aspects of the tax treatment of the contributions as regards the individual who derive benefits from a pension scheme. Thus the provision deals with issues such as whether or not the employee should be taxed on the employment benefit that an employer's contribution constitutes and whether or not the investment income derived from the contributions should be taxed in the hands of the individual. It does not, however, deal with the taxation of the pension fund on its income (this issue is dealt with in paragraph 69 below *[of the Commentary on Article 18 of the 2017 OECD Model]*). Contracting States wishing to modify the scope of the provision with respect to any of these issues may do so in their bilateral negotiations.

B. Aim of the provision

36. The aim of the provision is to ensure that, as far as possible, individuals are not discouraged from taking up overseas work by the tax treatment of their contributions to a home country pension scheme. The provision seeks, first, to determine the general equivalence of pension plans in the two countries and then to establish limits to

the contributions to which the tax relief applies based on the limits in the laws of both countries.

C. Suggested provision

37. The following is the suggested text of the provision that could be included in bilateral conventions to deal with the problem identified above:

> 1. Contributions to a pension scheme established in and recognised for tax purposes in a Contracting State that are made by or on behalf of an individual who renders services in the other Contracting State shall, for the purposes of determining the individual's tax payable and the profits of an enterprise which may be taxed in that State, be treated in that State in the same way and subject to the same conditions and limitations as contributions made to a pension scheme that is recognised for tax purposes in that State, provided that:
>
> *a)* the individual was not a resident of that State, and was participating in the pension scheme, immediately before beginning to provide services in that State, and
>
> *b)* the pension scheme is accepted by the competent authority of that State as generally corresponding to a pension scheme recognised as such for tax purposes by that State.
>
> 2. For the purposes of paragraph 1:
>
> *a*) the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the services referred to in paragraph 1; and
>
> *b*) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State.

38. The above provision is restricted to pension schemes established in one of the two Contracting States. As it is not unusual for individuals to work in a number of different countries in succession, some States may wish to extend the scope of the provision to cover situations where an individual moves from one Contracting State to another while continuing to make contributions to a pension scheme established in a third State. Such an extension may, however, create administrative difficulties if the host State cannot have access to

information concerning the pension scheme (e.g. through the exchange of information provisions of a tax convention concluded with the third State); it may also create a situation where relief would be given on a non-reciprocal basis because the third State would not grant similar relief to an individual contributing to a pension scheme established in the host State. States which, notwithstanding these difficulties, want to extend the suggested provision to funds established in third States can do so by adopting an alternative version of the suggested provision drafted along the following lines:

1. Contributions made by or on behalf of an individual who renders services in a Contracting State to a pension scheme

   a) recognised for tax purposes in the other Contracting State,

   b) in which the individual participated immediately before beginning to provide services in the first-mentioned State,

   c) in which the individual participated at a time when that individual was providing services in, or was a resident of, the other State, and

   d) that is accepted by the competent authority of the first-mentioned State as generally corresponding to a pension scheme recognised as such for tax purposes by that State,

   shall, for the purposes of

   e) determining the individual's tax payable in the first-mentioned State, and

   f) determining the profits of an enterprise which may be taxed in the first-mentioned State,

   be treated in that State in the same way and subject to the same conditions and limitations as contributions made to a pension scheme that is recognised for tax purposes in that first-mentioned State.

2. For the purposes of paragraph 1:

   a) the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the services referred to in paragraph 1; and

   b) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State.

D. Characteristics of the suggested provision

39. The following paragraphs discuss the main characteristics of the suggested provision found in paragraph 37 above *[of the Commentary on Article 18 of the 2017 OECD Model]*.

40. Paragraph 1 of the suggested provision lays down the characteristics of both the individual and the contributions in respect of which the provision applies. It also provides the principle that contributions made by or on behalf of an individual rendering services in one Contracting State (the host State) to a defined pension scheme in the other Contracting State (the home State) are to be treated for tax purposes in the host State, in the same way and subject to the same conditions and limitations as contributions to domestic pension schemes of the host State.

41. Tax relief with respect to contributions to the home country pension scheme under the conditions outlined can be given by either the home country, being the country where the pension scheme is situated or by the host country, where the economic activities giving rise to the contributions are carried out.

42. A solution in which relief would be given by the home country might not be effective, since the individual might have no or little taxable income in that country. Practical considerations therefore suggest that it would be preferable for relief to be given by the host country and this is the solution adopted in the suggested provision.

43. In looking at the characteristics of the individual, paragraph 1 makes it clear that, in order to get the relief from taxation in the host State, the individual must not have been resident in the host State immediately prior to working there.

44. Paragraph 1 does not, however, limit the application of the provision to individuals who become resident in the host State. In many cases individuals working abroad who remain resident in their home State will continue to qualify for relief there, but this will not be so in all cases. The suggested provision therefore applies to non-residents working in the host State as well as to individuals who attain residence status there. In some member countries the domestic legislation may restrict deductibility to contributions borne by residents, and these member countries may wish to restrict the suggested provision to cater for this. Also, States with a special regime for non-residents (e.g. taxation at a special low rate) may, in bilateral negotiations, wish to agree on a provision restricted to residents.

45. In the case where individuals temporarily cease to be resident in the host country in order to join a pension scheme in a country with more relaxed rules, individual States may want a provision which would prevent the possibility of abuse. One form such a provision could take would be a nationality test which could exclude from the suggested provision individuals who are nationals of the host State.

46. As already noted, it is not unusual for individuals to work in a number of different countries in succession; for that reason the suggested provision is not limited to individuals who are residents of the home State immediately prior to providing services in the host State. The provision covers an individual coming to the host State from a third country as it is only limited to individuals who were not resident in the host country before starting to work there. However, Article 1 restricts the scope of the Convention to residents of one or both Contracting States. An individual who is neither a resident of the host State nor of the home State where the pension scheme is established is therefore outside the scope of the Convention between the two States.

47. The suggested provision places no limits on the length of time for which an individual can work in a host State. It could be argued that, if an individual works in the host State for long enough, it in effect becomes his home country and the provision should no longer apply. Indeed, some host countries already restrict relief for contributions to foreign pension schemes to cases where the individuals are present on a temporary basis.

48. In addition, the inclusion of a time limit may be helpful in preventing the possibility of abuse outlined in paragraph 45 above *[of the Commentary on Article 18 of the 2017 OECD Model]*. In bilateral negotiations, individual countries may find it appropriate to include a limit on the length of time for which an individual may provide services in the host State after which reliefs granted by the suggested provision would no longer apply.

49. In looking at the characteristics of the contributions, paragraph 1 provides a number of tests. It makes it clear that the provision applies only to contributions made by or on behalf of an individual to a pension scheme established in and recognised for tax purposes in the home State. The phrase "recognised for tax purposes" is further defined in subparagraph 2 *b)* of the suggested provision; that phrase is unrelated to the definition of the term "recognised pension fund" in subparagraph [(*i*)] of paragraph 1 of Article 3 and therefore applies whether or not the pension scheme constitutes a "recognised pension

fund". The phrase "made by or on behalf of" is intended to apply to contributions that are made directly by the individual as well as to those that are made for that individual's benefit by an employer or another party (e.g. a spouse). Whilst paragraph 4 of Article 24 ensures that the employer's contributions to a pension fund resident of the other Contracting State (whether or not because it constitutes a "recognised pension fund") are deductible under the same conditions as contributions to a resident pension fund, that provision may not be sufficient to ensure the similar treatment of employer's contributions to domestic and foreign pension funds. This will be the case, for example, where the employer's contributions to the foreign fund are treated as a taxable benefit in the hands of the employee or where the deduction of the employer's contributions is not dependent on the fund being a resident but, rather, on other conditions (e.g. registration with tax authorities or the presence of offices) which have the effect of generally excluding foreign pension funds. For these reasons, employer's contributions are covered by the suggested provision even though paragraph 4 of Article 24 may already ensure a similar relief in some cases.

50. The second test applied to the characteristics of the contributions is that the contributions should be made to a home State scheme recognised by the competent authority of the host State as generally corresponding to a scheme recognised as such for tax purposes by the host State. This operates on the premise that only contributions to recognised schemes qualify for relief in member countries. This limitation does not, of course, necessarily secure equivalent tax treatment of contributions paid where an individual was working abroad and of contributions while working in the home country. If the host State's rules for recognising pension schemes were narrower than those of the home State, the individual could find that contributions to his home country pension scheme were less favourably treated when he was working in the host country than when working in the home country.

51. However, it would not be in accordance with the stated aim of securing, as far as possible, equivalent tax treatment of contributions to foreign schemes to give relief for contributions which do not – at least broadly – correspond to domestically recognised schemes. To do so would mean that the amount of relief in the host State would become dependent on legislation in the home State. In addition, it could be hard to defend treating individuals working side by side differently depending on whether their pension scheme was at home or abroad (and if abroad, whether it was one country rather than another). By

limiting the suggested provision to schemes which generally correspond to those in the host country such difficulties are avoided.

52. The suggested provision makes it clear that it is for the competent authority of the host State to determine whether the scheme in the home State generally corresponds to recognised schemes in the host State. Individual States may wish, in bilateral negotiations, to specify expressly to which existing schemes the provision will apply or to establish what interpretation the competent authority places on the term "generally corresponding"; for example how widely it is interpreted and what tests are imposed.

53. The contributions covered by the provision are limited to payments to schemes in which the individual was participating before beginning to provide services in the host State. This means that contributions to new pension schemes which an individual joins while in the host State are excluded from the suggested provision.

54. It is, however, recognised that special rules may be needed to cover cases where new pension schemes are substituted for previous ones. For instance, in some member countries the common practice may be that, if a company employer is taken over by another company, the existing company pension scheme for its employees may be ended and a new scheme opened by the new employer. In bilateral negotiations, therefore, individual States may wish to supplement the provision to cover such substitution schemes; this could be done by adding the following subparagraph to paragraph 2 of the suggested provision:

c) a pension scheme that is substituted for, but is substantially similar to, a pension scheme accepted by the competent authority of a Contracting State under subparagraph *b)* of paragraph 1 shall be deemed to be the pension scheme that was so accepted.

55. Paragraph 1 also sets out the relief to be given by the host State if the characteristics of the individual and the contributions fall within the terms of the provision. In brief, the contributions must be treated for tax purposes in a way which corresponds to the manner in which they would be treated if these contributions were to a scheme established in the host State. Thus, the contributions will qualify for the same tax relief (e.g. be deductible), for both the individual and the employer (where the individual is employed and contributions are made by the employer) as if these contributions had been made to a scheme in the host State. Also, the same treatment has to be given as regards the taxation of an employee on the employment benefit derived from an employer's contribution to either a foreign or a local scheme

(see paragraph 58 below *[of the Commentary on Article 18 of the 2017 OECD Model]*).

56. This measure of relief does not, of course, necessarily secure equivalent tax treatment given to contributions paid when an individual is working abroad and contributions paid when he is working in the home country. Similar considerations apply here to those discussed in paragraphs 50 and 51 above *[of the Commentary on Article 18 of the 2017 OECD Model]*. The measure does, however, ensure equivalent treatment of the contributions of co-workers. The following example is considered. The home country allows relief for pension contributions subject to a limit of 18 per cent of income. The host country allows relief subject to a limit of 20 per cent. The suggested provision in paragraph 37 would require the host country to allow relief up to its domestic limit of 20 per cent. Countries wishing to adopt the limit in the home country would need to amend the wording of the provision appropriately.

57. The amount and method of giving the relief would depend upon the domestic tax treatment of pension contributions by the host State. This would settle such questions as whether contributions qualify for relief in full, or only in part, and whether relief should be given as a deduction in computing taxable income (and if so, which income, for example, in the case of an individual, only employment or business income or all income) or as a tax credit.

58. For an individual who participates in an occupational pension scheme, being assigned to work abroad may not only mean that this employee's contributions to a pension scheme in his home country cease to qualify for tax relief. It may also mean that contributions to the pension scheme by the employer are regarded as the employee's income for tax purposes. In some member countries employees are taxed on employer's contributions to domestic schemes whilst working in the home country whereas in others these contributions remain exempt. Since it applies to both employees' and employers' contributions, the suggested provision ensures that employers' contributions in the context of the employees' tax liability are accorded the same treatment that such contributions to domestic schemes would receive.

59. Subparagraph 2 *a)* defines a pension scheme for the purposes of paragraph 1. It makes it clear that, for these purposes, a pension scheme is an arrangement in which the individual who makes the payments participates in order to secure retirement benefits. These benefits must be payable in respect of services provided in the host State. All the above conditions must apply to the pension scheme before it can qualify for relief under the suggested provision.

60. Subparagraph 2 *a)* refers to the participation of the individual in the pension scheme in order to secure retirement benefits. This definition is intended to ensure that the proportion of contributions made to secure benefits other than periodic pension payments on retirement, for example, a lump sum on retirement, will also qualify for relief under the provision.

61. The initial definition of a pension scheme is "an arrangement". This is a widely drawn term, the use of which is intended to encompass the various forms which pension schemes (whether social security, occupational or individual retirement schemes) may take in different member countries.

62. Although subparagraph 2 *a)* sets out that participation in this scheme has to be by the individual who provides services referred to in paragraph 1*[,]* there is no reference to the identity of the recipient of the retirement benefits secured by participation in the scheme. This is to ensure that any proportion of contributions intended to generate pension for other beneficiaries (e.g. surviving spouses, companions or children) may be eligible for relief under the suggested provision.

63. The definition of a pension scheme makes no distinction between pensions paid from State-run occupational pension schemes and similar privately-run schemes. Both are covered by the scope of the provision. Social security schemes are therefore covered by the provision to the extent that contributions to such schemes can be considered to be with respect to the services provided in the host State by an individual, whether as an employee or in an independent capacity.

64. Subparagraph 2 *b)* further defines the phrase "recognised for tax purposes". As the aim of the provision is, so far as possible, to ensure that contributions are neither more nor less favourably treated for tax purposes than they would be if the individual were resident in his home State, it is right to limit the scope of the provision to contributions which would have qualified for relief if the individual had remained in the home State. The provision seeks to achieve this aim by limiting its scope to contributions made to a scheme only if contributions to this scheme would qualify for tax relief in that State. As already explained in paragraph 49 above *[of the Commentary on Article 18 of the 2017 OECD Model]*, whether or not a pension scheme is recognised for tax purposes is unrelated to the question of whether the pension scheme constitutes a "recognised pension fund" under the definition of that term in subparagraph [(*i*)] of paragraph 1 of Article 3.

65. This method of attempting to achieve parity of treatment assumes that in all member countries only contributions to recognised pension schemes qualify for relief. The tax treatment of contributions to pension schemes under member countries' tax systems may differ from this assumption. It is recognised that, in bilateral negotiations, individual countries may wish to further define the qualifying pension schemes in terms that match the respective domestic laws of the treaty partners. They may also wish to define other terms used in the provision, such as "renders services" and "provides services".

Tax obstacles to the portability of pension rights

66. Another issue, which also relates to international labour mobility, is that of the tax consequences that may arise from the transfer of pension rights from a pension scheme established in one Contracting State to another scheme located in the other Contracting State. When an individual moves from one employer to another, it is frequent for the pension rights that this individual accumulated in the pension scheme covering the first employment to be transferred to a different scheme covering the second employment. Similar arrangements may exist to allow for the portability of pension rights to or from an individual retirement scheme.

67. Such transfers usually give rise to a payment representing the actuarial value, at the time of the transfer, of the pension rights of the individual or representing the value of the contributions and earnings that have accumulated in the scheme with respect to the individual. These payments may be made directly from the first scheme to the second one; alternatively, they may be made by requiring the individual to contribute to the new pension scheme all or part of the amount received upon withdrawing from the previous scheme. In both cases, it is frequent for tax systems to allow such transfers, when they are purely domestic, to take place on a tax-free basis.

68. Problems may arise, however, where the transfer is made from a pension scheme located in one Contracting State to a scheme located in the other State. In such a case, the Contracting State where the individual resides may consider that the payment arising upon the transfer is a taxable benefit. A similar problem arises when the payment is made from a scheme established in a State to which the relevant tax convention gives source taxing rights on pension payments arising therefrom as that State may want to apply that taxing right to any benefit derived from the scheme. Contracting States that wish to address that issue are free to include a provision drafted along the following lines:

> Where pension rights or amounts have accumulated in a pension scheme established in and recognised for tax purposes in one Contracting State for the benefit of an individual who is a resident of the other Contracting State, any transfer of these rights or amounts to a pension scheme established in and recognised for tax purposes in that other State shall, in each State, be treated for tax purposes in the same way and subject to the same conditions and limitations as if it had been made from one pension scheme established in and recognised for tax purposes in that State to another pension scheme established in and recognised for tax purposes in the same State.

The above provision could be modified to also cover transfers to or from pensions funds established and recognised in third States (this, however, could raise similar concerns as those described in the preamble of paragraph 38 above *[of the Commentary on Article 18 of the 2017 OECD Model]*).

Exemption of the income of a pension fund

69. Where, under their domestic law, two States follow the same approach of generally exempting from tax the investment income of pension funds established in their territory, these States, in order to achieve greater neutrality with respect to the location of capital, may want to extend that exemption to the investment income that a pension fund established in one State derives from the other State. In order to do so, States sometimes include in their conventions a provision drafted along the following lines:

> Notwithstanding any provision of this Convention, income arising in a Contracting State that is derived by a resident of the other Contracting State that was constituted and is operated exclusively to administer or provide pension benefits and has been accepted by the competent authority of the first-mentioned State as generally corresponding to a pension scheme recognised as such for tax purposes by that State, shall be exempt from tax in that State.

As explained in paragraphs 10.7 and 10.8 of the Commentary on Article 3 *[of the 2017 OECD Model, as quoted in paragraph 17 of the Commentary on Article 3 of this Model]*, States may prefer to simply refer to the income of a "recognised pension fund" when drafting such a provision.

Article 19

GOVERNMENT SERVICE

1. In 2011 the Committee of Experts made some changes in Article 19. Firstly, the words "other than a pension" were deleted in paragraph 1. Secondly, the words "Notwithstanding the provisions of paragraph 1" were added in paragraph 2. Thirdly, in paragraphs 2 and 3, the word "pension" was replaced by the words "pensions and other similar remuneration". As a result, Article 19 of the UN Model reproduces Article 19 of the OECD Model.

2. Since Article 19 of the UN Model incorporates all the provisions of Article 19 of the OECD Model, the Committee considers that the following part of the Commentary on Article 19 of the 2017 OECD Model is applicable to Article 19 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 1. This Article applies to salaries, wages, and other similar remuneration, and pensions, in respect of government service. Similar provisions in old bilateral conventions were framed in order to conform with the rules of international courtesy and mutual respect between sovereign States. They were therefore rather limited in scope. However, the importance and scope of Article 19 has increased on account of the fact that, consequent on the growth of the public sector in many countries, governmental activities abroad have been considerably extended. According to the original version of paragraph 1 of Article 19 in the 1963 *[OECD]* Draft Convention the paying State had a right to tax payments made for services rendered to that State or political subdivision or local authority thereof. The expression "may be taxed" was used and this did not connote an exclusive right of taxation.
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> 2. *[…] [S]*ubparagraph *a)* of paragraphs l and 2 are both based on the principle that the paying State shall have an exclusive right to tax the payments. Countries using the credit method as the general method for relieving double taxation in their conventions are thus, as an exception to that method, obliged to exempt from tax such payments to their residents as are dealt with under paragraphs 1 and 2. If both Contracting States apply the exemption method for relieving double

taxation, they can continue to use the expression "may be taxed" instead of "shall be taxable only". In relation to such countries the effect will of course be the same irrespective of which of these expressions they use. It is understood that the expression "shall be taxable only" shall not prevent a Contracting State from taking into account the income exempted under subparagraph *a)* of paragraphs 1 and 2 in determining the rate of tax to be imposed on income derived by its residents from other sources. The principle of giving the exclusive taxing right to the paying State is contained in so many of the existing conventions *[…]* that it can be said to be already internationally accepted. It is also in conformity with the conception of international courtesy which is at the basis of the Article and with the provisions of the Vienna Conventions on Diplomatic and Consular Relations. It should, however, be observed that the Article is not intended to restrict the operation of any rules originating from international law in the case of diplomatic missions and consular posts (see Article 28) but deals with cases not covered by such rules.

2.1 In 1994, a further amendment was made to paragraph 1 by replacing the term "remuneration" by the words "salaries, wages, and other similar remuneration". This amendment was intended to clarify the scope of the Article, which only applies to State employees and to persons deriving pensions from past employment by a State, and not to persons rendering independent services to a State or deriving pensions related to such services.

2.2 Member countries have generally understood the term "salaries, wages and other similar remuneration … paid" to include benefits in kind received in respect of services rendered to a State or political subdivision or local authority thereof (e.g. the use of a residence or automobile, health or life insurance coverage and club memberships).

3. The provisions of the Article apply to payments made not only by a State but also by its political subdivisions and local authorities (constituent states, regions, provinces, *départements,* cantons, districts, *arrondissements*, *Kreise,* municipalities, or groups of municipalities etc.).

4. An exception from the principle of giving exclusive taxing power to the paying State is contained in subparagraph *b*) of paragraph 1. It is to be seen against the background that, according to the Vienna Conventions mentioned above, the receiving State is allowed to tax remuneration paid to certain categories of personnel of foreign diplomatic missions and consular posts, who are permanent residents or nationals of that State. Given that pensions paid to retired government

officials ought to be treated for tax purposes in the same way as salaries or wages paid to such employees during their active time, an exception like the one in subparagraph *b)* of paragraph 1 is incorporated also in subparagraph *b*) of paragraph 2 regarding pensions. Since the condition laid down in subdivision *b*)(*ii*) of paragraph 1 cannot be valid in relation to a pensioner, the only prerequisite for the receiving State's power to tax the pension is that the pensioner must be one of its own residents and nationals.

5. According to Article 19 of the 1963 *[OECD]* Draft Convention, the services rendered to the State, political subdivision or local authority had to be rendered "in the discharge of functions of a governmental nature". That expression was deleted in the 1977 *[OECD]* Model Convention. Some OECD member countries, however, thought that the exclusion would lead to a widening of the scope of the Article. Contracting States who are of that view and who feel that such a widening is not desirable may continue to use, and preferably specify, the expression "in the discharge of functions of a governmental nature" in their bilateral conventions.

5.1 Whilst the word "pension", under the ordinary meaning of the word, covers only periodic payments, the words "other similar remuneration", which were added *[in 2005]* to paragraph 2 *[of Article 19 of the OECD Model]* are broad enough to cover non-periodic payments. For example, a lump-sum payment in lieu of periodic pension payments that is made to a former State employee after cessation of employment may fall within paragraph 2 of the Article. Whether a particular lump-sum payment made in these circumstances is to be considered as other remuneration similar to a pension falling under paragraph 2 or as final remuneration for work performed falling under paragraph 1 is a question of fact which can be resolved in light of the factors presented in paragraph 5 of the Commentary on Article 18 *[of the 2017 OECD Model, as quoted in paragraph 4 of the Commentary on Article 18 of this Model]*.

5.2 It should be noted that the expression "out of funds created by" in subparagraph *a*) of paragraph 2 covers the situation where the pension is not paid directly by the State, a political subdivision or a local authority but out of separate funds created by a government body. In addition, the original capital of the fund would not need to be provided by the State, a political subdivision or a local authority. The phrase would cover payments from a privately administered fund established for the government body.

5.3 An issue arises where pensions are paid for combined private and government services. This issue may frequently arise where a person has been employed in both the private and public sector and receives one pension in respect of both periods of employment. This may occur either because the person participated in the same scheme throughout the employment or because the person's pension rights were portable. A trend towards greater mobility between private and public sectors may increase the significance of this issue.

5.4 Where a civil servant having rendered services to a State has transferred a right to a pension from a public scheme to a private scheme the pension payments would be taxed only under Article 18 because such payment would not meet the technical requirement of subparagraph 2 *a*).

5.5 Where the transfer is made in the opposite direction and the pension rights are transferred from a private scheme to a public scheme, some States tax the whole pension payments under Article 19. Other States, however, apportion the pension payments based on the relative source of the pension entitlement so that part is taxed under Article 18 and another part under Article 19. In so doing, some States consider that if one source has provided by far the principal amount of the pension, then the pension should be treated as having been paid exclusively from that source. Nevertheless, it is recognised that apportionment often raises significant administrative difficulties.

5.6 Contracting States may be concerned about the revenue loss or the possibility of double non-taxation if the treatment of pensions could be changed by transferring the fund between public and private schemes. Apportionment may counter this; however, to enable apportionment to be applied to pensions rights that are transferred from a public scheme to a private scheme, Contracting States may, in bilateral negotiations, consider extending subparagraph 2 *a*) to cover the part of any pension or other similar remuneration that *[…]* is paid in respect of services rendered to a Contracting State or a political subdivision or a local authority thereof. Such a provision could be drafted as follows:

2. *a*) Notwithstanding the provisions of paragraph 1, the part of any pension or other similar remuneration that is paid in respect of services rendered to a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that Contracting State.

Alternatively Contracting States may address the concern by subjecting all pensions to a common treatment.

6. Paragraphs 1 and 2 do not apply if the services are performed in connection with business carried on by the State, or one of its political subdivisions or local authorities, paying the salaries, wages, pensions or other similar remuneration. In such cases the ordinary rules apply: Article 15 for wages and salaries, Article 16 for directors' fees and other similar payments, Article 17 for entertainers and sportspersons, and Article 18 for pensions. Contracting States, wishing for specific reasons to dispense with paragraph 3 in their bilateral conventions, are free to do so thus bringing in under paragraphs 1 and 2 also services rendered in connection with business. In view of the specific functions carried out by certain public bodies, for example, State Railways, the Post Office, State-owned theatres etc. Contracting States wanting to keep paragraph 3 may agree in bilateral negotiations to include under the provisions of paragraphs 1 and 2 salaries, wages, pensions, and other similar remuneration paid by such bodies, even if they could be said to be performing business activities.

3. All pensions paid in respect of services rendered to a Contracting State, political subdivision or local authority thereof are subject to Article 19, even if they are paid under the social security system of one of the States. In most cases the treatment would be the same whether such payments were subject to Article 18 or Article 19. The treatment differs, however, in those cases described in paragraph *2*(*b*) of Article 19 – where the recipient is both a resident and a national of the other State. Under Article 19, government service pensions received by such individuals are taxable only in the State of residence. If they were to be subject to tax under Article 18, they would be taxable only in the State of source. The purpose of this paragraph is to indicate that a public service pension paid by one State to a resident of the other State who is a national of that other State is taxable only in the latter State even if that pension is paid under the social security system of the first-mentioned State. Some countries prefer to extend the scope of Article 18 to cover also government pensions, so that private pensions and government pensions are subject to the same treatment. When such a solution is chosen, paragraph 2 of Article 19 is not necessary and should be deleted.

4. It was proposed that the question of tax treatment of a Government meeting the expenses of artistes resident of one Contracting State performing their activities in another Contracting State might be dealt with in the Commentaries. However, it was considered that the Contracting States, if they so desire, may discuss the matter during bilateral negotiations. A reference is made to the Commentary on Article 17 in this connection.

Article 20

STUDENTS

1. Article 20 of the UN Model, as presently worded, conforms to Article 20 of the OECD Model, with the addition of the word "trainee". As explained below, paragraph 2 of the 1980 version of the UN Model, which contained provisions dealing with grants and scholarships and remuneration from employment not covered by paragraph 1, was deleted in 1999.

2. Since Article 20 of the UN Model reproduces Article 20 of the OECD Model, the Committee considers that the following part of the Commentary on Article 20 of the 2017 OECD Model is applicable to Article 20 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 1. The rule established in this Article concerns certain payments received by students or business *[trainees or]* apprentices for the purpose of their maintenance, education or training. All such payments received from sources outside the State in which the student or business *[trainee or]* apprentice concerned is staying shall be exempted from tax in that State.
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> 2. The word "immediately" was inserted in the 1977 *[OECD Model]* in order to make clear that the Article does not cover a person who has once been a resident of a Contracting State but has subsequently moved his residence to a third State before visiting the other Contracting State.
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> 3. The Article covers only payments received for the purpose of the recipient's maintenance, education or training. It does not, therefore, apply to a payment, or any part thereof, that is remuneration for services rendered by the recipient and which is covered by Article 15 (or by *[Article 12AA or]* Article 7 in the case of independent services). Where the recipient's training involves work experience, however, there is a need to distinguish between a payment for services and a payment for the recipient's maintenance, education or training. The fact that the amount paid is similar to that paid to persons who provide similar services and are not students or business *[trainees or]* apprentices would

generally indicate that the payment is a remuneration for services. Also, payments for maintenance, education or training should not exceed the level of expenses that are likely to be incurred to ensure the recipient's maintenance, education or training.

4. The Article only applies to payments arising from sources outside the State where the student or business trainee or apprentice is present solely for the purposes of education or training. Payments arising from sources within that State are covered by other Articles of the Convention: for instance, if, during his presence in the first-mentioned State, the student or business apprentice remains a resident of the other State according to Article 4, payments such as grants or scholarships that are not covered by other provisions of the Convention (such as Article 15) *[may be taxed in both States under paragraphs 1 and 3 of Article 21]*. For the purpose of the Article, payments that are made by or on behalf of a resident of a Contracting State or that are borne by a permanent establishment which a person has in that State are not considered to arise from sources outside that State.

3. Article 20 of the 1980 version of the UN Model contained a paragraph 2 which read as follows:

> 2. In respect of grants, scholarships and remuneration from employment not covered by paragraph 1, a student or business apprentice described in paragraph 1 shall, in addition, be entitled during such education or training to the same exemptions, reliefs or reductions in respect of taxes available to residents of the State which he is visiting.

4. The question whether that paragraph 2 should be deleted engaged the attention of the former Group of Experts for some time. In this connection, it is relevant to reproduce paragraphs 25 to 29 of the Report of the former Group of Experts on International Cooperation in Tax Matters on the Work of its Seventh Meeting held in December 1995 (ST/ESA/250):

> 25. At its July 1995 meeting, the Steering Committee recommended that the group consider deleting from the Model Convention Article 20, paragraph 2, which provided that if a visiting student had income not exempted by paragraph 1 from taxation in the visited country, the student should, in the taxation of non-exempted income, be entitled to the same exemptions, reliefs, and reductions as were allowed to residents of that country.

26. A participant argued that the provision should be retained because it allowed visiting students to be taxed in the same way as resident students. Another participant responded that such parity was sometimes elusive because the resident student was taxable on all income, whereas a visiting student was taxable only on income from sources in the visited country.

27. A proponent of deleting the provision noted that Article 24, paragraph 4 (second sentence), stated that a country is not required to allow non-residents any personal allowances or other reliefs "on account of civil status or family responsibilities" which might be allowed to residents; Article 20, paragraph 2, it was argued, contradicted the provision of Article 24.

28. A participant noted that, as an alternative to Article 14, paragraph 1(*c*), a treaty might provide for exemption in the host State, for the normal duration of studies, of remuneration not exceeding a certain annual amount, but only to the extent that the remuneration was also not exempted in the other State. [Paragraph 1(*c*) of Article 14 was deleted in 1999.]

29. After discussion, it was concluded that a majority of the Group, but not a consensus, favoured deletion of Article 20, paragraph 2.

5. The matter was considered again at the ninth meeting of the former Group of Experts, in May 1999, and the Group agreed to delete paragraph 2 of Article 20.

6. Although, as worded, paragraph 2 of Article 20 of the 1980 UN Model covered grants and scholarships that had their source in the country visited as well as income from an employment in the country visited, the Commentary on that paragraph made it clear that the paragraph was mainly concerned with income from employment. The wording was intended to put visiting students etc. on exactly the same basis as students who were residents for tax purposes of the State where they were studying, but not to treat visiting students more favourably than tax-resident students.

7. Experience with the application of paragraph 2 in practice showed that, as worded, it could give rise to difficult problems of administration. For example, if the visiting student was subject to tax in the State visited

only on income from sources in that country, and not on his worldwide income, should the visitor have been entitled to the full allowances which a resident who was taxed on his worldwide income was allowed? Similarly, should a married student, whose spouse did not come to the country with the student, be entitled to the married person's allowance? These issues could not be settled from a strict reading of the text of paragraph 2 as worded.

8. A particular question raised by the inclusion of paragraph 2 was the tax residence status of a visiting student or business apprentice under the normal rules of residence in Article 4. A student who was following a full-time course of studies could become a tax resident of the host State: in which case, he would have become liable to tax there in respect of his worldwide income, and be entitled to all the personal reliefs, without the need of any special provision in Article 20.

9. Moreover, as the Commentary on paragraph 2 of the 1980 version went on to show, there were a number of ways in which the countries could have wished to consider expanding Article 20 in the course of negotiations in order to cover particular problems which could have arisen in special bilateral situations. The following examples were given in the Commentary on Article 20 of the 1980 UN Model, without suggesting any particular form of words to give effect to their intentions:

> *[…]* some countries in bilateral negotiations might wish to expand the Article by adding a paragraph permitting a further exemption (beyond that generally applicable as a personal exemption or similar allowance under the internal law of the Contracting State) of employment income under certain conditions. *[…]*
>
> Some countries may, for example, wish to extend the exemption to remuneration received for services performed in the country where the student or business apprentice is present, but to limit the exemption to a specified amount of remuneration. In fixing the amount, countries may take into account the fact that students or business apprentices may incur additional costs because they are away from their home country. *[…]*
>
> *[…]*
>
> It may also be appropriate, in cases where the exemption is extended, to place a time limit on such exemption in the case of

business apprentices, and also perhaps in the case of students, a longer period presumably being allowed in the latter situation.

10. In the light of the practical difficulties in applying paragraph 2, and the fact that there are a number of other issues affecting students and business apprentices that may need to be addressed in bilateral negotiations, the former Group of Experts decided that, rather than attempt a comprehensive rewording, it was preferable to omit paragraph 2 from the Convention. Countries wishing to broaden the scope of Article 20 to cover sources of income arising in the country visited should aim to draft a suitable provision as tightly as possible to meet their specific circumstances.

Article for teachers

11. During the course of discussions in the Seventh Meeting of the former Group of Experts, several participants argued for the addition to the Convention of an Article dealing with visiting teachers. Currently, under the UN Model, visiting teachers are subject to Article 12AA, if the teaching services are performed in an independent capacity; Article 15, if the services are dependent; or Article 19, if the remuneration is paid by a Contracting State. Notably, Article15 commonly does not exempt a visiting teacher's compensation from taxation at source because it generally allows source taxation of service performers who are present in the host country for more than 183 days, and many teaching assignments exceed that period of time; while Article 12AA requires no minimum period of performance of services to allow source taxation in the host country. Many treaties have an additional Article or paragraph dealing specifically with teachers and, sometimes, researchers, which typically exempts them from taxation in the source country if their stay does not exceed a prescribed length.

12. There was considerable controversy among participants about the need to provide an independent Article in the UN Model dealing exclusively with visiting teachers. But substantially, all participants agreed that an article for teachers, if included in the Convention, should not have the effect of exempting a teacher from tax both in the home country and the country visited. One member suggested a compromise on the issue: that the Convention should not be amended to include a provision on visiting teachers but that an addition should be made in

the Commentary, noting that many treaties contained such Articles and providing advice for bilateral negotiations on the subject. There was general consensus for this suggestion.

13. Accordingly, the former Group of Experts appointed a drafting committee to formulate language for inclusion in the Commentary on the Convention. After being discussed and amended, the following inclusion was adopted by the Group in 1999 (the references to deleted Article 14 have been updated for this 2025 Model to references, between square brackets, to Article 12AA):

> No special Model Convention provision has been made regarding remuneration derived by visiting professors and other teachers. In the absence of a special provision, Articles [12AA], 15, 19 or 23 of the Model Convention, depending on the circumstances, would apply. Many bilateral conventions, however, contain rules of some kind or other concerning such persons, the main purpose of which is to facilitate cultural relations and the exchange of knowledge by providing for a limited tax exemption in the host country for visiting teachers. Sometimes, tax exemption is already provided under domestic taxation laws, which many consider to be the preferred way of solving double taxation problems of visiting teachers.
>
> Notwithstanding the applicability of Articles [12AA], 15, 19 and 23 to prevent double taxation, some countries may wish to include an Article on teachers. The variety of domestic tax rules in different countries, on the one hand, or the absence of such rules, on the other, constitute an impediment to a specific provision on teachers in the Model Convention. If, however, in bilateral negotiations, the Contracting States choose to include a provision relating to visiting teachers, the following issues should be considered in preparing such a provision:
>
> (*a*) The purpose of a tax treaty generally is to avoid double taxation, and double exemption of teachers is not desirable;
>
> (*b*) It is advisable to limit benefits for visits of a maximum duration (normally two years), and the time limit should be subject to expansion in individual cases by mutual agreement between competent authorities of the Contracting States. It should be determined whether income from the

visits exceeding the time limit should be taxable as of the beginning of the visit or merely from the date beyond the expiration of the time limit;

(*c*) Whether the benefits should be limited to teaching services performed at certain institutions "recognized" by the Contracting States in which the services are performed;

(*d*) Whether, in the case of visiting professors and other teachers who also do research, to limit benefits remuneration for research performed in the public (vs. private) interest;

(*e*) Whether an individual may be entitled to the benefits of the Article more than once.

Article 21

OTHER INCOME

1. Article 21 of this Model reproduces Article 21 of the OECD Model Tax except that it includes an additional paragraph 3 containing a general provision relating to items of income of a resident of a Contracting State not dealt with in the preceding Articles and arising in the other Contracting State.

2. The Article covers income of a class not expressly dealt with in the preceding Articles (e.g. an alimony or a lottery income) as well as income from sources not expressly referred to therein (e.g. a rent paid by a resident of a Contracting State for the use of immovable property situated in a third State). The Article covers income arising in third States as well as income from a Contracting State.

Paragraph 1

3. This paragraph reproduces paragraph 1 of Article 21 of the OECD Model. The Committee considers that the following part of the Commentary on Article 21 of the 2017 OECD Model is applicable to paragraph 1 of Article 21 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 2. Under this paragraph the exclusive right to tax is given to the State of residence. In cases of conflict between two residences, Article 4 will also allocate the taxation right in respect of third-State income.
>
> 3. *[…] [W]*hen income arises in a third State and the recipient of this income is considered as a resident by both Contracting States under their domestic law, the application of Article 4 will result in the recipient being treated as a resident of one Contracting State only and being liable to comprehensive taxation ("full tax liability") in that State only. In this case, the other Contracting State may not impose tax on the income arising from the third State, even if the recipient is not taxed by the State of which he is considered a resident under Article 4. In order to avoid non-taxation, Contracting States may agree to limit the scope of the Article to income which is taxed in the Contracting

> State of which the recipient is a resident and may modify the provisions of the paragraph accordingly *[…]*.

However, as explained in paragraph 5 below, the scope of paragraph 1 of Article 21 of the UN Model is limited by the provisions of paragraph 3 of the Article.

Paragraph 2

4. This paragraph reproduces paragraph 2 of Article 21 of the OECD Model. The Committee considers that the following part of the Commentary on Article 21 of the 2017 OECD Model, which deals with paragraph 2 of the Article, is applicable to paragraph 2 of Article 21 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 4. This paragraph provides for an exception from the provisions of paragraph 1 where the income is associated with the activity of a permanent establishment which a resident of a Contracting State has in the other Contracting State. The paragraph includes income from third States. In such a case, a right to tax is given to the Contracting State in which the permanent establishment is situated. Paragraph 2 does not apply to immovable property for which, according to paragraph 4 of Article 6, the State of situs has a primary right to tax (see paragraphs 3 and 4 of the Commentary on Article 6 *[of the 2017 OECD Model]*). Therefore, immovable property situated in a Contracting State and forming part of the business property of a permanent establishment of an enterprise of that State situated in the other Contracting State shall be taxable only in the first-mentioned State in which the property is situated and of which the recipient of the income is a resident. This is in consistency with the rules laid down in Articles 13 and 22 in respect of immovable property since paragraph 2 of those Articles applies only to movable property of a permanent establishment.
>
> 5. The paragraph also covers the cases not dealt with in the previous Articles of the Convention where the beneficiary and the payer of the income are both residents of the same Contracting State, and the income is attributed to a permanent establishment which the beneficiary of the income has in the other Contracting State. In such a case a right to tax is given to the Contracting State in which the permanent establishment

is situated. Where double taxation occurs, the State of residence should give relief under the provisions of Article 23 A or 23 B (see paragraph 9 of the Commentary on these Articles [*of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*).

[…]

6. Some States which apply the exemption method (Article 23 A) may have reason to suspect that the treatment accorded in paragraph 2 may provide an inducement to an enterprise of a Contracting State to attach assets such as shares, bonds or patents, to a permanent establishment situated in the other Contracting State in order to obtain more favourable tax treatment there. Apart from the fact that paragraph 9 of Article 29 would deny the benefits of Article 23 A in the case of arrangements undertaken for that purpose, it is important to note that the requirement that such assets be "effectively connected" with such a permanent establishment requires more than merely recording these assets in the books of the permanent establishment for accounting purposes *[…]*.

Paragraph 3

5. This paragraph constitutes an addition to Article 21 of the OECD Model. It allows the State in which the income arises to tax such income if its law so provides while the provisions of paragraph 1 also allows taxation of that income in the State of residence. The concurrent application of the provisions of the two paragraphs may result in double taxation. In such a situation, the provisions of Article 23 A or 23 B as appropriate are applicable, as in other cases of double taxation. In some cases paragraphs 2 and 3 may overlap; they would then produce the same result.

6. During the Ninth Meeting of the former Group of Experts held in 1999, there was extensive discussion regarding the inclusion of a new paragraph dealing with financial instruments. Three options were identified. First, the Contracting States could adopt Article 21 of the UN Model with the three paragraphs. Second, the Contracting States could adopt paragraph 3 of Article 21 but add a reduced rate of tax in respect of income referred to in paragraph 3. Third, the Contracting States could adopt the UN Model with paragraphs 1 and 2 only. These alternatives were considered useful in dealing with this subject. It was

noted that the treatment of financial products is relevant for options 2 and 3, as discussed below in paragraph 7.

Optional additional paragraph on income from certain nontraditional financial instruments

7. The Committee considers that the following part of the Commentary on Article 21 of the 2017 OECD Model, which includes an optional additional paragraph dealing with income arising from certain nontraditional financial instruments when the parties to the instrument have a special relationship, is relevant for the purposes of Article 21 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 7. Some countries have encountered difficulties in dealing with income arising from certain nontraditional financial instruments when the parties to the instrument have a special relationship. These countries may wish to add the following paragraph to Article 21:
>
> > *[4].* Where, by reason of a special relationship between the person referred to in paragraph 1 and some other person, or between both of them and some third person, the amount of the income referred to in paragraph 1 exceeds the amount (if any) which would have been agreed upon between them in the absence of such a relationship, the provisions of this Article shall apply only to the last mentioned amount. In such a case, the excess part of the income shall remain taxable according to the laws of each Contracting State, due regard being had to the other applicable provisions of this Convention.
>
> The inclusion of this additional paragraph should carry no implication about the treatment of innovative financial transactions between independent persons or under other provisions of the Convention.
>
> 8. This paragraph restricts the operation of the provisions concerning the taxation of income not dealt with in other Articles in the same way that paragraph 6 of Article 11 restricts the operation of the provisions concerning the taxation of interest *[…]*.
>
> 9. Although the restriction could apply to any income otherwise subject to Article 21, it is not envisaged that in practice it is likely to

be applied to payments such as alimony payments or social security payments but rather that it is likely to be most relevant where certain nontraditional financial instruments are entered into in circumstances and on terms such that they would not have been entered into in the absence of the special relationship *[…]*.

10. The restriction of Article 21 differs from the restriction of Article 11 in two important respects. First, the paragraph permits, where the necessary circumstances exist, all of the payments under a nontraditional financial instrument to be regarded as excessive. Second, income that is removed from the operation of the interest Article might still be subject to some other Article of the Convention *[…]*. Income to which Article 21 would otherwise apply is by definition not subject to any other Article. Therefore, if the Article 21 restriction removes a portion of income from the operation of that Article, then Articles 6 through 20 of the Convention are not applicable to that income at all, and each Contracting State may tax it under its domestic law.

11. Other provisions of the Convention, however, will continue to be applicable to such income, such as Article 23 (Relief from double taxation), Article 25 (Mutual agreement procedure) and Article 26 (Exchange of information).

8. When the scope of Article 21 was discussed by the former Group of Experts, some members pointed out that there are artificial devices entered into by persons to take advantage of the provisions of Article 21 – especially if paragraph 3 is omitted or provides for only a reduced rate of tax in the source State – through, inter alia, creation or assignment of rights with respect to which income from, for example, financial instruments, arises. While it was then noted that substance over form rules, the abuse of rights principle or any similar doctrine could be used to counter such arrangements, the subsequent addition, in 2017, of paragraph 9 of Article 29 provided another way of addressing these concerns.

9. Countries, generally, do not include, in Article 21, a clause indicating where the income is deemed to arise for the purposes of paragraph 3. The domestic laws of both Contracting States will determine the source of the income. The domestic laws of the Contracting States may, however, differ and this may lead to double taxation (or non-taxation where the State of residence of the beneficiary applies Article 23 A to

eliminate double taxation). Countries that want to address the issue may include a clause on the following lines in their bilateral tax treaties:

> Income shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the income, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the liability to pay the income was incurred, and such income is borne by such permanent establishment, then such income shall be deemed to arise in the State in which the permanent establishment is situated.

Commentary on chapter IV

TAXATION ON CAPITAL

Article 22

CAPITAL

1. In the United Nations Model Tax Convention, Article 22 deals with taxes on capital, to the exclusion of taxes on estates and inheritances and on gifts and of transfer duties.

2. In the 1980 UN Model, all the paragraphs of Article 22 were in square brackets, which reflected the decision that the provisions of the Article be left to be formulated in bilateral negotiations. The question whether paragraphs 1 to 4 should continue to be placed within brackets was subsequently examined by the former Group of Experts. There was general agreement that brackets were not required for the first three paragraphs but it was decided to retain them so far as paragraph 4 was concerned. There was a strong argument that the situs State would have the right to tax where the property was situated in that country; that would bring it into line with the treatment in this Model of other income referred to in Article 21. In 1999, it was therefore decided to retain the brackets so far as paragraph 4 is concerned.

3. Should the negotiating parties decide to include an Article on the taxation of capital, they will have to determine whether to use the wording of paragraph 4, which is placed within brackets, or wording that leaves taxation to the State in which the capital is located. If the wording of paragraph 4, placed within brackets, is used, the Committee considers that the following part of the Commentary on Article 22 of the 2017 OECD Model, which provides additional explanations on the Article, is applicable to Article 22 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

1. This Article deals only with taxes on capital, to the exclusion of taxes on estates and inheritances and on gifts and of transfer duties. Taxes on capital to which the Article applies are those referred to in Article 2.

2. Taxes on capital generally constitute complementary taxation of income from capital. Consequently, taxes on a given element of capital can be levied, in principle, only by the State which is entitled to tax the income from this element of capital. However, it is not possible to refer purely and simply to the rules relating to the taxation of such class of income, for not all items of income are subject to taxation exclusively in one State.

3. The Article, therefore, enumerates first property which may be taxed in the State in which they are situated. To this category belong immovable property referred to in Article 6 which a resident of a Contracting State owns and which is situated in the other Contracting State (paragraph 1) and movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State (paragraph 2).

[…]

4. *[…S]*hips and aircraft operated in international traffic and movable property pertaining to the operation of such ships or aircraft shall be taxable only in the State of residence (paragraph 3) *[under the]* rule *[that]* corresponds to the provisions of Article 8 *[Alternative B]* and of paragraph 3 of Article 13. Contracting States which would prefer to confer the exclusive taxing right on the State in which the place of effective management of the enterprise is situated are free in bilateral conventions to substitute for paragraph 3 a provision corresponding to that proposed in paragraph *2 [quoted at paragraph 35 of the Commentary on Article 8 (alternative B) of this Model]* of the Commentary on Article 8 [*of the 2017 OECD Model]*. Immovable property pertaining to the operation of ships or aircraft may be taxed in the State in which *[it is]* situated in accordance with the rule laid down in paragraph 1.

4.1 Paragraph 3 applies where the enterprise that owns the property operates itself the ships or aircraft referred to in the paragraph, whether for its own transportation activities or when leasing the ships or aircraft on charter fully equipped, manned and supplied. It does not apply, however, where the enterprise owning the ships or aircraft does not operate them (for example, where the enterprise leases the property to another person, other than in the case of an occasional bare boat lease

as referred to in paragraph 5 of the Commentary on Article 8 *[of the 2017 OECD Model, as quoted in paragraph [38] of the Commentary on Article 8 of this Model]*). In such a case, the capital will be covered by paragraph 2 or 4.

5. As regards elements of capital other than those listed in paragraphs 1 to 3, the Article provides*[, where the paragraph 4 text is chosen during bilateral negotiations,]* that they are taxable only in the Contracting State of which the person to whom they belong is a resident (paragraph 4).

6. If, when the provisions of paragraph 4 are applied to elements of movable property under usufruct, double taxation subsists because of the disparity between domestic laws, the States concerned may resort to the mutual agreement procedure or settle the question by means of bilateral negotiations.

7. The Article does not provide any rule about the deductions of debts. The laws of OECD member countries are too different to allow a common solution for such a deduction. The problem of the deduction of debts which could arise when the taxpayer and the creditor are not residents of the same State is dealt with in paragraph 4 of Article 24.

4. Countries may be concerned about giving up their taxing rights by using the wording of paragraph 4, placed within brackets, in cases where there is no or low taxation of such capital in the other Contracting State. If that other State does not impose capital taxes at all, it may be appropriate not to include Article 22 in the treaty. However, if both Contracting States do impose capital taxes, but provide different exemptions or exclusions, countries may want to consider including in Article 22 a rule similar to that of paragraph (3) of Article 1, which addresses the issue in the case of taxes on income.

Commentary on chapter V

METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

Article 23

METHODS FOR THE ELIMINATION OF DOUBLE TAXATION

A. General considerations

1. This Model provides two alternative versions of Article 23 for the elimination of double taxation, namely Article 23 A on the exemption method and Article 23 B on the credit method.

2. The method by which a country gives relief from double taxation depends primarily on its general tax policy and the structure of its tax system. Owing to the differences which exist in the various tax systems, bilateral tax treaties provide the most flexible instrument for reconciling conflicting tax systems and for avoiding or mitigating double taxation.

3. When the UN Model was revised in 2001 by the former Group of Experts, members from developing countries felt that, as regards relief measures to be applied by developed countries, the methods of tax exemption and tax credit could be used as appropriate. The exemption method was considered eminently suitable where exclusive tax jurisdiction over certain income was allotted to the country of source under a treaty; it might take the form of an exemption with progression. One of the principal defects of the foreign tax credit method, in the eyes of the developing countries, is that the benefit of low taxes in developing countries or of special tax concessions granted by them may in large part inure to the benefit of the treasury of the capital-exporting country rather than to the foreign investor for whom the benefits were designed. Thus, revenue is shifted from the developing country to the capital-exporting country.

4. The effectiveness of the tax incentive measures introduced by most developing countries thus depends on the interrelationship

between the tax systems of the developing countries and those of the capital-exporting countries from which the investment originates. It is of primary importance to developing countries to ensure that the tax incentive measures shall not be made ineffective by taxation in the capital-exporting countries using the foreign tax credit system. This undesirable result is to some extent avoided in bilateral treaties through a "tax-sparing" credit, by which a developed country grants a credit not only for the tax paid but also for the tax spared by incentive legislation in the developing country. It is also avoided by the exemption method. Some members from developing countries considered it necessary to underline their understanding that either the exemption method or the tax-sparing clause is, for these countries, a basic and fundamental aim in the negotiation of tax treaties. On the other hand, some members noted that studies have shown that tax factors may not themselves be decisive in the process of investment decisions and, therefore, in their view, tax sparing may not be an appropriate policy.

5. Many members from both developed and developing countries agreed with the view that tax-sparing credits should be included in treaties between developed and developing countries, where the developed country used the credit method. However, some members expressed the view that for a variety of reasons tax-sparing credits are not an appropriate tool for economic development, an objective that can better be served by other measures.

6. While the exemption method of providing relief for double taxation eliminates the undesirable effects of the residence country's taxes on the source country's tax incentive scheme, many developed countries are unprepared to include this system in their treaties. Where the investor's home country applies the principle of foreign tax credit, the most effective method of preserving the effect of the tax incentives and concessions extended by developing countries is a tax-sparing credit. Three alternatives might be considered to cope with the problem.

7. First, a tax incentive-granting country's internal legislation might include provisions allowing the incentive only if the taxpayer can show to the satisfaction of the tax administration that, upon remittance of its profits abroad, the laws of the country to which the profits are remitted will not, directly or indirectly, tax the income covered by the incentive or will give credit for tax forgone by the incentive. Such a provision would

foreclose the possibility of the benefits of a tax incentive flowing from the developing country's fisc to the taxpayer and thence to the fisc of the developed country.

8. Second, a tax convention might include a provision barring each Contracting State from taxing the profits of an enterprise resident in that State from activities in the other State benefiting from tax incentives granted by the latter until the profits are repatriated or otherwise directly or indirectly remitted to the first Contracting State. Thus, those profits would have to be reinvested in the developing country in order to remain untaxed. Some accounting rules would have to be developed to reflect this provision, and a schedule or timetable for repatriation could be agreed upon by the Contracting States.

9. Third, the first Contracting State might be allowed to tax such profits, but be required, pursuant to a revenue-sharing agreement, to turn over to the Contracting State, where the income was produced, the amounts of tax revenue that can reasonably be attributed to the tax incentive granted by the country of source. This proposal has the attraction of preserving the incentive value of the developing country's fiscal sacrifice and of being relatively easy to administer. The existing rules in many developed countries for apportioning the source and nature of foreign income earned by its taxpayers may provide most of the information required to determine the tax revenues that can be attributed to a tax incentive.

10. On the other hand, some members contended that, theoretically, it could be argued that the effectiveness of the tax incentive measures introduced by many developing countries thus depends, in part, on the interrelationship between the tax systems of the developing countries and those of the capital-exporting countries which use the foreign tax credit system. This is because there is an expectation that the developing country tax incentives will be "matched" by a "tax-sparing" credit, granted by the developed country. By a "tax-sparing" credit is meant a credit granted not only for tax actually paid but, also, for tax that was forgone under the incentive legislation.

11. Since the original publication of the UN Model in 1980, there have been various studies undertaken of the economic justification for adopting fiscal incentives with the objective of stimulating investment.

According to some members, these studies have demonstrated that tax factors may not themselves be decisive in the process of investment decisions made by the enterprises and therefore, in their view, tax sparing may not be an appropriate policy. Other factors play a greater role in forming the so-called "investment climate" of any given country, for example, political and economic stability, a judicial system perceived as impartial, the availability of a skilled workforce, and labour laws and social security costs that do not serve as unintended obstacles to the development of enterprise. It has been argued that fiscal incentives undermine the tax base and can lead to the damaging effects of tax incentive competition which then takes place between neighbouring States, as they try to outdo each other's incentives and lend themselves to fiscal manipulation. Moreover, where "matching" credit provisions have been included in tax treaties, there have been examples of the artificial structuring of business transactions in order to take advantage of them, leading both to erosion of the tax base and to an unintended economic distortion in the process of investment decision-making.

12. That said, the reality is that, as a policy matter, countries remain free to adopt those investment incentives that seem to them to be useful or unavoidable, given the pressure resulting from the existence of preferential tax regimes, such as tax-free zones in the other jurisdictions, although, as a matter of observation, there is a tendency in more recent years for these to be more narrowly targeted than formerly. For example, they may be restricted to specific areas of economic activity, or to specific geographical regions, and, instead of being open-ended, they tend to be relatively tightly time-limited. Where developing countries choose to adopt such fiscal incentives, some experts from developing countries consider that they should continue to have, as a treaty negotiating aim, the inclusion of a "matching" or "tax-sparing" provision in treaties with capital exporting countries which have a foreign tax credit system. Studies of tax treaties concluded between developed and developing countries show that tax-sparing provisions still feature in these treaties, although these provisions, in their turn, now show a tendency to be more strictly time-limited than previously. Sometimes, there is a "break" or "sunset" clause, providing for the provision to be terminated after, say, five years, unless the treaty partner States agree to an extension. Where such clauses are included, it is the view of some experts from developing

countries that the capital-importing country should provide, both in its domestic tax laws and in its treaties, some protection against a future decision by the treaty partner to refuse to extend the life of the tax-sparing provision. This might, for instance, take the form of a so-called "soak-up tax", which consists of a tax or levy designed to reduce the benefit granted by means of the domestic tax incentive legislation, by the amount which would otherwise be transferred to the treasury of the treaty partner, in the absence of a tax-sparing provision. Some countries do not, however, allow a foreign tax credit for soak-up taxes.

13. The flow of international investment can also be hampered if a country's system of eliminating double taxation, although following Article 23 in form, does not lead to the elimination of double taxation in practice. For example, a system's mechanical features may lead to unusable foreign tax credits. Not only is this inconsistent with the spirit of Article 23, but it also might impede foreign investment.

14. When the UN Model was revised in 2017, the wording of paragraph 2 of Article 23 A was changed to refer to the part of the tax attributable to such items of income "which may be taxed in that other State" rather than "derived from that other State". This change was intended to make the wording of paragraph 2 of Article 23 A consistent with that of paragraph 1 of Article 23 B. The change in wording was not intended to change the meaning of paragraph 2 of Article 23 A. Under either wording, the credit for tax imposed by the other State is limited to the tax attributable to items of income which the other State is entitled to tax under the provisions of the treaty.

15. Subject to paragraphs 16 and 17 below, which provide additional explanations, the Committee considers that the following part of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which explains the exemption method of Article 23 A and the credit method of Article 23 B, as well as paragraphs 1 to 3 of Article 23 A, is applicable to Articles 23 A and 23 B of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

I. Preliminary remarks

A. The scope of the Articles

1. These Articles deal with the so-called juridical double taxation where the same income or capital is taxable in the hands of the same person by more than one State.

2. This case has to be distinguished especially from the so-called economic double taxation, that is, where two different persons are taxable in respect of the same income or capital. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

3. International juridical double taxation may arise in three cases:

a) where each Contracting State subjects the same person to tax on his worldwide income or capital (concurrent full liability to tax, see paragraph 4 below *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*);

b) where a person is a resident of a Contracting State (R)[1] and derives income from, or owns capital in, the other Contracting State (S or E) and both States impose tax on that income or capital (see paragraph 5 below *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*);

c) where each Contracting State subjects the same person, not being a resident of either Contracting State to tax on income derived from, or capital owned in, a Contracting State; this may result, for instance, in the case where a non-resident person has a permanent establishment in one Contracting State (E) through which he derives income from, or owns capital in, the other Contracting State (S) (concurrent limited tax liability, see paragraph 11 below *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*).

1 Throughout the Commentary on Articles 23 A and 23 B, the letter "R" stands for the State of residence within the meaning of the Convention, "S" for the State of source or situs, and "E" for the State where a permanent establishment is situated.

4. The conflict in case *a)* is reduced to that of case *b)* by virtue of Article 4. This is because that Article defines the term "resident of a Contracting State" by reference to the liability to tax of a person under domestic law by reason of his domicile, residence, place of management

or any other criterion of a similar nature (paragraph 1 of Article 4) and by providing special rules for the case of double residence to determine which of the two States is the State of residence (R) within the meaning of the Convention (paragraphs 2 and 3 of Article 4).

4.1 Article 4, however, only deals with cases of concurrent full liability to tax. The conflict in case *a)* may therefore not be solved if the same item of income is subject to the full liability to tax of two countries but at different times. The following example illustrates that problem. Assume that a resident of State R1 derives a taxable benefit from an employee stock-option that is granted to that person. State R1 taxes that benefit when the option is granted. The person subsequently becomes a resident of State R2, which taxes the benefit at the time of its subsequent exercise. In that case, the person is taxed by each State at a time when he is a resident of that State and Article 4 does not deal with the issue as there is no concurrent residence in the two States.

4.2 The conflict in that situation will be reduced to that of case *b)* and solved accordingly to the extent that the employment services to which the option relates have been rendered in one of the Contracting States so as to be taxable by that State under Article 15 because it is the State where the relevant employment is exercised. Indeed, in such a case, the State in which the services have been rendered will be the State of source for purposes of elimination of double taxation by the other State. It does not matter that the first State does not levy tax at the same time (see paragraph 32.8 *[below of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*). It also does not matter that that State considers that it levies tax as a State of residence as opposed to a State of source (see the last sentence of paragraph 8 *[below of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*).

4.3 Where, however, the relevant employment services have not been rendered in either State, the conflict will not be one of source-residence double taxation and, as confirmed by the phrase "except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State" found in paragraph 1 of Articles 23 A and 23 B, any resulting double taxation will be outside the scope of these Articles. The mutual agreement procedure provided for in paragraph 3 of Article 25 could be used to deal with such a case. One possible basis to solve the case would be for the competent authorities of the two States to agree that each State should provide relief as regards the residence-based tax that was levied by the other State on the part of the benefit that relates to services rendered during the period while the employee was a resident of that

other State. Thus, in the above example, if the relevant services were rendered in a third State before the person became a resident of State R2, it would be logical for the competent authority of State R2 to agree to provide relief (either through the credit or exemption method) for the State R1 tax that has been levied on the part of the employment benefit that relates to services rendered in the third State since, at the time when these services were rendered, the taxpayer was a resident of State R1 and not of State R2 for purposes of the convention between these two States.

5. The conflict in case *b)* may be solved by allocation of the right to tax between the Contracting States. Such allocation may be made by renunciation of the right to tax either by the State of source or situs (S) or of the situation of the permanent establishment (E), or by the State of residence (R), or by a sharing of the right to tax between the two States. The provisions of the Chapters III and IV of the Convention, combined with the provisions of Article 23 A or 23 B, govern such allocation.

6. For some items of income or capital, an exclusive right to tax is given to one of the Contracting States, and the relevant Article states that the income or capital in question "shall be taxable only" in a Contracting State.[1] The words "shall be taxable only" in a Contracting State preclude the other Contracting State from taxing, thus double taxation is avoided. The State to which the exclusive right to tax is given is normally the State of which the taxpayer is a resident within the meaning of Article 4, that is State R, but in Article 19[2] the exclusive right may be given to the other Contracting State (S) of which the taxpayer is not a resident within the meaning of Article 4.

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1 See first sentence of paragraph 1 of Article 7, paragraph 1 of Article 8 *[Alternative B]*, *[…]* paragraphs 3 and *[8]* of Article 13, first sentence of paragraph 1 as well as paragraphs 2 and 3 of Article 15, Article 18 *[except paragraphs 1 and 2 of Alternative B]*, paragraphs 1 and 2 of Article 19, paragraph 1 of Article 21 and paragraphs 3 and 4 of Article 22.

2 See subparagraph *a*) of paragraphs 1 and 2 of Article 19.

7. For other items of income or capital, the attribution of the right to tax is not exclusive, and the relevant Article then states that the income or capital in question "may be taxed" in the Contracting State (S or E) of which the taxpayer is not a resident within the meaning of Article 4. In such case the State of residence (R) must give relief so as to avoid the double taxation. Paragraphs 1 and 2 of Article 23 A and paragraph 1 of Article 23 B are designed to give the necessary relief.

8. Articles 23 A and 23 B apply to the situation in which a resident of State R derives income from, or owns capital in, the other Contracting State E or S (not being the State of residence within the meaning of the Convention) and *[…]* such income or capital, in accordance with the Convention, may be taxed in such other State E or S. The Articles, therefore, apply only to the State of residence and do not prescribe how the other Contracting State E or S has to proceed.

9. Where a resident of the Contracting State R derives income from the same State R through a permanent establishment which he has in the other Contracting State E, State E may tax such income (except income from immovable property situated in State R) if it is attributable to the said permanent establishment (paragraph 1 of Article 7 and paragraph 2 of Article 21). In this instance too, State R must give relief under Article 23 A or Article 23 B for income attributable to the permanent establishment situated in State E, notwithstanding the fact that the income in question originally arises in State R (see also paragraph 5 of the Commentary on Article 21 *[of the 2017 OECD Model, as quoted in paragraph 4 of the Commentary on Article 21 of this Model]*). However, where *[that income is income from the operation of ships or aircraft in international traffic, dividends, interest, royalties, fees for services, income from automated digital services or insurance premiums that State R taxes because it is the State of residence or because]* the Contracting States agree to give to State R a limited right to tax as the State of source of *[such income from the operation of ships or aircraft in international traffic,]* dividends*[, interest, royalties, fees for services, income from automated digital services or insurance premiums]* within the limits fixed in paragraph 2 of Articles *[8 (Alternative A),]* 10*[, 11, 12, 12AA, 12B or 12C (see paragraph 9.1 below),] […]* a credit *[should]* be given by State E for the tax levied by State R, along the lines of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B*[, on the basis of paragraph 3 of Article 24]*.

9.1 Where, however, State R applies the exemption method, a problem may arise as regards the taxation of *[income from the operation of ships or aircraft in international traffic,]* dividends*[, interest, royalties, fees for services, income from automated digital services or insurance premiums]* in the State of residence as the State of source: the combination of Articles 7 and 23 A prevents that State from levying tax on that income, whereas if it were paid to a resident of the other State, State R, being the State of source of the *[income from the operation of ships or aircraft in international traffic,]* dividends*[, interest, royalties, fees for services, income from automated digital services or insurance premiums]*, could

tax such *[income from the operation of ships or aircraft in international traffic,]* dividends*[, interest, royalties, fees for services, income from automated digital services or insurance premiums]* at the rates provided for in paragraph 2 of Articles *[8 (Alternative A),]* 10*[, 11, 12, 12AA, 12B or 12C]*. Contracting States which find this position unacceptable may include in their conventions a provision according to which the State of residence would be entitled, as State of source of the *[income from the operation of ships or aircraft in international traffic,]* dividends*[, interest, royalties, fees for services, income from automated digital services, or insurance premiums]*, to levy a tax on such income at the rates provided for in paragraph 2 of Articles *[8 (Alternative A),]* 10*[, 11, 12, 12AA, 12B or 12C]* notwithstanding the fact that it applies the exemption method. The State where the permanent establishment is situated would give a credit for such tax along the lines of the provisions of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B; of course, this credit would not be given in cases where the State in which the permanent establishment is situated does not tax the *[income from the operation of ships or aircraft in international traffic,]* dividends*[, interest, royalties, fees for services, income from automated digital services or insurance premiums]* attributed to the permanent establishment, in accordance with its domestic laws.

10. Where a resident of State R derives income from a third State through a permanent establishment which he has in State E, such State E may tax such income (except income from immovable property situated in the third State) if it is attributable to such permanent establishment (paragraph 1 of Article 7 and paragraph 2 of Article 21). State R must give relief under Article 23 A or Article 23 B in respect of income attributable to the permanent establishment in State E. There is no provision in the Convention for relief to be given by Contracting State E for taxes levied in the third State where the income arises; however, under paragraph 3 of Article 24 any relief provided for in the domestic laws of State E (double taxation conventions excluded) for residents of State E is also to be granted to a permanent establishment in State E of an enterprise of State R (see paragraphs 67 to 72 of the Commentary on Article 24 [*of the 2017 OECD Model, as quoted in paragraph 2 of the Commentary on Article 24 of this Model]*.

11. The conflict in case *c)* of paragraph 3 above is outside the scope of the Convention as, under Article 1, it applies only to persons who are residents of one or both of the States. It can, however, be settled by applying the mutual agreement procedure (see also paragraph 10 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*).

11.1 In some cases, the same income or capital may be taxed by each Contracting State as income or capital of one of its residents. This may happen where, for example, one of the Contracting States taxes the worldwide income of an entity that is a resident of that State whereas the other State views that entity as fiscally transparent and taxes the members of that entity who are residents of that other State on their respective share of the income. The phrase "(except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State)" clarifies that in such cases, both States are not reciprocally obliged to provide relief for each other's tax levied exclusively on the basis of the residence of the taxpayer and that each State is therefore only obliged to provide relief of double taxation to the extent that taxation by the other State is in accordance with provisions of the Convention that allow taxation of the relevant income or capital as the State of source or as a State where there is a permanent establishment to which that income or capital is attributable, thereby excluding taxation that would solely be the result of the residence of a person in that other State. Whilst this result would logically follow from the wording of Articles 23 A and 23 B even in the absence of that phrase, the addition of the phrase removes any doubt in this respect.

11.2 The principles put forward in the preceding paragraph are illustrated by the following examples:

— *Example A:* An entity established in State R constitutes a resident of State R and is therefore taxed on its worldwide income in that State. State S treats that entity as fiscally transparent and taxes the members of the entity on their respective share of the income derived through the entity. All the members of the entity are residents of State S. All the income of the entity constitutes business profits attributable to a permanent establishment situated in State R. In that case, in determining the tax payable by the entity, State R will not be obliged to provide relief under Article 23 A or 23 B with respect to the income of the entity as the only reason why State S may tax that income in accordance with the provisions of the Convention is because of the residence of the members of the entity. State S, on the other hand, will be required to provide relief under Article 23 A or 23 B with respect to the entire income of the entity as that income may be taxed in State R in accordance with the provisions of Article 7 regardless of the fact that State R considers that the income is derived by an entity

resident of State R. In determining the amount of income tax paid in State R for the purposes of providing relief from double taxation to the members of the entity under Article 23 B, State S will need to take account of the tax paid by the entity in State R.

— *Example B:* Same facts as in example A except that 30 per cent of the income derived through the entity is interest arising in State S that is attributable to a permanent establishment in State R, the rest of the income being business profits attributable to the same permanent establishment. In that case, relief of double taxation with respect to the business profits other than the interest will be provided as described in example A. In the case of the interest, however, State R will be required to provide a credit to the entity under paragraph 2 of Article 23 A or paragraph 1 of Article 23 B for the amount of tax on the interest paid in State S by all the members of the entity without exceeding the lower of 10 per cent of the gross amount of interest (which is the maximum amount of tax that may be paid in State S in accordance with paragraph 2 of Article 11 *[of the OECD Model]*) or the tax payable in State R on that interest (last part of paragraph 2 of Article 23 A and of paragraph 1 of Article 23 B). State S, on the other hand, will also be required to provide relief under Article 23 A or 23 B to the members of the entity that are residents in State S because that income may be taxed by State R in accordance with the provisions of paragraph 1 of Article 7. If State S applies the exemption method of Article 23 A, that suggests that State S will need to exempt the share of the interest attributable to the members that are residents of State S (see paragraph 5 of the Commentary on Article 21 *[of the 2017 OECD Model, as quoted in paragraph 4 of the Commentary on Article 21 of this Model]* and paragraph 9 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted above]*). If State S applies the credit method of Article 23 B, the credit should only be applicable against the part of the tax payable in State S that exceeds the amount of tax that State S would be entitled to levy under paragraph 2 of Article 11 and that credit should be given for the amount of tax paid in State R after deduction of the credit that State R itself must grant for the tax payable in State S under paragraph 2 of Article 11.

— *Example C:* Same facts as in example A except that all the income of the entity is derived from immovable property situated in State S. In that case, in determining the tax payable by the entity, State R will be required to provide relief under Article 23 A or 23 B with respect to the entire income of the entity as that

income may be taxed in State S in accordance with the provisions of Article 6 regardless of the fact that State S considers that the income is derived by the members who are residents of State S. State S, on the other hand, is not required to provide relief under Article 23 A *[or]* 23 B because the only reason why State R may tax the income in accordance with the provisions of the Convention is because of the residence of the entity (the result would be the same even if the income were attributable to a permanent establishment situated in State R: see the first sentence of paragraph 9 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted above]*).

— *Example D:* Same facts as in example A except that all the income of the entity is interest arising in State S which is not attributable to a permanent establishment. In that case, in determining the tax payable by the entity, State R will be required to provide a credit to the entity under paragraph 2 of Article 23 A or paragraph 1 of Article 23 B for the amount of tax on the interest paid in State S by all the members of the entity without exceeding the lower of 10 per cent of the gross amount of the interest (which is the maximum amount of tax that may be paid in State S in accordance with paragraph 2 of Article 11 *[of the OECD Model]*) or the tax payable in State R on that interest (last part of paragraph 2 of Article 23 A and of paragraph 1 of Article 23 B). State S, on the other hand, will not be obliged to provide relief under Article 23 A or 23 B with respect to the income of the entity since that income does not arise in State R and is not attributable to a permanent establishment in State R and the only reason why State R may tax the income is because the income is also income derived by a resident of State R. Paragraph 1 of Article 11 confirms State R's *[right to tax]* the interest as income derived by an entity resident of State R.

— *Example E:* Same facts as in example D except that all the income of the entity is interest arising in State R. In that case, in determining the tax payable by the entity, State R will not be obliged to provide relief under Article 23 A or 23 B with respect to the income of the entity as the only reason why State S may tax that income in accordance with the provisions of the Convention is because of the residence of the members of the entity. State S, on the other hand, will be required to provide a credit to the members under paragraph 2 of Article 23 A or paragraph 1 of Article 23 B for the amount of tax on the interest paid in State R by the entity without exceeding the lower of 10 per cent of the

gross amount of the interest (which is the maximum amount of tax that may be paid in State R in accordance with paragraph 2 of Article 11 *[of the OECD Model]*) or the tax payable in State S on that interest (last part of paragraph 2 of Article 23 A and of paragraph 1 of Article 23 B). State S, however, will not be obliged to provide relief under Article 23 A or 23 B with respect to tax paid in State R in excess of the maximum amount of tax that may be *[levied]* in accordance with paragraph 2 of Article 11 since the interest is not attributable to a permanent establishment in State R and the only reason why State R may levy such additional tax is because the income is also income derived by a resident of State R. Whilst paragraph 2 of Article 11 and paragraph 3 of Article 1 confirm State R's right to tax the interest as interest arising in State R, State S considers that the interest is beneficially owned by a resident of State S, which explains why it does not take account of the tax levied in State R in excess of 10 per cent.

— *Example F:* Same facts as in example D except that all the income of the entity is interest arising in a third State. In that case, in determining the tax payable by the entity, State R will not be obliged to provide relief under Article 23 A or 23 B with respect to the income of the entity as the only reason why State S may tax that income in accordance with the provisions of the Convention is because of the residence of the members of the entity. State S will also not be obliged to provide relief under Article 23 A or 23 B with respect to the income of the entity since that income does not arise in State R and is not attributable to a permanent establishment in State R and the only reason why State R may tax the income is because the income is also income derived by a resident of State R. Paragraph 1 of Article 21 confirms State R's right to tax the interest as income derived by an entity resident of State R. Paragraph 1 of Article 21 also confirms State S' *[right to tax]* the interest as income derived by the entity's members who are residents of State S.

B. Description of methods for elimination of double taxation

12. In the existing conventions, two leading principles are followed for the elimination of double taxation by the State of which the taxpayer is a resident. For purposes of simplicity, only income tax is referred to in what follows; but the principles apply equally to capital tax.

1. The principle of exemption

13. Under the principle of exemption, the State of residence R does not tax the income which according to the Convention may be taxed in State E or S (nor, of course, also income which shall be taxable only in State E or S; see paragraph 6 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*).

14. The principle of exemption may be applied by two main methods:

a) the income which may be taxed in State E or S is not taken into account at all by State R for the purposes of its tax; State R is not entitled to take the income so exempted into consideration when determining the tax to be imposed on the rest of the income; this method is called "full exemption";

b) the income which may be taxed in State E or S is not taxed by State R, but State R retains the right to take that income into consideration when determining the tax to be imposed on the rest of the income; this method is called "exemption with progression".

2. The principle of credit

15. Under the principle of credit, the State of residence R calculates its tax on the basis of the taxpayer's total income including the income from the other State E or S which, according to the Convention, may be taxed in that other State (but not including income which shall be taxable only in State S; see paragraph 6 above). It then allows a deduction from its own tax for the tax paid in the other State.

16. The principle of credit may be applied by two main methods:

a) State R allows the deduction of the total amount of tax paid in the other State on income which may be taxed in that State, this method is called "full credit";

b) the deduction given by State R for the tax paid in the other State is restricted to that part of its own tax which is appropriate to the income which may be taxed in the other State; this method is called "ordinary credit".

17. Fundamentally, the difference between the methods is that the exemption methods look at income, while the credit methods look at tax.

C. Operation and effects of the methods

18. An example in figures will facilitate the explanation of the effects of the various methods. Suppose the total income to be 100,000, of which 80,000 is derived from one State (State of residence R) and 20,000 from the other State (State of source S). Assume that in State R the rate of tax on an income of 100,000 is 35 per cent and on an income of 80,000 is 30 per cent. Assume further that in State S the rate of tax is either 20 per cent – case (i) or 40 per cent – case (ii), so that the tax payable therein on 20,000 is 4,000 in case (i) or 8,000 in case (ii), respectively.

19. If the taxpayer's total income of 100,000 arises in State R, his tax would be 35,000. If he had an income of the same amount, but derived in the manner set out above, and if no relief is provided for in the domestic laws of State R and no convention exists between State R and State S, then the total amount of tax would be, in case (i): 35,000 plus 4,000 = 39,000, and in case (ii): 35,000 plus 8,000 = 43,000.

1. Exemption methods

20. Under the exemption methods, State R limits its taxation to that part of the total income which, in accordance with the various Articles of the Convention, it has a right to tax, that is, 80,000.

a) Full exemption

State R imposes tax on 80,000 at the rate of tax applicable to 80,000, that is, at 30 per cent.

	Case (*i*)	Case (*ii*)
Tax in State R, 30 % of 80,000	24,000	24,000
Plus tax in State S	4,000	8,000
Total taxes	28,000	32,000
Relief has been given by State R in the amount of	11,000	11,000

b) Exemption with progression

State R imposes tax on 80,000 at the rate of tax applicable to total income wherever it arises (100,000), that is, at 35 per cent.

	Case (*i*)	Case (*ii*)
Tax in State R, 35 % of 80,000	28,000	28,000
Plus tax in State S	4,000	8,000
Total taxes	32,000	36,000
Relief has been given by State R in the amount of	7,000	7,000

21. In both cases, the level of tax in State S does not affect the amount of tax given up by State R. If the tax on the income from State S is lower in State S than the relief to be given by State R – cases *a (i), a (ii),* and *b (i)* – then the taxpayer will fare better than if his total income were derived solely from State R. In the converse case – case *b (ii)* – the taxpayer will be worse off.

22. The example shows also that the relief given where State R applies the full exemption method may be higher than the tax levied in State S, even if the rates of tax in State S are higher than those in State R. This is due to the fact that under the full exemption method, not only the tax of State R on the income from State S is surrendered (35 per cent of 20,000 = 7,000; as under the exemption with progression), but that also the tax on remaining income (80,000) is reduced by an amount corresponding to the differences in rates at the two income levels in State R (35 less 30 = 5 per cent applied to 80,000 = 4,000).

2. Credit methods

23. Under the credit methods, State R retains its right to tax the total income of the taxpayer, but against the tax so imposed, it allows a deduction.

a) Full credit

State R computes tax on total income of 100,000 at the rate of 35 per cent and allows the deduction of the tax due in State S on the income from S.

	Case (*i*)	Case (*ii*)
Tax in State R, 35 % of 100,000	35,000	35,000
less tax in State S	-4,000	-8,000
Tax due	31,000	27,000
Total taxes	35,000	35,000
Relief has been given by State R in the amount of	4,000	8,000

b) Ordinary credit

State R computes tax on total income of 100,000 at the rate of 35 per cent and allows the deduction of the tax due in State S on the income from S, but in no case it allows more than the portion of tax in State R attributable to the income from S (maximum deduction). The maximum deduction would be 35 per cent of 20,000 = 7,000.

	Case (*i*)	Case (*ii*)
Tax in State R, 35 % of 100,000	35,000	35,000
less tax in State S	-4,000	
less maximum tax		7,000
Tax due	31,000	28,000
Total taxes	35,000	36,000
Relief has been given by State R in the amount of	4,000	7,000

24. A characteristic of the credit methods compared with the exemption methods is that State R is never obliged to allow a deduction of more than the tax due in State S.

25. Where the tax due in State S is lower than the tax of State R appropriate to the income from State S (maximum deduction), the taxpayer will always have to pay the same amount of taxes as he would have had to pay if he were taxed only in State R, that is, as if his total income were derived solely from State R.

26. The same result is achieved, where the tax due in State S is the higher while State R applies the full credit, at least as long as the total tax due to State R is as high or higher than the amount of the tax due in State S.

27. Where the tax due in State S is higher and where the credit is limited (ordinary credit), the taxpayer will not get a deduction for the whole of the tax paid in State S. In such event the result would be less favourable to the taxpayer than if his whole income arose in State R, and in these circumstances the ordinary credit method would have the same effect as the method of exemption with progression.

Table 23 – 1 Total amount of tax in the different cases illustrated above

A. All income arising in State R	Total tax = 35,000	
B. Income arising in two States, viz. 80,000 in State R and 20,000 in State S	Total tax if tax in State S is	
	4,000 (case (*i*))	8,000 (case (*ii*))
No convention (19)[a]	39,000	43,000
Full exemption (20*a*)	28,000	32,000
Exemption with progression (20*b*)	32,000	36,000
Full credit (23*a*)	35,000	35,000
Ordinary credit (23*b*)	35,000	36,000

a Numbers in brackets refer to paragraphs in this Commentary.

Table 23 – 2 Amount of tax given up by the state of residence

	If tax in State S is	
	4,000 (case *(i)*)	8,000 (case *(ii)*)
No convention	0	0
Full exemption (20*a*)[a]	11,000	11,000
Exemption with progression (20*b*)	7,000	7,000
Full credit (23*a*)	4,000	8,000
Ordinary credit (23*b*)	4,000	7,000

a Numbers in brackets refer to paragraphs in this Commentary.

D. The methods proposed in the Articles

28. In the conventions concluded between OECD member countries both leading principles have been followed. Some States have a preference for the first one, some for the other. Theoretically a single principle could be held to be more desirable, but, on account of the preferences referred to, each State has been left free to make its own choice.

29. On the other hand, it has been found important to limit the number of methods based on each leading principle to be employed. In view of this limitation, the Articles have been drafted so that member countries are left free to choose between two methods:

— the exemption method with progression (Article 23 A), and

— the ordinary credit method (Article 23 B).

30. If two Contracting States both adopt the same method, it will be sufficient to insert the relevant Article in the convention. On the other hand, if the two Contracting States adopt different methods, both Articles may be amalgamated in one, and the name of the State must be inserted in each appropriate part of the Article, according to the method adopted by that State.

31. Contracting States may use a combination of the two methods. Such combination is indeed necessary for a Contracting State R which generally adopts the exemption method in the case of income which under Articles 10 and 11*[, as well as 12, 12AA, 12B and 12C]* may be subjected to a limited tax in the other Contracting State S. For such case, Article 23 A provides in paragraph 2 a credit for the limited tax levied in the other Contracting State S (adjustments to paragraphs 1 and 2 of Article 23 A may, however, be required in the case of distributions from Real Estate Investment Trusts (REITs) where provisions similar to those referred to in paragraphs 67.1 to 67.7 of the Commentary on Article 10 *[of the 2017 OECD Model, as quoted in paragraph 48 of the Commentary on Article 1 of this Model]* have been adopted by the Contracting States). Moreover, States which in general adopt the exemption method may wish to exclude specific items of income from exemption and to apply to such items the credit method. In such case, paragraph 2 of Article 23 A could be amended to include these items of income.

[…]

32. The two Articles are drafted in a general way and do not give detailed rules on how the exemption or credit is to be computed, this being left to the domestic laws and practice applicable. Contracting States which find it necessary to settle any problem in the Convention itself are left free to do so in bilateral negotiations.

E. Conflicts of qualification

32.1 Both Articles 23 A and 23 B require that relief be granted, through the exemption or credit method, as the case may be, where an item of

income or capital may be taxed by the State of source in accordance with the provisions of the Convention. Thus, the State of residence has the obligation to apply the exemption or credit method in relation to an item of income or capital where the Convention authorises taxation of that item by the State of source.

32.2 The interpretation of the phrase "may be taxed in the other Contracting State in accordance with the provisions of this Convention", which is used in both Articles, is particularly important when dealing with cases where the State of residence and the State of source classify the same item of income or capital differently for purposes of the provisions of the Convention.

32.3 Different situations need to be considered in that respect. Where, due to differences in the domestic law between the State of source and the State of residence, the former applies, with respect to a particular item of income or capital, provisions of the Convention that are different from those that the State of residence would have applied to the same item of income or capital, the income is still being taxed in accordance with the provisions of the Convention, as interpreted and applied by the State of source. In such a case, therefore, the two Articles require that relief from double taxation be granted by the State of residence notwithstanding the conflict of qualification resulting from these differences in domestic law.

32.4 This point may be illustrated by the following example. A business is carried on through a permanent establishment in State E by a partnership established in that State. A partner, resident in State R, alienates his interest in that partnership. State E treats the partnership as fiscally transparent whereas State R treats it as taxable entity. State E therefore considers that the alienation of the interest in the partnership is, for the purposes of its Convention with State R, an alienation by the partner of the underlying assets of the business carried on by the partnership, which may be taxed by that State in accordance with paragraph 1 or 2 of Article 13. State R, as it treats the partnership as a taxable entity, considers that the alienation of the interest in the partnership is akin to the alienation of a share in a company, which could not be taxed by State E by reason of paragraph 5 of Article 13 *[of a treaty similar to the OECD Model]*. In such a case, the conflict of qualification results exclusively from the different treatment of partnerships in the domestic laws of the two States and State E must be considered by State R to have taxed the gain from the alienation "in accordance with the provisions of the Convention" for purposes of

the application of Article 23 A or Article 23 B. State R must therefore grant an exemption pursuant to Article 23 A or give a credit pursuant to Article 23 B irrespective of the fact that, under its own domestic law, it treats the alienation gain as income from the disposition of shares in a corporate entity and that, if State E's qualification of the income were consistent with that of State R, State R would not have to give relief under Article 23 A or Article 23 B. No double taxation will therefore arise in such a case.

32.5 Article 23 A and Article 23 B, however, do not require that the State of residence eliminate double taxation in all cases where the State of source has imposed its tax by applying to an item of income a provision of the Convention that is different from that which the State of residence considers to be applicable. For instance, in the example above, if, for purposes of applying paragraph 2 of Article 13, State E considers that the partnership carried on business through a fixed place of business but State R considers that paragraph 5 *[of Article 13 of a treaty similar to the OECD Model]* applies because the partnership did not have a fixed place of business in State E, there is actually a dispute as to whether State E has taxed the income in accordance with the provisions of the Convention. The same may be said if State E, when applying paragraph 2 of Article 13, interprets the phrase "forming part of the business property" so as to include certain assets which would not fall within the meaning of that phrase according to the interpretation given to it by State R. Such conflicts resulting from different interpretation of facts or different interpretation of the provisions of the Convention must be distinguished from the conflicts of qualification described in the above paragraph where the divergence is based not on different interpretations of the provisions of the Convention but on different provisions of domestic law. In the former case, State R can argue that State E has not imposed its tax in accordance with the provisions of the Convention if it has applied its tax based on what State R considers to be a wrong interpretation of the facts or a wrong interpretation of the Convention. States should use the provisions of Article 25 (Mutual agreement procedure), and in particular paragraph 3 thereof, in order to resolve this type of conflict in cases that would otherwise result in unrelieved double taxation.

32.6 The phrase "*[may be taxed . . .]* in accordance with the provisions of this Convention*[…]*" must also be interpreted in relation to possible cases of double non-taxation that can arise under Article 23 A. Where the State of source considers that the provisions of the Convention preclude it from taxing an item of income or capital which it would

otherwise have had the right to tax, the State of residence should, for purposes of applying paragraph 1 of Article 23 A, consider that the item of income may not be taxed by the State of source in accordance with the provisions of the Convention, even though the State of residence would have applied the Convention differently so as to have the right to tax that income if it had been in the position of the State of source. Thus the State of residence is not required by paragraph 1 to exempt the item of income, a result which is consistent with the basic function of Article 23 which is to eliminate double taxation *[see, however, paragraph 16 below of the Commentary on Articles 23 A and 23 B of this Model]*.

32.7 This situation may be illustrated by reference to a variation of the example described above. A business is carried on through a fixed place of business in State E by a partnership established in that State and a partner, resident in State R, alienates his interest in that partnership. Changing the facts of the example, however, it is now assumed that State E treats the partnership as a taxable entity whereas State R treats it as fiscally transparent; it is further assumed that State R is a State that applies the exemption method. State E, as it treats the partnership as a corporate entity, considers that the alienation of the interest in the partnership is akin to the alienation of a share in a company, which it cannot tax by reason of paragraph 5 of Article 13 *[of a treaty similar to the 2017 OECD Model]*. State R, on the other hand, considers that the alienation of the interest in the partnership should have been taxable by State E as an alienation by the partner of the underlying assets of the business carried on by the partnership to which paragraph 1 or 2 of Article 13 *[of that treaty]* would have been applicable. In determining whether it has the obligation to exempt the income under paragraph 1 of Article 23 A, State R should nonetheless consider that, given the way that the provisions of the Convention apply in conjunction with the domestic law of State E, that State may not tax the income in accordance with the provisions of the Convention. State R is thus under no obligation to exempt the income.

F. Timing mismatch

32.8 The provisions of the Convention that allow the State of source to tax particular items of income or capital do not provide any restriction as to when such tax is to be levied (see, for instance, paragraph 2.2 of the Commentary on Article 15) *[of the 2017 OECD Model, as quoted in paragraph 2 of the Commentary on Article 15 of this Model]*. Since both Articles 23 A and 23 B require that relief be granted where an item of

income or capital may be taxed by the State of source in accordance with the provisions of the Convention, it follows that such relief must be provided regardless of when the tax is levied by the State of source. The State of residence must therefore provide relief of double taxation through the credit or exemption method with respect to such item of income or capital even though the State of source taxes it in an earlier or later year. Some States, however, do not follow the wording of Article 23 A or 23 B in their bilateral conventions and link the relief of double taxation that they give under tax conventions to what is provided under their domestic laws. These countries, however, would be expected to seek other ways (the mutual agreement procedure, for example) to relieve the double taxation which might otherwise arise in cases where the State of source levies tax in a different taxation year.

II. Commentary on the provisions of Article 23 A (exemption method)

Paragraph 1

A. The obligation of the State of residence to give exemption

33. In the Article it is laid down that the State of residence R shall exempt from tax income and capital which in accordance with the Convention "may be taxed" in the other State E or S.

34. The State of residence must accordingly exempt income and capital which may be taxed by the other State in accordance with the Convention whether or not the right to tax is in effect exercised by that other State. This method is regarded as the most practical one since it relieves the State of residence from undertaking investigations of the actual taxation position in the other State.

[…]

35. Occasionally, negotiating States may find it reasonable in certain circumstances, in order to avoid double non-taxation, to make an exception to the absolute obligation on the State of residence to give exemption *[…]*. Such may be the case where no tax on specific items of income or capital is provided under the domestic laws of the State of source, or tax is not effectively collected owing to special circumstances such as the set-off of losses, a mistake, or the statutory time limit having expired. To avoid such double non-taxation of specific items of income, Contracting States may agree to amend the relevant Article

itself *[…]*. One might also make an exception to the general rule, in order to achieve a certain reciprocity, where one of the States adopts the exemption method and the other the credit method. Finally, another exception to the general rule may be made where a State wishes to apply to specific items of income the credit method rather than exemption (see paragraph 31 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model. See also the observations in paragraph 17 below of the Commentary on Articles 23 A and 23 B of this Model]*).

36. It should also be noted that, as explained in paragraphs 11.1 and 11.2 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*, Article 23 A does not oblige a Contracting State to exempt income or capital where the only reason why the other Contracting State may tax that income or capital in accordance with the provisions of the Convention is because that other State attributes that income or capital to a resident of that other State.

B. Alternative formulation of the Article

37. An effect of the exemption method as it is drafted in the Article is that the taxable income or capital in the State of residence is reduced by the amount exempted in that State. If in a particular State the amount of income as determined for income tax purposes is used as a measure for other purposes, for example, social benefits, the application of the exemption method in the form proposed may have the effect that such benefits may be given to persons who ought not to receive them. To avoid such consequences, the Article may be altered so that the income in question is included in the taxable income in the State of residence. The State of residence must, in such cases, give up that part of the total tax appropriate to the income concerned. This procedure would give the same result as the Article in the form proposed. States can be left free to make such modifications in the drafting of the Article. If a State wants to draft the Article as indicated above, paragraph 1 may be drafted as follows:

> Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, shall be taxable only or may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraph 2, allow as a deduction from the income tax or capital tax that part of the income tax or capital tax, respectively, which is applicable, as the case may be, to the income derived from or the capital owned in that other State.

If the Article is so drafted, paragraph 3 would not be necessary and could be omitted.

C. Miscellaneous problems

38. Article 23 A contains the principle that the State of residence has to give exemption, but does not give detailed rules on how the exemption has to be implemented. This is consistent with the general pattern of the Convention. Articles 6 to 22 too lay down rules attributing the right to tax in respect of the various types of income or capital without dealing, as a rule, with the determination of taxable income or capital, deductions, rate of tax, etc. (see however, *[paragraph 3 of Article 7 and]* Article 24). Experience has shown that many problems may arise. This is especially true with respect to Article 23 A. Some of them are dealt with in the following paragraphs. In the absence of a specific provision in the Convention, the domestic laws of each Contracting State are applicable. Some conventions contain an express reference to the domestic laws but of course this would not help where the exemption method is not used in the domestic laws. In such cases, Contracting States which face this problem should establish rules for the application of Article 23 A, if necessary, after having consulted with the competent authority of the other Contracting State (paragraph 3 of Article 25).

1. Amount to be exempted

39. The amount of income to be exempted from tax by the State of residence is the amount which, but for the Convention, would be subjected to domestic income tax according to the domestic laws governing such tax. It may, therefore, differ from the amount of income subjected to tax by the State of source according to its domestic laws.

40. Normally, the basis for the calculation of income tax is the total net income, that is, gross income less allowable deductions. Therefore, it is the gross income derived from the State of source less any allowable deductions (specified or proportional) connected with such income which is to be exempted.

41. Problems arise from the fact that most countries provide in their respective taxation laws for additional deductions from total income or specific items of income to arrive at the income subject to tax. Anumerical example may illustrate the problem:

a)	Domestic income (gross less allowable expenses)	100
b)	Income from the other State (gross less allowable expenses)	100
c)	Total income	200
d)	Deductions for other expenses provided for under the laws of the State of residence which are not connected with any of the income under a or b, such as insurance premiums, contributions to welfare institutions	-20
e)	"Net" income	180
f)	Personal and family allowances	-30
g)	Income subject to tax	150

The question is, what amount should be exempted from tax, for example.

— 100 (line *b*), leaving a taxable amount of 50

— 90 (half of line *e*, according to the ratio between line *b* and line *c*), leaving 60 (line *f* being fully deducted from domestic income)

— 75 (half of line *g*, according to the ratio between line *b* and line *c*), leaving 75

— or any other amount.

42. A comparison of the laws and practices of the OECD member countries shows that the amount to be exempted varies considerably from country to country. The solution adopted by a State will depend on the policy followed by that State and its tax structure. It may be the intention of a State that its residents always enjoy the full benefit of their personal and family allowances and other deductions. In other States these tax free amounts are apportioned. In many States personal or family allowances form part of the progressive scale, are granted as a deduction from tax, or are even unknown, the family status being taken into account by separate tax scales.

43. In view of the wide variety of fiscal policies and techniques in the different States regarding the determination of tax, especially deductions, allowances and similar benefits, it is preferable not to propose an express and uniform solution in the Convention, but to leave each State free to apply its own legislation and technique. Contracting States which prefer to have special problems solved in their convention are, of course, free to do so in bilateral negotiations. Finally, attention

is drawn to the fact that the problem is also of importance for States applying the credit method *[…]*.

2. Treatment of losses

44. Several States in applying Article 23 A treat losses incurred in the other State in the same manner as they treat income arising in that State: as State of residence (State R), they do not allow deduction of a loss incurred from immovable property or a permanent establishment situated in the other State (E or S). Provided that this other State allows carryover of such loss, the taxpayer will not be at any disadvantage as he is merely prevented from claiming a double deduction of the same loss namely in State E (or S) and in State R. Other States may, as State of residence R, allow a loss incurred in State E (or S) as a deduction from the income they assess. In such a case State R should be free to restrict the exemption under paragraph 1 of Article 23 A for profits or income which are made subsequently in the other State E (or S) by deducting from such subsequent profits or income the amount of earlier losses which the taxpayer can carry over in State E (or S). As the solution depends primarily on the domestic laws of the Contracting States and as the laws of the OECD member countries differ from each other substantially, no solution can be proposed in the Article itself, it being left to the Contracting States, if they find it necessary, to clarify the above-mentioned question and other problems connected with losses *[…]* bilaterally, either in the Article itself or by way of a mutual agreement procedure (paragraph 3 of Article 25).

3. Taxation of the rest of the income

45. Apart from the application of progressive tax rates which is now dealt with in paragraph 3 of the Article *[…]*, some problems may arise from specific provisions of the tax laws. Thus, for example, some tax laws provide that taxation starts only if a minimum amount of taxable income is reached or exceeded (tax exempt threshold). Total income before application of the Convention may clearly exceed such tax free threshold; but by virtue of the exemption resulting from the application of the Convention which leads to a deduction of the tax exempt income from total taxable income, the remaining taxable income may be reduced to an amount below this threshold. For the reasons mentioned in paragraph 43 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*, no uniform solution can be proposed. It may be noted, however, that the problem will not arise, if the alternative formulation of paragraph 1 of Article 23 A *[…]* is adopted.

46. Certain States have introduced special systems for taxing corporate income *[…]*. In States applying a split rate corporation tax *[…]*, the problem may arise whether the income to be exempted has to be deducted from undistributed income (to which the normal rate of tax applies) or from distributed income (to which the reduced rate applies) or whether the income to be exempted has to be attributed partly to distributed and partly to undistributed income. Where, under the laws of a State applying the split rate corporation tax, a supplementary tax is levied in the hands of a parent company on dividends which it received from a domestic subsidiary company but which it does not redistribute (on the grounds that such supplementary tax is a compensation for the benefit of a lower tax rate granted to the subsidiary on the distributions), the problem arises, whether such supplementary tax may be charged where the subsidiary pays its dividends out of income exempt from tax by virtue of the Convention. Finally a similar problem may arise in connection with taxes (*précompte*, Advance Corporation Tax) which are levied on distributed profits of a corporation in order to cover the tax credit attributable to the shareholders *[…]*. The question is whether such special taxes connected with the distribution of profits, could be levied insofar as distributions are made out of profits exempt from tax. It is left to Contracting States to settle these questions by bilateral negotiations.

Paragraph 2

47. In Articles 10 and 11 *[as well as 12, 12AA, 12B and 12C]* the right to tax dividends*[, interest, royalties, fees for technical services, income from automated digital services and insurance premiums]* is divided between the State of residence and the State of source. In these cases, the State of residence is left free not to tax if it wants to do so *[…]* and to apply the exemption method also to the above-mentioned items of income. However, where the State of residence prefers to make use of its right to tax such items of income, it cannot apply the exemption method to eliminate the double taxation since it would thus give up fully its right to tax the income concerned. For the State of residence, the application of the credit method would normally seem to give a satisfactory solution. Moreover, as already indicated in paragraph 31 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model]*, States which in general apply the exemption method may wish to apply to specific items of income the credit method rather than exemption. Consequently, the paragraph is drafted in accordance with the ordinary credit method. The Commentary on Article 23 B hereafter applies *mutatis mutandis* to paragraph 2 of Article 23 A.

48. In the cases referred to in the previous paragraph, certain maximum percentages are laid down for tax reserved to the State of source. In such cases, the rate of tax in the State of residence will very often be higher than the rate in the State of source. The limitation of the deduction which is laid down in the second sentence of paragraph 2 and which is in accordance with the ordinary credit method is therefore of consequence only in a limited number of cases. If, in such cases, the Contracting States prefer to waive the limitation and to apply the full credit method, they can do so by deleting the second sentence of paragraph 2.

Dividends from substantial holdings by a company

49. The combined effect of paragraphs 1 and 2 of Article 10 and Article 23 (Article 23 A or 23 B as appropriate) is that the State of residence of the shareholder is allowed to tax dividends arising in the other State, but that it must credit against its own tax on such dividends the tax which has been collected by the State where the dividends arise at a rate fixed under paragraph 2 of Article 10. This regime equally applies when the recipient of the dividends is a parent company receiving dividends from a subsidiary; in this case, the tax withheld in the State of the subsidiary – and credited in the State of the parent company – is limited to *[the percentage agreed during bilateral negotiations]* of the gross amount of the dividends by the application of subparagraph *a)* of paragraph 2 of Article 10.

50. These provisions effectively avoid the juridical double taxation of dividends but they do not prevent recurrent corporate taxation on the profits distributed to the parent company: first at the level of the subsidiary and again at the level of the parent company. Such recurrent taxation creates a very important obstacle to the development of international investment. Many States have recognised this and have inserted in their domestic laws provisions designed to avoid this obstacle. Moreover, provisions to this end are frequently inserted in double taxation conventions.

51. The *[OECD]* Committee on Fiscal Affairs has considered whether it would be appropriate to modify Article 23 of the Convention in order to settle this question. Although many States favoured the insertion of such a provision in the Model Convention this met with many difficulties, resulting from the diverse opinions of States and the variety of possible solutions. Some States, fearing tax evasion, preferred to maintain their freedom of action and to settle the question only in their domestic laws.

52. In the end, it appeared preferable to leave States free to choose their own solution to the problem. For States preferring to solve the problem in their conventions, the solutions would most frequently follow one of the principles below:

a) Exemption with progression

The State of which the parent company is a resident exempts the dividends it receives from its subsidiary in the other State, but it may nevertheless take these dividends into account in computing the tax due by the parent company on the remaining income (such a provision will frequently be favoured by States applying the exemption method specified in Article 23 A).

b) Credit for underlying taxes

As regards dividends received from the subsidiary, the State of which the parent company is a resident gives credit as provided for in paragraph 2 of Article 23 A or in paragraph 1 of Article 23 B, as appropriate, not only for the tax on dividends as such, but also for the tax paid by the subsidiary on the profits distributed (such a provision will frequently be favoured by States applying as a general rule the credit method specified in Article 23 B).

c) Assimilation to a holding in a domestic subsidiary

The dividends that the parent company derives from a foreign subsidiary are treated, in the State of the parent company, in the same way for tax purposes as dividends received from a subsidiary which is a resident of that State.

53. When the State of the parent company levies taxes on capital, a similar solution should also be applied to such taxes.

54. Moreover, States are free to fix the limits and methods of application of these provisions (definition and minimum duration of holding of the shares, proportion of the dividends deemed to be taken up by administrative or financial expenses) or to make the relief granted under the special regime subject to the condition that the subsidiary is carrying out a genuine economic activity in the State of which it is a resident, or that it derives the major part of its income from that State or that it is subject to a substantial taxation on profits therein.

Paragraph 3

55. The 1963 *[OECD]* Draft Convention reserved expressly the application of the progressive scale of tax rates by the State of residence (last sentence of paragraph 1 of Article 23 A) and most conventions

> concluded between OECD member countries which adopt the exemption method follow this principle. According to paragraph 3 of Article 23 A, the State of residence retains the right to take the amount of exempted income or capital into consideration when determining the tax to be imposed on the rest of the income or capital. The rule applies even where the exempted income (or items of capital) and the taxable income (or items of capital) accrue to those persons (e.g. husband and wife) whose incomes (or items of capital) are taxed jointly according to the domestic laws. This principle of progression applies to income or capital exempted by virtue of paragraph 1 of Article 23 A as well as to income or capital which under any other provision of the Convention "shall be taxable only" in the other Contracting State *[…]*. This is the reason why, in the 1977 *[OECD]* Model Convention, the principle of progression was transferred from paragraph 1 of Article 23 A to a new paragraph 3 of the said Article, and reference was made to exemption "in accordance with any provision of the Convention".
>
> 56. Paragraph 3 of Article 23 A relates only to the State of residence. The form of the Article does not prejudice the application by the State of source of the provisions of its domestic laws concerning the progression.

16. Paragraph 32.6 of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which is quoted in paragraph 15 above (in relation to the phrase "may be taxed . . . in accordance with the provisions of this Convention" in paragraph 1 of Article 23 A), is not applicable to cases where, absent any conflict of qualification, the Convention gives a right to tax to the State of source but that State, pursuant to its domestic law rather than any provision of the Convention, does not exercise this right, for example, where a developing country grants special tax incentives designed to promote economic development for specific items of income. In such cases, the State of residence must still exempt the items of income under the provisions of paragraph 1 of Article 23 A (see paragraph 34 of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model quoted in paragraph 15 above).

17. As regards paragraph 35 of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which is quoted in paragraph 15 above, it should be noted that in the UN Model, the right to tax in the country of source extends in many cases to income which under the OECD Model is taxable only in the country of residence. As a consequence, many countries adopting the exemption method in their bilateral conventions may wish to restrict the application of paragraph 1

of Article 23 A, for example, by limiting the exemption from tax to income effectively taxed in the country of source or by applying to some items of income the tax credit provided for in paragraph 2 of Article 23 A rather than the tax exemption. Also, because paragraph 1 of Article 23 A of the UN Model has a much broader scope than the corresponding provision of the OECD Model, because of extended source country rights, a State which generally chooses the exemption method may, in the negotiation of a bilateral convention, elect the credit method for specific items of income not mentioned in paragraph 2 of Article 23 A of the Model Convention.

Paragraph 4

18. The Committee considers that, subject to the additional explanations in paragraphs 19 to 24 below, the following Commentary on paragraph 4 of Article 23 A of the OECD Model is applicable to paragraph 4 of Article 23 A of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 56.1 The purpose of this paragraph is to avoid double non taxation as a result of disagreements between the State of residence and the State of source on the facts of a case or on the interpretation of the provisions of the Convention. The paragraph applies where, on the one hand, the State of source interprets the facts of a case or the provisions of the Convention in such a way that an item of income or capital falls under a provision of the Convention that eliminates its right to tax that item or limits the tax that it can impose while, on the other hand, the State of residence adopts a different interpretation of the facts or of the provisions of the Convention and thus considers that the item may be taxed in the State of source in accordance with the Convention, which, absent this paragraph, would lead to an obligation for the State of residence to give exemption under the provisions of paragraph 1.
>
> 56.2 The paragraph only applies to the extent that the State of source has applied the provisions of the Convention to exempt an item of income or capital or has applied the provisions of paragraph 2 of Article 10*[, 11, 12, 12AA or 12C, or the provisions of Article 12B]* to an item of income. The paragraph would therefore not apply where the State of source considers that it may tax an item of income or capital in

accordance with the provisions of the Convention but where no tax is actually payable on such income or capital under the provisions of the domestic laws of the State of source. In such a case, the State of residence must exempt that item of income under the provisions of paragraph 1 because the exemption in the State of source does not result from the application of the provisions of the Convention but, rather, from the domestic law of the State of source (see paragraph 34 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 above of the Commentary on Articles 23 A and 23 B of this Model]*). Similarly, where the source and residence States disagree not only with respect to the qualification of the income but also with respect to the amount of such income, paragraph 4 applies only to that part of the income that the State of source exempts from tax through the application of the Convention or to which that State applies paragraph 2 of Article 10*[, 11, 12, 12AA or 12C, or the provisions of Article 12B]*.

56.3 Cases where the paragraph applies must be distinguished from cases where the qualification of an item of income under the domestic law of the State of source interacts with the provisions of the Convention to preclude that State from taxing an item of income or capital in circumstances where the qualification of that item under the domestic law of the State of residence would not have had the same result. In such a case, which is discussed in paragraphs 32.6 and 32.7 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 above of the Commentary on Articles 23 A and 23 B of this Model]*), paragraph 1 does not impose an obligation on the State of residence to give exemption because the item of income may not be taxed in the State of source in accordance with the Convention. Since paragraph 1 does not apply, the provisions of paragraph 4 are not required in such a case to ensure the taxation right of the State of residence.

19. Paragraph 4 applies where the State of source interprets the facts of a case or the provisions of the Convention in such a way that an item of income or capital falls under a provision of the Convention that does not allow the State of source to tax the item while the State of residence adopts a different interpretation under which the item falls under a provision of the Convention that allows the State of source to tax the item. For example, on the one hand, the State of source considers that services performed by an enterprise of the State of residence through employees are not performed within its territory for more than 183 days

within a twelve-month period and, therefore, considers that, according to Articles 5 and 7, it may not tax the income attributable to those services. On the other hand, the State of residence of the enterprise considers that those services are performed during more than 183 days in the State of source. The State of residence considers therefore that the income attributable to those services is taxable in the State of source in accordance with Articles 5 and 7. In the absence of paragraph 4, the State of residence should, according to its interpretation of the Convention, exempt the income attributable to those services according to paragraph 1. In such case, to the extent that the difference of views is not solved through the mutual agreement procedure (which the taxpayer is unlikely to initiate as he benefits from this difference of views which results in non-taxation), paragraph 4 allows the State of residence not to apply paragraph 1 thereby avoiding double non-taxation.

20. Paragraph 4 is only applicable to the extent that the State of source "applies the provisions of this Convention" to either exempt an item of income or to restrict its right to tax under paragraphs 2 of Articles 10, 11, 12, 12AA or 12C, or under the provisions of Article 12B. Clearly, therefore, paragraph 4 will not apply to cases where the Convention gives an unlimited right to tax to the State of source but that State, pursuant to its domestic law, does not exercise this right. For example, both Contracting States consider that services are performed during more than 183 days in the State of source and the income attributable to those services is taxable in the State of source in accordance with Articles 5 and 7. Under the domestic law of the State of source, however, non-residents are only taxable on profits attributable to a permanent establishment situated in the State and no tax is therefore payable on the income. In such a case, the State of source cannot be said to have applied the provisions of the Convention to exempt the income since these provisions clearly provide that the income may be taxed by that State. Paragraph 4 therefore does not apply and the State of residence must exempt the income according to paragraph 1.

21. Paragraph 4 also applies where the State of source interprets the facts of a case or the provisions of the Convention in such a way that an item of income falls under the provisions of paragraph 2 of Article 10, 11, 12, 12AA or 12C, or the provisions of Article 12B, that provide for limited taxation in the State of source while the State of

residence adopts a different interpretation and considers that the item falls under a provision of the Convention that allows the State of source to tax the item without any limitation. For example, on the one hand, the State of source considers that royalties paid by one of its residents and beneficially owned by a resident of the other Contracting State are taxable at the limited rate provided for in paragraph 2 of Article 12. On the other hand, the State of residence of the beneficial owner considers that the right in respect of which the royalties are paid is effectively connected with a permanent establishment situated in the State of source through which the beneficial owner carries on business. The State of residence considers therefore that the royalties are taxable in the State of source without any limitation in accordance with paragraph 4 of Article 12 and must therefore be exempted under the provisions of paragraph 1 of Article 23 A. In such case, to the extent that the difference of views is not solved through the mutual agreement procedure, paragraph 4 allows the State of residence not to apply paragraph 1.

22. Where the State of source applies the provisions of paragraph 2 of Article 10, 11, 12, 12AA or 12C, or the provisions of Article 12B, the State of residence, in order to eliminate double taxation, should grant a credit pursuant to paragraph 2 of Article 23 A. This should be the case even if the State of residence has interpreted the facts of the case or the provisions of the Convention in such a way that would result in the State of source having an unlimited right to tax the income under the Convention, which would mean that the State of residence should normally exempt that income under the provisions of paragraph 1 of Article 23 A. Applying the credit method in that case is more efficient than trying to determine, pursuant to the mutual agreement procedure how the treaty requires that double taxation be relieved. The last part of paragraph 4, which is not found in the OECD Model, has been added for the sake of clarity in order to make that point explicit. In paragraph 2 of Article 23 A, some States may require a credit for taxes payable in the other Contracting State to be granted subject to the provisions of their domestic law regarding the allocation of a credit for foreign taxes but without affecting the general principle provided in such paragraph. Such wording would generally allow the application of the credit resulting from paragraph 4. However, where the reference to domestic law is not so limited, the Contracting States should verify during the negotiations that no inconsistency between

the domestic law and the treaty rules exists that could prevent the granting of the credit (e.g. the domestic law of the State of residence may not provide for a credit for foreign taxes where an item of income is taxed under its domestic law as a business profit attributable to a permanent establishment and not as a royalty).

23. Where the State of source applies the provisions of paragraph 2 of Article 10, 11, 12, 12AA or 12C, or the provisions of Article 12B, to an item of income, some States may prefer not to deny the application of the provisions of paragraph 1 despite the fact that the State of source must limit its tax on such income. Those States may limit the scope of paragraph 4 to cases where the State of source applies the provisions of the Convention to exempt an income or capital from tax and delete the part dealing with Articles 10, 11, 12, 12AA, 12B and 12C.

24. Paragraph 56.3 of the Commentary on Articles 23 A and 23 B of the OECD Model, which is quoted in paragraph 18 above, clarifies that paragraph 1 does not impose an obligation on the State of residence to give exemption in cases of conflicts of qualification and that paragraph 4 is therefore not required to avoid double non-taxation in those cases. The State of residence could, however, have an obligation to give exemption under paragraph 1 in cases of conflict of qualification if that State did not agree with the interpretation given in paragraphs 32.6 and 32.7 of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 above, to the phrase "in accordance with the provisions of this Convention" in paragraph 1 of Article 23 A or if the wording of paragraph 1 in the relevant bilateral Convention was different from that used in the UN Model and did not allow such interpretation. In such situations, paragraph 4 also ensures that the State of residence is not obliged to exempt the relevant income.

25. The Committee considers that the following part of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which explains the provisions of paragraph 1 of Article 23 B, is applicable to paragraph 1 of Article 23 B of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

III. Commentary on the provisions of Article 23 B (credit method)

Paragraph 1

A. Methods

57. Article 23 B, based on the credit principle, follows the ordinary credit method: the State of residence (R) allows, as a deduction from its own tax on the income or capital of its resident, an amount equal to the tax paid in the other State E (or S) on the income derived from, or capital owned in, that other State E (or S), but the deduction is restricted to the appropriate proportion of its own tax.

58. The ordinary credit method is intended to apply also for a State which follows the exemption method but has to give credit, under paragraph 2 of Article 23 A, for the tax levied at limited rates in the other State on dividends*[, interest, royalties, fees for services, income from automated digital services and insurance premiums]* (see paragraph 47 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*). The possibility of some modification as mentioned in paragraphs 47 and 48 above (full credit) could, of course, also be of relevance in the case of dividends*[, interest, royalties, fees for services, income from automated digital services and insurance premiums]* paid to a resident of a State which adopted the ordinary credit method (see also paragraph 63 *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted below]*).

59. The obligation imposed by Article 23 B on a State R to give credit for the tax levied in the other State E (or S) on an item of income or capital depends on whether this item may be taxed by the State E (or S) in accordance with the Convention *[…]*. Items of income which according to subparagraph *a)* of paragraphs 1 and 2 of Article 19 "shall be taxable only" in the other State are from the outset exempt from tax in State R *[…]*, and the Commentary on Article 23 A applies to such exempted income. As regards progression, reference is made to paragraph 2 of the Article *[…]*.

60. Article 23 B sets out the main rules of the credit method, but does not give detailed rules on the computation and operation of the credit. This is consistent with the general pattern of the Convention. Experience has shown that many problems may arise. Some of them are dealt with in the following paragraphs. In many States, detailed

rules on credit for foreign tax already exist in their domestic laws. A number of conventions, therefore, contain a reference to the domestic laws of the Contracting States and further provide that such domestic rules shall not affect the principle laid down in Article 23 B. Where the credit method is not used in the domestic laws of a Contracting State, this State should establish rules for the application of Article 23 B, if necessary after consultation with the competent authority of the other Contracting State (paragraph 3 of Article 25).

61. The amount of foreign tax for which a credit has to be allowed is the tax effectively paid in accordance with the Convention in the other Contracting State (excluding the amount of tax paid in that other State solely because the income or capital is also income derived by a resident of that State or capital owned by a resident of that State). Problems may arise, for example, where such tax is not calculated on the income of the year for which it is levied but on the income of a preceding year or on the average income of two or more preceding years. Other problems may arise in connection with different methods of determining the income or in connection with changes in the currency rates (devaluation or revaluation). However, such problems could hardly be solved by an express provision in the Convention.

62. According to the provisions of the second sentence of paragraph 1 of Article 23 B, the deduction which the State of residence (R) is to allow is restricted to that part of the income tax which is appropriate to the income derived from the State S, or E (so-called "maximum deduction"). Such maximum deduction may be computed either by apportioning the total tax on total income according to the ratio between the income for which credit is to be given and the total income, or by applying the tax rate for total income to the income for which credit is to be given. In fact, in cases where the tax in State E (or S) equals or exceeds the appropriate tax of State R, the credit method will have the same effect as the exemption method with progression. Also under the credit method, similar problems as regards the amount of income, tax rate etc. may arise as are mentioned in the Commentary on Article 23 A *[…]*. For the same reasons mentioned in paragraphs 42 and 43 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*, it is preferable also for the credit method not to propose an express and uniform solution in the Convention, but to leave each State free to apply its own legislation and technique. This is also true for some further problems which are dealt with below.

63. The maximum deduction is normally computed as the tax on net income, that is, on the income from State E (or S) less allowable deductions (specified or proportional) connected with such income *[…]*. For such reason, the maximum deduction in many cases may be lower than the tax effectively paid in State E (or S). This may especially be true in the case where, for instance, a resident of State R deriving interest from State S has borrowed funds from a third person to finance the interest-producing loan. As the interest due on such borrowed money may be offset against the interest derived from State S, the amount of net income subject to tax in State R may be very small, or there may even be no net income at all. *[…] [This problem could be solved by using the full credit method in State R as mentioned in paragraph 48 above. Another solution would be to exempt such income from tax in State S, as it is proposed in the Commentary in respect of interest on credit sales and on loans granted by banks.]*

64. If a resident of State R derives income of different kinds from State S, and the latter State, according to its tax laws imposes tax only on one of these items, the maximum deduction which State R is to allow will normally be that part of its tax which is appropriate only to that item of income which is taxed in State S. However, other solutions are possible, especially in view of the following broader problem: the fact that credit has to be given, for example, for several items of income on which tax at different rates is levied in State S, or for income from several States, with or without conventions, raises the question whether the maximum deduction or the credit has to be calculated separately for each item of income, or for each country, or for all foreign income qualifying for credit under domestic laws and under conventions. Under an "overall credit" system, all foreign income is aggregated, and the total of foreign taxes is credited against the domestic tax appropriate to the total foreign income.

65. Further problems may arise in case of losses. A resident of State R, deriving income from State E (or S), may have a loss in State R, or in State E (or S) or in a third State. For purposes of the tax credit, in general, a loss in a given State will be set off against other income from the same State. Whether a loss suffered outside State R (e.g. in a permanent establishment) may be deducted from other income, whether derived from State R or not depends on the domestic laws of State R. Here similar problems may arise, as mentioned in the Commentary on Article 23 A (paragraph 44 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*). When the total

income is derived from abroad, and no income but a loss not exceeding the income from abroad arises in State R, then the total tax charged in State R will be appropriate to the income from State S, and the maximum deduction which State R is to allow will consequently be the tax charged in State R. Other solutions are possible.

66. The aforementioned problems depend very much on domestic laws and practice, and the solution must, therefore, be left to each State. In this context, it may be noted that some States are very liberal in applying the credit method. Some States are also considering or have already adopted the possibility of carrying over unused tax credits. Contracting States are, of course, free in bilateral negotiations to amend the Article to deal with any of the aforementioned problems.

67. In so-called "thin capitalisation" situations, the Model Convention allows the State of the borrower company, under certain conditions, to treat an interest payment as a distribution of dividends in accordance with its domestic legislation; the essential condition is that the contributor of the loan should effectively share the risks run by the borrower company. This gives rise to two consequences:

— the taxing at source of such "interest" at the rate for dividends (paragraph 2 of Article 10);

— the inclusion of such "interest" in the taxable profits of the lender company.

68. If the relevant conditions are met, the State of residence of the lender would be obliged to give relief for any juridical or economic double taxation of the interest as if the payment was in fact a dividend. It should then give credit for tax effectively withheld on this interest in the State of residence of the borrower at the rate applicable to dividends and, in addition, if the lender is the parent company of the borrower company, apply to such "interest" any additional relief under its parent/subsidiary regime. This obligation may result:

a) from the actual wording of Article 23 of the Convention, when it grants relief in respect of income defined as dividends in Article 10 or of items of income dealt with in Article 10;

b) from the context of the Convention, that is, from a combination of Articles 9, 10, 11, and 23 and, if need be, by way of the mutual agreement procedure:

— where the interest has been treated in the country of residence of the borrower company as a dividend under rules which are in accordance with paragraph 1 of Article 9

or paragraph 6 of Article 11 and where the State of residence of the lender agrees that it has been properly so treated and is prepared to apply a corresponding adjustment;

— when the State of residence of the lender applies similar thin capitalisation rules and would treat the payment as a dividend in a reciprocal situation, that is, if the payment were made by a company established in its territory to a resident in the other Contracting State;

— in all other cases where the State of residence of the lender recognises that it was proper for the State of residence of the borrower to treat the interest as a dividend.

69. As regards dividends from a substantial holding by a company, reference is made to paragraphs 49 to 54 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*.

69.1 Problems may arise where Contracting States treat entities such as partnerships in a different way. Assume, for example, that the State where a partnership is established treats that partnership as a company and the State of residence of a partner treats it as fiscally transparent. The State of the partnership may, subject to the applicable provisions of the Convention, tax the partnership on its income when that income is realised and, subject to the limitations of paragraph 2 of Article 10, may also tax the distribution of profits by the partnership to its non-resident partners. The State of residence of the partner, however, will only tax the partner on his share of the partnership's income when that income is realised by the partnership.

69.2 The first issue that arises in this case is whether the State of residence of the partner, which taxes the partner on his share in the partnership's income, is obliged, under the Convention, to give credit for the tax that is levied on the partnership in the State of the partnership, which that latter State treats as a separate taxable entity. The answer to that question must be affirmative to the extent that the income may be taxed by the State of the partnership in accordance with the provisions of the Convention that allow taxation of the relevant income as the State of source or as a State where there is a permanent establishment to which that income is attributable (see also paragraphs 11.1 and 11.2 above *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*). To the extent that the State of residence of the partner flows through the income of the partnership to the partner for the purpose of taxing that partner,

it must adopt a coherent approach and flow through to the partner the tax paid by the partnership (but only to the extent that such tax is paid in accordance with the provisions of the Convention that allow source taxation) for the purposes of eliminating double taxation arising from its taxation of the partner. In other words, if the corporate status given to the partnership by the State of source is ignored by the State of residence for purposes of taxing the partner on his share of the income, it should likewise be ignored for purposes of the foreign tax credit.

69.3 A second issue that arises in this case is the extent to which the State of residence of the partner must provide credit for the tax levied by the State of the partnership on the distribution, which is not taxed in the State of residence. The answer to that question lies in that last fact. Since the distribution is not taxed in the State of residence of the partner, there is simply no tax in that State against which to credit the tax levied by the State of the partnership upon the distribution. A clear distinction must be made between the generation of profits and the distribution of those profits and the State of residence of the partner should not be expected to credit the tax levied by the State of the partnership upon the distribution against its own tax levied upon generation (see the first sentence of paragraph 64 *[of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, as quoted above]*).

26. However, as regards paragraph 69.2 of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model which is quoted in paragraph 25 above, some members of the Committee are of the view that a special rule is required in a convention to provide such a result.

27. The Committee considers that the following part of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which provides additional explanations concerning the application of paragraph 1 of Article 23 B in the case of capital taxes, is applicable to paragraph 1 of Article 23 B of this Model:

B. Remarks concerning capital tax

70. As paragraph 1 is drafted, credit is to be allowed for income tax only against income tax and for capital tax only against capital tax. Consequently, credit for or against capital tax will be given only if there is a capital tax in both Contracting States.

71. In bilateral negotiations, two Contracting States may agree that a tax called a capital tax is of a nature closely related to income tax and may, therefore, wish to allow credit for it against income tax and

vice versa. There are cases where, because one State does not impose a capital tax or because both States impose capital taxes only on domestic assets, no double taxation of capital will arise. In such cases it is, of course, understood that the reference to capital taxation may be deleted. Furthermore, States may find it desirable, regardless of the nature of the taxes under the convention, to allow credit for the total amount of tax in the State of source or situs against the total amount of tax in the State of residence. Where, however, a convention includes both real capital taxes and capital taxes which are in their nature income taxes, the States may wish to allow credit against income tax only for the latter capital taxes. In such cases, States are free to alter the proposed Article so as to achieve the desired effect.

28. Subject to the remarks in paragraphs 3 to 13 above and in paragraphs 29 and 30 below, the Committee considers that the following part of the Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which explains the concept of tax sparing, is applicable with respect to Article 23 B of this Model:

C. Tax sparing

72. Some States grant different kinds of tax incentives to foreign investors for the purpose of attracting foreign investment. When the State of residence of a foreign investor applies the credit method, the benefit of the incentive granted by a State of source may be reduced to the extent that the State of residence, when taxing income that has benefited from the incentive, will allow a deduction only for the tax actually paid in the State of source. Similarly, if the State of residence applies the exemption method but subjects the application of that method to a certain level of taxation by the State of source, the granting of a tax reduction by the State of source may have the effect of denying the investor the application of the exemption method in his State of residence.

73. To avoid any such effect in the State of residence, some States that have adopted tax incentive programmes wish to include provisions, usually referred to as "tax sparing" provisions, in their conventions. The purpose of these provisions is to allow non-residents to obtain a foreign tax credit for the taxes that have been "spared" under the incentive programme of the source State or to ensure that these taxes will be taken into account for the purposes of applying certain conditions that may be attached to exemption systems.

74. Tax sparing provisions constitute a departure from the provisions of Articles 23 A and 23 B. Tax sparing provisions may take different forms, as for example:

a) the State of residence will allow as a deduction the amount of tax which the State of source could have imposed in accordance with its general legislation or such amount as limited by the Convention (e.g. limitations of rates provided for dividends and interest in Articles 10 and 11) even if the State of source has waived all or part of that tax under special provisions for the promotion of its economic development;

b) as a counterpart for the tax reduction by the State of source the State of residence agrees to allow a deduction against its own tax of an amount (in part fictitious) fixed at a higher rate;

c) the State of residence exempts the income which has benefited from tax incentives in the State of source.

29. Contracting States are free to devise other tax sparing formulae in the course of bilateral negotiations. The Committee considers that the following part of the Commentary on Articles 23 A and 23 B of the 1998 OECD Model is still relevant in this respect (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

76. If a Contracting State agrees to stimulate especially investments in the other State being a developing country, the above provisions will generally be accompanied by guarantees for the investors, that is to say, the convention will limit the rate of tax which can be imposed in the State of source on dividends, interest and royalties.

77. Moreover, time restrictions or time limits can be provided for the application of the advantages referred to in formula *a)*, and possibly *c)*, *[described in paragraph 74 of the Commentary on Articles 23A and 23B of the 2017 OECD Model, as quoted in paragraph 28 of the Commentary on Articles 23A and 23B of this Model]* the extended credit (or the exemption) may be granted only in respect of incentives applied temporarily in developing countries, or only for investments made or contracts concluded in the future (for instance, from the date of entry into force of the convention) or for a determined period of time.

> 78. Thus, there exist a considerable number of solutions to this problem. In fact, the concrete effects of the provisions concerned can also vary as a result of other factors such as the amount to be included in the taxable income in the State of residence (formulae *a)* and *b) [described in paragraph 74 of the Commentary on Articles 23A and 23B of the 2017 OECD Model, as quoted in paragraph 28 of the Commentary on Articles 23A and 23B of this Model]*); it may be the net income derived (after deduction of the tax effectively paid in the State of source), or the net income grossed-up by an amount equal to the tax effectively paid in the State of source, or to the tax which could have been levied in accordance with the convention (rates provided for in Articles 10 and 11) or to the tax which the State of residence agrees to allow as a deduction.

30. The Committee also considers that the following part of the Commentary on Article 23 A and 23 B of the 2017 OECD Model is applicable to the issue of tax sparing (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 75. A 1998 report by the Committee of Fiscal Affairs, entitled "Tax Sparing: Reconsideration",[1] analyses the tax policy considerations that underlie tax sparing provisions as well as their drafting. The report identifies a number of concerns that put into question the overall usefulness of the granting of tax sparing relief. These concerns relate in particular to:
>
> — the potential for abuse offered by tax sparing;
>
> — the effectiveness of tax sparing as an instrument of foreign aid to promote economic development of the source country; and
>
> — general concerns with the way in which tax sparing may encourage States to use tax incentives.

1 Reproduced *[at page R(14)-1 of]* volume II of the full-length version of the *[2017]* OECD Model Tax Convention *[available at* https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page2039*, accessed on 10 May 2021]*.

31. The Committee considers that the following part of the

Commentary on Articles 23 A and 23 B of the 2017 OECD Model, which explains the provisions of paragraph 2 of Article 23 B, is applicable to paragraph 2 of Article 23 B of this Model:

> ***Paragraph 2***
>
> 79. This paragraph has been added to enable the State of residence to retain the right to take the amount of income or capital exempted in that State into consideration when determining the tax to be imposed on the rest of the income or capital. The right so retained extends to income or capital which "shall be taxable only" in the other State. The principle of progression is thus safeguarded for the State of residence, not only in relation to income or capital which "may be taxed" in the other State, but also for income or capital which "shall be taxable only" in that other State. The Commentary on paragraph 3 of Article 23 A in relation to the State of source also applies to paragraph 2 of Article 23 B.

Commentary on chapter VI

SPECIAL PROVISIONS

Article 24

NON-DISCRIMINATION

1. Article 24 of the UN Model reproduces Article 24 of the OECD Model except for the list of exceptions mentioned in paragraph 4 of the Article. The Committee considers that the following part of the Commentary on Article 24 of the 2017 OECD Model, which includes general remarks on the Article, is applicable to Article 24 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 1. This Article deals with the elimination of tax discrimination in certain precise circumstances. All tax systems incorporate legitimate distinctions based, for example, on differences in liability to tax or ability to pay. The non-discrimination provisions of the Article seek to balance the need to prevent unjustified discrimination with the need to take account of these legitimate distinctions. For that reason, the Article should not be unduly extended to cover so-called "indirect" discrimination. For example, whilst paragraph 1, which deals with discrimination on the basis of nationality, would prevent a different treatment that is really a disguised form of discrimination based on nationality such as a different treatment of individuals based on whether or not they hold, or are entitled to, a passport issued by the State, it could not be argued that non-residents of a given State include primarily persons who are not nationals of that State to conclude that a different treatment based on residence is indirectly a discrimination based on nationality for purposes of that paragraph.
>
> 2. Likewise, the provisions of the Article cannot be interpreted as to require most-favoured-nation treatment. Where a State has concluded a bilateral or multilateral agreement which affords tax benefits to nationals or residents of the other Contracting State(s) party to that agreement, nationals or residents of a third State that is

not a Contracting State of the treaty may not claim these benefits by reason of a similar non-discrimination provision in the double taxation convention between the third State and the first-mentioned State. As tax conventions are based on the principle of reciprocity, a tax treatment that is granted by one Contracting State under a bilateral or multilateral agreement to a resident or national of another Contracting State party to that agreement by reason of the specific economic relationship between those Contracting States may not be extended to a resident or national of a third State under the non-discrimination provision of the tax convention between the first State and the third State.

3. The various provisions of Article 24 prevent differences in tax treatment that are solely based on certain specific grounds (e.g. nationality, in the case of paragraph 1). Thus, for these paragraphs to apply, other relevant aspects must be the same. The various provisions of Article 24 use different wording to achieve that result (e.g. "in the same circumstances" in paragraphs 1 and 2; "carrying on the same activities" in paragraph 3; "similar enterprises" in paragraph 5). Also, whilst the Article seeks to eliminate distinctions that are solely based on certain grounds, it is not intended to provide foreign nationals, non-residents, enterprises of other States or domestic enterprises owned or controlled by non-residents with a tax treatment that is better than that of nationals, residents or domestic enterprises owned or controlled by residents (see, for example, paragraph 34 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted in paragraph 2 below of the Commentary on Article 24 of this Model]*).

4. Finally, as illustrated by paragraph 79 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted in paragraph 2 below of the Commentary on Article 24 of this Model]*, the provisions of the Article must be read in the context of the other Articles of the Convention so that measures that are mandated or expressly authorised by the provisions of these Articles cannot be considered to violate the provisions of the Article even if they only apply, for example, as regards payments to non-residents. Conversely, however, the fact that a particular measure does not constitute a violation of the provisions of the Article does not mean that it is authorised by the Convention since that measure could violate other Articles of the Convention.

Paragraphs 1 to 4

2. The Committee considers that the following part of the Commentary on Article 24 of the 2017 OECD Model, which deals with

paragraphs 1 to 4 of the Article, is applicable to paragraphs 1 to 4 of Article 24 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

Paragraph 1

5. This paragraph establishes the principle that for purposes of taxation discrimination on the grounds of nationality is forbidden, and that, subject to reciprocity, the nationals of a Contracting State may not be less favourably treated in the other Contracting State than nationals of the latter State in the same circumstances.

6. It is noteworthy that the principle of non-discrimination, under various descriptions and with a more or less wide scope, was applied in international fiscal relations well before the appearance, at the end of the 19th Century, of the classic type of double taxation conventions. Thus, in a great many agreements of different kinds (consular or establishment conventions, treaties of friendship or commerce, etc.) concluded by States, especially in the 19th Century, in order to extend and strengthen the diplomatic protection of their nationals wherever resident, there are clauses under which each of the two Contracting States undertakes to accord nationals of the other State equality of treatment with its own nationals. The fact that such clauses subsequently found their way into double taxation conventions has in no way affected their original justification and scope. The text of paragraph 1 provides that the application of this paragraph is not restricted by Article 1 to nationals solely who are residents of a Contracting State, but on the contrary, extends to all nationals of each Contracting State, whether or not they be residents of one of them. In other words, all nationals of a Contracting State are entitled to invoke the benefit of this provision as against the other Contracting State. This holds good, in particular, for nationals of the Contracting States who are not residents of either of them but of a third State.

7. The expression "in the same circumstances" refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and in fact. The expression "in particular with respect to residence" makes clear that the residence of the taxpayer is one of the factors that are relevant

in determining whether taxpayers are placed in similar circumstances. The expression "in the same circumstances" would be sufficient by itself to establish that a taxpayer who is a resident of a Contracting State and one who is not a resident of that State are not in the same circumstances. In fact, whilst the expression "in particular with respect to residence" did not appear in the 1963 *[OECD]* Draft Convention or in the 1977 *[OECD]* Model Convention, the member countries have consistently held, in applying and interpreting the expression "in the same circumstances", that the residence of the taxpayer must be taken into account. However, in revising the *[OECD]* Model Convention, the *[OECD]* Committee on Fiscal Affairs felt that a specific reference to the residence of the taxpayers would be a useful clarification as it would avoid any possible doubt as to the interpretation to be given to the expression "in the same circumstances" in this respect.

8. In applying paragraph 1, therefore, the underlying question is whether two persons who are residents of the same State are being treated differently solely by reason of having a different nationality. Consequently if a Contracting State, in giving relief from taxation on account of family responsibilities, distinguishes between its own nationals according to whether they reside in its territory or not, that State cannot be obliged to give nationals of the other State who do not reside in its territory the same treatment as it gives its resident nationals but it undertakes to extend to them the same treatment as is available to its nationals who reside in the other State. Similarly, paragraph 1 does not apply where a national of a Contracting State (State R) who is also a resident of State R is taxed less favourably in the other Contracting State (State S) than a national of State S residing in a third State (for instance, as a result of the application of provisions aimed at discouraging the use of tax havens) as the two persons are not in the same circumstances with respect to their residence.

9. The expression "in the same circumstances" can in some cases refer to a person's tax situation. This would be the case, for example, where a country would subject its nationals, or some of them, to a more comprehensive tax liability than non-nationals (this, for example, is a feature of the United States tax system). As long as such treatment is not itself a violation of paragraph 1, it could not be argued that persons who are not nationals of that State are in the same circumstances as its nationals for the purposes of the application of the other provisions of the domestic tax law of that State with respect to which the comprehensive or limited liability to tax of a taxpayer would be relevant (e.g. the granting of personal allowances).

10. Likewise, the provisions of paragraph 1 are not to be construed as obliging a State which accords special taxation privileges to its own public bodies or services as such, to extend the same privileges to the public bodies and services of the other State.

11. Neither are they to be construed as obliging a State which accords special taxation privileges to private institutions not for profit whose activities are performed for purposes of public benefit, which are specific to that State, to extend the same privileges to similar institutions whose activities are not for its benefit.

12. To take the first of these two cases, if a State accords immunity from taxation to its own public bodies and services, this is justified because such bodies and services are integral parts of the State and at no time can their circumstances be comparable to those of the public bodies and services of the other State. Nevertheless, this reservation is not intended to apply to State corporations carrying on gainful undertakings. To the extent that these can be regarded as being on the same footing as private business undertakings, the provisions of paragraph 1 will apply to them.

13. As for the second case, if a State accords taxation privileges to certain private institutions not for profit, this is clearly justified by the very nature of these institutions' activities and by the benefit which that State and its nationals will derive from those activities.

14. Furthermore, paragraph 1 has been deliberately framed in a negative form. By providing that the nationals of a Contracting State may not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the other Contracting State in the same circumstances are or may be subjected, this paragraph has the same mandatory force as if it enjoined the Contracting States to accord the same treatment to their respective nationals. But since the principal object of this clause is to forbid discrimination in one State against the nationals of the other, there is nothing to prevent the first State from granting to persons of foreign nationality, for special reasons of its own, or in order to comply with a special stipulation in a double taxation convention, such as, notably, the requirement that profits of permanent establishments are to be taxed in accordance with Article 7, certain concessions or facilities which are not available to its own nationals. As it is worded, paragraph 1 would not prohibit this.

15. Subject to the foregoing observation, the words "… shall not be subjected … to any taxation or any requirement connected therewith which is other or more burdensome …" mean that when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the same form as regards both the basis of charge and the method of assessment, its rate must be the same and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals.

16. In view of the legal relationship created between the company and the State under whose law it is constituted, which from certain points of view is closely akin to the relationship of nationality in the case of individuals, it seems justifiable not to deal with legal persons, partnerships and associations in a special provision, but to assimilate them with individuals under paragraph 1. This result is achieved through the definition of the term "national" in subparagraph [(*g*)] of paragraph 1 of Article 3.

17. By virtue of that definition, in the case of a legal person such as a company, "national of a Contracting State" means a legal person "deriving its status as such from the laws in force in that Contracting State". A company will usually derive its status as such from the laws in force in the State in which it has been incorporated or registered. Under the domestic law of many countries, however, incorporation or registration constitutes the criterion, or one of the criteria, to determine the residence of companies for the purposes of Article 4. Since paragraph 1 of Article 24 prevents different treatment based on nationality but only with respect to persons or entities "in the same circumstances, in particular with respect to residence", it is therefore important to distinguish, for purposes of that paragraph, a different treatment that is solely based on nationality from a different treatment that relates to other circumstances and, in particular, residence. As explained in paragraphs 7 and 8 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted above]*, paragraph 1 only prohibits discrimination based on a different nationality and requires that all other relevant factors, including the residence of the entity, be the same. The different treatment of residents and non-residents is a crucial feature of domestic tax systems and of tax treaties; when Article 24 is read in the context of the other Articles of the Convention, most of which provide for a different treatment of residents and non-residents, it is clear that two companies that are not residents of the same State for purposes of the Convention (under the rules of Article 4) are usually not in the same circumstances for purposes of paragraph 1.

18. Whilst residents and non-residents are usually not in the same circumstances for the purposes of paragraph 1, it is clear, however, that this is not the case where residence has no relevance whatsoever with respect to the different treatment under consideration.

19. The following examples illustrate these principles.

20. *Example 1:* Under the domestic income tax law of State A, companies incorporated in that State or having their place of effective management in that State are residents thereof. Under the domestic income tax law of State B, only companies that have their place of effective management in that State are residents thereof. The State A – State B tax convention is identical to *[the OECD]* Model Tax Convention. The domestic tax law of State A provides that dividends paid to a company incorporated in that country by another company incorporated in that country are exempt from tax. Since a company incorporated in State B that would have its place of effective management in State A would be a resident of State A for purposes of the State A – State B Convention, the fact that dividends paid to such a company by a company incorporated in State A would not be eligible for this exemption, even though the recipient company is in the same circumstances as a company incorporated in State A with respect to its residence, would constitute a breach of paragraph 1 absent other relevant different circumstances.

21. *Example 2:* Under the domestic income tax law of State A, companies incorporated in that State are residents thereof and companies incorporated abroad are non-residents. The State A – State B tax convention is identical to *[the OECD]* Model Tax Convention except that paragraph 3 of Article 4 provides that if a legal person is a resident of both States under paragraph 1 of that Article, that legal person shall be deemed to be a resident of the State in which it has been incorporated. The domestic tax law of State A provides that dividends paid to a company incorporated in that country by another company incorporated in that country are exempt from tax. Paragraph 1 does not extend that treatment to dividends paid to a company incorporated in State B. Even if a company incorporated in State A and a company incorporated in State B that receive such dividends are treated differently, these companies are not in the same circumstances with regard to their residence and residence is a relevant factor in this case (as can be concluded, for example, from paragraph 5 of Article 10, which would prevent the subsequent taxation of dividends paid by a non-resident company but not those paid by a resident company).

22. *Example 3:* Under the domestic income tax law of State A, companies that are incorporated in that State are residents thereof. Under the domestic tax law of State B, companies that have their place of effective management in that State are residents thereof. The State A – State B tax convention is identical to *[the OECD]* Model Tax Convention. The domestic tax law of State A provides that a non-resident company that is a resident of a State with which State A does not have a tax treaty that allows for the exchange of tax information is subject to an annual tax equal to 3 per cent of the value of its immovable property instead of a tax on the net income derived from that property. A company incorporated in State B but which is a resident of a State with which State A does not have a tax treaty that allows for the exchange of tax information cannot claim that paragraph 1 prevents the application of the 3 per cent tax levied by State A because it is treated differently from a company incorporated in State A. In that case, such a company would not be in the same circumstances, with respect to its residence, as a company incorporated in State A and the residence of the company would be relevant (e.g. for purposes of accessing the information necessary to verify the net income from immovable property derived by a non-resident taxpayer).

23. *Example 4:* Under the domestic income tax law of State A, companies incorporated in that State are residents of State A and companies incorporated abroad are non-residents. The State A – State B tax convention is identical to *[the OECD]* Model Tax Convention except that paragraph 3 of Article 4 provides that if a legal person is a resident of both States under paragraph 1 of that Article, that legal person shall be deemed to be a resident of the State in which it has been incorporated. Under State A's payroll tax law, all companies that employ resident employees are subject to a payroll tax that does not make any distinction based on the residence of the employer but that provides that only companies incorporated in State A shall benefit from a lower rate of payroll tax. In that case, the fact that a company incorporated in State B will not have the same residence as a company incorporated in State A for the purposes of the A-B convention has no relevance at all with respect to the different tax treatment under the payroll tax and that different treatment would therefore be in violation of paragraph 1 absent other relevant different circumstances.

24. *Example 5:* Under the domestic income tax law of State A, companies incorporated in that State or which have their place of effective management in that State are residents of the State and companies that do not meet one of these two conditions are non-residents. Under the

domestic income tax law of State B, companies incorporated in that State are residents of that State. The State A – State B tax convention is identical to *[the OECD]* Model Tax Convention except that paragraph 3 of Article 4 provides that if a legal person is a resident of both States under paragraph 1 of that Article, that legal person shall be deemed to be a resident only of the State in which it has been incorporated. The domestic tax law of State A further provides that companies that have been incorporated and that have their place of effective management in that State are entitled to consolidate their income for tax purposes if they are part of a group of companies that have common shareholders. Company X, which was incorporated in State B, belongs to the same group as two companies incorporated in State A and all these companies are effectively managed in State A. Since it was not incorporated in State A, company X is not allowed to consolidate its income with that of the two other companies.

25. In that case, even if company X is a resident of State A under the domestic law of that State, it is not a resident of State A for purposes of the Convention by virtue of paragraph 3 of Article 4. It will therefore not be in the same circumstances as the other companies of the group as regards residence and paragraph 1 will not allow it to obtain the benefits of consolidation even if the different treatment results from the fact that company X has not been incorporated in State A. The residence of company X is clearly relevant with respect to the benefits of consolidation since certain provisions of the Convention, such as Articles 7 and 10, would prevent State A from taxing certain types of income derived by company X.

Paragraph 2

26. On 28 September 1954, a number of States concluded in New York a Convention relating to the status of stateless persons, under Article 29 of which stateless persons must be accorded national treatment. The signatories of the Convention include several OECD member countries.

27. It should, however, be recognised that the provisions of paragraph 2 will, in a bilateral convention, enable national treatment to be extended to stateless persons who, because they are in one of the situations enumerated in paragraph 2 of Article 1 of the above-mentioned Convention of 28 September 1954, are not covered by that Convention. This is mainly the case, on the one hand, of persons receiving at the time of signature of that Convention, protection or assistance from organs or agencies of the United Nations other than the United Nations High Commissioner for Refugees, and, on the other

hand, of persons who are residents of a country and who there enjoy and are subject to the rights and obligations attaching to the possession of that country's nationality.

28. The purpose of paragraph 2 is to limit the scope of the clause concerning equality of treatment with nationals of a Contracting State solely to stateless persons who are residents of that or of the other Contracting State.

29. By thus excluding stateless persons who are residents of neither Contracting State, such a clause prevents their being privileged in one State as compared with nationals of the other State.

30. However, if States were to consider it desirable in their bilateral relations to extend the application of paragraph 2 to all stateless persons, whether residents of a Contracting State or not, so that in all cases they enjoy the most favourable treatment accorded to nationals of the State concerned, in order to do this they would need only to adopt the following text which contains no condition as to residence in a Contracting State:

> Notwithstanding the provisions of Article 1, stateless persons shall not be subjected in a Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that State in the same circumstances, in particular with respect to residence, are or may be subjected.

31. Some States may consider that the provisions of paragraph 2 are too liberal insofar as they entitle stateless persons who are residents of one State to claim equality of treatment not only in the other State but also in their State of residence and thus benefit in particular in the latter from the provisions of double taxation conventions concluded by it with third States. States wishing to avoid this latter consequence are free to modify paragraph 2 as follows:

> Stateless persons who are residents of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.

32. Finally, it should be understood that the definition of the term "stateless person" to be used for the purposes of such a clause can only be that laid down in paragraph 1 of Article 1 of the Convention of 28

September 1954, which defines a stateless person as "a person who is not considered as a national by any State under the operation of its law".

Paragraph 3

33. Strictly speaking, the type of discrimination which this paragraph is designed to end is discrimination based not on nationality but on the actual situs of an enterprise. It therefore affects without distinction, and irrespective of their nationality, all residents of a Contracting State who have a permanent establishment in the other Contracting State.

34. It appears necessary first to make it clear that the wording of the first sentence of paragraph 3 must be interpreted in the sense that it does not constitute discrimination to tax non-resident persons differently, for practical reasons, from resident persons, as long as this does not result in more burdensome taxation for the former than for the latter. In the negative form in which the provision concerned has been framed, it is the result alone which counts, it being permissible to adapt the mode of taxation to the particular circumstances in which the taxation is levied. For example, paragraph 3 does not prevent the application of specific mechanisms that apply only for the purposes of determining the profits that are attributable to a permanent establishment. The paragraph must be read in the context of the Convention and, in particular, of paragraph 2 of Article 7 *[of the UN Model, which provides that the profits attributable to the permanent establishment are those which the permanent establishment might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment]*. Clearly, rules or administrative practices that seek to determine the profits that are attributable to a permanent establishment on the basis required by paragraph 2 of Article 7 *[of this Model]* cannot be considered to violate paragraph 3, which is based on the same principle since it requires that the taxation on the permanent establishment be not less favourable than that levied on a domestic enterprise carrying on similar activities.

35. By the terms of the first sentence of paragraph 3, the taxation of a permanent establishment shall not be less favourably levied in the State concerned than the taxation levied on enterprises of that State carrying on the same activities. The purpose of this provision is to end all discrimination in the treatment of permanent establishments as compared with resident enterprises belonging to the same sector of activities, as regards taxes based on business activities, and especially taxes on business profits.

36. However, the second sentence of paragraph 3 specifies the conditions under which the principle of equal treatment set forth in the first sentence should be applied to individuals who are residents of a Contracting State and have a permanent establishment in the other State. It is designed mainly to ensure that such persons do not obtain greater advantages than residents, through entitlement to personal allowances and reliefs for family responsibilities, both in the State of which they are residents, by the application of its domestic laws, and in the other State by virtue of the principle of equal treatment. Consequently, it leaves it open to the State in which the permanent establishment is situated whether or not to give personal allowances and reliefs to the persons concerned in the proportion which the amount of the permanent establishment's profits bears to the world income taxable in the other State.

37. It is also clear that, for purposes of paragraph 3, the tax treatment in one Contracting State of the permanent establishment of an enterprise of the other Contracting State should be compared to that of an enterprise of the first-mentioned State that has a legal structure that is similar to that of the enterprise to which the permanent establishment belongs. Thus, for example, paragraph 3 does not require a State to apply to the profits of the permanent establishment of an enterprise carried on by a non-resident individual the same rate of tax as is applicable to an enterprise of that State that is carried on by a resident company.

38. Similarly, regulated and unregulated activities would generally not constitute the "same activities" for the purposes of paragraph 3. Thus, for instance, paragraph 3 would not require that the taxation on a permanent establishment whose activities include the borrowing and lending of money but which is not registered as a bank be not less favourably levied than that of domestic banks since the permanent establishment does not carry on the same activities. Another example would be that of activities carried on by a State or its public bodies, which, since they are controlled by the State, could not be considered, for the purposes of paragraph 3, to be similar to activities that an enterprise of the other State performs through a permanent establishment.

39. As regards the first sentence, experience has shown that it was difficult to define clearly and completely the substance of the principle of equal treatment and this has led to wide differences of opinion with regard to the many implications of this principle. The main reason for difficulty seems to reside in the actual nature of the permanent establishment, which is not a separate legal entity but only a part of an

enterprise that has its head office in another State. The situation of the permanent establishment is different from that of a domestic enterprise, which constitutes a single entity all of whose activities, with their fiscal implications, can be fully brought within the purview of the State where it has its head office. The implications of the equal treatment clause will be examined below under several aspects of the levying of tax.

A. Assessment of tax

40. With regard to the basis of assessment of tax, the principle of equal treatment normally has the following implications:

a) Permanent establishments must be accorded the same right as resident enterprises to deduct the trading expenses that are, in general, authorised by the taxation law to be deducted from taxable profits. Such deductions should be allowed without any restrictions other than those also imposed on resident enterprises *[…]*.

b) Permanent establishments must be accorded the same facilities with regard to depreciation and reserves. They should be entitled to avail themselves without restriction not only of the depreciation facilities which are customarily available to enterprises (straight line depreciation, declining balance depreciation), but also of the special systems that exist in a number of countries ("wholesale" writing down, accelerated depreciation, etc.). As regards reserves, it should be noted that these are sometimes authorised for purposes other than the offsetting – in accordance with commercial accounting principles – of depreciation on assets, expenses or losses which have not yet occurred but which circumstances make likely to occur in the near future. Thus, in certain countries, enterprises are entitled to set aside, out of taxable profit, provisions or "reserves" for investment. When such a right is enjoyed by all enterprises, or by all enterprises in a given sector of activity, it should normally also be enjoyed, under the same conditions, by non-resident enterprises with respect to their permanent establishments situated in the State concerned, insofar, that is, as the activities to which such provisions or reserves would pertain are taxable in that State.

c) Permanent establishments should also have the option that is available in most countries to resident enterprises of carrying forward or backward a loss brought out at the close of an accounting period within a certain period of time (e.g. 5 years). It is hardly necessary to specify that in the case of permanent

establishments it is the loss on their own business activities which will qualify for such carry-forward.

d) Permanent establishments should further have the same rules applied to resident enterprises, with regard to the taxation of capital gains realised on the alienation of assets, whether during or on the cessation of business.

41. As clearly stated in subparagraph *c*) above, the equal treatment principle of paragraph 3 only applies to the taxation of the permanent establishment's own activities. That principle, therefore, is restricted to a comparison between the rules governing the taxation of the permanent establishment's own activities and those applicable to similar business activities carried on by an independent resident enterprise. It does not extend to rules that take account of the relationship between an enterprise and other enterprises (e.g. rules that allow consolidation, transfer of losses or tax-free transfers of property between companies under common ownership) since the latter rules do not focus on the taxation of an enterprise's own business activities similar to those of the permanent establishment but, instead, on the taxation of a resident enterprise as part of a group of associated enterprises. Such rules will often operate to ensure or facilitate tax compliance and administration within a domestic group. It therefore follows that the equal treatment principle has no application. For the same reasons, rules related to the distribution of the profits of a resident enterprise cannot be extended to a permanent establishment under paragraph 3 as they do not relate to the business activities of the permanent establishment (see paragraph 59 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted below]*).

42. Also, it is clear that the application of transfer pricing rules based on the arm's length standard in the case of transfers from a permanent establishment to its head office (or vice versa) cannot be considered to be a violation of paragraph 3 even if such rules do not apply to transfers within an enterprise of the Contracting State where the permanent establishment is located. Indeed, the application of the arm's length standard to the determination of the profits attributable to a permanent establishment is mandated by paragraph 2 of Article 7 *[of this Model]* and that paragraph forms part of the context in which paragraph 3 of Article 24 must be read; also, since Article 9 would authorise the application of the arm's length standard to a transfer between a domestic enterprise and a foreign related enterprise, one cannot consider that its application in the case of a permanent establishment results in less favourable taxation than that levied on an

enterprise of the Contracting State where the permanent establishment is located.

43. Although the general rules mentioned above rarely give rise to any difficulties with regard to the principle of non-discrimination, they do not constitute an exhaustive list of the possible consequences of that principle with respect to the determination of the tax base. The application of that principle may be less clear in the case of tax incentive measures which most countries, faced with such problems as decentralisation of industry, development of economically backward regions, or the promotion of new activities necessary for the expansion of the economy, have introduced in order to facilitate the solution of these problems by means of tax exemptions, reductions or other tax advantages given to enterprises for investment which is in line with official objectives.

44. As such measures are in furtherance of objectives directly related to the economic activity proper of the State concerned, it is right that the benefit of them should be extended to permanent establishments of enterprises of another State which has a double taxation convention with the first embodying the provisions of Article 24, once they have been accorded the right to engage in business activity in that State, either under its legislation or under an international agreement (treaties of commerce, establishment conventions, etc.) concluded between the two States.

45. It should, however, be noted that although non-resident enterprises are entitled to claim these tax advantages in the State concerned, they must fulfil the same conditions and requirements as resident enterprises. They may, therefore, be denied such advantages if their permanent establishments are unable or refuse to fulfil the special conditions and requirements attached to the granting of them.

46. Also it goes without saying that non-resident enterprises are not entitled to tax advantages attaching to activities the exercise of which is strictly reserved, on grounds of national interest, defence, protection of the national economy, etc., to domestic enterprises, since non-resident enterprises are not allowed to engage in such activities.

47. Finally, the provisions of paragraph 3 should not be construed as obliging a State which accords special taxation privileges to non-profit institutions whose activities are performed for purposes of public benefit that are specific to that State, to extend the same privileges to permanent establishments of similar institutions of the other State whose activities are not exclusively for the first-mentioned State's public benefit.

B. Special treatment of dividends received in respect of holdings owned by permanent establishments

48. In many countries special rules exist for the taxation of dividends distributed between companies (parent company – subsidiary treatment, the *Schachtelprivileg*, the rule *non bis in idem*). The question arises whether such treatment should, by effect of the provisions of paragraph 3, also be enjoyed by permanent establishments in respect of dividends on holdings forming part of their assets.

49. On this point opinions differ. Some States consider that such special treatment should be accorded to permanent establishments. They take the view that such treatment was enacted in order to avoid double taxation on profits made by a subsidiary and distributed to a parent company. In principle, profits tax should be levied once, in the hands of the subsidiary performing the profit-generating activities. The parent company should be exempted from tax on such profits when received from the subsidiary or should, under the indirect credit method, be given relief for the taxation borne by the subsidiary. In cases where shares are held as direct investment by a permanent establishment the same principle implies that such a permanent establishment receiving dividends from the subsidiary should likewise be granted the special treatment in view of the fact that a profits tax has already been levied in the hands of the subsidiary. On the other hand, it is hardly conceivable on this line of thought to leave it to the State where the head office of the parent company is situated to give relief from double taxation brought about by a second levying of tax in the State of the permanent establishment. The State of the parent company, in which no activities giving rise to the doubly taxed profits have taken place, will normally exempt the profits in question or will levy a profits tax which is not sufficient to bear a double credit (i.e. for the profits tax on the subsidiary as well as for such tax on the permanent establishment). All this assumes that the shares held by the permanent establishment are effectively connected with its activity. Furthermore, an obvious additional condition is that the profits out of which the dividends are distributed should have borne a profits tax.

50. Other States, on the contrary, consider that assimilating permanent establishments to their own enterprises does not entail any obligation to accord such special treatment to the former. They justify their position on various grounds. The purpose of such special treatment is to avoid economic double taxation of dividends and it should be for the recipient company's State of residence and not the permanent establishment's State to bear its cost, because it is more

interested in the aim in view. Another reason put forward relates to the sharing of tax revenue between States. The loss of tax revenue incurred by a State in applying such special treatment is partly offset by the taxation of the dividends when they are redistributed by the parent company which has enjoyed such treatment (withholding tax on dividends, shareholder's tax). A State which accorded such treatment to permanent establishments would not have the benefit of such a compensation. Another argument made is that when such treatment is made conditional upon redistribution of the dividends, its extension to permanent establishments would not be justified, for in such a case the permanent establishment, which is only a part of a company of another State and does not distribute dividends, would be more favourably treated than a resident company. Finally, the States which feel that paragraph 3 does not entail any obligation to extend such treatment to permanent establishments argue that there is a risk that companies of one State might transfer their holdings in companies of another State to their permanent establishments in that other State for the sole purpose of availing themselves of such treatment.

51. The fact remains that there can be very valid reasons for a holding being owned and managed by a permanent establishment rather than by the head office of the enterprise, viz.,

— reasons of necessity arising principally from a legal or regulatory obligation on banks and financial institutions and insurance companies to keep deposited in countries where they operate a certain amount of assets, particularly shares, as security for the performance of their obligations;

— or reasons of expediency, where the holdings are in companies which have business relations with the permanent establishment or whose head offices are situated in the same country as the permanent establishment;

— or simple reasons of practical convenience, in line with the present tendency towards decentralisation of management functions in large enterprises.

52. In view of these divergent attitudes, as well as of the existence of the situations just described, it would be advisable for States, when concluding bilateral conventions, to make clear the interpretation they give to the first sentence of paragraph 3. They can, if they so desire, explain their position, or change it as compared with their previous practice, in a protocol or any other document annexed to the convention.

53. A solution could also be provided in such a document to meet the objection mentioned above that the extension of the treatment of holdings in a State (A) to permanent establishments of companies which are residents of another State (B) results in such companies unduly enjoying privileged treatment as compared with other companies which are residents of the same State and whose head offices own holdings in the capital of companies which are residents of State A, in that whereas the dividends on their holdings can be repatriated by the former companies without bearing withholding tax, such tax is levied on dividends distributed to the latter companies at the rate *[provided in paragraph 2a) or b) of Article 10 of the relevant convention]* as the case may be. Tax neutrality and the equality of tax burdens as between permanent establishments and subsidiary companies, as advocated by the States concerned, could be ensured by adapting, in the bilateral convention between States A and B, the provisions of paragraphs 2 and 4 of Article 10, so as to enable withholding tax to be levied in State A on dividends paid by companies which are residents of that State to permanent establishments of companies which are residents of State B in the same way as if they are received directly, that is, by the head offices of the latter companies, viz., at the rate *[provided in paragraph 2 of Article 10 of that convention].*

54. Should it not be possible, because of the absence of appropriate provisions in the domestic laws of the State concerned, to levy a withholding tax there on dividends paid to permanent establishments, the treatment of inter-company dividends could be extended to permanent establishments, as long as its application is limited in such manner that the tax levied by the State of source of the dividends is the same whether the dividends are received by a permanent establishment of a company which is a resident of the other State or are received directly by such a company.

C. Structure and rate of tax

55. In countries where enterprises, mainly companies, are charged a tax on their profits which is specific to them, the provisions of paragraph 3 raise, with regard to the rate applicable in the case of permanent establishments, some specific issues related to the fact that the permanent establishment is only a part of a legal entity which is not under the jurisdiction of the State where the permanent establishment is situated.

56. When the taxation of profits made by companies which are residents of a given State is calculated according to a progressive scale

of rates, such a scale should, in principle, be applied to permanent establishments situated in that State. If in applying the progressive scale, the permanent establishment's State takes into account the profits of the whole company to which such a permanent establishment belongs, such a rule would not appear to conflict with the equal treatment rule, since resident companies are in fact treated in the same way (see paragraphs 55, 56 and 79 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted in paragraphs 15 and 31 of the Commentary on Articles 23 A and 23 B of this Model]*). States that tax their own companies in this way could therefore define in their bilateral conventions the treatment applicable to permanent establishments.

57. When a system of taxation based on a progressive scale of rates includes a rule that a minimum rate is applicable to permanent establishments, it cannot be claimed a priori that such a rule is incompatible with the equal treatment principle. The profits of the whole enterprise to which the permanent establishment belongs should be taken into account in determining the rate applicable according to the progressive scale. The provisions of the first sentence of paragraph 3 are not observed only if the minimum rate is higher.

58. However, even if the profits of the whole enterprise to which the permanent establishment belongs are taken into account when applying either a progressive scale of rates or a minimum rate, this should not conflict with the principle of the *[distinct and separate enterprise]*, according to which the profits of the permanent establishment must be determined under paragraph 2 of Article 7 *[of this Model]*. The minimum amount of the tax levied in the State where the permanent establishment is situated is, therefore, the amount which would be due if it were a *[distinct and separate enterprise]*, without reference to the profits of the whole enterprise to which it belongs. The State where the permanent establishment is situated is, therefore, justified in applying the progressive scale applicable to resident enterprises solely to the profits of the permanent establishment, leaving aside the profits of the whole enterprise when the latter are less than those of the permanent establishment. This State may likewise tax the profits of the permanent establishment at a minimum rate, provided that the same rate applies also to resident enterprises, even if taking into account the profits of the whole enterprise to which it belongs would result in a lower amount of tax, or no tax at all.

59. Since a permanent establishment, by its very nature, does not distribute dividends, the tax treatment of distributions made

by the enterprise to which the permanent establishment belongs is therefore outside the scope of paragraph 3. Paragraph 3 is restricted to the taxation of the profits from the activities of the permanent establishment itself and does not extend to the taxation of the enterprise as a whole. This is confirmed by the second sentence of the paragraph, which confirms that tax aspects related to the taxpayer that owns the permanent establishment, such as personal allowances and deductions, are outside the scope of the paragraph. Thus, issues related to various systems for the integration of the corporate and shareholder's taxes (e.g. advance corporate tax, *précompte mobilier*, computation of franked income and related dividend tax credits) are outside the scope of the paragraph.

60. In some States, the profits of a permanent establishment of an enterprise of another Contracting State are taxed at a higher rate than the profits of enterprises of that State. This additional tax, sometimes referred to as a "branch tax", may be explained by the fact that if a subsidiary of the foreign enterprise earned the same profits as the permanent establishment and subsequently distributed these profits as a dividend, an additional tax would be levied on these dividends in accordance with paragraph 2 of Article 10. Where such tax is simply expressed as an additional tax payable on the profits of the permanent establishment, it must be considered as a tax levied on the profits of the activities of the permanent establishment itself and not as a tax on the enterprise in its capacity as owner of the permanent establishment. Such a tax would therefore be contrary to paragraph 3. *[However, the issue of branch profits taxes is discussed in paragraphs 24 to 30 of the Commentary on Article 10 of this Model and these paragraphs include a suggested optional provision, set out at paragraph 27, that would ensure that a branch profits tax could be applied notwithstanding the other provisions of the Convention, including the provisions of Article 24].*

61. That situation must, however, be distinguished from that of a tax that would be imposed on amounts deducted, for instance as interest, in computing the profits of a permanent establishment (e.g. "branch level interest tax"); in that case, the tax would not be levied on the permanent establishment itself but, rather, on the enterprise to which the interest is considered to be paid and would therefore be outside the scope of paragraph 3 (depending on the circumstances, however, other provisions, such as those of Articles 7 and 11, may be relevant in determining whether such a tax is allowed by the Convention; see the last sentence of paragraph 4 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted in paragraph 1 above]*).

D. Withholding tax on dividends, interest[, royalties, fees for services, income from automated digital services and insurance premiums] received by a permanent establishment

62. When permanent establishments receive dividends, interest*[, royalties, fees for services, income from automated digital services or insurance premiums]* such *[types of]* income, by virtue of *[paragraph 4 of Articles 10, 11, 12 and 12AA, paragraph 8 of Article 12B and paragraph 4 of Article 12C],* respectively, come*[…]* under the provisions of Article 7 and consequently – subject to the observations made in paragraph 53 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted above]* as regards dividends received on holdings of permanent establishment – fall*[…]* to be included in the taxable profits of such permanent establishments *[…]*.

63. According to the respective Commentaries on the above-mentioned provisions of Articles 10, 11*[, 12, 12AA, 12B and 12C],* these provisions dispense the State of source of the dividends, interest*[, royalties, fees for services, income from automated digital services or insurance premiums]* received by the permanent establishment from applying any limitation provided for in those Articles, which means – and this is the generally accepted interpretation – that they leave completely unaffected the right of the State of source, where the permanent establishment is situated, to apply its withholding tax at the full rate.

64. While this approach does not create any problems with regard to the provisions of paragraph 3 of Article 24 in the case of countries where a withholding tax is levied on all such income, whether the latter be paid to residents (permanent establishments, like resident enterprises, being allowed to set such withholding tax off against the tax on profits due by virtue of Article 7) or to non residents (subject to the limitations provided for in Articles 10, 11*[, 12, 12AA, 12B and 12C]*), the position is different when withholding tax is applied exclusively to income paid to non-residents.

65. In this latter case, in fact, it seems difficult to reconcile the levy of withholding tax with the principle set out in paragraph 3 that for the purpose of taxing the income which is derived from their activity, or which is normally connected with it – as is recognised to be the case with dividends, interest*[, royalties, fees for services, income from automated digital services or insurance premiums respectively referred to in paragraph 4 of Articles 10, 11, 12 and 12AA, paragraph 8 of Article 12B and paragraph 4 of Article 12C]* – permanent establishments must be

treated as resident enterprises and hence in respect of such income be subjected to tax on profits solely.

66. In any case, it is for Contracting States which have this difficulty to settle it in bilateral negotiations in the light of their peculiar circumstances.

E. Credit for foreign tax

67. In a related context, when foreign income is included in the profits attributable to a permanent establishment, it is right by virtue of the same principle to grant to the permanent establishment credit for foreign tax borne by such income when such credit is granted to resident enterprises under domestic laws.

68. If in a Contracting State (A) in which is situated a permanent establishment of an enterprise of the other Contracting State (B) credit for tax levied in a third State (C) can be allowed only by virtue of a convention, then the more general question arises, as to the extension to permanent establishments of the benefit of credit provisions included in tax conventions concluded with third States. Whilst the permanent establishment is not itself a person and is therefore not entitled to the benefits of these tax conventions, this issue is relevant to the taxation on the permanent establishment. This question is examined below *[…]*.

F. Extension to permanent establishments of the benefit of the credit provisions of double taxation conventions concluded with third States

69. When the permanent establishment in a Contracting State of a resident enterprise of another Contracting State receives dividends*[,]* interest*[, royalties, fees for services, income from automated digital services or insurance premiums]* from a third State, then the question arises as to whether and to what extent the Contracting State in which the permanent establishment is situated should credit the tax that cannot be recovered from the third State.

70. There is agreement that double taxation arises in these situations and that some method of relief should be found. The majority of member countries are able to grant credit in these cases on the basis of their domestic law or under paragraph 3. States that cannot give credit in such a way or that wish to clarify the situation may wish to supplement the provision in their convention with the Contracting State in which the enterprise is resident by wording that allows the State in which the permanent establishment is situated to credit the tax liability in the

State in which the income originates to an amount that does not exceed the amount that resident enterprises in the Contracting State in which the permanent establishment is situated can claim on the basis of the Contracting State's convention with the third State. If the tax that cannot be recovered under the convention between the third State and the State of residence of the enterprise which has a permanent establishment in the other Contracting State is lower than that under the convention between the third State and the Contracting State in which the permanent establishment is situated, then only the lower tax collected in the third State shall be credited. This result would be achieved by adding the following words after the first sentence of paragraph 3:

> When a permanent establishment in a Contracting State of an enterprise of the other Contracting State receives dividends or interest*[, royalties, fees for services, income from automated digital services or insurance premiums]* from a third State and
>
> *a*) the holding*[,]* debt claim*[, right, property or contract]* in respect of which the dividends or interest *[or royalties, or insurance premiums]* are paid*[*, or
>
> *b) the fees for services or income from automated digital services,*
>
> *as the case may be, is or are]* effectively connected
>
> *[c)]* with that permanent establishment*[, or*
>
> *d) in the case of a debt claim, right, property, contract, fees for services or income from automated digital services, with the business activities referred to in (c) of paragraph 1 of Article 7,]*
>
> the first-mentioned State shall grant a tax credit in respect of the tax paid in the third State on the dividends*[,]* interest*[, royalties, fees for services, income from automated digital services or insurance premiums]*, as the case may be, by applying the rate of tax provided in the convention with respect to taxes on income and capital between the State of which the enterprise is a resident and the third State. However, the amount of the credit shall not exceed the amount that an enterprise that is a resident of the first-mentioned State can claim under that State's convention on income and capital with the third State.

If the convention also provides for other categories of income that may be taxed in the State in which they arise and for which credit should be given *[…]*, the above provision should be amended to also cover these.

71. Where a permanent establishment situated in a Contracting State of an enterprise resident of another Contracting State (the State of residence) receives dividends, interest*[, royalties, fees for services, income from automated digital services or insurance premiums]* from a third State (the State of source) and, according to the procedure agreed to between the State of residence and the State of source, a certificate of domicile is requested by the State of source for the application of the withholding tax at the rate provided for in the convention between the State of source and the State of residence, this certificate must be issued by the latter State. While this procedure may be useful where the State of residence employs the credit method, it seems to serve no purposes where that State uses the exemption method as the income from the third State is not liable to tax in the State of residence of the enterprise. On the other hand, the State in which the permanent establishment is located could benefit from being involved in the certification procedure as this procedure would provide useful information for audit purposes. Another question that arises with triangular cases is that of abuses. For example, if a Contracting State applies the exemption method of Article 23 A to the profits attributable to a permanent establishment situated in a third State which does not tax passive income that arises in the other Contracting State but that is attributable to such permanent establishment, there is risk that such income might not be taxed in any of the three States. Paragraph 8 of Article 29 addresses this issue.

72. In addition to the typical triangular case considered here, other triangular cases arise, particularly that in which the State of the enterprise is also the State from which the income attributed to the permanent establishment in the other State originates (see also paragraph 5 of the Commentary on Article 21 *[of the 2017 OECD Model, as quoted in paragraph 4 of the Commentary on Article 21 of this Model]* and paragraphs 9 and 9.1 of the Commentary on Articles 23 A and 23 B *[of the 2017 OECD Model, as quoted in paragraph 15 of the Commentary on Articles 23 A and 23 B of this Model]*). States can settle these matters in bilateral negotiations.

Paragraph 4

73. This paragraph is designed to end a particular form of discrimination resulting from the fact that in certain countries the deduction of interest, royalties*[, fees for services, payments underlying income from automated digital services, insurance premiums]* and other disbursements allowed without restriction when the recipient is resident, is restricted or even prohibited when he is a non-resident.

> The same situation may also be found in the sphere of capital taxation, as regards debts contracted to a non-resident. It is however open to Contracting States to modify this provision in bilateral conventions to avoid its use for tax avoidance purposes.
>
> 74. Paragraph 4 does not prohibit the country of the borrower from applying its domestic rules on thin capitalisation insofar as these are compatible with paragraph 1 of Article 9 or paragraph 6 of Article 11. However, if such treatment results from rules which are not compatible with the said Articles and which only apply to non-resident creditors (to the exclusion of resident creditors), then such treatment is prohibited by paragraph 4.
>
> 75. Also, paragraph 4 does not prohibit additional information requirements with respect to payments made to non-residents since these requirements are intended to ensure similar levels of compliance and verification in the case of payments to residents and non-residents.

3. When paragraph 4 of Article 24 was discussed by the former Group of Experts in the context of the revision of the UN Model in 1999, the question was raised whether such a paragraph was suitable for inclusion in a tax treaty between developed and developing countries. It was then suggested that the paragraph would not be acceptable to those countries that made deductibility of disbursements made abroad by foreign-owned companies conditional on the recipient being taxed in such countries. After substantial discussion, the feeling of the Group was that the special circumstances mentioned above ought not to be the basis for treaty Articles of broad application but that in cases where they were likely to create a problem they should be raised in bilateral negotiations.

Paragraph 5

4. Since paragraph 5 of Article 24 of the UN Model reproduces paragraph 5 of Article 24 of the OECD Model, the Committee considers that the following part of the Commentary on Article 24 of the 2017 OECD Model is applicable to paragraph 5 of Article 24 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

76. This paragraph forbids a Contracting State to give less favourable treatment to an enterprise, the capital of which is owned or controlled, wholly or partly, directly or indirectly, by one or more residents of the other Contracting State. This provision, and the discrimination which it puts an end to, relates to the taxation only of enterprises and not of the persons owning or controlling their capital. Its object therefore is to ensure equal treatment for taxpayers residing in the same State, and not to subject foreign capital, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital.

77. Since the paragraph relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital, it follows that it cannot be interpreted to extend the benefits of rules that take account of the relationship between a resident enterprise and other resident enterprises (e.g. rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership). For example, if the domestic tax law of one State allows a resident company to consolidate its income with that of a resident parent company, paragraph 5 cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company. This would require comparing the combined treatment of a resident enterprise and the non-resident that owns its capital with that of a resident enterprise of the same State and the resident that owns its capital, something that clearly goes beyond the taxation of the resident enterprise alone.

78. Also, because paragraph 5 is aimed at ensuring that all resident companies are treated equally regardless of who owns or controls their capital and does not seek to ensure that distributions to residents and non-residents are treated in the same way (see paragraph 76 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted above]*), it follows that withholding tax obligations that are imposed on a resident company with respect to dividends paid to non-resident shareholders but not with respect to dividends paid to resident shareholders cannot be considered to violate paragraph 5. In that case, the different treatment is not dependent on the fact that the capital of the company is owned or controlled by non-residents but, rather, on the fact that dividends paid to non-residents are taxed differently. A similar example would be that of a State that levies a tax on resident companies that make distributions to their shareholders regardless of whether or not they are residents or non-residents, but which, in order to avoid a multiple application of that tax, would not apply it to distributions made to related resident companies that are themselves subject to the tax upon their own distributions. The fact that the latter

exemption would not apply to distributions to non-resident companies should not be considered to violate paragraph 5. In that case, it is not because the capital of the resident company is owned or controlled by non-residents that it is treated differently; it is because it makes distributions to companies that, under the provisions of the treaty, cannot be subjected to the same tax when they re-distribute the dividends received from that resident company. In this example, all resident companies are treated the same way regardless of who owns or controls their capital and the different treatment is restricted to cases where distributions are made in circumstances where the distribution tax could be avoided.

79. Since the paragraph prevents the discrimination of a resident enterprise that is solely based on who owns or controls the capital of that enterprise, it would not *prima facie* be relevant with respect to rules that provide for a different treatment of an enterprise based on whether it pays interest to resident or non-resident creditors. The paragraph is not concerned with rules based on a debtor-creditor relationship as long as the different treatment resulting from the rules is not based on whether or not non-residents own or control, wholly or partly, directly or indirectly, the capital of the enterprise. For example, if under a State's domestic thin capitalisation rules, a resident enterprise is not allowed to deduct interest paid to a non-resident associated enterprise, that rule would not be in violation of paragraph 5 even where it would be applied to payments of interest made to a creditor that would own or control the capital of the enterprise, provided that the treatment would be the same if the interest had been paid to a non-resident associated enterprise that did not itself own or control any of the capital of the payer. Clearly, however, such a domestic law rule could be in violation of paragraph 4 to the extent that different conditions would apply for the deduction of interest paid to residents and non-residents and it will therefore be important to determine, for purposes of that paragraph, whether the application of the rule is compatible with the provisions of paragraph 1 of Article 9 or paragraph 6 of Article 11 (see paragraph 74 *[of the Commentary on Article 24 of the 2017 OECD Model, as quoted in paragraph 2 above of the Commentary on Article 24 of this Model]*). This would also be important for purposes of paragraph 5 in the case of thin capitalisation rules that would apply only to enterprises of a Contracting State the capital of which is wholly or partly owned or controlled, directly or indirectly, by non-residents. Indeed, since the provisions of paragraph 1 of Article 9 or paragraph 6 of Article 11 form part of the context in which paragraph 5 must be read (as required by Article 31 of the *Vienna Convention on the Law of Treaties*), adjustments

> which are compatible with these provisions could not be considered to violate the provisions of paragraph 5.
>
> 80. In the case of transfer pricing enquiries, almost all member countries *[of the OECD]* consider that additional information requirements which would be more stringent than the normal requirements, or even a reversal of the burden of proof, would not constitute discrimination within the meaning of the Article.

5. When the UN Model was revised in 1999, some members from developing countries proposed that special measures applicable to foreign-owned enterprises should not be construed as constituting prohibited discrimination as long as all foreign-owned enterprises were treated alike; they said that, although such a change represented a notable departure from the general principle of taxing foreign persons on the same basis as nationals, the problems of tax compliance in cases in which foreign ownership was involved and the politically sensitive position of foreign-owned enterprises in developing countries warranted the change. Therefore, they proposed that paragraph 5 of Article 24 be amended to read as follows:

> 5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which are subjected other similar enterprises the capital of which is wholly or partly owned or controlled, directly or indirectly, by residents of third States.

They further pointed out that this proposed change to paragraph 5 had been included in several tax treaties to which developed countries were parties. Some members from developed countries noted that such a proposal would limit the effect of the non-discrimination Article to the prevention of discrimination between enterprises owned by non-residents, thus leaving the door open to discrimination against enterprises owned by non-residents as a class.

6. Several members from developed countries expressed reservations concerning the proposed change and said that they considered the OECD non-discrimination Article as the backbone of the Convention.

They recalled that the antecedents of the non-discrimination Article, as it appears in the OECD Model, dated from the nineteenth century. They felt that if such a fundamental principle were to be altered, it would have a significant effect on international tax relations generally. Further, since the proposed change was motivated in part by problems with tax compliance where foreign ownership was involved – essentially, problems with transfer pricing – it was suggested that the problem might be dealt with more properly in other parts of the Model Convention, such as in Article 9 dealing with associated enterprises.

7. Some members from developing countries indicated that, while recognizing the essential importance of, and need for, the Article on non-discrimination, some countries might wish to modify certain paragraphs of that Article in bilateral negotiations. It was suggested for example that, because of the difficulties involved in determining what constituted reasonable amounts in the case of transfer payments on account of royalties, fees for services, head office expenses and so on, a country might desire to deny deductions for such payments or compute the amount of deduction in accordance with the domestic law of the country when such payments were made by an enterprise situated within its territory to a foreign controlling company, whether the latter was resident in the other Contracting State or in a third country. Another example cited was that of a country which granted tax preferences with a view to the attainment of certain national objectives which might wish to make a given percentage of local ownership of the enterprise involved a condition for the granting of such tax preferences. The Group recognized that special situations such as those mentioned as examples should be resolved in bilateral negotiations.

Paragraph 6

8. Since paragraph 6 of Article 24 of the United Nations Model reproduces paragraph 6 of Article 24 of the OECD Model, the Committee considers that the following part of the Commentary on Article 24 of the 2017 OECD Model is applicable to paragraph 6 of Article 24 of this Model:

> 81. This paragraph states that the scope of the Article is not restricted by the provisions of Article 2. The Article therefore applies to taxes of every kind and description levied by, or on behalf of, the State, its political subdivisions or local authorities.

Article 25

MUTUAL AGREEMENT PROCEDURE

A. General considerations

1. Two alternative versions are given for Article 25 of the UN Model. Alternative A reproduces Article 25 of the OECD Model with the addition of a second sentence in paragraph 4 but excludes arbitration as is provided for in paragraph 5 of the OECD Model. Alternative B reproduces Article 25 of the OECD Model with the addition of a second sentence in paragraph 4 and includes mandatory arbitration as is provided for in paragraph 5 of the OECD Model but with four differences. First, paragraph 5 provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case rather than within two years as provided in the OECD Model. Second, while the OECD Model provides that arbitration must be requested by the person who initiated the case, paragraph 5 provides that arbitration must be requested by the competent authority of one of the Contracting States (this means that a case shall not be submitted to arbitration if the competent authorities of both Contracting States consider that such a case is not suitable for arbitration and neither of them makes a request). Third, paragraph 5, unlike the corresponding provision of the OECD Model, allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them. Fourth, while the OECD Model provides that the two-year period begins when all the information required by the competent authorities in order to address the mutual agreement procedure case has been provided, paragraph 5 provides that the three-year period begins with the presentation of the mutual agreement procedure case to the competent authority of the State that did not initially receive the case.

2. The mutual agreement procedure is designed not only to furnish a means of settling questions relating to the interpretation and application of the Convention, but also to provide (*a*) a forum in which residents of the States involved can seek redress for actions not in accordance with the Convention and (*b*) a mechanism for eliminating double taxation in cases not provided for in the Convention.

3. Many developing countries have no or little experience with the practical application of the mutual agreement procedure. Section C below, which addresses various procedural aspects of the mutual agreement procedure, may be particularly useful to these countries. In addition, the *United Nations Handbook on the Avoidance and Resolution of Tax Disputes*,[99] which focusses primarily on the avoidance and resolution of tax disputes from the perspective of developing countries, includes practical additional guidance on the mutual agreement procedure.

4. The mutual agreement procedure applies in connection with all Articles of the Convention, and, in particular, to Article 7 (Business profits), Article 9 (Associated enterprises), Article 10 (Dividends), Article 11 (Interest), Article 12 (Royalties) and Article 23 (Methods for the elimination of double taxation). Even if a bilateral convention does not contain paragraph 2 of Article 9, the inclusion of paragraph 1 of Article 9 is sufficient to indicate that the intention of the Contracting States was to have economic double taxation covered by the convention. As a result, most countries consider that, in the absence of rules similar to those of paragraph 2 of Article 9, economic double taxation resulting from adjustments made to profits by reason of transfer pricing falls within the scope of the mutual agreement procedure set up under Article 25 (see paragraph 11 of the Commentary on Article 25 of the 2017 OECD Model, as quoted in paragraph 12 below). Some countries consider, however, that in the absence of rules similar to those of paragraph 2 of Article 9, economic double taxation arising from transfer pricing adjustments does not fall within the scope of the mutual agreement procedure provided for under paragraphs 1 and 2 of Article 25. Contracting States that do not include paragraph 2 of Article 9 in a convention should therefore clarify during the negotiations the consequences of the absence of paragraph 2 as to the scope of the mutual agreement procedure.

5. Article 9 of the UN Model contains a paragraph 3 which provides that the provisions of paragraph 2 shall not apply where in relation to the adjustment of profits under paragraph 1 of Article 9, an enterprise has suffered a penalty for fraud, gross negligence or wilful default. Where the conditions provided for in paragraph 3 are fulfilled, a Contracting

99 United Nations publication, 2021, available at https://financing.desa.un.org/sites/default/files/2024-04/DAR-Sept-21-Final-Cover_Back_ISBN_update-2Aug22.pdf, accessed on 10 May 2021.

State has no obligation to make the corresponding adjustment under paragraph 2 and the taxpayer may not initiate the mutual agreement procedure under paragraph 1 of Article 25 in order to request such corresponding adjustment. However, the taxpayer may initiate the mutual agreement procedure where the taxpayer considers that all the conditions provided for in paragraph 3 are not met or that the adjustment of profits is not in accordance with paragraph 1.

6. The decision whether to agree in a bilateral convention on a mutual agreement procedure without mandatory arbitration as in Alternative A or with mandatory arbitration as in Alternative B depends on policy and administrative considerations of each Contracting State and that State's actual experience with mutual agreement procedures. Countries should in advance analyse the advantages and disadvantages of mandatory or voluntary arbitration (see paragraph 18 below) and evaluate whether or not arbitration is appropriate for them. Countries having limited experience with mutual agreement procedures could have difficulties to determine the consequences of adding arbitration in a mutual agreement procedure. Those countries could simply decide to refuse arbitration at this stage. They could, however, also include arbitration but postpone its entry into force until each country has notified the other that the provision should become effective. Those countries could also decide that despite their lack of experience they are willing to add arbitration in a mutual agreement procedure in order to give certainty to taxpayers that a case presented under paragraph 1 of Article 25 will be solved through mutual agreement unless a taxpayer rejects the mutual agreement.

7. Members of the Committee in favour of Alternative A pointed mainly to the following considerations and arguments:

- only a small number of cases are submitted to the mutual agreement procedure under paragraphs 1 and 2 of Article 25 and very few of them remain unresolved;
- domestic legal remedies can resolve the few cases that the competent authorities are not able to resolve through the mutual agreement procedure;
- due to the lack of expertise in many developing countries with mutual agreement procedures, arbitration would be unfair to

those countries when the dispute occurs with more experienced countries;

— the interests of countries, which are so fundamental to their public policy, could hardly be safeguarded by private arbitrators in tax matters; arbitrators cannot be expected to make up for the lack of expertise in many developing countries;

— the neutrality and independence of possible arbitrators appears difficult to guarantee;

— it is very difficult to find experienced arbitrators;

— mandatory arbitration is costly and therefore not suitable for developing countries and countries in transition;

— it is not in the interest of a State to limit its sovereignty in tax matters through mandatory arbitration.

8. Members of the Committee in favour of Alternative B pointed mainly to the following considerations and arguments:

— despite the fact that only a small number of cases remain unresolved, each of these cases represents a situation where there is no resolution for a case where one competent authority considers that there is taxation not in accordance with the Convention and where there may be significant double taxation;

— arbitration provides more certainty to taxpayers that their cases can be resolved under the mutual agreement procedure and contributes to cross-border investment;

— domestic remedies may not resolve adequately and rapidly disputes concerning the application of bilateral conventions (risks of inconsistent court decisions in both countries and of unilateral interpretation of the Convention based on domestic law);

— the obligation to submit unresolved cases to arbitration after a given period of time may facilitate the endeavours of the competent authorities to reach an agreement within that period of time;

— on the basis of the experience under the EU Arbitration Convention, the effective recourse to mandatory arbitration should be rather unusual and the costs relating to that mechanism should be low; moreover, as arbitration provides more certainty

to the taxpayers, it reduces the number of costly "protective" appeals and uncertain domestic proceedings;

— arbitrators have to reach a well founded and impartial decision; consequently, they can adjust for the levels of expertise of countries and overcome the possible lack of experience of some countries;

— skilled and impartial arbitrators do exist from various backgrounds (government officials, judges, academics and practitioners) and from various regions (including from developing countries);

— it is in the interest of a State to limit its sovereignty in tax matters through mandatory arbitration.

9. In some countries, constitutional or legal impediments may restrict the ability of the competent authorities to provide relief, in certain cases, through the mutual agreement procedure. Treaty negotiators should discuss any such impediments that they are aware of. Under Alternative A, the presence of such impediments should not, however, lead to a modification of the Article that would restrict its scope (especially if, in the future, such impediments are removed): the requirement that competent authorities "shall endeavour" to resolve the case does not entail an obligation to reach a resolution and acknowledges that certain factors may affect the ability of a competent authority to reach a mutual agreement or provide relief. Under Alternative B, however, negotiators should ensure that the scope of paragraph 5, which provides for mandatory arbitration, is restricted to take account of any such restrictions in order to avoid the situation where a binding arbitration decision cannot be implemented because of such impediments.

10. Under Alternative B, however, the scope of paragraph 5 has already been restricted in order to take into consideration some possible constitutional or legal impediments. In some States, where a decision on issues submitted to the mutual agreement procedure has already been rendered by one of their courts or administrative tribunals, a mutual agreement on the same issues is no longer allowed under domestic law. To take this situation into account, paragraph 5 states that unresolved issues shall not be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. States that have the possibility in individual cases to deviate

from court decisions may delete that sentence. Also, the domestic law of many States provides that no one can be deprived of the judicial remedies available under domestic law. Therefore, under paragraph 5, the arbitration process applies irrespective of the remedies provided by the domestic law of the Contracting States and the persons directly affected by the case have the possibility to reject the mutual agreement implementing the arbitration decision and to pursue any available domestic remedies.

B. Commentary on the paragraphs of Article 25

Paragraphs 1 and 2 of Article 25 (Alternatives A and B)

11. These paragraphs reproduce the full text of paragraphs 1 and 2 of Article 25 of the OECD Model subject to one exception: unlike paragraph 1 of the UN Model, paragraph 1 of the OECD Model allows a case to be presented to the competent authority of either State. As regards the last sentence of paragraph 1, however, some members of the Committee noted that, in bilateral negotiations, States may wish to agree on a different time limit for the presentation of the case to the competent authority of a Contracting State.

12. The Committee considers that the following parts of the Commentary on paragraphs 1 and 2 of Article 25 of the 2017 OECD Model (and, in some cases, of the 2014 OECD Model), are applicable to the corresponding paragraphs of both Alternatives A and B of Article 25 of this Model (the additional comments that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations, reflect the differences between the provisions of the OECD Model and those of this Model or identify the paragraphs that are taken from the 2014 OECD Model rather than from the 2017 OECD Model):

> 5.1 The undertaking to resolve by mutual agreement cases of taxation not in accordance with the Convention is an integral part of the obligations assumed by a Contracting State in entering into a tax treaty and must be performed in good faith. In particular, the requirement in paragraph 2 that the competent authority "shall endeavour" to resolve the case by mutual agreement with the competent authority of the other Contracting State means that the competent authorities are obliged to seek to resolve the case in a fair and objective manner, on its

merits, in accordance with the terms of the Convention and applicable principles of international law on the interpretation of treaties. *[It must be emphasized, however, that the obligation to "endeavour to resolve" a case is not an obligation to reach a solution: in some rare cases, the competent authorities may be unable to reach an agreement despite their best efforts to resolve the case.]*

[…]

6.1 Through Article 25, the Contracting States have delegated to the competent authorities broad powers concerning the application and interpretation of the provisions of the Convention. Paragraph 2 authorises the competent authorities to resolve by mutual agreement cases presented by taxpayers in order to avoid taxation which could otherwise result from domestic laws but would not be in accordance with the Convention. Paragraph 3 similarly authorises the competent authorities to resolve by mutual agreement difficulties or doubts concerning the interpretation or application of the Convention, both in individual cases (e.g. with respect to a single taxpayer's case) and more generally (e.g. through the joint interpretation of a provision of the treaty applicable to a large number of taxpayers). Under paragraph 3, the competent authorities can, in particular, enter into a mutual agreement to define a term not defined in the Convention, or to complete or clarify the definition of a defined term, where such an agreement would resolve difficulties or doubts arising as to the interpretation or application of the Convention. Such circumstances could arise, for example, where a conflict in meaning under the domestic laws of the two States creates difficulties or leads to an unintended or absurd result. *[…] [In order to ensure a proper resolution of such cases, an agreement reached under paragraph 3 concerning the meaning of a term used in the Convention should prevail over each State's domestic law meaning of that term.]*

6.2 More generally, whilst the status under domestic law of a mutual agreement reached pursuant to Article 25 may vary between States, it is clear that the principles of international law for the interpretation of treaties, as embodied in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*, allow domestic courts to take account of such an agreement. The object of Article 25 is to promote, through consultation and mutual agreement between the competent authorities, the consistent treatment of individual cases and the same interpretation and/or application of the provisions of the Convention in both States. Article 25 also authorises the competent authorities to resolve, by mutual agreement, difficulties or doubts as to the interpretation or application of the Convention; such a mutual agreement, reached pursuant to the

express mandate contained in paragraph 3 of the Article, represents objective evidence of the competent authorities' mutual understanding of the meaning of the Convention and its terms. For these reasons, an agreement reached by the competent authorities under Article 25 *[is a relevant consideration to take]* into account for purposes of the interpretation of the Convention.

6.3 *[T]*here are some cases*[, however,]* where the application of certain treaty provisions has been expressly delegated by the Contracting States to the competent authorities and the agreements reached by the competent authorities in these matters legally govern the application of these provisions. Subparagraph *d*) of paragraph 2 of Article 4, for example, provides that the competent authorities shall resolve by mutual agreement certain cases where an individual is a resident of both Contracting States under paragraph 1 of that Article. Some treaties similarly delegate to the competent authorities the power to determine jointly the status of various entities or arrangements for the purposes of certain treaty provisions (see, for example, subparagraph *b*) of the suggested provision in paragraph 46 of the Commentary in Article 1 *[of the OECD Model, which is quoted in paragraph 46 of the Commentary on Article 1 of this Model])* or the power to supplement or modify lists of entities, arrangements or domestic law provisions referred to in these treaties.

[…]

7. The rules laid down in paragraphs 1 and 2 provide for the elimination in a particular case of taxation which does not accord with the Convention. As is known, in such cases it is normally open to taxpayers to litigate in the tax court, either immediately or upon the dismissal of their objections by the taxation authorities. When taxation not in accordance with the Convention arises from an incorrect application of the Convention in both States, taxpayers are then obliged to litigate in each State, with all the disadvantages and uncertainties that such a situation entails. So paragraph 1 makes available to taxpayers affected, without depriving them of the ordinary legal remedies available, a procedure which is called the mutual agreement procedure because it is aimed, in its second stage, at resolving the dispute on an agreed basis, that is, by agreement between competent authorities, the first stage being conducted exclusively in *[the State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national)]* from the presentation of the objection up to the decision taken regarding it by the competent authority on the matter.

8. In any case, the mutual agreement procedure is clearly a special procedure outside the domestic law. It follows that it can be set in motion solely in cases coming within paragraph 1, that is, cases where tax has been charged, or is going to be charged, in disregard of the provisions of the Convention. So where a charge of tax has been made contrary both to the Convention and the domestic law, this case is amenable to the mutual agreement procedure to the extent only that the Convention is affected, unless a connecting link exists between the rules of the Convention and the rules of the domestic law which have been misapplied.

9. In practice, the procedure applies to cases – by far the most numerous – where the measure in question leads to double taxation which it is the specific purpose of the Convention to avoid. Among the most common cases, mention must be made of the following:

— questions relating to the attribution of profits to a permanent establishment under paragraph 2 of Article 7;

— the taxation in the State of the payer – in case of a special relationship between the payer and the beneficial owner – of the excess part of interest and royalties, under the provisions of Article 9, paragraph 6 of Article 11*[, paragraph 6 of Article 12, paragraph 7 of Article 12AA, paragraph 11 of Article 12B or paragraph 7 of Article 12C of this Model]*;

— cases of application of legislation to deal with thin capitalisation when the State of the debtor company has treated interest as dividends, insofar as such treatment is based on clauses of a convention corresponding for example to Article 9 or paragraph 6 of Article 11;

— cases where lack of information as to the taxpayer's actual situation has led to misapplication of the Convention, especially in regard to the determination of residence (paragraph 2 of Article 4), the existence of a permanent establishment (Article 5), or the temporary nature of the services performed by an employee (paragraph 2 of Article 15).

10. Article 25 also provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of profits of associated enterprises under paragraph 1 of Article 9; the corresponding adjustments to be made in pursuance of paragraph 2 of the same Article

thus fall within the scope of the mutual agreement procedure, both as concerns assessing whether they are well founded and for determining their amount.

11. This in fact is implicit in the wording of paragraph 2 of Article 9 when the bilateral convention in question contains a clause of this type. When the bilateral convention does not contain rules similar to those of paragraph 2 of Article 9 (as is usually the case for conventions signed before 1977) the mere fact that Contracting States inserted in the convention the text of Article 9, as limited to the text of paragraph 1 – which usually only confirms broadly similar rules existing in domestic laws – indicates that the intention was to have economic double taxation covered by the Convention. As a result, most member countries consider that economic double taxation resulting from adjustments made to profits by reason of transfer pricing is not in accordance with – at least – the spirit of the convention and falls within the scope of the mutual agreement procedure set up under Article 25.

12. Whilst the mutual agreement procedure has a clear role in dealing with issues arising as to the sorts of adjustments referred to in paragraph 2 of Article 9, it follows that even in the absence of such a provision, States should be seeking to avoid double taxation, including by giving corresponding adjustments in cases of the type contemplated in paragraph 2. Whilst there may be some difference of view, States would therefore generally regard a taxpayer initiated mutual agreement procedure based upon economic double taxation contrary to the terms of Article 9 as encompassing issues of whether a corresponding adjustment should have been provided, even in the absence of a provision similar to paragraph 2 of Article 9. States which do not share this view do, however, in practice, find the means of remedying economic double taxation in most cases involving *bona fide* companies by making use of provisions in their domestic laws.

13. The mutual agreement procedure is also applicable in the absence of any double taxation contrary to the Convention, once the taxation in dispute is in direct contravention of a rule in the Convention. Such is the case when one State taxes a particular class of income in respect of which the Convention gives an exclusive right to tax to the other State even though the latter is unable to exercise it owing to a gap in its domestic laws. Another category of cases concerns persons who, being nationals of one Contracting State but residents of the other State, are subjected in that other State to taxation treatment which is discriminatory under the provisions of paragraph 1 of Article 24.

14. It should be noted that the mutual agreement procedure, unlike the disputed claims procedure under domestic law, can be set in motion by a taxpayer without waiting until the taxation considered by him to be "not in accordance with the Convention" has been charged against or notified to him. To be able to set the procedure in motion, he must, and it is sufficient if he does, establish that the "actions of one or both of the Contracting States" will result in such taxation, and that this taxation appears as a risk which is not merely possible but probable. Such actions mean all acts or decisions, whether of a legislative or a regulatory nature, and whether of general or individual application, having as their direct and necessary consequence the charging of tax against the complainant contrary to the provisions of the Convention. Thus, for example, if a change to a Contracting State's tax law would result in a person deriving a particular type of income being subjected to taxation not in accordance with the Convention, that person could set the mutual agreement procedure in motion as soon as the law has been amended and that person has derived the relevant income or it becomes probable that the person will derive that income. Other examples include filing a return in a self assessment system or the active examination of a specific taxpayer reporting position in the course of an audit, to the extent that either event creates the probability of taxation not in accordance with the Convention (e.g. where the self assessment reporting position the taxpayer is required to take under a Contracting State's domestic law would, if proposed by that State as an assessment in a non-self assessment regime, give rise to the probability of taxation not in accordance with the Convention, or where circumstances such as a Contracting State's published positions or its audit practice create a significant likelihood that the active examination of a specific reporting position such as the taxpayer's will lead to proposed assessments that would give rise to the probability of taxation not in accordance with the Convention). Another example might be a case where a Contracting State's transfer pricing law requires a taxpayer to report taxable income in an amount greater than would result from the actual prices used by the taxpayer in its transactions with a related party, in order to comply with the arm's length principle, and where there is substantial doubt whether the taxpayer's related party will be able to obtain a corresponding adjustment in the other Contracting State in the absence of a mutual agreement procedure. *[…]* As indicated by the opening words of paragraph 1, whether or not the actions of one or both of the Contracting States will result in taxation not in accordance with the Convention must be determined from the perspective of the taxpayer. Whilst the taxpayer's belief that there will be such taxation must be reasonable and must be based on facts that

can be established, the tax authorities should not refuse to consider a request under paragraph 1 merely because they consider that it has not been proven (for example to domestic law standards of proof on the "balance of probabilities") that such taxation will occur.

15. Since the first steps in a mutual agreement procedure may be set in motion at a very early stage based upon the mere probability of taxation not in accordance with the Convention, the initiation of the procedure in this manner would not be considered the *[presentation of the case to the competent authority]* for the purposes of determining the *[start]* of the *[three-year]* period referred to in paragraph 5 of *[Alternative B of this Article; see paragraph 8 of the Annex to this Commentary on Article 25]. […]*

16. To be admissible objections presented under paragraph 1 must first meet a twofold requirement expressly formulated in that paragraph: *[in principle,]* they must be presented to the competent authority of the *[taxpayer's State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national)]*, and they must be so presented within three years of the first notification of the action which gives rise to taxation which is not in accordance with the Convention. The Convention does not lay down any special rule as to the form of the objections. The competent authorities may prescribe special procedures which they feel to be appropriate *[paragraphs 22 ff. below, under the heading "Necessary cooperation of the person who makes the request", include a number of suggestions concerning such special procedures]*. If no special procedure has been specified, the objections may be presented in the same way as objections regarding taxes are presented to the tax authorities of the State concerned.

17. *[This quoted paragraph 17 is from the Commentary on Article 25 of the 2014 OECD Model]* The requirement laid on the taxpayer to present his case to the competent authority of the State of which he is a resident (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) is of general application, regardless of whether the taxation objected to has been charged in that or the other State and regardless of whether it has given rise to double taxation or not. If the taxpayer should have transferred his residence to the other Contracting State subsequently to the measure or taxation objected to, he must nevertheless still present his objection to the competent authority of the State of which he was a resident during the year in respect of which such taxation has been or is going to be charged.

18. *[This quoted paragraph 18 is from the Commentary on Article 25 of the 2014 OECD Model]* However, in the case already alluded to where a person who is a national of one State but a resident of the other complains of having been subjected in that other State to an action or taxation which is discriminatory under paragraph 1 of Article 24, it appears more appropriate for obvious reasons to allow him, by way of exception to the general rule set forth above, to present his objection to the competent authority of the Contracting State of which he is a national. Finally, it is to the same competent authority that an objection has to be presented by a person who, while not being a resident of a Contracting State, is a national of a Contracting State, and whose case comes under paragraph 1 of Article 24.

19. *[This quoted paragraph 19 is from the Commentary on Article 25 of the 2014 OECD Model]* On the other hand, Contracting States may, if they consider it preferable, give taxpayers the option of presenting their cases to the competent authority of either State. In such a case, paragraph 1 would have to be modified as follows:

> 1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

20. The time limit of three years set by the second sentence of paragraph 1 for presenting objections is intended to protect administrations against late objections. This time limit must be regarded as a minimum, so that Contracting States are left free to agree in their bilateral conventions upon a longer period in the interests of taxpayers, for example, on the analogy in particular of the time limits laid down by their respective domestic regulations in regard to tax conventions. Contracting States may omit the second sentence of paragraph 1 if they concur that their respective domestic regulations apply automatically to such objections and are more favourable in their effects to the taxpayers affected, either because they allow a longer time for presenting objections or because they do not set any time limits for such purpose.

21. The provision fixing the starting point of the three year time limit as the date of the "first notification of the action resulting in

taxation not in accordance with the provisions of the Convention" should be interpreted in the way most favourable to the taxpayer. Thus, even if such taxation should be directly charged in pursuance of an administrative decision or action of general application, the time limit begins to run only from the date of the notification of the individual action giving rise to such taxation, that is to say, under the most favourable interpretation, from the act of taxation itself, as evidenced by a notice of assessment or an official demand or other instrument for the collection or levy of tax. Since a taxpayer has the right to present a case as soon as the taxpayer considers that taxation will result in taxation not in accordance with the provisions of the Convention, whilst the three year limit only begins when that result has materialised, there will be cases where the taxpayer will have the right to initiate the mutual agreement procedure before the three year time limit begins (see the examples of such a situation given in paragraph 14 *[of the Commentary on Article 25 of the 2017 OECD Model quoted above]*).

22. In most cases it will be clear what constitutes the relevant notice of assessment, official demand or other instrument for the collection or levy of tax, and there will usually be domestic law rules governing when that notice is regarded as "given". Such domestic law will usually look to the time when the notice is sent (time of sending), a specific number of days after it is sent, the time when it would be expected to arrive at the address it is sent to (both of which are times of presumptive physical receipt), or the time when it is in fact physically received (time of actual physical receipt). Where there are no such rules, either the time of actual physical receipt or, where this is not sufficiently evidenced, the time when the notice would normally be expected to have arrived at the relevant address should usually be treated as the time of notification, bearing in mind that this provision should be interpreted in the way most favourable to the taxpayer.

23. In self assessment cases, there will usually be some notification effecting that assessment (such as a notice of a liability or of denial or adjustment of a claim for refund), and generally the time of notification, rather than the time when the taxpayer lodges the self-assessed return, would be a starting point for the three year period to run. *[…]* There may, however, be cases where there is no notice of a liability or the like. In such cases, the relevant time of "notification" would be the time when the taxpayer would, in the normal course of events, be regarded as having been made aware of the taxation that is in fact not in accordance with the Convention. This could, for example, be when information recording the transfer of funds is first made available to

a taxpayer, such as in a bank balance or statement. The time begins to run whether or not the taxpayer actually regards the taxation, at that stage, as contrary to the Convention, provided that a reasonably prudent person in the taxpayer's position would have been able to conclude at that stage that the taxation was not in accordance with the Convention. In such cases, notification of the fact of taxation to the taxpayer is enough. Where, however, it is only the combination of the self assessment with some other circumstance that would cause a reasonably prudent person in the taxpayer's position to conclude that the taxation was contrary to the Convention (such as a judicial decision determining the imposition of tax in a case similar to the taxpayer's to be contrary to the provisions of the Convention), the time begins to run only when the latter circumstance materialises.

24. If the tax is levied by deduction at the source, the time limit begins to run from the moment when the income is paid; however, if the taxpayer proves that only at a later date did he know that the deduction had been made, the time limit will begin from that date. Where it is the combination of decisions or actions taken in both Contracting States that results in taxation not in accordance with the Convention, the time limit begins to run only from the first notification of the most recent decision or action. This means that where, for example, a Contracting State levies a tax that is not in accordance with the Convention but the other State provides relief for such tax pursuant to Article 23 A or Article 23 B so that there is no double taxation, a taxpayer will in practice often not initiate the mutual agreement procedure in relation to the action of the first State. If, however, the other State subsequently notifies the taxpayer that the relief is denied so that double taxation now arises, a new time limit begins from that notification, since the combined actions of both States then result in the taxpayer's being subjected to double taxation contrary to the provisions of the Convention. In some cases, especially of this type, the records held by taxing authorities may have been routinely destroyed before the period of the time limit ends, in accordance with the normal practice of one or both of the States. The Convention obligations do not prevent such destruction, or require a competent authority to accept the taxpayer's arguments without proof, but in such cases the taxpayer should be given the opportunity to supply the evidential deficiency, as the mutual agreement procedure continues, to the extent domestic law allows. In some cases, the other Contracting State may be able to provide sufficient evidence, in accordance with Article 26 of the Model. It is, of course, preferable that such records be retained by tax authorities for the full

period during which a taxpayer is able to seek to initiate the mutual agreement procedure in relation to a particular matter.

25. The three-year period continues to run during any domestic law (including administrative) proceedings (e.g. a domestic appeal process). This could create difficulties by in effect requiring a taxpayer to choose between domestic law and mutual agreement procedure remedies. Some taxpayers may rely solely on the mutual agreement procedure, but many taxpayers will attempt to address these difficulties by initiating a mutual agreement procedure whilst simultaneously initiating domestic law action, even though the domestic law process is initially not actively pursued. This could result in mutual agreement procedure resources being inefficiently applied. Where domestic law allows, some States may wish to specifically deal with this issue by allowing for the three-year (or longer) period to be suspended during the course of domestic law proceedings. Two approaches, each of which is consistent with Article 25 are, on one hand, requiring the taxpayer to initiate the mutual agreement procedure, with no suspension during domestic proceedings, but with the competent authorities not entering into talks in earnest until the domestic law action is finally determined, or else, on the other hand, having the competent authorities enter into talks, but without finally settling an agreement unless and until the taxpayer agrees to withdraw domestic law actions. This second possibility is discussed at paragraph 42 *[of the Commentary on Article 25 of the 2017 OECD Model quoted below]*. In either of these cases, the taxpayer should be made aware that the relevant approach is being taken. Whether or not a taxpayer considers that there is a need to lodge a "protective" appeal under domestic law (because, for example, of domestic limitation requirements for instituting domestic law actions) the preferred approach for all parties is often that the mutual agreement procedure should be the initial focus for resolving the taxpayer's issues, and for doing so on a bilateral basis.

26. Some States may deny the taxpayer the ability to initiate the mutual agreement procedure under paragraph 1 of Article 25 in cases where the transactions to which the request relates are regarded as abusive. This issue is closely related to the issue of "improper use of the Convention" discussed *[in paragraph 50 and the following paragraphs of the Commentary on Article 1 of this Model]*. In the absence of a special provision, there is no general rule denying perceived abusive situations going to the mutual agreement procedure, however. The simple fact that a charge of tax is made under an avoidance provision of domestic law should not be a reason to deny access to mutual agreement. However,

where serious violations of domestic laws resulting in significant penalties are involved, some States may wish to deny access to the mutual agreement procedure. The circumstances in which a State would deny access to the mutual agreement procedure must be made clear in the Convention.[100]

27. Some States regard certain issues as not susceptible to resolution by the mutual agreement procedure generally, or at least by taxpayer initiated mutual agreement procedure, because of constitutional or other domestic law provisions or decisions. An example would be a case where granting the taxpayer relief would be contrary to a final court decision that the tax authority is required to adhere to under that State's constitution. The recognised general principle for tax and other treaties is that domestic law, even domestic constitutional law, does not justify a failure to meet treaty obligations, however. Article 27 of the *Vienna Convention on the Law of Treaties* reflects this general principle of treaty law. It follows that any justification for what would otherwise be a breach of the Convention needs to be found in the terms of the Convention itself, as interpreted in accordance with accepted tax treaty interpretation principles. Such a justification would be rare, because it would not merely govern how a matter will be dealt with by the two States once the matter is within the mutual agreement procedure, but would instead prevent the matter from even reaching the stage when it is considered by both States. Since such a determination might in practice be reached by one of the States without consultation with the other, and since there might be a bilateral solution that therefore remains unconsidered, the view that a matter is not susceptible of taxpayer initiated mutual agreement procedure should not be lightly made, and needs to be supported by the terms of the Convention as negotiated. A competent authority relying upon a domestic law impediment as the reason for not allowing the mutual agreement procedure to be initiated by a taxpayer should inform the other competent authority of this and duly explain the legal basis of its position. More usually, genuine domestic law impediments will not prevent a matter from entering into the mutual agreement procedure, but if they will clearly and unequivocally prevent a competent authority from resolving the issue in a way that avoids taxation of the taxpayer which is not in accordance with the Convention, and there is no realistic chance of

100 *[See also paragraph 5 above concerning the access to the mutual agreement procedure where a convention includes paragraph 3 of Article 9 of the UN Model.]*

the other State resolving the issue for the taxpayer, then that situation should be made public to taxpayers, so that taxpayers do not have false expectations as to the likely outcomes of the procedure.

28. In other cases, initiation of the mutual agreement procedure may have been allowed but domestic law issues that have arisen since the negotiation of the treaty may prevent a competent authority from resolving, even in part, the issue raised by the taxpayer. Where such developments have a legally constraining effect on the competent authority, so that bilateral discussions can clearly not resolve the matter, most States would accept that this change of circumstances is of such significance as to allow that competent authority to withdraw from the procedure. In some cases, the difficulty may be only temporary however; such as whilst rectifying legislation is enacted, and in that case, the procedure should be suspended rather than terminated. The two competent authorities will need to discuss the difficulty and its possible effect on the mutual agreement procedure. There will also be situations where a decision wholly or partially in the taxpayer's favour is binding and must be followed by one of the competent authorities but where there is still scope for mutual agreement discussions, such as for example in one competent authority's demonstrating to the other that the latter should provide relief.

29. There is less justification for relying on domestic law for not implementing an agreement reached as part of the mutual agreement procedure. The obligation of implementing such agreements is unequivocally stated in the last sentence of paragraph 2, and impediments to implementation that were already existing should generally be built into the terms of the agreement itself. As tax conventions are negotiated against a background of a changing body of domestic law that is sometimes difficult to predict, and as both parties are aware of this in negotiating the original Convention and in reaching mutual agreements, subsequent unexpected changes that alter the fundamental basis of a mutual agreement would generally be considered as requiring revision of the agreement to the extent necessary. Obviously where there is a domestic law development of this type, something that should only rarely occur, good faith obligations require that it be notified as soon as possible, and there should be a good faith effort to seek a revised or new mutual agreement, to the extent the domestic law development allows. In these cases, the taxpayer's request should be regarded as still operative, rather than a new application's being required from that person.

30. As regards the procedure itself, it is necessary to consider briefly the two distinct stages into which it is divided (see paragraph 7 *[of the Commentary on Article 25 of the 2017 OECD Model quoted above]*).

31. In the first stage, which opens with the presentation of the taxpayer's objections, the procedure takes place exclusively at the level of dealings between the taxpayer and the competent authorities of *[the taxpayer's State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national)]*. The provisions of paragraph 1 give the taxpayer concerned the right to apply to the competent authority of *[the State of which he is a resident]*, whether or not all the remedies available under the domestic law of each of the two States have been exhausted. On the other hand, the competent authority is under an obligation to consider whether the objection is justified and, if it appears to be justified, take action on it in one of the two forms provided for in paragraph 2.

[…]

32. If the competent authority duly approached recognises that the complaint is justified and considers that the taxation complained of is due wholly or in part to a measure taken in that State, it must give the complainant satisfaction as speedily as possible by making such adjustments or allowing such reliefs as appear to be justified. In this situation, the issue can be resolved without moving beyond the first (unilateral) stage of the mutual agreement procedure. On the other hand, it may be found useful to exchange views and information with the competent authority of the other Contracting State, in order, for example, to confirm a given interpretation of the Convention.

33. If, however, it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other State, it will be incumbent on it, indeed it will be its duty – as clearly appears by the terms of paragraph 2 – to set in motion the second (bilateral) stage of the mutual agreement procedure. It is important that the competent authority in question carry out this duty as quickly as possible, especially in cases where the profits of associated enterprises have been adjusted as a result of transfer pricing adjustments.

34. A taxpayer is entitled to present his case under paragraph 1 to the competent authority of *[the State of which he is a resident]* whether or not he may also have made a claim or commenced litigation under the domestic law of *[that State]*. If litigation is pending *[…]*, the

competent authority of *[the State of residence]* should not wait for the final adjudication, but should say whether it considers the case to be eligible for the mutual agreement procedure. If it so decides, it has to determine whether it is itself able to arrive at a satisfactory solution or whether the case has to be submitted to the competent authority of the other Contracting State. An application by a taxpayer to set the mutual agreement procedure in motion should not be rejected without good reason.

35. If a claim has been finally adjudicated by a court in *[the State of residence]*, a taxpayer may wish even so to present or pursue a claim under the mutual agreement procedure. In some States, the competent authority may be able to arrive at a satisfactory solution which departs from the court decision. In other States, the competent authority is bound by the court decision *[…]*. It may nevertheless present the case to the competent authority of the other Contracting State and ask the latter to take measures for avoiding double taxation.

36. In its second stage – which opens with the approach to the competent authority of the other State by the competent authority to which the taxpayer has applied – the procedure is henceforward at the level of dealings between States, as if, so to speak, the State to which the complaint was presented had given it its backing. But whilst this procedure is indisputably a procedure between States, it may, on the other hand, be asked:

— whether, as the title of the Article and the terms employed in the first sentence of paragraph 2 suggest, it is no more than a simple procedure of mutual agreement, or constitutes the implementation of a *pactum de contrahendo* laying on the parties a mere duty to negotiate but in no way laying on them a duty to reach agreement;

— or whether on the contrary, it is to be regarded (based *[in the case of Article 25 Alternative B]* on the existence of the arbitration process provided for in paragraph 5 *[of that alternative]* to address unresolved issues or on the assumption that the procedure takes place within the framework of a joint commission) as a procedure of a jurisdictional nature laying on the parties a duty to resolve the dispute.

37. Paragraph 2 no doubt entails a duty to negotiate; but as far as reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavours and not to achieve a result. Paragraph 5 *[of Article 25*

Alternative B], however, provides a mechanism that will allow an agreement to be reached even if there are issues on which the competent authorities have been unable to reach agreement through negotiations.

38. In seeking a mutual agreement, the competent authorities must first, of course, determine their position in the light of the rules of their respective taxation laws and of the provisions of the Convention, which are as binding on them as much as they are on the taxpayer. Should the strict application of such rules or provisions preclude any agreement, it may reasonably be held that the competent authorities, as in the case of international arbitration, can, subsidiarily, have regard to considerations of equity in order to give the taxpayer satisfaction.

38.1 The combination of bilateral tax conventions concluded among several States may allow the competent authorities of these States to resolve multilateral cases by mutual agreement under paragraphs 1 and 2 of Article 25 of these conventions. A multilateral mutual agreement may be achieved either through the negotiation of a single agreement between all the competent authorities of the States concerned or through the negotiation of separate, but consistent, bilateral mutual agreements.

38.2 This may, for instance, be the case to determine an appropriate allocation of profits between the permanent establishments that an enterprise has in two different States with which the State of the enterprise has tax conventions. In such case an adjustment made with respect to dealings between the two permanent establishments may affect the taxation of the enterprise in the State of residence. Based on paragraphs 1 and 2 of Article 25 of the tax conventions between the State of the enterprise and the States in which the permanent establishments are situated, the competent authority of the State of the enterprise clearly has the authority to endeavour to resolve the case by mutual agreement with the competent authorities of the States in which the permanent establishments are situated and to determine the appropriate attribution of profits to the permanent establishments of its resident in accordance with both tax conventions. Where the tax conventions between the State of the enterprise and the States in which the permanent establishments are situated contain different versions of Article 7 (e.g. the version included in the *[2017 OECD Model]* in one convention and the *[…]* version of Article *7 [found in the UN Model]* in the other convention), the competent authorities may have regard to considerations of equity as mentioned under paragraph 38 *[of the Commentary on Article 25 of the 2017 OECD Model quoted above]* in

order to find an appropriate solution with a view to ensuring taxation in accordance with the provisions of the applicable conventions.

38.3 This may, for instance, also be the case where a number of associated enterprises of different States are involved in a series of integrated controlled transactions and there are bilateral tax conventions among the States of all the enterprises. Such a series of integrated controlled transactions could exist, for example, where intellectual property is licensed in a controlled transaction between two members of a multinational enterprise (MNE) group and is then used by the licensee to manufacture goods sold by the licensee to other members of the MNE group. Based on paragraphs 1 and 2 of Article 25 of these tax conventions, the competent authorities of the States of these enterprises clearly have the authority to endeavour to determine the appropriate arm's length transfer prices for the controlled transactions in accordance with the arm's length principle of Article 9.

38.4 As recognised in paragraph 55 *[of the Commentary on Article 25 of the 2017 OECD Model quoted below]*, in the multilateral case described in paragraph 38.2 *[above]*, paragraph 3 of Article 25 of the tax convention between the States in which the permanent establishments are situated enables those two States to consult together to ensure that the convention operates effectively and that the double taxation that can occur in such a situation is appropriately eliminated.

38.5 The desire for certainty may result in taxpayers seeking multilateral advance pricing arrangements ("APAs") to determine, in advance, the transfer pricing of controlled transactions between associated enterprises of several States. Where there exist bilateral tax conventions among all these States and it appears that the actions of at least one of these States are likely to result for the taxpayer in taxation not in accordance with the provisions of a convention, Article 25 of these conventions allows the competent authorities of these States to negotiate on a multilateral basis an appropriate set of criteria for the determination of the transfer pricing for the controlled transactions. A multilateral APA may be achieved either through the negotiation of a single agreement between all the competent authorities of the States concerned or through the negotiation of separate, but consistent, bilateral mutual agreements.

39. The purpose of the last sentence of paragraph 2 is to enable countries with time limits relating to adjustments of assessments and tax refunds in their domestic law to give effect to an agreement despite such time limits. This provision does not prevent, however, such States as are

not, on constitutional or other legal grounds, able to overrule the time limits in the domestic law from inserting in the mutual agreement itself such time limits as are adapted to their internal statute of limitation *[…]*. In certain extreme cases, a Contracting State may prefer not to enter into a mutual agreement, the implementation of which would require that the internal statute of limitation had to be disregarded *[…]*. Apart from time limits there may exist other obstacles such as "final court decisions" to giving effect to an agreement. Contracting States are free to agree on firm provisions for the removal of such obstacles. As regards the practical implementation of the procedure, it is generally recommended that every effort should be made by tax administrations to ensure that as far as possible the mutual agreement procedure is not in any case frustrated by operational delays or, where time limits would be in point, by the combined effects of time limits and operational delays.

40. The *[OECD]* Committee on Fiscal Affairs made a number of recommendations on the problems raised by corresponding adjustments of profits following transfer pricing adjustments (implementation of paragraphs 1 and 2 of Article 9) and of the difficulties of applying the mutual agreement procedure to such situations:

a) Tax authorities should notify taxpayers as soon as possible of their intention to make a transfer pricing adjustment (and, where the date of any such notification may be important, to ensure that a clear formal notification is given as soon as possible), since it is particularly useful to ensure as early and as full contacts as possible on all relevant matters between tax authorities and taxpayers within the same jurisdiction and, across national frontiers, between the associated enterprises and tax authorities concerned.

b) Competent authorities should communicate with each other in these matters in as flexible a manner as possible, whether in writing, by telephone, or by face-to-face or round-the-table discussion, whichever is most suitable, and should seek to develop the most effective ways of solving relevant problems. Use of the provisions of Article 26 on the exchange of information should be encouraged in order to assist the competent authority in having well-developed factual information on which a decision can be made.

c) In the course of mutual agreement proceedings on transfer pricing matters, the taxpayers concerned should be given every reasonable opportunity to present the relevant facts and arguments to the competent authorities both in writing and orally.

41. As regards the mutual agreement procedure in general, the Committee recommended that:

a) The formalities involved in instituting and operating the mutual agreement procedure should be kept to a minimum and any unnecessary formalities eliminated.

b) Mutual agreement cases should each be settled on their individual merits and not by reference to any balance of the results in other cases.

c) Competent authorities should, where appropriate, formulate and publicise domestic rules, guidelines and procedures concerning use of the mutual agreement procedure.

42. The case may arise where a mutual agreement is concluded in relation to a taxpayer who has brought a suit for the same purpose in the competent court of either Contracting State and such suit is still pending. In such a case, there would be no grounds for rejecting a request by a taxpayer that he be allowed to defer acceptance of the solution agreed upon as a result of the mutual agreement procedure until the court had delivered its judgment in that suit.[101] *[One member of the Committee considered, however, that a taxpayer should not be allowed to defer acceptance of the mutual agreement until a court has delivered its judgment in a suit. Once an agreement has been reached between the competent authorities, the taxpayer should decide within a reasonable period of time whether to accept that agreement.]* Also, a view that competent authorities might reasonably take is that where the taxpayer's suit is ongoing as to the particular issue upon which mutual agreement is sought by that same taxpayer, discussions of any depth at the competent authority level should await a court decision. If the taxpayer's request for a mutual agreement procedure applied to different tax years than the court action, but to essentially the same factual and legal issues, so that the court outcome would in practice be expected to affect the treatment of the taxpayer in years not specifically the subject

101 *[However, as noted in paragraph 45 of the Commentary on Article 25 of the 2017 OECD Model quoted below, in most countries, a mutual agreement cannot be finalized before the taxpayer has given agreement and renounced domestic legal remedies. If the taxpayer chooses to wait until the domestic legal proceedings have been concluded, the risk exists that a court decision will prevent a competent authority from implementing the proposed agreement and the taxpayer cannot be guaranteed that the proposed agreement will still be available at the conclusion of the legal proceedings].*

of litigation, the position might be the same, in practice, as for the cases just mentioned. In either case, awaiting a court decision or otherwise holding a mutual agreement procedure in abeyance whilst formalised domestic recourse proceedings are underway will not infringe upon, or cause time to expire from, the *[three-year]* period referred to in paragraph 5 *[of Alternative B]* of the Article. Of course, if competent authorities consider, in either case, that the matter might be resolved notwithstanding the domestic law proceedings (because, for example, the competent authority where the court action is taken will not be legally bound or constrained by the court decision) then the mutual agreement procedure may proceed as normal. *[…]*

43. The situation is also different if there is a suit ongoing on an issue, but the suit has been taken by another taxpayer than the one who is seeking to initiate the mutual agreement procedure. In principle, if the case of the taxpayer seeking the mutual agreement procedure supports action by one or both competent authorities to prevent taxation not in accordance with the Convention, that should not be unduly delayed pending a general clarification of the law at the instance of another taxpayer, although the taxpayer seeking mutual agreement might agree to this if the clarification is likely to favour that taxpayer's case. In other cases, delaying competent authority discussions as part of a mutual agreement procedure may be justified in all the circumstances, but the competent authorities should be mindful of the time constraints imposed by paragraph 5 *[of Article 25 Alternative B]* and should as far as possible seek to prevent disadvantage to the taxpayer seeking mutual agreement in such a case. This could be done, where domestic law allows, by deferring payment of the amount outstanding during the course of the delay, or at least during that part of the delay which is beyond the taxpayer's control.

44. Depending upon domestic procedures, the choice of redress is normally that of the taxpayer and in most cases it is the domestic recourse provisions such as appeals or court proceedings that are held in abeyance in favour of the less formal and bilateral nature of mutual agreement procedure.

45. As noted above, there may be a pending suit by the taxpayer on an issue, or else the taxpayer may have preserved the right to take such domestic law action, yet the competent authorities might still consider that an agreement can be reached. In such cases, it is, however, necessary to take into account the concern of a particular competent authority to avoid any divergences or contradictions between the decision of the court and the mutual agreement that is being sought,

with the difficulties or risks of abuse that these could entail. In short, therefore, the implementation of such a mutual agreement should normally be made subject:

— to the acceptance of such mutual agreement by the taxpayer, and

— to the taxpayer's withdrawal of the suit at law concerning those points settled in the mutual agreement.

[…]

46. Some States take the view that a mutual agreement procedure may not be initiated by a taxpayer unless and until payment of all or a specified portion of the tax amount in dispute has been made. They consider that the requirement for payment of outstanding taxes, subject to repayment in whole or in part depending on the outcome of the procedure, is an essentially procedural matter not governed by Article 25, and is therefore consistent with it. A contrary view, held by many States, is that Article 25 indicates all that a taxpayer must do before the procedure is initiated, and that it imposes no such requirement. Those States find support for their view in the fact that the procedure may be implemented even before the taxpayer has been charged to tax or notified of a liability (as noted at paragraph 14 *[of the Commentary on Article 25 of the 2017 OECD Model quoted above]*) and in the acceptance that there is clearly no such requirement for a procedure initiated by a competent authority under paragraph 3.

47. Article 25 gives no absolutely clear answer as to whether a taxpayer initiated mutual agreement procedure may be denied on the basis that there has not been the necessary payment of all or part of the tax in dispute. However, whatever view is taken on this point, in the implementation of the Article it should be recognised that the mutual agreement procedure supports the substantive provisions of the Convention and that the text of Article 25 should therefore be understood in its context and in the light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

47.1 Unlike disputes that involve solely the application of a Contracting State's domestic law, the disputes that are addressed through the mutual agreement procedure will in most cases involve double taxation. States therefore should as far as possible take into account the cash flow issues in requiring advance payment of an amount that the taxpayer contends was at least in part levied contrary to the terms of the relevant Convention. Even if a mutual agreement procedure ultimately eliminates any double taxation or other taxation

not in accordance with the Convention, the requirement to pay tax prior to the conclusion of the mutual agreement procedure may permanently cost the taxpayer the time value of the money represented by the amount inappropriately imposed for the period prior to the mutual agreement procedure resolution, at least in the fairly common case where the respective interest policies of the relevant Contracting States do not fully compensate the taxpayer for that cost. Thus, this means that in such cases the mutual agreement procedure would not achieve the goal of fully eliminating, as an economic matter, the burden of the double taxation or other taxation not in accordance with the Convention. Moreover, even if that economic burden is ultimately removed, a requirement that the taxpayer pay taxes on the same income to two Contracting States can impose cash flow burdens that are inconsistent with the Convention's goals of eliminating barriers to cross-border trade and investment. As a minimum, payment of outstanding tax should not be a requirement to initiate the mutual agreement procedure if it is not a requirement before initiating domestic law review. States may wish to provide so expressly in the Convention by adding the following text to the end of paragraph 2:

> The suspension of assessment and collection procedures during the period that any mutual agreement proceeding is pending shall be available under the same conditions as apply to a person pursuing a domestic administrative or judicial remedy.

It also appears, as a minimum, that if the mutual agreement procedure is initiated prior to the taxpayer's being charged to tax (such as by an assessment), a payment should only be required once that charge to tax has occurred.

48. For the reasons described in the preceding paragraph, suspension of the collection of tax pending resolution of a mutual agreement procedure can be a desirable policy. Moreover, any requirement to pay a tax assessment specifically as a condition of obtaining access to the mutual agreement procedure in order to get relief from that very tax would generally be inconsistent with the policy of making the mutual agreement procedure broadly available to resolve such disputes. Another unfortunate complication of such a requirement may be delays in the resolution of cases if a country is less willing to enter into good faith mutual agreement procedure discussions when a probable result could be the refunding of taxes already collected. In many States, the suspension of the assessment and/or collection of tax pending the resolution of a mutual agreement procedure may require legislative changes for the purpose of its implementation. States may also wish to

provide expressly in the Convention for the suspension of assessment and collection procedures by adding the following text to the end of paragraph 2:

> Assessment and collection procedures shall be suspended during the period that any mutual agreement proceeding is pending.

In connection with any suspension of collection of tax pending the resolution of a mutual agreement procedure, it is important to recall the availability of measures of conservancy pursuant to paragraph 4 of Article 27.

48.1 As there may be substantial differences in the domestic law assessment and collection procedures of the Contracting States, it may be important to verify, during the course of bilateral negotiations, how those procedures will operate in each State pending the resolution of a mutual agreement procedure, in order to address any obstacles such procedures may present to the effective implementation of the Article. For example, where a State takes the view that payment of outstanding tax is a precondition to the taxpayer initiated mutual agreement procedure, this should be notified to the treaty partner during negotiations on the terms of a Convention. Where both Contracting States take this view, there is a common understanding, but also the particular risk of the taxpayer's being required to pay an amount twice. Where domestic law (or a treaty provision such as that in the preceding paragraph) allows it, one possibility which States might consider to deal with this would be for the higher of the two amounts to be held in trust, escrow or similar, pending the outcome of the mutual agreement procedure. Alternatively, a bank guarantee provided by the taxpayer's bank could be sufficient to meet the requirements of the competent authorities. As another approach, one State or the other (decided by time of assessment, for example, or by residence State status under the treaty) could agree to seek a payment of no more than the difference between the amount paid to the other State, and that which it claims, if any. Which of these possibilities is open will ultimately depend on the domestic law (including administrative requirements) of a particular State and the provisions of the applicable treaty, but they are the sorts of options that should as far as possible be considered in seeking to have the mutual agreement procedure operate as effectively as possible. Where States require some payment of outstanding tax as a precondition to the taxpayer initiated mutual agreement procedure, or to the active consideration of an issue within that procedure, they should have a system in place for refunding an amount of interest on any underlying amount to be returned to the taxpayer as the result of

a mutual agreement reached by the competent authorities. Any such interest payment should sufficiently reflect the value of the underlying amount and the period of time during which that amount has been unavailable to the taxpayer.

49. Paragraph 4 of the Commentary on Article 2 *[of the OECD Model, as quoted in paragraph 4 of the Commentary on Article 2 of this Model]* clarifies that whilst most States do not consider interest and administrative penalties accessory to the taxes covered under Article 2 to themselves be covered by Article 2, where such interest and administrative penalties are directly connected to taxes covered under Article 2, they should be appropriately reduced or withdrawn to the same extent as the underlying covered tax is reduced or withdrawn pursuant to the mutual agreement procedure. Consequently, a Contracting State that has applied interest or an administrative penalty that is computed with reference to an underlying tax liability (or with reference to some other amount relevant to the determination of tax, such as the amount of an adjustment or an amount of taxable income) and that has subsequently agreed pursuant to a mutual agreement procedure under paragraphs 1 and 2 of Article 25 to reduce or withdraw that underlying tax liability should proportionally reduce the amount of or withdraw such interest or administrative penalty.

49.1 In contrast, other administrative penalties (for example, a penalty for failure to maintain proper transfer pricing documentation) may concern domestic law compliance issues that are not directly connected to a tax liability that is the object of a mutual agreement procedure request. Such administrative penalties would generally not fall within the scope of the mutual agreement procedure under paragraphs 1 and 2 of the Article. Under paragraph 3 of Article 25, however, the competent authorities may consult together and agree, in a specific case, that a penalty not directly connected with taxation not in accordance with the Convention was not or is no longer justified. For instance, where an administrative penalty for negligence, wilful conduct or fraud has been levied at a fixed amount and it is subsequently agreed in the mutual agreement procedure that there was no fraudulent intent, wilful conduct or negligence, the competent authorities may agree that the Contracting State that applied such penalty will withdraw it. Under paragraph 3 of the Article, the competent authorities may also enter into a general mutual agreement pursuant to which they will endeavour through the mutual agreement procedure to resolve under paragraphs 1 and 2 issues related to interest and administrative penalties that give rise to difficulties or doubts as to the application of the Convention.

Contracting States may, if they consider it preferable, expressly provide in paragraph 2 of Article 25 for the application of that paragraph to interest and administrative penalties in mutual agreement procedure cases presented in accordance with paragraph 1 by adding the following as a second sentence:

> The competent authorities shall also endeavour to agree on the application of domestic law provisions regarding interest and administrative penalties related to the case.

49.2 Criminal penalties imposed by a public prosecutor or a court would generally not fall within the scope of the mutual agreement procedure. In many States, competent authorities would have no legal authority to reduce or withdraw those penalties.

49.3 A mutual agreement will often result in a tax liability being maintained in one Contracting State whilst the other Contracting State has to refund all or part of the tax it has levied. In such cases, the taxpayer may suffer a significant economic burden if there are asymmetries with respect to how interest accrues on tax liabilities and refunds in the two Contracting States. This will, for instance, be the case where the first Contracting State has charged late payment interest on the tax that was the object of the mutual agreement procedure request and the second Contracting State does not grant overpayment interest on the amount it has to refund to the taxpayer. Therefore, Contracting States should seek to adopt flexible approaches to provide relief from interest accessory to the tax liability that is the object of a mutual agreement procedure request. Relief from interest would be especially appropriate for the period during which the taxpayer is in the mutual agreement process, given that the amount of time it takes to resolve a case through the mutual agreement procedure is, for the most part, outside the taxpayer's control. Changes to the domestic law of a Contracting State may be required to permit the competent authority to provide interest relief agreed upon under the mutual agreement procedure.

49.4 The object of the Convention in avoiding double taxation, and the requirement for States to implement conventions in good faith, suggest that interest and penalty payments should not be imposed in a way that effectively discourages taxpayers from initiating a mutual agreement procedure, because of the cost and the cash flow impact that this would involve. Interest and administrative penalties should not be applied in a way that severely discourages or nullifies taxpayer reliance upon the benefits of the Convention, including the right to

initiate the mutual agreement procedure as provided by Article 25. For example, a State's requirements as to payment of outstanding penalties and interest should not be more onerous to taxpayers in the context of the mutual agreement procedure than they would be in the context of taxpayer initiated domestic law review.

Paragraph 3 of Article 25 (Alternatives A and B)

13. This paragraph reproduces paragraph 3 of Article 25 of the OECD Model. The Committee considers that the following part of the Commentary on Article 25 of the 2017 OECD Model is applicable to paragraph 3 of Article 25 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 50. The first sentence of this paragraph invites and authorises the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. These are essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers, even if they have arisen in connection with an individual case normally coming under the procedure defined in paragraphs 1 and 2.
>
> 51. This provision makes it possible to resolve difficulties arising from the application of the Convention. Such difficulties are not only those of a practical nature, which might arise in connection with the setting up and operation of procedures for the relief from tax deducted *from [income from the operations of ships or aircraft in international traffic,]* dividends, interest*[, royalties, fees for services, income from automated digital services or insurance premiums]* in the Contracting State in which they arise, but also those which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators, the solution of which does not depend on a prior agreement as to the interpretation of the Convention.
>
> 52. Under this provision the competent authorities can, in particular:
>
> — Where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty.
>
> — Where the laws of a State have been changed without impairing the balance or affecting the substance of the Convention, settle

any difficulties that may emerge from the new system of taxation arising out of such changes.

— Determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).

— Conclude bilateral advance pricing arrangements (APAs) as well as conclude multilateral APAs with competent authorities of third States with which each of the Contracting States has concluded a bilateral tax convention in cases where difficulties or doubts exist as to the interpretation or application of the conventions (especially in cases where no actions of the Contracting States are likely to result in taxation not in accordance with the provisions of a convention). A multilateral APA may be concluded either through the negotiation of a single agreement between all the competent authorities of the concerned States or through the negotiation of separate, but consistent, bilateral mutual agreements.

— Determine appropriate procedures, conditions and modalities for the application of paragraphs 1 and 2 as well as the second sentence of this paragraph to multilateral cases (see paragraphs 38.1 to 38.5 *[of the Commentary on Article 25 of the 2017 OECD Model, as quoted in paragraph 12 above]* and paragraphs 55 to 55.2 *[of the Commentary on Article 25 of the 2017 OECD Model, as quoted below]*) and for the involvement of third States in the mutual agreement procedure where the resolution of the case may affect or be affected by taxation in third States.

53. Paragraph 3 confers on the "competent authorities of the Contracting States", that is, generally the Ministers of Finance or their authorised representatives normally responsible for the administration of the Convention, authority to resolve by mutual agreement any difficulties arising as to the interpretation of the Convention. However, it is important not to lose sight of the fact that, depending on the domestic law of Contracting States, other authorities (Ministry of Foreign Affairs, courts) have the right to interpret international treaties and agreements as well as the "competent authority" designated in the Convention, and that this is sometimes the exclusive right of such other authorities.

54. Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities do not agree to modify or rescind the mutual agreement.

55. The second sentence of paragraph 3 enables the competent authorities to deal also with such cases of double taxation as do not come within the scope of the provisions of the Convention. Of special interest in this connection is the case of a resident of a third State having permanent establishments in both Contracting States. The second sentence of paragraph 3 allows the competent authorities of the Contracting States to consult with each other in order to eliminate double taxation that may occur with respect to dealings between the permanent establishments. This could for instance be the case where one or both of the Contracting States have no bilateral tax convention with the third State. Where both Contracting States have a convention with the third State, the combination of these two conventions may, however, allow the competent authorities of all three States to resolve the case by mutual agreement under paragraphs 1, 2 and 3 of Article 25 of these conventions (see paragraphs 38.2 and 38.4 *[of the Commentary on Article 25 of the 2017 OECD Model, as quoted in paragraph 12 above]*). A multilateral agreement between the competent authorities of all involved States is the best way of ensuring that any double taxation can be eliminated.

55.1 There will be Contracting States whose domestic law prevents the Convention from being complemented on points which are not explicitly or at least implicitly dealt with in the Convention. In these situations the Convention could be complemented by a protocol dealing with this issue. The second sentence of paragraph 3 does not, however, allow the Contracting States to eliminate double taxation where the provision of such relief would contravene their respective domestic laws or is not authorised by the provisions of other applicable tax treaties. That sentence only allows the Contracting States, in cases not provided for in the Convention, to consult each other in order to eliminate double taxation in accordance with their respective domestic laws or in accordance with a tax treaty one of the Contracting States has concluded with a third State. Thus, for instance, in the case of an enterprise of a third State having permanent establishments in both Contracting States, the second sentence of paragraph 3 allows the competent authorities of the Contracting States to agree on the facts and circumstances of a case in order to apply their respective domestic tax laws in a coherent manner, in particular with respect to any dealings between those permanent establishments; the Contracting States could provide relief from any double taxation of the profits of such permanent

establishments, however, only to the extent allowed by their respective domestic laws or by the provisions of a tax treaty concluded between a Contracting State and that third State (i.e. applying the provisions of Article 7 and Article 23 of a tax treaty between a Contracting State and the third State). As shown by these examples, paragraph 3 therefore plays a crucial role to allow competent authority consultation to ensure that tax treaties operate in a coordinated and effective manner.

55.2 Under the first sentence of paragraph 3, the competent authorities may agree on a general basis that they shall endeavour to resolve a case presented under paragraph 1 with the competent authority of any third State in circumstances where taxation on income or on capital in that third State is likely to affect or be affected by the resolution of the case. Contracting States that wish to make express provision for multilateral mutual agreement procedures may agree to use the following alternative formulation of paragraph 2:

> 2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Where the resolution of the case may affect or be affected by taxation on income or on capital in any third State, the competent authorities shall endeavour to resolve the case by mutual agreement with the competent authority of any such third State provided there is a tax convention in force between each of the Contracting States and that third State and the competent authority of that third State agrees within the three-year period provided in paragraph 1 to consult with the competent authorities of the Contracting States to resolve the case by mutual agreement. In order to resolve the case, the competent authorities shall take into consideration the relevant provisions of this Convention together with the relevant provisions of the tax conventions between the Contracting States and any third State involved in the procedure. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

Paragraph 4 of Article 25 (Alternatives A and B)

14. This paragraph consists of two sentences, the first of which reproduces the first sentence of paragraph 4 of Article 25 of the OECD

Model, while the second sentence is not contained in that Model. In the first sentence, the words "including through a joint commission consisting of themselves or their representatives" were inserted in 1999 between the words "with each other directly" and "… for the purpose of reaching", so as to bring the provision on a par with that of the corresponding provision in the OECD Model. The second sentence allows the competent authorities to develop bilateral procedures for the implementation of the mutual agreement procedure. Section C below discusses various procedural aspects of the mutual agreement procedure and includes suggestions concerning procedures that could be adopted by the competent authorities. These suggestions are not exhaustive and should be adapted or supplemented based on the experience and circumstances of each country.

15. The Committee considers that the following part of the Commentary on Article 25 of the 2017 OECD Model, which provides explanations on paragraph 4 of the Article, is applicable to the first sentence of paragraph 4 of Article 25 of this Model:

> 56. This paragraph determines how the competent authorities may consult together for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention, and which are referred to in paragraph 3.
>
> 57. It provides first that the competent authorities may communicate with each other directly. It would therefore not be necessary to go through diplomatic channels.
>
> 58. The competent authorities may communicate with each other by letter, facsimile transmission, telephone, direct meetings, or any other convenient means. They may, if they wish, formally establish a joint commission for this purpose.
>
> 59. As to this joint commission, paragraph 4 leaves it to the competent authorities of the Contracting States to determine the number of members and the rules of procedure of this body.
>
> 60. However, whilst the Contracting States may avoid any formalism in this field, it is nevertheless their duty to give taxpayers whose cases are brought before the joint commission under paragraph 2 certain essential guarantees, namely:

— the right to make representations in writing or orally, either in person or through a representative;

— the right to be assisted by counsel.

61. However, disclosure to the taxpayer or his representatives of the papers in the case does not seem to be warranted, in view of the special nature of the procedure.

62. Without infringing upon the freedom of choice enjoyed in principle by the competent authorities in designating their representatives on the joint commission, it would be desirable for them to agree to entrust the chairmanship of each Delegation – which might include one or more representatives of the service responsible for the procedure – to a high official or judge chosen primarily on account of his special experience; it is reasonable to believe, in fact, that the participation of such persons would be likely to facilitate reaching an agreement.

Paragraph 5 of Article 25 (Alternative B)

16. Paragraph 5, which is only found in Alternative B of the Article, provides for mandatory arbitration under which the competent authorities are obliged to submit unresolved issues to arbitration if one of them so requests after they were unable to resolve these issues within a given period of time.

17. This paragraph reproduces paragraph 5 of Article 25 of the OECD Model with four differences. First, the paragraph provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case rather than within two years as provided in the OECD Model. Second, while the OECD Model provides that arbitration must be requested by the person who initiated the case, paragraph 5 of Article 25 Alternative B provides that arbitration must be requested by the competent authority of one of the Contracting States (this means that a case shall not be submitted to arbitration if the competent authorities of both Contracting States consider that such a case is not suitable for arbitration and neither of them make a request). Third, paragraph 5 of Article 25 Alternative B, unlike the corresponding provision of the OECD Model, allows the competent authorities to depart from the arbitration decision if they agree on a different solution

within six months after the decision has been communicated to them. Fourth, while the OECD Model provides that the two-year period begins when all the information required by the competent authorities in order to address the mutual agreement procedure case has been provided, paragraph 5 of Article 25 Alternative B provides that the three-year period begins with the presentation of the mutual agreement procedure case to the competent authority of the State that did not initially receive the case.

18. For different reasons, some States consider that it is not appropriate to commit themselves to proceed to arbitration whenever the competent authority of the other Contracting State so requests. Those States may, however, wish to include in their treaties a voluntary arbitration provision under which both competent authorities must agree, on a case-by-case basis, to submit a case to arbitration before an arbitration procedure will begin. An example of such an additional paragraph could read:

> If the competent authorities are unable to resolve by mutual agreement a case pursuant to paragraph 1, the case may, if both competent authorities and the person who has presented the case pursuant to paragraph 2 agree, be submitted for arbitration, provided any person directly affected by the case agrees in writing to be bound by the decision of the arbitration board. If the competent authorities are unable to resolve by mutual agreement a difficulty or a doubt pursuant to paragraph 3, the difficulty or doubt may also, if both competent authorities agree, be submitted for arbitration. The decision of the arbitration board in a particular case shall be binding on the Contracting States with respect to that case. Where a general difficulty of interpretation or application is submitted to arbitration, the decision of the arbitration board shall be binding on the Contracting States as long as the competent authorities do not agree to modify or rescind the decision. The competent authorities shall by mutual agreement settle the procedures for such an arbitration board.

19. Voluntary arbitration allows greater control over the types of issues that will proceed to arbitration. In certain circumstances, a competent authority may consider it inappropriate to compromise its position with respect to a specific issue and thus inappropriate for

that issue to be submitted to arbitration. Under voluntary arbitration countries preserve great flexibility as to the issues that will be subjected to arbitration and may restrict the potential number of cases that could proceed to arbitration and reduce the potential costs of arbitration.

20. Under voluntary arbitration, however, where the competent authority of one State refuses to depart from its own interpretations of the treaty with respect to specific issues, that competent authority may also refuse to submit those issues to arbitration, with the result that mutual agreement procedure cases involving those issues may remain unresolved. The arbitration of issues on which the competent authorities disagree is essential to ensure that treaty disputes are effectively resolved in a consistent manner in both States. In this respect, arbitration that may be requested by either competent authority gives more certainty that unresolved issues will effectively be submitted for arbitration than voluntary arbitration which needs the agreement of both competent authorities.

21. Some States that decide to include Alternative B in their bilateral treaties may prefer to amend paragraph 5 so that unresolved issues shall be submitted to arbitration at the request of the person who has presented the case pursuant to paragraph 1. In order to do so, those States may replace the terms "any unresolved issues arising from the case shall be submitted to arbitration if either competent authority so requests. The person who has presented the case shall be notified of the request" by the terms "any unresolved issues arising from the case shall be submitted to arbitration if the person so requests".

22. The Committee considers that the following part of the Commentary on paragraph 5 of Article 25 of the 2014[102] OECD Model, together with the Annex to that Commentary (reproduced in the Annex included after paragraph 98 below), are applicable to paragraph 5 of Article 25 Alternative B of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional

102 Reference is made to the 2014 version of the Commentary on paragraph 5 of Article 25 of the OECD Model because the Committee did not examine in detail the large number of changes that were made in 2017 to that Commentary and its Annex.

explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 63. This paragraph provides that, in the cases where the competent authorities are unable to reach an agreement under paragraph 2 within *[three]* years, the unresolved issues will, at the request of *[one of the competent authorities]*, be solved through an arbitration process. This process is not dependent on a prior authorization by *[both]* competent authorities: once the requisite procedural requirements have been met, the unresolved issues that prevent the conclusion of a mutual agreement must be submitted to arbitration. *[A taxpayer may always ask a competent authority to submit the unresolved issues in a case to arbitration. However, the competent authority has no obligation to do so. It has the discretionary power to request arbitration or not in each specific case.]*
>
> 64. The arbitration process provided for by the paragraph is not an alternative or additional recourse: where the competent authorities have reached an agreement that does not leave any unresolved issues as regards the application of the Convention, there are no unresolved issues that can be brought to arbitration even if the person who made the mutual agreement request does not consider that the agreement reached by the competent authorities provides a correct solution to the case. The paragraph is, therefore, an extension of the mutual agreement procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration. Thus, under the paragraph, the resolution of the case continues to be reached through the mutual agreement procedure, whilst the resolution of a particular issue which is preventing agreement in the case is handled through an arbitration process. This distinguishes the process established in paragraph 5 from other forms of commercial or government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.
>
> 65. It is recognised, however, that in some States, national law, policy or administrative considerations may not allow or justify the type of arbitration process provided for in the paragraph. For example, there may be constitutional barriers preventing arbitrators from deciding tax issues. In addition, some countries may only be in a position to include this paragraph in treaties with particular States. For these reasons, the paragraph should only be included in the Convention where each State concludes that the process is capable of effective implementation.

66. In addition, some States may wish to include paragraph 5 but limit its application to a more restricted range of cases. For example, access to arbitration could be restricted to cases involving issues which are primarily factual in nature. It could also be possible to provide that arbitration would always be available for issues arising in certain classes of cases, for example, highly factual cases such as those related to transfer pricing or the question of the existence of a permanent establishment, whilst extending arbitration to other issues on a case-by-case basis.

67. States which are members of the European Union must co-ordinate the scope of paragraph 5 with their obligations under the European Arbitration Convention.

68. *[Paragraph 5 allows the]* arbitration of unresolved issues in all cases dealt with under the mutual agreement procedure that have been presented under paragraph 1 on the basis that the actions of one or both of the Contracting States have resulted for a person in taxation not in accordance with the provisions of this Convention. Where the mutual agreement procedure is not available, for example because of the existence of serious violations involving significant penalties (see paragraph 26 *[of the Commentary on Article 25 of the 2017 OECD Model, as quoted in paragraph 12 above]*) it is clear that paragraph 5 is not applicable.

69. Where two Contracting States that have not included the paragraph in their Convention wish to implement an arbitration process for general application or to deal with a specific case, it is still possible for them to do so by mutual agreement. In that case, the competent authorities can conclude a mutual agreement along the lines of the sample wording presented in the annex, to which they would add the following first paragraph:

1. Where,

   a) under paragraph 1 of Article 25 of the Convention, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

   b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 of the Article within *[three]* years from the presentation of the case to the competent authority of the other Contracting State,

any unresolved issues arising from the case shall be submitted to arbitration in accordance with the following paragraphs if *[either competent authority so requests. The person who has presented the case shall be notified of the request]*. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless *[both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless]* a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, the competent authorities hereby agree to consider themselves bound by the arbitration decision and to resolve the case pursuant to paragraph 2 of Article 25 on the basis of that decision.

This agreement would go on to address the various structural and procedural issues discussed in the annex. Whilst the competent authorities would thus be bound by such process, such agreement would be given as part of the mutual agreement procedure and would therefore only be effective as long as the competent authorities continue to agree to follow that process to solve cases that they have been unable to resolve through the traditional mutual agreement procedure.

70. Paragraph 5 provides that *[either competent authority]* may request that any unresolved issues arising from *[a]* case be submitted to arbitration *[and in that case, that the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 shall be notified of that request. The obligation to notify the person who has presented the case is, however, not a condition for initiating arbitration and the failure to notify such person does not suspend the arbitration process.]* This request may be made at any time after a period of *[three]* years that begins when the case is presented to the competent authority of the other Contracting State. Recourse to arbitration is therefore not automatic; the *[competent authorities]* may prefer to wait beyond the end of the *[three]* year period (for example, to allow *[themselves]* more time to resolve the case under paragraph 2) or simply not to pursue the case. States are free to provide that, in certain circumstances, a longer period of time will be required before the request can be made.

71. Under paragraph 2 of Article 25, the competent authorities must endeavour to resolve a case presented under paragraph 1 with a view to the avoidance of taxation not in accordance with the Convention. For the purposes of paragraph 5, a case should therefore not be considered

to have been resolved as long as there is at least one issue on which the competent authorities disagree and which, according to one of the competent authorities, indicates that there has been taxation not in accordance with the Convention. One of the competent authorities could not, therefore, unilaterally decide that such a case is closed and that *[the other competent authority]* cannot request the arbitration of unresolved issues; similarly, the two competent authorities could not consider that the case has been resolved *[…]* if there are still unresolved issues that prevent them from agreeing that there has not been taxation not in accordance with the Convention. Where, however, the two competent authorities agree that taxation by both States has been in accordance with the Convention, there are no unresolved issues and the case may be considered to have been resolved, even in the case where there might be double taxation that is not addressed by the provisions of the Convention.

72. The arbitration process is only available in cases where the person considers that taxation not in accordance with the provisions of the Convention has actually resulted from the actions of one or both of the Contracting States; it is not available, however, in cases where it is argued that such taxation will eventually result from such actions even if the latter cases may be presented to the competent authorities under paragraph 1 of the Article *[…]*. For that purpose, taxation should be considered to have resulted from the actions of one or both of the Contracting States as soon as, for example, tax has been paid, assessed or otherwise determined or even in cases where the taxpayer is officially notified by the tax authorities that they intend to tax him on a certain element of income.

73. As drafted, paragraph 5 only provides for arbitration of unresolved issues arising from a request made under paragraph 1 of the Article. States wishing to extend the scope of the paragraph to also cover mutual agreement cases arising under paragraph 3 of the Article are free to do so. In some cases, a mutual agreement case may arise from other specific treaty provisions, such as subparagraph 2 *d*) of Article 4. Under that subparagraph, the competent authorities are, in certain cases, required to settle by mutual agreement the question of the status of an individual who is a resident of both Contracting States. As indicated in paragraph 20 of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 10 of the Commentary on Article 4 of this Model]*, such cases must be resolved according to the procedure established in Article 25. If the competent authorities fail to reach an agreement on such a case and this results in taxation not in

accordance with the Convention (according to which the individual should be a resident of only one State for purposes of the Convention), the taxpayer's case comes under paragraph 1 of Article 25 and, therefore, paragraph 5 is applicable.

74. In some States, it may be possible for the competent authorities to deviate from a court decision on a particular issue arising from the case presented to the competent authorities. Those States should therefore be able to omit the second sentence of the paragraph.

75. The presentation of the case to the competent authority of the other State, which is the beginning of the *[three-]*year period referred to in the paragraph, may be made by the person who presented the case to the competent authority of the first State under paragraph 1 of Article 25 (e.g. by presenting the case to the competent authority of the other State at the same time or at a later time) or by the competent authority of the first State, who would contact the competent authority of the other State pursuant to paragraph 2 if it is not itself able to arrive at a satisfactory solution of the case. For the purpose of determining the start of the *[three-]*year period, a case will only be considered to have been presented to the competent authority of the other State if sufficient information has been presented to that competent authority to allow it to decide whether the objection underlying the case appears to be justified. The mutual agreement providing for the mode of application of paragraph 5 (see the Annex) should specify which type of information will normally be sufficient for that purpose.

76. The paragraph also deals with the relationship between the arbitration process and rights to domestic remedies. For the arbitration process to be effective and to avoid the risk of conflicting decisions, *[…]* the arbitration process *[should not be available]* if the *[relevant]* issues *[…]* have already been resolved through the domestic litigation process of either State (which means that any court or administrative tribunal of one of the Contracting States has already rendered a decision that deals with these issues and that applies to that person). This is consistent with the approach adopted by most countries as regards the mutual agreement procedure and according to which:

a) A person cannot pursue simultaneously the mutual agreement procedure and domestic legal remedies. Where domestic legal remedies are still available, the competent authorities will generally either require that the taxpayer agree to the suspension of these remedies or, if the taxpayer does not agree, will delay the mutual agreement procedure until these remedies are exhausted.

b) Where the mutual agreement procedure is first pursued and a mutual agreement has been reached, the taxpayer and other persons directly affected by the case are offered the possibility to reject the agreement and pursue the domestic remedies that had been suspended; conversely, if these persons prefer to have the agreement apply, they will have to renounce the exercise of domestic legal remedies as regards the issues covered by the agreement.

c) Where the domestic legal remedies are first pursued and are exhausted in a State, a person may only pursue the mutual agreement procedure in order to obtain relief of double taxation in the other State. Indeed, once a legal decision has been rendered in a particular case, most countries consider that it is impossible to override that decision through the mutual agreement procedure and would therefore restrict the subsequent application of the mutual agreement procedure to trying to obtain relief in the other State.

The same general principles should be applicable in the case of a mutual agreement procedure that would involve one or more issues submitted to arbitration. It would not be helpful to submit an issue to arbitration if it is known in advance that one of the countries is limited in the response that it could make to the arbitral decision. This, however, would not be the case if the country could, in a mutual agreement procedure, deviate from a court decision (see paragraph 74 *[of the Commentary on Article 25 of the 2014 OECD Model quoted above]*) and in that case paragraph 5 could be adjusted accordingly.

77. A second issue involves the relationship between existing domestic legal remedies and arbitration where the taxpayer has not undertaken (or has not exhausted) these legal remedies. In that case, the approach that would be the most consistent with the basic structure of the mutual agreement procedure would be to apply the same general principles when arbitration is involved. Thus, the legal remedies would be suspended pending the outcome of the mutual agreement procedure involving the arbitration of the issues that the competent authorities are unable to resolve and a tentative mutual agreement would be reached on the basis of that decision. As in other mutual agreement procedure cases, that agreement would then be presented to the taxpayer who would have to choose to accept the agreement, which would require abandoning any remaining domestic legal remedies, or reject the agreement to pursue these remedies.

78. This approach is in line with the nature of the arbitration process set out in paragraph 5. The purpose of that process is to allow the competent authorities to reach a conclusion on the unresolved issues that prevent an agreement from being reached. When that agreement is achieved though the aid of arbitration, the essential character of the mutual agreement remains the same.

79. In some cases, this approach will mean that the parties will have to expend time and resources in an arbitration process that will lead to a mutual agreement that will not be accepted by the taxpayer. As a practical matter, however, experience shows that there are very few cases where the taxpayer rejects a mutual agreement to resort to domestic legal remedies. Also, in these rare cases, one would expect the domestic courts or administrative tribunals to take note of the fact that the taxpayer had been offered an administrative solution to his case that would have bound both States.

80. In some States, unresolved issues between competent authorities may only be submitted to arbitration if domestic legal remedies are no longer available. In order to implement an arbitration approach, these States could consider the alternative approach of requiring a person to waive the right to pursue domestic legal remedies before arbitration can take place. This could be done by replacing the second sentence of the paragraph by "these unresolved issues shall not, however, be submitted to arbitration if any person directly affected by the case is still entitled, under the domestic law of either State, to have courts or administrative tribunals of that State decide these issues or if a decision on these issues has already been rendered by such a court or administrative tribunal." To avoid a situation where a taxpayer would be required to waive domestic legal remedies without any assurance as to the outcome of the case, it would then be important to also modify the paragraph to include a mechanism that would guarantee, for example, that double taxation would in fact be relieved. Also, since the taxpayer would then renounce the right to be heard by domestic courts, the paragraph should also be modified to ensure that sufficient legal safeguards are granted to the taxpayer as regards his participation in the arbitration process to meet the requirements that may exist under domestic law for such a renunciation to be acceptable under the applicable legal system (e.g. in some countries, such renunciation might not be effective if the person were not guaranteed the right to be heard orally during the arbitration).

81. Paragraph 5 provides that, *[unless both competent authorities agree on a different solution within six months after the decision has been*

communicated to them or] unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both States. Thus, the taxation of any person directly affected by the case will have to conform with the decision reached on the issues submitted to arbitration and the decisions reached in the arbitral process will be reflected in the mutual agreement that will be presented to these persons.

82. As noted in subparagraph 76 *b*) *[of the Commentary on Article 25 of the 2014 OECD Model quoted above]*, where a mutual agreement is reached before domestic legal remedies have been exhausted, it is normal for the competent authorities to require, as a condition for the application of the agreement, that the persons affected renounce the exercise of domestic legal remedies that may still exist as regards the issues covered by the agreement. Without such renunciation, a subsequent court decision could indeed prevent the competent authorities from applying the agreement. Thus, for the purpose of paragraph 5, if a person to whom the mutual agreement that implements the arbitration decision has been presented does not agree to renounce the exercise of domestic legal remedies, that person must be considered not to have accepted that agreement.

83. The arbitration decision is only binding with respect to the specific issues submitted to arbitration. Whilst nothing would prevent the competent authorities from solving other similar cases (including cases involving the same persons but different taxable periods) on the basis of the decision, there is no obligation to do so and each State therefore has the right to adopt a different approach to deal with these other cases.

[…]

85. The last sentence of the paragraph leaves the mode of application of the arbitration process to be settled by mutual agreement. Some aspects could also be covered in the Article itself, a protocol or through an exchange of diplomatic notes. Whatever form the agreement takes, it should set out the structural and procedural rules to be followed in applying the paragraph, taking into account the paragraph's requirement that the arbitration decision be binding on both States. Ideally, that agreement should be drafted at the same time as the Convention so as to be signed, and to apply, immediately after the paragraph becomes effective. Also, since the agreement will provide the details of the process to be followed to bring unresolved issues to arbitration, it would be important that this agreement be made public.

A sample form of such agreement is provided in the Annex together with comments on the procedural rules that it puts forward.

23. As regards paragraph 83 of the Commentary on Article 25 of the 2014 OECD Model quoted in paragraph 22 above, it should be kept in mind that paragraph 5 of Article 25 Alternative B of the UN Model allows the competent authorities to agree on a solution that is different from the solution adopted in the arbitration decision provided they do so within six months after the arbitration decision has been communicated to them. The arbitration decision is consequently not binding if both competent authorities consider that the decision is not appropriate and are able to agree on a different solution within the stated period. By contrast, a subsequent mutual agreement differing from the arbitration decision is not allowed under paragraph 5 of Article 25 of the OECD Model but is allowed under Article 12 of the EU Arbitration Convention.

24. At any time after arbitration has been requested pursuant to paragraph 5 and before the arbitrators have communicated a decision to the competent authorities, the competent authorities may agree on a resolution of the unresolved issues that led to arbitration. If so, the case shall be considered as resolved under the mutual agreement procedure and no arbitration decision shall be provided. The competent authorities are however not allowed to put an end to the arbitration process without having resolved the case. Otherwise, the certainty attached to the arbitration process would be undermined (e.g. the person who has presented the case pursuant to paragraph 1 could have renounced to judicial recourses because the case has been submitted to arbitration).

Paragraph 5 of Article 25 (Alternative A) and paragraph 6 of Article 25 (Alternative B)

25. In some rare cases, a dispute between countries concerning the application of the national treatment rule of Article XVII of the General Agreement on Trade in Services (GATS) to taxes covered by a tax treaty could lead to both the mutual agreement procedure and the dispute resolution mechanism of the GATS being applicable to address the issue.

26. The negotiation of the GATS raised concerns that certain tax measures that differentiated based on taxpayer residency could breach the national treatment obligation contained in Article XVII of the GATS.

To remedy potential conflicts, Article XIV of the GATS allows measures that diverge from the national treatment provision if such differences aim to ensure "equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members". A specific footnote to Article XIV provides examples of measures that meet the "equitable or effective" criterion.

27. Additionally, Article XXII, paragraph 3, of the GATS stipulates that a Member cannot invoke Article XVII, under the dispute resolution mechanisms provided by Articles XXII and XXIII, in relation to a measure falling within the scope of a bilateral double taxation agreement. Should there be a dispute over whether a measure falls within the scope of such an agreement, either Member may seek resolution of the dispute through the Council for Trade in Services, which shall refer the matter to arbitration. Notably, a footnote to paragraph 3 of Article XXII indicates that for double taxation agreements in existence as of the date of entry into force of the GATS – January 1, 1995 – this recourse to the Council for Trade in Services is only available with both parties' consent.

28. Article XXII, paragraph 3, of the GATS and its related footnote introduced two critical issues concerning tax treaties. First, the different treatment of tax agreements established before and after the GATS entry into force could be seen as inappropriate, in particular where a convention in existence at the time of the entry into force of the GATS is subsequently renegotiated or where a protocol is concluded after that time in relation to a convention existing at that time. Second, the term "falls within the scope" of a tax Convention, can be difficult to apply in practice, which may lead to disputes, as indicated by the inclusion in paragraph 3 of Article XXII of the GATS of both an arbitration procedure to deal with such disputes and a clause exempting pre-existing conventions from the application of that arbitration procedure.

29. To mitigate these complications, the Commentary on Article 25 of this Model (from 2001 – quoting the OECD Model discussion first seen in the equivalent Commentary from 1995) proposed an optional provision with the aim of extending the grandfathering protection of pre-1995 treaties, provided for in the footnote to paragraph 3 of Article XXII of the GATS, to those tax conventions concluded or modified after the GATS came into effect. The proposed provision was the same in both Models:

> For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States.

30. Accordingly, under this provision, disputes about the scope of a Convention would require mutual consent for referral to the WTO Council for Trade in Services. This approach was endorsed in the Commentary on Article 25 of this Model, from 2001 until the 2025 version.

31. In 2025, the Committee decided to amend Article 25 to include in the text of Article 25 itself the provision referred to in the preceding paragraph, with no substantive amendments. It is paragraph 5 in Alternative A of Article 25 and paragraph 6 of Alternative B. In making this change, the Committee recognized the need for a clear, consistent framework to address potential issues arising from the interaction between tax treaties and the GATS. The inclusion of the GATS clause in the Article itself was in response to concerns that providing the text of the GATS provision in the Commentary alone did not sufficiently promote solution of the identified potential issues.

32. In making this change, the Committee noted that this provision had not been included in tax treaties to the extent that might have been expected. In the view of the Committee, integrating the GATS provision into the text would raise the profile of a solution already provided in both the UN and OECD Models. The Committee considered that the provision's presence in the Article itself would encourage not only discussion of the treaty interaction issue, before and during treaty negotiations, but also wider adoption across jurisdictions, recognizing the importance of the UN Model in tax treaty negotiations, especially for developing countries. In light of these considerations, the Committee deemed it prudent to elevate the GATS provision, establishing it as a standard element of the text of Article 25. It is important to note,

however, that the supporting reasons for such a provision in the UN Model and OECD Model Commentaries are essentially the same, despite being stated differently.

Paragraph 6 of Article 25 (Alternative A) and Paragraph 7 of Article 25 (Alternative B)

General Considerations

33. Previous versions of UN and OECD Model Commentaries on Article 25, noted that issues similar to those discussed above in relation to the GATS may arise in relation to other bilateral or multilateral agreements related to trade or investment and that Contracting States may, in the course of their bilateral negotiations, amend the provision suggested above "so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure rather than through the dispute settlement mechanisms of such agreements."

34. However, the GATS provision is a provision directed towards specific aspects of the interaction of the GATS and Double Tax Conventions: As a limited coordination provision directed towards GATS-specific purposes, the GATS provision is not a model provision that could be readily adapted, as respects a wider range of bilateral or multilateral investment agreements, to the broader purposes, which underlie paragraph 6 of Alternative A, and paragraph 7 of Alternative B, of Article 25 of this Model (the *extended provision*), of ensuring the primacy of double taxation conventions and domestic tribunals and courts in relation to tax disputes.

35. Accordingly, while the UN and OECD Model Commentaries have long indicated that the GATS provision could be a basis for provisions of wider application, the Committee's discussions leading to the development of the extended provision focused instead on a significant number of actual bilateral provisions of wider scope. These provisions were in treaties between Contracting States that included developed and developing countries. Therefore, rather than looking to the long-standing GATS provision, it was from considering more recent actual provisions, which were substantially broader in scope than the GATS provision, that the elements of the model extended provision were

derived: The extended provision has been developed by the Committee taking account of actual in-force provisions that are substantially wider in scope than the GATS provision.

36. On foot of that work, in 2025 the Committee decided to include a specific clause in Article 25 to address the relationship of tax treaties to a wider range of bilateral or multilateral agreements related to trade or investment. This model clause comprises paragraph 6 of Article 25 (Alternative A) and paragraph 7 of Article 25 (Alternative B). Adoption in bilateral tax Conventions of the specific model provision, which addresses interactions of tax treaty-related measures and other tax measures with a wider range of agreements, will enable greater uniformity in those interactions.

37. With that background, the purpose of this paragraph ("the extended provision") is to ensure that tax disputes, whether or not they relate to a Double Taxation Convention, do not become subject to a dispute resolution procedure under an International Investment Agreement (IIA) – being, for the purposes of this Commentary, an investment agreement or other treaty that, in whole or part, addresses international investment. Under the extended provision, where a dispute could be settled by reference to the provisions of the Convention, it must be settled solely by reference to the provisions of that Convention and without recourse to dispute resolution arrangements under any other treaty.

38. It is important, for an accurate understanding of the extended provision, to note that, unlike what was envisaged for provisions adapted from the GATS provision (see text quoted at paragraph 29 above), such settlement "by reference to the provisions of the Convention" need not be under MAP or arbitration provisions set out in Article 25: A determination by a Court or Administrative Tribunal by reference to any provisions of the Convention concerned would equally be a settlement "by reference to the provisions of the Convention." Although the extended provision has been added to the Model Convention in Article 25, its main purposes are, first, to prescribe an appropriate interaction between, on one hand, IIAs and their dispute resolution arrangements, and, on the other hand, tax measures that are in accordance with the tax Convention concerned and, second, to limit recourse to IIA dispute resolution arrangements for disputes about tax measures that

do not involve the tax Convention. Consistent with these purposes, the extended provision gives no priority to MAPs or arbitration as a means of dispute settlement over other means, such as recourse to domestic administrative tribunals or courts. Consistent with those purposes also, specific terms used in the extended provision have not been aligned with terms used in other provisions of Article 25.

39. In the case of a dispute that does not relate to the Convention concerned (i.e. "any other dispute in relation to a tax measure" in the words of the extended provision), it is to be settled without recourse to dispute resolution arrangements under the IIAs identified in the extended provision. This exclusion of recourse to such dispute resolution arrangements applies unless both competent authorities agree that such arrangements may be used, that is, the exclusion of recourse to such arrangements will continue to apply if one of the competent authorities concerned has not agreed to such arrangements being used.

40. Some Contracting Parties may regard their agreement to include the extended provision in a tax convention as rendering a specific GATS clause unnecessary: Such Contracting Parties may omit the specific GATS clause from their convention that includes the extended provision. However, others may prefer to follow the established wording in relation to GATS in so far as, unlike the extended provision, it could, with the agreement of both Competent Authorities, provide access to the Council for Trade in Services for disputes that relate to the tax convention concerned. Accordingly, where the GATS provision and the extended provision are both included in a convention, as is done in Article 25 of this Model, the GATS provision is expressed as applying 'notwithstanding' the extended provision: "Notwithstanding paragraph [6/7], for the purposes of paragraph 3 of Article XXII . . . ".

41. A medium-sized minority of the members of the Committee did not agree with the arguments put forth in justifying the introduction of the "extended provision".[103]

42. Those members do not consider that the problems identified in relation to GATS are similar to issues that may arise in relation to

103 The decision to include that minority view in the Commentary was taken at the thirtieth session of the Committee held in March 2025.

other bilateral or multilateral agreements related to trade or investment. The "GATS provision" (paragraph 5 in Alternative A and paragraph 6 in Alternative B), is a coordinating provision ensuring that potential issues arising from the interaction between tax treaties and the GATS are addressed; that is, for the purposes of paragraph 3 of Article XXII (Consultations) of the GATS, a dispute as to whether a measure falls within the scope of a tax treaty may be brought before the Council for Trade in Services, only with the consent of both Contracting States. In contrast, in the view of those members, the "extended provision" (paragraph 6 in Alternative A and paragraph 7 in Alternative B) is an override provision, not a coordinating provision. The first sentence of the "extended provision" overrides the substantive standards of protection and the dispute settlement provisions in an IIA. The second sentence of the "extended provision" overrides the dispute settlement provisions in an IIA, effectively limiting the investor's recourse for a tax-related trade or investment dispute to the competent authority process under Article 25, if applicable, or the domestic courts of the host state. In addition, if Article 25 of the Convention does not include an arbitration provision, investors face the risk that the competent authorities will agree to disagree, with the result that there is no effective resolution for the investor.

43. Further, those members note that the "extended provision" impacts all taxes, not only taxes covered by the Convention as referred to in paragraph 33 above. Those members do not agree that taxation measures falling outside the scope of the Convention are best dealt with in the "applicable tax environment" rather than in the "investment agreement environment". First, most countries do not have tax specialist courts, and some that do would not have the jurisdiction to hear a tax-related investment or trade agreement dispute. Second, a dispute that falls outside the scope of the Convention and is based on a standard of protection under an IIA is arguably more related to the investment environment than to the tax environment.

44. Those members were also concerned that the "extended provision" could frustrate the whole-of-government approach adopted in the guidance document "Addressing the Issue of Taxation in International Investment Agreements: Guidance for Tax and Investment Officials for the Implementation of an Integrated Approach", approved by the Committee at its 29th session (attachment A to E/C.18/2024/CRP.23).

To ensure that a whole-of-government approach is respected, it would be important for tax officials to have in-depth discussions with investment officials regarding both the GATS provision and the "extended provision" and to develop a common view as to how tax measures should be addressed in IIAs. Those members are of the view that if government policy has changed since the conclusion of an IIA, it would be preferable to renegotiate the IIA directly rather than indirectly overriding certain aspects of the IIA in a tax treaty. IIAs and tax treaties both serve the purpose of facilitating cross-border trade and investment. IIAs and tax treaties govern different subject matters and use different tools to promote that purpose. Tax treaties primarily achieve this by allocating taxing rights between the parties with a view to eliminating double taxation. IIAs set out rights and obligations for the contracting states and for investors and their investments in the wider regulatory framework with a view to encouraging cross-border investment by ensuring access to the market by aiming for equal treatment of domestic and foreign investors. In addition, those members were of the view that directly amending the IIA, rather than introducing the "extended provision", would provide more certainty and transparency for taxpayers and investors. It would also avoid the possibility of an investor making a claim under an IIA and the claim proceeding to an arbitration panel because one or more of the parties is unaware of the existence of the "extended provision" (and the IIA makes no reference to such provision) or an arbitration panel does not agree that the "extended provision" effectively negates the dispute settlement provisions under the IIA.

45. Further, those members of the Committee that did not agree with the inclusion of the "extended provision", noted the complexity of international law in relation to successive treaties and conflicts and the uncertainty that could be introduced. They noted that the concern is more acute if, in accordance with paragraph 68 below, the "extended provision" covers not only specifically listed IIAs but also any other future treaty. As in the above paragraph, and assuming the country adopts a whole-of-government approach, explicitly dealing with tax measures in the IIA would provide more certainty and transparency for taxpayers and investors.

46. Those members of the Committee that did not agree with the inclusion of the "extended provision", were also concerned that several terms, such as "taxation measure" and "whether a taxation measure

taken by a Contracting State is in accordance with this Convention", used in the Article were not adequately defined in the Article itself. Further, the terminology used in the "extended provision" is not consistent with the terms otherwise used in Article 25 such as "actions" of a contracting state resulting in "taxation not in accordance with the provisions of the convention, "a case", and "endeavour…to resolve". Those members were therefore concerned that the application of the Article would result in increased uncertainty and disputes.

47. As a matter of broader economic policy, those members that opposed the inclusion of the "extended provision" were concerned that, as a result of the "extended provision", foreign investment may be reduced or discouraged given the override of the IIA and the resulting restriction on the recourses available to an investor to enforce the investment protection rights granted to them under an IIA.

48. Those members were of the view that countries sharing the above concerns may wish not to include the extended provision in their bilateral tax treaties. In addition to omitting the extended provision, such countries should, consequently, substitute "For" for "Notwithstanding paragraph [6/7], for" at the start of the GATS provision.

49. The extended provision comprises two sentences, each of which has its own separate focus: The first sentence sets out that, as respects disputes about tax measures that concern the scope and correct application of the Convention, such disputes are to be settled solely ("only") by reference to the provisions of that Convention and without recourse to dispute settlement arrangements under other treaties. The second sentence then restricts recourse to dispute settlement arrangements under IIAs as respects all other disputes about tax measures.

50. While "taxation measure" is a core term used in both the first and second sentences of the extended provision, it is not defined. In IIAs, the term "measure" is frequently used without reference to taxation, as well as in references to "taxation measures". It is often left undefined in IIAs or else defined very broadly, but not exhaustively, such as by providing that "a 'measure' includes any law, regulation, procedure, requirement, or practice". The term is used in the extended provision to represent the area of likely overlap between an IIA and the tax Convention concerned (first sentence) or between an IIA and taxation outside the scope of the

tax Convention (second sentence). Where the relevant term used in investment agreements between the two parties to a tax Convention is different, or if some form of definition would be seen as helpful, these matters could be addressed in the Convention concerned or its explanatory material.

First sentence of the extended provision

51. The first part of the first sentence provides that to the extent that a taxation measure taken by a Contracting State is in accordance with the bilateral Convention concerned, the measure will be deemed not to breach any other treaty of which the Contracting States are parties:

— If a tax-related measure that is taken by the State is in accordance with the tax Convention relevant to the investor making a claim, then the first sentence of the extended provision excludes any possibility that it could, nevertheless, be construed as contravening or breaching any provision of an IIA.

— To be "in accordance with" a Convention, a measure must, first, be a tax measure and, second, fall within the scope of the Convention concerned. It must, therefore, involve a tax covered by Article 2 of the Convention or, where relevant, covered by paragraph 6 of Article 24 or paragraph 1 of Article 26 ("taxes of every kind and description"). Accordingly, the scope of "taxation measures" encompassed by this first sentence will, as respects the type of tax involved, be determined by the relevant provisions of the Convention concerned. A tax measure that is the subject of a dispute will only be within the scope of a tax Convention if provisions of that Convention address such a tax measure or dispute. Where the tax Convention does not address such a tax measure or dispute, the tax measure cannot be within the scope of, or in accordance with, the tax Convention.

— By providing that there can be no breach of an IIA if the tax measure concerned is in accordance with the provisions of the Convention, the first sentence of the extended provision will, in effect, require all claims under IIAs to be channelled into a consideration of whether the measure concerned is in accordance with the Convention (which, as set out above, will include the initial steps of considering whether the measure is

a tax measure and, if so, whether it falls within scope of the tax Convention concerned).

52. Accordingly, providing that a tax measure is deemed not to breach an IIA if that measure is aligned with the tax Convention concerned ensures that consideration under the Convention is a mandatory requirement for all investor claims in respect of tax measures – and this creates the context for what is set out in the second half of the first sentence.

53. The second part of the first sentence provides that every dispute about whether a measure is aligned with a Convention, or within the scope of the Convention, must be determined or settled solely ("only") by reference to the provisions of that Convention. Settlement by reference to the provisions of the Convention could, but need not, be through a procedure under Article 25: The requirement or constraint set out is not settlement by reference to the provisions of Article 25; the requirement is settlement by reference to the provisions of the Convention. In many cases, such settlement would be a determination, by reference to the provisions of the Convention, by the Courts of the Contracting State whose measure is alleged not to be in accordance with, or within the scope of, the Convention concerned. Accordingly, where the Contracting States adopt the extended provision in a Double Taxation Convention, the prospect of final settlement of disputes in relation to tax measures will not be dependent on the inclusion of an arbitration provision in that Convention.

54. In addition to the requirement that every dispute about whether a measure is in accordance with the Taxation Convention concerned, or within the scope of that Convention, must be determined or settled solely by reference to the provisions of the Convention, the first sentence of the extended provision prohibits, without qualification, recourse to dispute settlement arrangements under any other treaty of which the Contracting States are parties. This is to prevent any interpretation or application of this first sentence as permitting dispute settlement under such arrangements so long as the sole provisions taken into account in settling the dispute under such arrangements are provisions of the Convention.

55. Accordingly, disputes within the scope of the Convention will be determined, firstly, solely by reference to the provisions of the Convention

and, secondly, without recourse to dispute resolution arrangements under any other treaty. Further, in the case of first-sentence disputes, the competent authorities have no discretionary power whatsoever to allow recourse to dispute resolution arrangements under any other treaty.

56. It should be noted that, in the case of disputes within the scope of the Tax Convention concerned ("first-sentence disputes") it is not just the procedural provisions for dispute settlement under IIAs that are inapplicable: No substantive provision of any IIA may be considered in a first-sentence dispute, since such a dispute must be decided solely by reference to the provisions of the tax Convention concerned.

57. The first sentence of the extended provision may be negatively characterized as overriding protections under IIAs. However, a focus, on the non-application of IIA-related, substantive and procedural, provisions as respects disputes in relation to tax measures, ignores the clear delineation and purpose of the first sentence of the extended provision, in so far as it disapplies such IIA provisions if, and only if, the tax measure in dispute can be shown to be in accordance with the provisions of the Double Taxation Convention entered into by the Contracting States concerned, which are provisions that set out the intentions of those States as respects the tax matters within the scope of those provisions. Instead of characterizing the first sentence of the extended provision as overriding IIAs, it is more accurately and appropriately viewed as a carefully circumscribed provision that upholds the operation of the tax Convention, where the facts and circumstances of a case involve the intended tax outcomes by reference to that Convention.

Second sentence of the extended provision

58. The second sentence of the extended provision addresses "any other dispute over a taxation measure, or as to whether a measure is a taxation measure". Such other disputes are disputes that do not relate to the first-sentence issues of whether the tax measure falls within the scope of a Convention and whether it is in accordance with that Convention. Disputes over taxation measures could fall outside the scope of the relevant Convention for various reasons, including the following (as possible examples only):

— The Convention could be silent in relation to the alleged IIA breach, in the sense that the Convention Articles might include no provision on the basis of which the disputed claim could be determined – for instance, a claim that a generally applicable increase in a tax rate represents an expropriation.
— The disputed claim could involve an indirect tax, in a context in which the Convention does not apply to indirect taxes.
— A dispute in relation to administrative actions that are the subject of a claim might not come within the scope of the Convention.

59. If, as respects any dispute over a taxation measure, it could not be settled by reference to the provisions of the relevant Convention then, unless both competent authorities agree otherwise, the second sentence prohibits a claimant from recourse to dispute resolution arrangements under other treaties. The purpose of the second sentence is to prevent the involvement of such arrangements in the settlement of disputes in relation to tax measures, where such disputes are outside the scope of the Convention. The underlying approach is that even those disputes that relate to taxation measures falling outside the scope of the Convention concerned are best dealt with in the applicable tax environment rather than in the investment agreement environment.

60. Having so provided, the second sentence goes no further to limit the modes of settlement of such disputes. The investor may bring its case to the relevant courts, claiming a breach of the IIA concerned, or to any tribunal seized with such matters – but not to any dispute settlement arrangements provided under an IIA.

61. It should be noted that the prohibition or exclusion refers only to the dispute settlement arrangements under an IIA. The restriction or exclusion does not extend to the substantive provisions of an IIA – and an investor will remain entitled to invoke the protections set out in such provisions in making its claim to the Courts. Accordingly, while the second sentence disapplies IIA procedural provisions, the substantive IIA provisions are unaffected by this second leg of the extended provision.

62. In the case of disputes that cannot be settled under the Convention (second-sentence disputes), the competent authorities have discretion to allow recourse to the IIA dispute settlement arrangements – but only

if both competent authorities agree to permit such recourse. In the absence of the agreement of one competent authority, the exclusion of recourse to such dispute settlement arrangements will continue to apply in relation to the dispute in question.[104] In that case, the prohibition of such recourse would be the intended result of the extended provision agreed by the Contracting States.

63. The second sentence also recognizes the possibility of a dispute about whether a measure is a tax measure. An example would be where the tax elements of a measure might not be readily separated from significant non-tax elements of a State action: A claimant might wish to dispute the identification of the measure as a tax measure and, if there were no specific reference to such disputes in the provision, an IIA dispute settlement panel could effectively disapply the whole provision by determining that the measure was not a tax measure. However, under the extended provision, such a dispute cannot be brought to an IIA dispute settlement panel unless both competent authorities are agreeable to involving the panel in the settlement of the dispute.

64. The provision is to operate with a targeted, specific, coverage, as respects the other international treaties concerned. This targeted approach identifies relevant existing bilateral or multilateral treaties, access to the dispute settlement arrangements of which would be restricted under the extended provision. The treaties concerned would be identified by the Contracting States.

65. The adoption of the extended provision in a tax Convention will align with general whole-of-government approaches to IIAs in those countries where the whole-of-government approach assigns primacy to Double Taxation Conventions and to domestic tribunals and courts in relation to tax disputes. In addition, the identification of specific bilateral and multilateral treaties in the second sentence of the extended provision enables the scope of the disapplication of IIA dispute settlement arrangements by that sentence, as respects the

104 The requirement, of agreement by both competent authorities if discretionary access to a dispute settlement arrangement under an IIA is to be allowed, is the same as for the exercise of a similar discretion under the GATS provision (see paragraphs 29 and 30 above), although the relevant matters in dispute would be different.

treaties identified, to be agreed so as to recognize and complement the prior inclusion of comprehensive tax carve-outs in, or their absence from, such treaties. As respects both the general approach to the interaction of tax Conventions and IIAs and the specific identification of particular interactions, the coherence and alignment of the respective policies will be enhanced by arrangements to ensure timely and effective communication between the tax arm and the trade and investment arm of government policymaking.

66. On the agreement of an actual bilateral tax Convention, the italicized brackets and text of the Model Tax Convention would be replaced by the agreed identification of the treaties concerned, which, on a straightforward approach, could be the inclusion of the full titles of the identified treaties.

67. The Contracting States may negotiate a new IIA after they have entered into the tax Convention and wish the tax Convention to continue to have primacy in disputes concerning tax measures. In such circumstances, the Contracting States may either arrange for appropriate tax carve-outs from the IIA concerned or, alternatively, for the agreement of a Protocol to add the new IIA to the treaties specified in paragraph 6 of Alternative A, or paragraph 7 of Alternative B, of Article 25 of the tax convention.

68. While the second sentence of the Model Tax Convention's extended provision included in Article 25 only applies to the IIAs identified in bilateral negotiations, some Contracting States may prefer a very broad application of the prohibition of recourse to dispute settlement arrangements under IIAs that would extend to explicitly covering treaties entered into subsequently to the agreement of the extended provision in the tax Convention concerned. In that case the extended provision could be stated to exclude recourse to such arrangements under –

> "any other treaty of which the Contracting States are, or become, parties."

Any "other treaty" would be any treaty, such as bilateral or multilateral treaties, other than the Convention concerned. Such a broad coverage expressed in general terms would, of course, only be possible with the agreement in principle of both Contracting States concerned. Where

the Contracting States adopt this very broad approach in the second sentence of the extended provision, they may also wish to consider replacing one or both instances of the phrase "any other treaty of which the Contracting States are parties" in the first sentence with the following words –

> "any other treaty of which the Contracting States are, or become, parties."

69. Where the approach set out in paragraph 68 above is adopted and the provision is intended to operate in relation to treaties later in time than the tax Convention, care should be taken (drawing upon relevant government expertise) to make sure that such an intention is clear and will be effective in practice, as treaty practice might otherwise defer to the later treaty.[105] Nevertheless, this approach of giving the tax agreement precedence over IIAs that are later in time would *prima facie* be effective in applying to subsequent IIAs. However, it is important to note that the Contracting States would not be bound by such a provision as to what they could agree in subsequent treaties: they could, at that later time, provide that, notwithstanding the provisions of the tax Convention, the subsequent IIA would prevail.

70. Whether the extended provision text agreed between Contracting States is the text in the Model Article 25 or follows the paragraph 68 approach above, provisions of a separate treaty or other legal instrument that do not directly amend the Tax Convention concerned but, instead, apply alongside the Convention and modify its effect, could be inappropriately treated as provisions of "any other treaty", in the words of the extended provision. This would be contrary to the intention of the Contracting States that the Convention concerned should be construed together with the applicable provisions of that separate treaty

105 The Committee noted that countries considering using the approach set out at paragraph 68 should carefully evaluate the issues that could arise in relation to its interaction with their specific network of bilateral and multilateral agreements, whether with respect to international law, constitutional or other legal considerations. This, including consultation with other relevant departments or ministries, would be important for avoiding misunderstandings and inconsistencies and for ensuring the effectiveness over time of any such provisions.

or instrument. Where this consideration is relevant[106] for Contracting States that propose to include the extended provision in their bilateral tax treaty, they may wish to include a third sentence in the extended provision as follows:

> "In this paragraph, references to this Convention shall be construed as including references to such provisions of any other convention or instrument as modify this Convention and references to 'any other treaty' shall be deemed not to refer to those provisions."

C. Additional procedural issues related to the mutual agreement procedure

71. The last sentence of paragraph 4 of Article 25 (Alternatives A and B) allows the competent authorities to develop bilateral procedures for the implementation of the mutual agreement procedure. The following paragraphs discuss various procedural aspects of the mutual agreement procedure and include suggestions concerning procedures that could be adopted by the competent authorities. These suggestions are not exhaustive and should be adapted or supplemented based on the experience and circumstances of each country.

(a) Aspects of the mutual agreement procedure that should be dealt with

72. The procedural arrangements for mutual agreements in general should be suitable to the number and types of issues expected to be dealt

106 For example, this would be relevant where both Contracting States are Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and their Double Taxation Convention is a "covered tax agreement" for the purposes of the MLI. In such cases, the Contracting States may wish to refer specifically to the MLI in the third sentence of paragraph 6/7, as follows:

> "In this paragraph, references to this Convention shall be construed as including references to such provisions of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting as modify this Convention and references to 'any other treaty' shall be deemed not to refer to those provisions."

with by the competent authorities and to the administrative capability and resources of those authorities. The arrangements should not be rigidly structured but instead should embody the degree of flexibility required to facilitate consultation and agreement rather than hinder them by elaborate procedural requirements and mechanisms. But even relatively simple procedural arrangements must incorporate certain minimum rules that inform taxpayers of their essential rights and obligations under the mutual agreement procedure. Such minimum rules would appear to involve such questions as:

— at what stage in a tax matter a taxpayer can invoke action by the competent authority under the mutual agreement procedure;

— whether any particular form must be followed by a taxpayer in invoking action by the competent authority;

— whether any time limits are applicable to a taxpayer's invocation of action by the competent authority;

— if a taxpayer invokes action by the competent authority, whether the taxpayer is bound by the decision of the competent authorities and whether the taxpayer must waive recourse to other administrative or judicial processes as a condition for the implementation of a proposed mutual agreement reached by the competent authorities;

— in what manner, if at all, a taxpayer can participate in the competent authority proceedings and what requirements regarding the furnishing of information by a taxpayer are involved.

(b) Necessary cooperation of the person who makes the request

73. The successful outcome of the mutual agreement procedure depends to a large extent on the full cooperation of the person who made the request. That person must, in particular, help the competent authorities to establish the facts on which the case is based. That requires the person to make a full and accurate disclosure of all relevant facts and supporting evidence known to that person. Where, in particular, transactions have been carried on in the other Contracting State, the person who made the request must provide the relevant documents establishing the conditions of these transactions and supply complete information on the facts and circumstances of these transactions.

74. The competent authority may, in particular, require that the person making the request provide the following as early as possible:

- a description of the general background for the case, which would include a description of the business activities of the relevant persons as well as a description of the contracts and arrangements that provide that general background, such as a shareholders' agreement, a partnership agreement, a licence agreement or a project agreement;
- the details of the situation that allegedly resulted or will result in taxation that is not in accordance with the provisions of the Convention, which could include, for example, the details of transactions or events (e.g. a payment or the delivery of a good or service) that were characterised in a certain way by the tax administration of the other Contracting State, supported by all the relevant documentation and, especially, the documents that have been presented to the tax administration of the other Contracting State;
- the amounts of income and tax involved (or an estimate thereof);
- the relevant financial statements of the person(s) involved in the transactions or activities at issue;
- a description of the relevant taxation years or periods affected by the case (in each State, where these are different);
- a description of the procedural status of the case in the other Contracting State, for example, whether a tax audit report has been produced, a tax assessment received, an appeal filed or litigation undertaken; and
- a reference to the relevant provisions of the applicable tax treaty and the analysis supporting the claim that there is or will be taxation not in accordance with these provisions (when available, the legal analysis of the tax authorities of the other Contracting State should also be provided).

75. It may be more difficult to obtain some of the above information when the relevant transactions involve third parties which are not associated enterprises of the person making the request. In addition, certain information might not be available at the time the request is made. The information provided at the initial stage should, however, be sufficient to allow the competent authority to which the case is presented

to determine whether the objection is justified. A competent authority would not in any case be able to initiate a mutual agreement procedure where the person making the request provides insufficient or inadequate information.

76. The mutual agreement procedure under paragraph 1 of Article 25 is only available in cases where a person considers that the actions of one or both States result or will result in taxation that is not in accordance with the provisions of the Convention. There may be cases where double taxation will arise because a taxpayer has failed to observe procedural rules (e.g. the expiry of time limits) without there being any taxation contrary to the provisions of the Convention; in those cases, that mutual agreement procedure will not be available.

(c) Information on adjustments

77. The competent authorities should decide on the extent of the information to be provided on adjustments involving income allocation and the time when it is to be given by one competent authority to the other. Thus, the information could cover adjustments proposed or finalized by the tax administration of one country, the related entities involved and the general nature of the adjustments.

78. Generally speaking, most competent authorities are likely to conclude that the automatic transmittal of such information is not needed or desirable. The competent authority of the country making an adjustment may find it difficult or time-consuming to gather the information and prepare it in a suitable form for transmission. In addition, the other competent authority may find it burdensome merely to process a volume of data routinely transmitted by the first competent authority. Moreover, a taxpaying corporation can usually be counted upon to inform its related entity in the other country of the proceedings and the latter is thus in a position to inform, in turn, its competent authority. For this reason, the functioning of a consultation system would be aided if a tax administration considering an adjustment possibly involving an international aspect were to give the taxpayer as much warning as possible.

79. Some competent authorities, while not wishing to be informed routinely of all adjustments in the other country, may desire to receive,

either from their own taxpayers or from the other competent authority, "early warning" of serious cases or of the existence of a significant degree or pattern of activity respecting particular types of cases; similarly, they may want to transmit such information. In this event, a process should be worked out for obtaining the information. Some competent authorities may want to extend this early warning system to less serious cases, thus covering a larger number of cases.

(d) Initiation of competent authority consultation at the point of proposed or finalized adjustments

80. Paragraph 1 of the Article includes general rules concerning the presentation of a case by the taxpayer. The competent authority to which a case is validly presented must first examine whether it is itself able to arrive at a satisfactory solution. If it is unable to do so, it must determine at what stage it will consult the competent authority of the other State.

81. Many competent authorities, at least in the early stages of their experience, would prefer that the consultation process with the other State not be initiated at the point of a proposed adjustment and probably not even at the point of a finalised adjustment. A proposed adjustment may never result in final action and even a finalized adjustment may or may not trigger a claim for a correlative adjustment; even if it does, the latter adjustment may occur without problems. As a consequence, many competent authorities may decide that the consultation process should not be initiated until the correlative adjustment (or other tax consequence in the second country) is involved at some point.

82. However, some competent authorities prefer that the bilateral process be initiated earlier, perhaps at the proposed adjustment stage. Such involvement may make the process of consultation easier, in that the first country will not have an initial fixed position. In such a case, the other competent authority should be prepared to discuss the case at this early stage with the first competent authority. Other competent authorities may be willing to let the taxpayer decide, and thus stand ready to have the process invoked at any point starting with the proposed adjustment.

83. At a minimum, taxpayers must be informed when they can invoke the mutual agreement procedure and which competent authority

is to be addressed. Taxpayers should also be informed in what form the request should be submitted, although it is likely that a simple form would normally be suitable.

(e) Correlative adjustments

(i) Governing rule

84. It is recognized that, to be effective, a treaty with a correlative adjustment provision based on paragraph 2 of Article 9 must also provide that any domestic law procedural or other barriers to the making of the correlative adjustment are to be disregarded. Thus, such provisions as statutes of limitations and finality of assessments would have to be overridden to permit the correlative adjustment to be made, as required by the last sentence of paragraph 2 of Article 25. If a particular country cannot, through the application of the treaty, override such aspects of its domestic law, this would have to be provided for in the treaty, although it would be hoped that domestic law could be amended to permit the treaty to operate so as to avoid the need for such an exceptional provision.

(ii) Competent authority procedure

85. Paragraph 2 of Article 9 does not prescribe the method of the correlative adjustment since this depends on the nature of the initial adjustment and its effect on the tax payable on the profits of the associated enterprise. The method of the correlative adjustment is thus an aspect of the substantive issue underlying the initial adjustment. Given the correlative adjustment requirement imposed by Article 9, it is clear that the mutual agreement procedure must be available at this point. Thus, if the tax authorities of the Contracting State that is required to make such an adjustment do not themselves work out the correlative adjustment, the taxpayers should be entitled to invoke the mutual agreement procedure. When a taxpayer makes a request to the competent authority of a Contracting State, that competent authority may be in a position to dispose of the matter without having to consult the competent authority of the other Contracting State, as provided in the first part of paragraph 2 of Article 25. For example, that competent authority may be in a position to handle a matter having potential international consequences that arises from an adjustment proposed by a political subdivision of the State even if the competent authority

represents the central government of that State. This is, of course, an aspect of domestic law as affected by the treaty.

86. As a minimum procedural aspect, the competent authorities should indicate the extent to which a taxpayer may be allowed to participate in the competent authority procedure and the manner of such participation. Some countries may wish to favour a reasonable degree of taxpayer participation. Some countries may wish to allow a taxpayer to present information and even to appear before them; others may restrict the taxpayer to the presentation of data. Presumably, the competent authorities would make it a condition that a taxpayer invoking the procedure be required to submit to them relevant information needed to decide the matter. In addition, some competent authorities may, where appropriate, require that data furnished by a taxpayer be prepared as far as possible in accordance with internationally accepted accounting standards so the data provided will have some uniformity and objectivity. It is to be noted that rapid progress is being made in developing international accounting standards and the work of competent authorities should be aided by this development. As a further aspect concerning the taxpayer's participation, there should be a requirement that the taxpayer who invokes the mutual agreement procedure should be informed of the response of the competent authority.

87. The competent authorities will have to decide how their consultation should proceed once that part of the procedure comes into operation. Presumably, the nature of the consultation will depend on the number and character of the cases involved. The competent authorities should keep the consultation procedure flexible and leave every method of communication open, so that the method appropriate to the matter at hand can be used.

88. Various alternatives are available, such as informal consultation by telecommunication or in person; meetings between technical personnel or auditors of each country, whose conclusions are to be accepted or ratified by the competent authorities; appointment of a joint commission for a complicated case or a series of cases; formal meetings of the competent authorities in person etc. It does not seem desirable to place a time limit on when the competent authorities must conclude a matter, since the complexities of particular cases may differ. Nevertheless, competent authorities should develop working habits that

are conducive to prompt disposition of cases and should endeavour not to allow undue delay.

89. As discussed in paragraphs 25 and 42 of the Commentary on Article 25 of the 2017 OECD Model quoted in paragraph 12 above, an important minimum procedural aspect of the competent authority procedure is the effect of a taxpayer's invocation of that procedure. Must a taxpayer who invokes that process be bound by the decision of the competent authorities in the sense that the taxpayer must give up rights to alternative procedures, such as recourse to domestic administrative or judicial procedures? If the competent authorities want their procedure to be exclusive and binding, it would be necessary that the treaty provisions be so drawn as to permit this result. Presumably, this may be accomplished under the general delegation in Article 25, paragraph 4, by requiring the taxpayer to waive recourse to those alternative procedures. However, even with this paragraph, some countries may consider that their domestic law requires a more explicit statement to permit the competent authority procedure to be binding, especially in view of the present practice under treaties not to make the procedure a binding one. Some competent authorities may desire that their actions be binding, since they will not want to go through the effort of reaching agreements only to have the taxpayer reject the result on the basis that the taxpayer can do better in the courts or elsewhere. Other competent authorities may desire to follow the present practice and thus may not want to bind taxpayers or may not be in a position to do so under domestic law. This would appear to be a matter on which developing experience would be a useful guide.

90. A basic issue regarding the competent authority procedure is the extent to which the competent authorities should consider themselves under obligation to reach an agreement on a matter that comes before them. At a minimum, the treaty requires consultation and the obligation to endeavour to find a solution to economic double taxation. But must the consultation end in agreement? Presumably, disagreement would, in general, leave the related entities in a situation where double taxation may result contrary to the treaty, for example, when a country has opposed a correlative adjustment on the grounds that the initial adjustment was not in conformity with the arm's length standard. On the other hand, an agreement would mean a correlative adjustment made, or a change

in the initial adjustment followed then by a correlative adjustment, or perhaps the withdrawal of the initial adjustment. In essence, the general question is whether the competent authority consultation is to be governed by the requirement that there be an "agreement to agree".

91. In practice, this question is not as serious as it may seem. The experience of most competent authorities is that in the end an agreement or solution is almost always reached. Of course, the solution may often be a compromise, but compromise is an essential aspect of the process of consultation and negotiation. Hence, in reality, it would not be much of a further step for competent authorities to decide that their procedure should be governed by the standard of "agreement to agree". However, some countries would consider the formal adoption of such standard as a step possessing significant juridical consequences and hence would not be disposed to adopt such a requirement.

92. It is recognized that, for some countries, the process of agreement might well be facilitated if competent authorities, when faced with an extremely difficult case or an impasse, could call, either informally or formally, upon outside experts to give an advisory opinion or otherwise assist in the resolution of the matter. Such experts could be persons currently or previously associated with other tax administrations and possessing the requisite experience in this field. In essence, it would largely be the personal experience of these experts that would be significant. This resort to outside assistance could be useful even where the competent authorities are not operating under the standard of an "agreement to agree", since the outside assistance, by providing a fresh point of view, may help to resolve an impasse.

93. The possibility for such assistance may include the utilization of non-binding methods of dispute resolution, such as mediation. For countries that wish to use such procedures, there are several non-binding methods that can be used to resolve disputes between parties at an early or later stage of the competent authority process. Such non-binding means of dispute resolution could range from facilitating the relational aspects of the competent authority process to providing insights or views on the substantive tax matters at hand in the dispute. Such methods are presently used for the resolution of tax disputes under the domestic laws of a number of countries. These procedures should, however, be utilized with due regard to issues such as the timing and

duration of the procedures, the mechanism and criteria for selection of the mediator or other such appointed person and, the treatment of confidential information.

(f) Publication of competent authority procedures and determinations

94. The competent authorities should make public the procedures they have adopted with regard to their consultation procedure. The description of the procedures should be as complete as is feasible and at the least should contain the minimum procedural aspects discussed above.

95. Where the consultation procedure has produced a substantive determination in an important area that can reasonably be viewed as providing a guide to the viewpoints of the competent authorities, the competent authorities should develop a procedure for publication in their countries of that determination or decision.

(g) Procedures to implement adjustments

96. The competent authorities should consider what procedures may be required to implement the various adjustments involved. For example:

(i) The first country may consider deferring a tax payment under the adjustment or even waiving the payment if, for example, payment or reimbursement of an expense charge by the associated enterprise is prohibited at the time because of currency or other restrictions imposed by the second country.

(ii) The first country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. Thus, if income is imputed and taxed to a parent corporation because of service to a related foreign subsidiary, the related subsidiary may be allowed, as far as the parent country is concerned, to establish on its books an account payable in favour of the parent, and the parent will not be subject to a second tax in its country on the establishment or payment of the amount receivable. Such payment should not be considered a dividend by the country of the subsidiary.

(iii) The second country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. This may, for example, involve recognition of the payment made as a deductible item, even though prior to the adjustment there was no legal obligation to pay such amount. This is really an aspect of the correlative adjustment.

(h) Unilateral procedures

97. The above discussion has related almost entirely to bilateral procedures to be agreed upon by the competent authorities to implement the mutual agreement procedure. In addition, a competent authority may consider it useful to develop certain unilateral rules or procedures involving its relationship to its own taxpayers, so that these relationships may be better understood. These unilateral rules can cover such matters as the form to be followed in bringing matters to the attention of the competent authority; the permission to taxpayers to bring matters to the competent authority at an early stage even where the bilateral procedure does not require consultation at that stage; the question whether the competent authority will raise new domestic issues (so-called affirmative issues) between the tax authorities and the taxpayer if the taxpayer goes to the competent authority; and requests for information that will assist the competent authority in handling cases.

98. Unilateral rules regarding the operation of a competent authority would not require agreement to them by the other competent authority, since the rules are limited to the domestic relationship with its own taxpayers. However, it would seem appropriate to communicate such unilateral rules to the other treaty competent authorities, and to avoid, wherever possible, material differences, if any, in such rules in relation to the various treaties.

Annex to the commentary on paragraph 5 of Article 25 (Alternative B)

Sample Mutual Agreement on Arbitration

1. As indicated in paragraph 22 of the Commentary on Article 25 above, the Committee considers that the sample mutual agreement on arbitration included in the Annex to the Commentary on Article 25 of

the 2014[107] OECD Model is relevant to the application of paragraph 5 of Article 25 Alternative B of this Model, subject to a number of differences introduced in the sample mutual agreement itself, which are primarily:

— The following sample mutual agreement provides that, unless the competent authorities agree in a particular case that the arbitration panel will issue an independent decision, the so-called "last best offer" or "final offer" approach (commonly referred to as "baseball arbitration") will be followed. Such a simplified arbitration process is less costly. Choosing between the competent authorities' positions on each of the questions to be resolved will be quicker than developing and issuing an independent opinion on each of these questions; in addition, such choice may require only one independent arbitrator even if the basic rule is to have three arbitrators.

— The sample mutual agreement provides also that a case shall not be submitted to arbitration if it involves less than a certain amount of taxes (to be specified by the competent authorities). Such cases shall only be submitted to arbitration if both competent authorities agree that it is appropriate to do so (e.g. in order to resolve a question of principle). Clearly, however, taxpayers expect competent authorities to directly resolve cases that involve small amounts of taxes and no questions of principle.

— In order to guarantee their neutrality, the sample agreement provides that the appointed arbitrators are asked to fill in a statement in which they declare that, as far as they know, there exist no circumstances that might give rise to justifiable doubts regarding their independence or impartiality and that they will disclose promptly in writing to both competent authorities any such circumstances arising during the course of the arbitration process.

— The sample mutual agreement contains some rules in order to determine the remuneration of the arbitrators.

107 Reference is made to the Annex to the 2014 version of the Commentary on Article 25 of the OECD Model because the Committee did not examine in detail the large number of changes that were made to that Annex in the 2017 OECD Model.

2. The Committee therefore considers that the following paragraphs of the Annex to the Commentary on Article 25 of the 2014 OECD Model that are reproduced below are relevant for the application of paragraph 5 of Article 25 Alternative B of this Model. The additional comments that appear in italics between square brackets, which are not part of the Annex to the Commentary on Article 25 of the 2014 OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model as well as the differences described in paragraph 1 above:

> 1. The following is a sample form of agreement that the competent authorities may use as a basis for a mutual agreement to implement the arbitration process provided for in paragraph 5 of *[Alternative B of the Article]*. Paragraphs 2 to 43 below discuss the various provisions of the agreement and, in some cases, put forward alternatives. Competent authorities are of course free to modify, add or delete any provisions of this sample agreement when concluding their bilateral agreement.

Mutual agreement on the implementation of paragraph 5 of Article 25

The competent authorities of [State A] and [State B] have entered into the following mutual agreement to establish the mode of application of the arbitration process provided for in paragraph 5 of Article 25 of the [title of the Convention], which entered into force on [date of entry into force]. The competent authorities may modify or supplement this agreement by an exchange of letters between them.

1. Request for submission of case to arbitration

A request that unresolved issues arising from a mutual agreement case be submitted to arbitration pursuant to paragraph 5 of Article 25 of the Convention (the "request for arbitration") shall be made in writing and sent *[by one competent authority to the other competent authority and to the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 of Article 25]*. The request shall contain sufficient information to identify the case. The request shall also be accompanied by a written statement by each of the persons who either *[has presented the case]* or is directly affected by the case that no decision on the same

issues has already been rendered by a court or administrative tribunal of the States *[…]*.

[No request for arbitration shall be made by a competent authority where the amount of taxes involved in the relevant mutual agreement procedure case is less than [amount to be determined bilaterally], unless both competent authorities agree that it is appropriate to do so (e.g. in order to resolve a question of principle).]

2. *Time for submission of the case to arbitration*

A request for arbitration may only be made after *[three]* years from the date on which a case presented to the competent authority of one Contracting State under paragraph 1 of Article 25 has also been presented to the competent authority of the other State. For this purpose, a case shall be considered to have been presented to the competent authority of the other State only if the following information has been presented: [the necessary information and documents will be specified in the agreement].

3. *Terms of Reference*

Within three months after the request for arbitration has been received by *[the other competent authority]*, the competent authorities shall agree on the questions to be resolved by the arbitration panel and communicate them in writing to the person who *[presented the case]*. This will constitute the "Terms of Reference" for the case. Notwithstanding the following paragraphs of this agreement, the competent authorities may also, in the Terms of Reference, provide procedural rules that are additional to, or different from, those included in these paragraphs and deal with such other matters as are deemed appropriate.

4. *Failure to communicate the Terms of Reference*

If *[,]* within the period referred to in paragraph 3 above, *[the Terms of Reference have not been agreed by the competent authorities and communicated to the person who has presented the case,]* each competent authority may,[1] within one month after the end of that period, communicate in writing to each

other a list of issues to be resolved by the arbitration. All the lists so communicated during that period shall constitute the tentative Terms of Reference. Within one month after all the arbitrators have been appointed as provided in paragraph 5 below, the arbitrators shall communicate to the competent authorities and the person who *[presented the case]* a revised version of the tentative Terms of Reference based on the lists so communicated. Within one month after the revised version has been received by both of them, the competent authorities will have the possibility to agree on different Terms of Reference and to communicate them in writing to the arbitrators and the person who *[presented the case]*. If they do so within that period, these different Terms of Reference shall constitute the Terms of Reference for the case. If no different Terms of Reference have been agreed to between the competent authorities and communicated in writing within that period, the revised version of the tentative Terms of Reference prepared by the arbitrators shall constitute the Terms of Reference for the case.

5. *Selection of arbitrators*

Within three months after the Terms of Reference have been received by the person who *[presented the case]* or, where paragraph 4 applies, within four months after the request for arbitration has been received by *[the other]* competent authorit*[y]*, the competent authorities shall each appoint one arbitrator. Within two months of the latter appointment, the arbitrators so appointed will appoint a third arbitrator who will function as Chair. If any appointment is not made within the required time period, the arbitrator(s) not yet appointed shall be appointed by the *[Chair of the United Nations Committee of Experts on International Cooperation in Tax Matters, or if the Chair is a national or resident of one of the two States involved in the case, by the longest serving member of that Committee who is not a national or resident of these States. Such appointment shall be made]* within *[one month]* of receiving a request to that effect *[from either competent authority].*[2] The same procedure shall apply with the necessary adaptations if for any reason it is necessary to replace an arbitrator after the arbitral process has begun. Unless the Terms of Reference provide otherwise, the remuneration of all arbitrators *[will be determined as follows under the streamlined arbitration process:*

a) *The fees of the arbitrators will be set at the fixed amount of [amount to be determined bilaterally] per day, subject to modification by the competent authorities.*

b) *For one case, each arbitrator will be compensated for no more than three days of preparation, for two meeting days (including through video-conference) and for the travel days necessary to attend the meetings. If, however, the arbitrators consider that they require additional time to properly consider the case, the arbitrators may be compensated for additional time.*

c) *In addition, arbitrators are entitled to be reimbursed for reasonable expenses subject to prior authorization by the competent authorities.]*

6. *Streamlined arbitration process*

[Unless the competent authorities indicate otherwise in the Terms of Reference,] the following rules shall apply to a particular case *[…]*:

[…]

[a)] Within two months from the appointment of the *[arbitrators or, where paragraph 4 applies, within two months from the end of the period during which the competent authorities may agree on and communicate different Terms of Reference]*, each competent authority will present in writing to the *[arbitrators]* its own reply to the questions contained in the Terms of Reference.

[b)] Within *[three]* month*[s]* from having received the last of the replies from the competent authorities, the *[arbitrators]* will decide each question included in the Terms of Reference in accordance with one of the two replies received from the competent authorities as regards that question and will notify the competent authorities of the choice, together with short reasons explaining that choice. Such decision will be implemented as provided in paragraph *[18 below]*.

7. *Eligibility and appointment of arbitrators*

Any person, including a government official of a Contracting State, may be appointed as an arbitrator, unless that person

has been involved in prior stages of the case that results in the arbitration process. [*Before his appointment, an arbitrator will provide a written statement in which he declares that, as far as he knows, there exist no circumstances that might give rise to justifiable doubts regarding his independence or impartiality and that he will disclose promptly in writing to both competent authorities any such circumstances arising during the course of the arbitration process.]* An arbitrator will be considered to have been appointed when a letter confirming that appointment has been signed both by the person or persons who have the power to appoint that arbitrator and by the arbitrator himself.

8. *Communication of information and confidentiality*

For the sole purposes of the application of the provisions of Articles 25 and 26, and of the domestic laws of the Contracting States, concerning the communication and the confidentiality of the information related to the case that results in the arbitration process, each arbitrator shall be designated as authorised representative of the competent authority that has appointed that arbitrator or, if that arbitrator has not been appointed exclusively by one competent authority, of the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented. For the purposes of this agreement, where a case giving rise to arbitration was initially presented simultaneously to both competent authorities, "the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented" means the competent authority referred to in paragraph 1 of Article 25.

9. *Failure to provide information in a timely manner*

Notwithstanding *[paragraph 5]*, where both competent authorities agree that the failure to resolve an issue within the *[three-]*year period provided in paragraph 5 of Article 25 is mainly attributable to the failure of a person directly affected by the case to provide relevant information in a timely manner, the competent authorities may postpone the nomination of the arbitrator for a period of time corresponding to the delay in providing that information.

10. Procedural and evidentiary rules

Subject to this agreement and the Terms of Reference, the arbitrators shall adopt those procedural and evidentiary rules that they deem necessary to answer the questions set out in the Terms of Reference. They will have access to all information necessary to decide the issues submitted to arbitration, including confidential information. Unless the competent authorities agree otherwise, any information that was not available to both competent authorities before the request for arbitration was *[sent by one]* of them shall not be taken into account for purposes of the decision.

[11. Independent opinion approach]

[If the competent authorities so indicate in the Terms of Reference, the "independent opinion" approach will be followed instead of the streamlined arbitration process. Under this approach, the arbitrators will reach their own decision and the following rules shall apply to a particular case:

a) Unless otherwise provided in the Terms of Reference, the decision of the arbitral panel will be presented in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. With the permission of the person who presented the case and both competent authorities, the decision of the arbitral panel will be made public in redacted form without mentioning the names of the parties involved or any details that might disclose their identity and with the understanding that the decision has no formal precedential value.

b) The arbitration decision must be communicated to the competent authorities and the person who presented the case within six months from the date on which the Chair notifies in writing the competent authorities and the person who presented the case that he has received all the information necessary to begin consideration of the case. Notwithstanding the first part of this paragraph, if at any time within two months from the date on which the last arbitrator was appointed, the Chair, with the consent of one of the competent authorities, notifies in writing the other competent authority and the person who presented the case

that he has not received all the information necessary to begin consideration of the case, then

— *if the Chair receives the necessary information within two months after the date on which that notice was sent, the arbitration decision must be communicated to the competent authorities and the person who presented the case within six months from the date on which the information was received by the Chair, and*

— *if the Chair has not received the necessary information within two months after the date on which that notice was sent, the arbitration decision must, unless the competent authorities agree otherwise, be reached without taking into account that information even if the Chair receives it later and the decision must be communicated to the competent authorities and the person who presented the case within eight months from the date on which the notice was sent.*

c) The person who presented the case may, either directly or through his representatives, present his position to the arbitrators in writing to the same extent that the person is entitled to do so during the mutual agreement procedure.]

12. *Logistical arrangements*

Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented will be responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of the arbitration process. The administrative personnel so provided will report only to the Chair of the arbitration panel concerning any matter related to that process.

13. *Costs*

Unless agreed otherwise by the competent authorities:

a) each competent authority and the person who *[presented the case]* will bear the costs related to his own participation in the arbitration proceedings (including travel costs and costs related to the preparation and presentation of his views);

b) each competent authority will bear the remuneration of the arbitrator appointed exclusively by that competent authority, or appointed by *[another person]* because of the failure of that competent authority to appoint that arbitrator, together with that arbitrator's travel, telecommunication and secretariat costs;

c) the remuneration of the other arbitrators and their travel, telecommunication and secretariat costs will be borne equally by the two Contracting States;

d) costs related to the meetings of the arbitral panel and to the administrative personnel necessary for the conduct of the arbitration process will be borne by the competent authority to which the case giving rise to the arbitration was initially presented, or if presented in both States, will be shared equally; and

e) all other costs (including costs of translation and of recording the proceedings) related to expenses that both competent authorities have agreed to incur, will be borne equally by the two Contracting States.

14. *Applicable legal principles*

The arbitrators shall decide the issues submitted to arbitration in accordance with the applicable provisions of the *[Convention]* and, subject to these provisions, of those of the domestic laws of the Contracting States. Issues of treaty interpretation will be decided by the arbitrators in the light of the principles of interpretation incorporated in Articles 31 to 33 of the *Vienna Convention on the Law of Treaties […]*. The arbitrators will also consider any other sources which the competent authorities may expressly identify in the Terms of Reference.

15. *Arbitration decision*

Where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators. *[…]*

[16]. Failure to communicate the decision within the required period

In the event that the decision has not been communicated to the competent authorities within the period provided for in

paragraphs 6 *[b)]* or *[11 b)]*, the competent authorities may agree to extend that period for a period not exceeding six months or, if they fail to do so within one month from the end of the period provided for in paragraphs 6 *[b)]* or *[11 b)]*, they shall appoint a new arbitrator or arbitrators in accordance with paragraph 5 *[…]*.

[17]. Final decision

The arbitration decision shall be final, *[unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or]* unless that decision is found to be unenforceable by the courts of one of the Contracting States because of a violation of paragraph 5 of Article 25 or of any procedural rule included in the Terms of Reference or in this agreement that may reasonably have affected the decision. If a decision is found to be unenforceable for one of these reasons *[or if both competent authorities agree on a different solution within six months after the decision has been communicated to them]*, the request for arbitration shall be considered not to have been made and the arbitration process shall be considered not to have taken place (except for the purposes of paragraphs 8 "Communication of information and confidentiality" and 13 "Costs").

[18]. Implementing the arbitration decision

[Unless both competent authorities agree on a different solution as provided in paragraph 17 above, the] competent authorities will implement the arbitration decision within six months from the communication of the decision to them by reaching a mutual agreement on the case that led to the arbitration.

[19]. Where no arbitration decision will be provided

Notwithstanding paragraphs 6, *[11]* and *[16]*, where, at any time after a request for arbitration has been made and before the arbitrators have delivered a decision to the competent authorities and the person who *[presented the case]*, the competent authorities notify in writing the arbitrators and that person that they have solved all the unresolved issues described in the Terms of Reference, the case shall be considered as solved

under the mutual agreement procedure and no arbitration decision shall be provided.

This agreement applies to any request for arbitration made pursuant to paragraph 5 of Article 25 of the Convention after that provision has become effective.

[Date of signature of the agreement]

[Signature of the competent authority of each Contracting State]

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1 *[Some members of the United Nations Committee of Experts consider however that in such a situation the person who has presented the case should also be allowed to communicate its list of issues to be resolved by arbitration. Once arbitration has been requested that person is relying on arbitration and should have the right to make up for the failure of the competent authorities.]*

2 *[Some members of the United Nations Committee of Experts consider that in such a situation the person who has presented the case should also be allowed to request the designated chair or member of the said Committee to appoint the arbitrators not yet appointed. Once arbitration has been requested that person is relying on arbitration and should have the right to make up for the failure of the competent authorities.]*

General approach of the sample agreement

2. A number of approaches can be taken to structuring the arbitral process which is used to supplement the mutual agreement procedure. Under one approach, which might be referred to as the "independent opinion" approach, the arbitrators would be presented with the facts and arguments by the parties based on the applicable law, and would then reach their own independent decision which would be based on a written, reasoned analysis of the facts involved and applicable legal sources.

3. Alternatively, under the so-called "last best offer" or "final offer" approach, each competent authority would be required to give to the arbitral panel a proposed resolution of the issue involved and the arbitral panel would choose between the two proposals which were presented to it. There are obviously a number of variations between these two positions. For example, the arbitrators could reach an independent decision but would not be required to submit a written

decision but simply their conclusions. To some extent, the appropriate method depends on the type of issue to be decided.

4. The above sample agreement takes as its starting point the *["streamlined" process, based on the "last best offer" or "final offer" approach]*, in recognition of the fact that many cases, especially those which involve primarily factual questions, may be best handled *[that way.] [I]*t also provides for an alternative *["independent opinion" process]*. Competent authorities can therefore agree to use that *[independent opinion process]* on a case-by-case basis. Competent authorities may of course adopt this combined approach, adopt the *[independent opinion process]* as the generally applicable process with the *[streamlined process]* as an option in some circumstances or limit themselves to only one of the two approaches.

The request for arbitration

5. Paragraph 1 of the sample agreement provides the manner in which a request for arbitration should be made. Such request should be presented in writing *[by one competent authority to the other competent authority and to the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 of Article 25]*.

6. In order to determine that the conditions of paragraph 5 of Article 25 have been met (see paragraph 76 *[of the Commentary on Article 25 of the 2014 OECD Model, as quoted above in paragraph 22 of the Commentary on Article 25 of this Model]*) the request should be accompanied by statements indicating that no decision on these issues has already been rendered by domestic courts or administrative tribunals in either Contracting State.

7. Since the arbitration process is an extension of the mutual agreement procedure that is intended to deal with cases that cannot be *[re]*solved under that procedure, it would seem inappropriate to ask the person who *[initiated the mutual agreement procedure]* to reimburse the expenses incurred by the competent authorities in the course of the arbitration proceedings. Unlike taxpayers' requests for rulings or other types of advance agreements, where a charge is sometimes made, providing a *[re]*solution to disputes between the Contracting States is the responsibility of these States for which they in general should bear the costs.

8. A request for arbitration may not be made before *[three]* years from the date when a mutual agreement case presented to the competent authority of a Contracting State has also been presented to

the competent authority of the other Contracting State. Paragraph 2 of the sample agreement provides that for this purpose, a case shall only be considered to have been presented to the competent authority of that other State if the information specified in that paragraph has been so provided. The paragraph should therefore include a list of the information required; in general, that information will correspond to the information and documents that were required to initiate the mutual agreement procedure *[see paragraphs 73 to 75 above of the Commentary on Article 25 of the UN Model dealing with the necessary cooperation of the person who makes the request]*.

Terms of Reference

9. Paragraph 3 of the sample agreement refers to the "Terms of Reference", which is the document that sets forth the questions to be resolved by the arbitrators. It establishes the jurisdictional basis for the issues which are to be decided by the arbitral panel. It is to be established by the competent authorities who may wish in that connection to consult with the person who *[initiated the mutual agreement procedure]*. If the competent authorities cannot agree on the Terms of Reference within the period provided for in paragraph 3, some mechanism is necessary to ensure that the procedure goes forward. Paragraph 4 provides for that eventuality.

10. Whilst the Terms of Reference will generally be limited to a particular issue or set of issues, it would be possible for the competent authorities, given the nature of the case and the interrelated nature of the issues, to draft the Terms of Reference so that the whole case (and not only certain specific issues) be submitted to arbitration.

11. The procedural rules provided for in the sample agreement shall apply unless the competent authorities provide otherwise in the Terms of Reference. It is therefore possible for the competent authorities, through the Terms of Reference, to depart from any of these rules or to provide for additional rules in a particular case.

Streamlined process

12. The normal process provided for by the sample agreement allows the consideration of questions of either law or fact, as well as of mixed questions of law and fact. *[Under this streamlined process, which takes the form of the so-called "last best offer" or "final offer" arbitration, each competent authority is required to submit to the arbitrator, or arbitrators, that competent authority's own reply to the questions included in the*

Terms of Reference, and the arbitrator, or the arbitrators, simply chooses one of the competent authorities' replies. The competent authorities may, as for most procedural rules, amend or supplement the streamlined process through the Terms of Reference applicable to a particular case.]

13. *[That streamlined process will especially be appropriate to deal with factual issues]*, for example a determination of the amount of adjustments to the income and deductions of the respective related parties. Such circumstances will often arise in transfer pricing cases, where the unresolved issue may be simply the determination of an arm's length transfer price or range of prices (although there are other transfer pricing cases that involve complex factual issues); there are also cases in which an analogous principle may apply, for example, the determination of the existence of a permanent establishment. In some cases, the decision may be a statement of the factual premises on which the appropriate legal principles should then be applied by the competent authorities *[…]*.

[13.1 The replies to be provided by the competent authorities under the streamlined process may take alternative positions. For example, a competent authority may take the position that no permanent establishment exists and, nevertheless, propose an amount of income to be attributed to a permanent establishment, in the event that the arbitrators determine that a permanent establishment exists.]

Selection of arbitrators

14. Paragraph 5 of the sample agreement describes how arbitrators will be selected unless the Terms of Reference drafted for a particular case provide otherwise (for instance, by [*providing for only one arbitrator]* or by providing for more than one arbitrator to be appointed by each competent authority). Normally, the two competent authorities will each appoint one arbitrator. These appointments must be made within three months after the Terms of Reference have been received by the person who *[initiated the mutual agreement procedure]* (a different deadline is provided for cases where the competent authorities do not agree on the Terms of Reference within the required period). The arbitrators thus appointed will select a Chair who must be appointed within two months of the time at which the last of the initial appointments was made. If the competent authorities do not appoint an arbitrator during the required period, or if the arbitrators so appointed do not appoint the third arbitrator within the required period, the paragraph provides that the appointment will be made by the *[Chair of the United Nations Committee of Experts on International*

Cooperation in Tax Matters, or if the Chair is a national or resident of one of the two States involved in the case, by the longest-serving member of that Committee who is not a national or resident of these States] The competent authorities may, of course, provide for other ways to address these rare situations but it seems important to provide for an independent appointing authority to solve any deadlock in the selection of the arbitrators.

15. There is no need for the agreement to stipulate any particular qualifications for an arbitrator as it will be in the interests of the competent authorities to have qualified and suitable persons act as arbitrators and in the interests of the arbitrators to have a qualified Chair. However, it might be possible to develop a list of qualified persons to facilitate the appointment process and this function could be developed by the *[United Nations Committee of Experts on International Cooperation in Tax Matters]*. It is important that the Chair of the panel have experience with the types of procedural, evidentiary and logistical issues which are likely to arise in the course of the arbitral proceedings as well as having familiarity with tax issues. There may be advantages in having representatives of each Contracting State appointed as arbitrators as they would be familiar with this type of issue. Thus it should be possible to appoint to the panel governmental officials who have not been directly involved in the case. Once an arbitrator has been appointed, it should be clear that his role is to decide the case on a neutral and objective basis; he is no longer functioning as an advocate for the country that appointed him.

16. Paragraph 9 of the sample agreement provides that the appointment of the arbitrators may be postponed where both competent authorities agree that the failure to reach a mutual agreement within the *[three]* year period is mainly attributable to the lack of cooperation by a person directly affected by the case *[see paragraphs 73 to 75 above of the Commentary on Article 25 of the UN Model dealing with the necessary cooperation of the person who makes the request]*. In that case, the approach taken by the sample agreement is to allow the competent authorities to postpone the appointment of the arbitrators by a period of time corresponding to the undue delay in providing them with the relevant information. If that information has not yet been provided when the request for arbitration is submitted, the period of time corresponding to the delay in providing the information continues to run until such information is finally provided. Where, however, the competent authorities are not provided with the information necessary to solve a particular case, there is nothing that prevents them from

resolving the case on the basis of the limited information that is at their disposal, thereby preventing any access to arbitration. Also, it would be possible to provide in the agreement that if within an additional period (e.g. one year), the taxpayer still had not provided the necessary information for the competent authorities to properly evaluate the issue, the issue would no longer be required to be submitted to arbitration.

Communication of information and confidentiality

17. It is important that arbitrators be allowed full access to the information needed to resolve the issues submitted to arbitration but, at the same time, be subjected to the same strict confidentiality requirements as regards that information as apply to the competent authorities themselves. The proposed approach to ensure that result, which is incorporated in paragraph 8 of the sample agreement, is to make the arbitrators authorised representatives of the competent authorities. This, however, will only be for the purposes of the application of the relevant provisions of the Convention (*i.e.* Articles 25 and 26) and of the provisions of the domestic laws of the Contracting States, which would normally include the sanctions applicable in case of a breach of confidentiality. The designation of the arbitrator as authorised representative of a competent authority would typically be confirmed in the letter of appointment but may need to be done differently if domestic law requires otherwise or if the arbitrator is not appointed by a competent authority.

Procedural and evidentiary rules

18. The simplest way to establish the evidentiary and other procedural rules that will govern the arbitration process and that have not already been provided in the agreement or the Terms of Reference is to leave it to the arbitrators to develop these rules on an ad hoc basis. In doing so, the arbitrators are free to refer to existing arbitration procedures, such as the International Chamber of Commerce Rules which deal with many of these questions. It should be made clear in the procedural rules that as general matter, the factual material on which the arbitral panel will base its decision will be that developed in the mutual agreement procedure. Only in special situations would the panel be allowed to investigate factual issues which had not been developed in the earlier stages of the case.

19. Paragraph 10 of the sample agreement follows that approach. Thus, decisions as regards the dates and format of arbitration meetings will be made by the arbitrators unless the agreement or Terms of

Reference provide otherwise. Also, whilst the arbitrators will have access to all information necessary to decide the issues submitted to arbitration, including confidential information, any information that was not available to both competent authorities shall not be taken into account by the arbitrators unless the competent authorities agree otherwise.

[Independent opinion approach]

[19.1 Under the alternative independent opinion approach provided for in paragraph 11 of the sample agreement, the person who initiated the mutual agreement procedure may, either directly or through his representatives, present a written submission to the arbitrators to the same extent that he may do so during the mutual agreement procedure. If the arbitrators agree, that person may also make an oral presentation during a meeting of the arbitrators.]

[19.2 Where the competent authorities have agreed to follow the independent opinion approach in a particular case, and unless otherwise provided in the Terms of Reference, the decision of the arbitral panel is presented in writing and indicates the sources of law relied upon and the reasoning which led to its result. It is important that the arbitrators support their decision with the reasoning leading to it. Showing the method through which the decision was reached is important in assuring acceptance of the decision by all relevant participants.]

[19.3 Pursuant to paragraph 11 b) of the sample agreement, the arbitration decision must be communicated to the competent authorities and the person who initiated the mutual agreement procedure within six months from the date on which the Chair notifies in writing the competent authorities and the person who initiated the mutual agreement procedure that he has received all of the information necessary to begin consideration of the case. However, at any time within two months from the date on which the last arbitrator was appointed, the Chair, with the consent of one of the competent authorities, may notify in writing the other competent authority and the person who initiated the mutual agreement procedure that he has not received all the information necessary to begin consideration of the case. In that case, a further two months will be given for the necessary information to be sent to the Chair. If the information is not received by the Chair within that period, it is provided that the decision will be rendered within the next six months without taking that information into account (unless both competent authorities agree otherwise). If, on the other hand, the information is received by the Chair within the two-month period, that information

will be taken into account and the decision will be communicated within six months from the reception of that information.]

Practical arrangements

21. A number of practical arrangements will need to be made in connection with the actual functioning of the arbitral process. They include the location of the meetings, the language of the proceedings and possible translation facilities, the keeping of a record, dealing with practical details such as filing etc.

22. As regards the location and the logistical arrangements for the arbitral meetings, the easiest solution is to leave the matter to be dealt with by the competent authority to which the case giving rise to the arbitration was initially presented. That competent authority should also provide the administrative personnel necessary for the conduct of the arbitration process. This is the approach put forward in paragraph 12 of the sample agreement. It is expected that, for these purposes, the competent authority will use meeting facilities and personnel that it already has at its disposal. The two competent authorities are, however, entitled to agree otherwise (e.g. to take advantage of another meeting in a different location that would be attended by both competent authorities and the arbitrators).

23. It is provided that the administrative personnel provided for the conduct of the arbitration process will report only to the Chair of the arbitration panel concerning any matter related to that procedure.

24. The language of the proceedings and whether, and which, translation facilities should be provided is a matter that should normally be dealt with in the Terms of Reference. It may be, however, that a need for translation or recording will only arise after the beginning of the proceedings. In that case, the competent authorities are entitled to reach agreement for that purpose. In the absence of such agreement, the arbitrators could, at the request of one competent authority and pursuant to paragraph 10 of the sample agreement, decide to provide such translation or recording; in that case, however, the costs thereof would have to be borne by the requesting party (see under "Costs" below).

25. Other practical details (e.g. notice and filing of documents) should be similarly dealt with. Thus, any such matter should be decided by agreement between the competent authorities (ideally, included in the Terms of Reference) and, failing such agreement, by decision of the arbitrators.

Costs

26. Different costs may arise in relation to the arbitration process and it should be clear who should bear these costs. Paragraph 13 of the sample agreement, which deals with this issue, is based on the principle that where a competent authority or a person involved in the case can control the amount of a particular cost, this cost should be borne by that party and that other costs should be borne equally by the two competent authorities.

27. Thus, it seems logical to provide that each competent authority, as well as the person who *[initiated the mutual agreement procedure],* should pay for its own participation in the arbitration proceedings. This would include costs of being represented at the meetings and of preparing and presenting a position and arguments, whether in writing or orally.

28. The fees to be paid to the arbitrators are likely to be one of the major costs of the arbitration process. Each competent authority will bear the remuneration of the arbitrator appointed exclusively by that competent authority (or appointed by *[another person]* because of the failure of that competent authority to appoint that arbitrator), together with that arbitrator's travel, telecommunication and secretariat costs.

29. The fees and the travel, telecommunication and secretariat costs of the other arbitrators will, however, be shared equally by the competent authorities. The competent authorities will normally agree to incur these costs at the time that the arbitrators are appointed and this would typically be confirmed in the letter of appointment. The fees should be large enough to ensure that appropriately qualified experts could be recruited. One possibility would be to use a fee structure similar to that established under the EU Arbitration Convention Code of Conduct.

30. The costs related to the meetings of the arbitral panel, including those of the administrative personnel necessary for the conduct of the arbitration process, should be borne by the competent authority to which the case giving rise to the arbitration was initially presented, as long as that competent authority is required to arrange such meetings and provide the administrative personnel (see paragraph 12 of the sample agreement). In most cases, that competent authority will use meeting facilities and personnel that it already has at its disposal and it would seem inappropriate to try to allocate part of the costs thereof to the other competent authority. Clearly, the reference to "costs related to the meetings" does not include the travel and accommodation costs incurred by the participants; these are dealt with above.

31. The other costs (not including any costs resulting from the taxpayers' participation in the process) should be borne equally by the two competent authorities as long as they have agreed to incur the relevant expenses. This would include costs related to translation and recording that both competent authorities have agreed to provide. In the absence of such agreement, the party that has requested that particular costs be incurred should pay for these.

32. As indicated in paragraph 13 of the sample agreement, the competent authorities may, however, agree to a different allocation of costs *[in a particular case]*. Such agreement can be included in the Terms of Reference or be made afterwards (e.g. when unforeseen expenses arise). *[The competent authorities may also agree, in the sample agreement, on different methods of allocating the costs of the arbitration procedure, especially where there is a significant disparity in the level of development of the two Contracting States.]*

Applicable legal principles

33. An examination of the issues on which competent authorities have had difficulties reaching an agreement shows that these are typically matters of treaty interpretation or of applying the arm's length principle underlying Article 9 and paragraph 2 of Article 7. As provided in paragraph 14 of the sample agreement, matters of treaty interpretation should be decided by the arbitrators in the light of the principles of interpretation incorporated in Articles 31 to 33 of the *Vienna Convention on the Law of Treaties […]*. Since Article 32 of the *Vienna Convention on the Law of Treaties* permits a wide access to supplementary means of interpretation, arbitrators will, in practice, have considerable latitude in determining relevant sources for the interpretation of treaty provisions.

34. In many cases, the application of the provisions of a tax convention depends on issues of domestic law (for example, the definition of immovable property in paragraph 2 of Article 6 depends primarily on the domestic law meaning of that term). As a general rule, it would seem inappropriate to ask arbitrators to make *[a]* determination of purely domestic legal issues and the description of the issues to be resolved, which will be included in the Terms of Reference, should take this into account. *[However, where a matter of domestic law directly affects the application of the provisions of a tax convention the arbitrators may decide on this matter.]*

35. Also, there may be cases where the competent authorities agree that the interpretation or application of a provision of a tax treaty depends on a particular document (e.g. a memorandum of understanding or mutual agreement concluded after the entry into force of a treaty) but may disagree about the interpretation of that document. In such a case, the competent authorities may wish to make express reference to that document in the Terms of Reference.

Arbitration decision

36. Paragraph 15 of the sample agreement provides that where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators.

[…]

38. In order to deal with the unusual circumstances in which the arbitrators may be unable or unwilling to present an arbitration decision, paragraph *[16]* provides that if the decision is not communicated within the relevant period, the competent authorities may agree to extend the period for presenting the arbitration decision or, if they fail to reach such agreement within one month, appoint new arbitrators to deal with the case. In the case of the appointment of new arbitrators, the arbitration process would go back to the point where the original arbitrators were appointed and will continue with the new arbitrators.

Publication of the decision

39. Decisions on individual cases reached under the mutual agreement procedure *[and under the streamlined arbitration process]* are generally not made public. In the case of reasoned arbitral decisions *[presented under the independent opinion approach*], however, publishing the decisions would lend additional transparency to the process. Also, whilst the decision would not be in any sense a formal precedent, having the material in the public domain could influence the course of other cases so as to avoid subsequent disputes and lead to a more uniform approach to the same issue.

40. Paragraph *[11]* of the sample agreement therefore provides for the possibility to publish the decision *[presented under the independent opinion approach]*. Such publication, however, should only be made if both competent authorities and the person who *[initiated the mutual agreement procedure]* so agree. Also, in order to maintain the confidentiality of information communicated to the competent

authorities, the publication should be made in a form that would not disclose the names of the parties nor any element that would help to identify them.

Implementing the decision

41. Once the arbitration process has provided a binding solution to the issues that the competent authorities have been unable to resolve, the competent authorities will proceed to conclude a mutual agreement that reflects that decision and that will be presented to the persons directly affected by the case. *[Both competent authorities may, however, agree on a different solution within six months after the decision has been communicated to them.]* In order to avoid further delays, it is suggested that the mutual agreement that incorporates the solution arrived at should be completed and presented to the taxpayer within six months from the date of the communication of the decision. This is provided in paragraph *[18]* of the sample agreement.

42. Paragraph 2 of Article 25 provides that the competent authorities have the obligation to implement the agreement reached notwithstanding any time limit in their domestic law. Paragraph 5 of the Article also provides that the arbitration decision is binding on both Contracting States *[unless they are able to reach agreement on a different solution]*. Failure to assess taxpayers in accordance with the agreement or to implement the arbitration decision through the conclusion of a mutual agreement *[unless a different solution has been agreed to]* would therefore result in taxation not in accordance with the Convention and, as such, would allow the person whose taxation is affected to seek relief through domestic legal remedies or by making a new request pursuant to paragraph 1 of the Article.

43. Paragraph *[19]* of the sample agreement deals with the case where the competent authorities are able to solve the unresolved issues that led to arbitration before the decision is rendered. Since the arbitration process is an exceptional mechanism to deal with issues that cannot be *[re]*solved under the usual mutual agreement procedure, it is appropriate to put an end to that exceptional mechanism if the competent authorities are able to resolve these issues by themselves. The competent authorities may agree on a resolution of these issues as long as the arbitration decision has not been rendered *[and as already explained, within a further period of six months afterwards]*.

Article 26

EXCHANGE OF INFORMATION

A. General considerations

1. Article 26 embodies rules under which information may be exchanged to the widest possible extent, both to facilitate the proper application of the treaty and to assist the Contracting States in the enforcement of their domestic tax laws. Consequently, the obligation to exchange information under this Article should be interpreted broadly, and the limitations on that obligation should not be extended by analogy beyond their specific meaning. In particular, the Article should be understood to require the Contracting States to promote an effective exchange of information.

2. In a global economy, cooperation among nations on fiscal matters has become increasingly important, and the former reluctance of nations to concern themselves with the revenue laws of other countries has mostly disappeared. Article 26 provides a basis for the effective exchange of information between the Contracting States, whereas Article 27 provides for assistance in collection. Exchanges of information for the purpose of tax collection are, however, governed by Article 26 (see paragraph 5 of the Commentary on Article 27). Similarly, mutual agreement procedures are dealt with in Article 25, but exchanges of information for the purposes of a mutual agreement procedure are governed by Article 26. From the perspective of many developing countries, Article 26 is particularly important not only for curtailing cross-border tax evasion and avoidance, but also to curtail the capital flight that is often accomplished through such evasion and avoidance.

3. Much of the language of Article 26 is also found in the comparable Article of the OECD Model. Consequently, the Commentary on Article 26 of the 2017 OECD Model generally is relevant in interpreting Article 26 of the UN Model. It should be understood, nevertheless, that Article 26 is intended to be broader in a number of respects than the comparable provision in the OECD Model.

4. Although Article 26 imposes reciprocal obligations on the Contracting States, it does not allow a developed country to refuse

to provide information to a developing country on the ground that the developing country does not have an administrative capacity comparable to the developed country. Reciprocity has to be measured by reference to the overall effects of a treaty, not with respect to the effects of a single article.

5. The text of paragraph 1 of Article 26 makes clear that the exchange of information is not restricted by Article 1 (Persons covered) or Article 2 (Taxes covered). Consequently, the information exchanged may relate to persons who are not resident of either Contracting State and to the administration or enforcement of taxes not mentioned in Article 2. Some countries may object to the extension of paragraph 1 to all taxes, for constitutional or other reasons. Those concerns are addressed in section B below.

6. Following the pattern of the 2005 revisions made to Article 26 of the OECD Model, paragraph 1 of Article 26 was broken up into three separate paragraphs, now paragraphs 1, 2 and 6. This change was made for clarity and had no substantive significance.

7. Article 26 was modified substantially in 2011, with a view to clarifying certain issues, expanding the scope of the Article, and limiting exceptions to the obligation to exchange information. In some cases, the changes made were not intended to be substantive, but rather were intended to remove doubts as to the proper interpretation of the Article. For example, the term "necessary" in paragraph 1 was changed to "foreseeably relevant" to clarify the intended meaning of the prior language. By contrast, the change in that paragraph providing for an exchange of information with respect to taxes not mentioned in Article 2 was intended to be a substantive change. Another example of substantive change was the addition of paragraph 4, which removes the requirement for a domestic tax interest.

8. Article 26 and its Commentary were further modified in 2014 to take account of subsequent developments and to further elaborate on the interpretation of certain provisions of the Article. Following the 2012 update to Article 26 of the OECD Model, paragraph 2 of the Article was amended to allow the competent authorities to use information received for other purposes provided such use is allowed under the laws of both States and the competent authority of the supplying State authorises

such use. This was previously included as an optional provision in paragraph 13.3 of the Commentary on Article 26 of the 2011 UN Model.

9. Further, the Commentary was expanded, amongst others, to develop the interpretation of the standard of "foreseeable relevance" and to explicitly refer to the term "fishing expeditions" as an element within the determination of foreseeable relevance. The latter term was introduced in the Commentary on Article 26 of the OECD Model as part of the 2005 revisions to that Article and had since given rise to much debate over its interpretation. The 2012 update of the OECD Model provided additional guidance on the interpretation of the term. The introduction of the term "fishing expedition" into this Commentary was not intended to be a substantive change, but rather was intended to further clarify the interpretation of the standard of "foreseeable relevance". The interpretation of the latter standard and the term "fishing expeditions" was developed through the addition of: general clarifications (see paragraph 22 below), language in respect of the identification of the taxpayer under examination or investigation (see paragraph 23 below), language in respect of requests in relation to a group of taxpayers (see paragraph 24 below) and new examples (see paragraphs 33(*e*), 33(*g*), 33(*h*), 33(*j*) and 34). Insofar as group requests were concerned, many countries had always interpreted Article 26 to include such requests. For some countries, however, this represented a new interpretation. Other clarifications were added throughout the Commentary.

10. In some cases, the issue of whether a change made to Article 26 is intended to be substantive or interpretative depends on the prior practices of the Contracting States. For example, in some cases, the addition of paragraph 5, which removes, inter alia, domestic bank secrecy laws as a basis for refusing to exchange information, may simply clarify the meaning of the limitations on the exchange of information contained in paragraph 3. In other cases, it may modify that paragraph substantively. The effect of the change depends in part on the particular prior practices of the Contracting States. The position taken in paragraph 19.10 of the Commentary on Article 26 of the 2017 OECD Model is that paragraph 5 is primarily interpretative with respect to treaties between the OECD member States. This issue may be of particular importance in interpreting treaties that entered into force prior to the adoption of the 2014 changes to Article 26.

11. One difference in the wording of Article 26 and the comparable provision of the OECD Model is that Article 26 includes in paragraph 1 the following sentence: "In particular, information shall be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes." The phrase "that would be helpful to a Contracting State in preventing avoidance or evasion" was inserted in 2011. That change was thought to be useful by members of the Committee, especially members from developing countries, to make clear in the text of Article 26 a point that already was clear in the Commentary and was implicit in the language of the last sentence of the prior version of paragraph 1, now revised and moved to paragraph 6. The statement of the purposes of information exchanges in the text of Article 26 is intended to provide guidance to the Contracting States on the proper interpretation of the Article.

12. Although tax evasion is illegal and tax avoidance is not, both result in loss of revenue to the Government, and, by definition, both defeat the intent of the Government in enacting its taxing statutes. Consequently, mutual assistance in combating tax avoidance is an important aspect of mutual cooperation on tax matters. In addition, some forms of aggressive tax avoidance are so close to the line between avoidance and evasion that a Contracting State is unlikely to know for sure whether the information it is requesting deals with avoidance or evasion until after it obtains the requested information. Information on tax avoidance may be extremely useful to a Contracting State in its efforts to close possible loopholes in its taxing statutes.

13. The term "exchange of information" should be understood broadly to include an exchange of documents and an exchange of information unrelated to specific taxpayers and the provision of information by one Contracting State whether or not information is also being provided at that time by the other Contracting State.

14. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State should provide information under Article 26 in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts or writings), to the extent feasible. Under paragraph 3, the requested State may decline to provide the information in the specific form requested if,

for instance, the requested form is not known or permitted under its law or administrative practice. A refusal to provide the information in the form requested does not affect the obligation to provide the information.

15. Contracting States may wish to use electronic or other communication and information technologies, including appropriate security systems, to improve the timeliness and quality of exchanges of information. Indeed, the Contracting States may be obligated to provide requested information in electronic form if such action is necessary for an effective exchange of information. Contracting States which are required, according to their law, to observe data protection laws may wish to include provisions in their bilateral conventions concerning the protection of personal data exchanged. Data protection concerns the rights and fundamental freedoms of an individual, and in particular, the right to privacy, with regard to automatic processing of personal data. In no event is a Contracting State relieved of its obligation to exchange information simply because its domestic laws do not allow it to provide the information in the form requested.

16. The scope of exchange of information covers all tax matters without prejudice to the general rules and legal provisions governing the rights of defendants and witnesses in judicial proceedings. Exchange of information for criminal tax matters can also be based on bilateral or multilateral treaties on mutual legal assistance (to the extent that they also apply to tax crimes).

17. Paragraph 6 of Article 26 provides that "the competent authorities shall, through consultation, develop appropriate methods and techniques concerning the matters in respect of which exchanges of information under paragraph 1 shall be made". This language authorizes the competent authorities to exchange information in at least three modes: exchange by specific request, automatic exchange, and other exchanges, understood to include spontaneous exchanges.

18. Nothing in the UN Model prevents the application of the provisions of Article 26 to the exchange of information that existed prior to the entry into force of the Convention, as long as the assistance with respect to this information is provided after the Convention has entered into force and the provisions of the Article have become effective. Contracting States may find it useful, however, to clarify the extent to

which the provisions of the Article are applicable to such information, in particular when the provisions of that Convention will have effect with respect to taxes arising or levied from a certain time.

19. The Committee of Experts has suggested some guidelines for arrangements regarding the implementation of appropriate exchanges of information (see paragraphs 99 and following below). Those guidelines are in the form of an inventory of options available to the competent authorities. The inventory is not intended to be exhaustive or to impose any procedural obligations on a Contracting State. Instead, the inventory is a listing of suggestions to be examined by competent authorities in developing procedures for an effective exchange of information.

B. Commentary on the paragraphs of Article 26

Paragraph 1

20. The first sentence of paragraph 1 sets forth the basic obligation of the Contracting States concerning the exchange of information. It requires, subject to the limitations of paragraph 3, that the competent authorities exchange such information as is "foreseeably relevant" for the proper application of the Convention or for the administration or enforcement of their domestic tax laws, as long as taxation under those laws is not inconsistent with the Convention.

21. Prior to the 2011 changes to Article 26, the term "necessary" was used instead of the term "foreseeably relevant". The view of the Committee, and that put forward in paragraph 4.1 of the Commentary on Article 26 of the 2017 OECD Model, is that these terms have similar, if not identical, meanings. That is, the term "necessary" is understood to mean "appropriate and helpful", not "essential". In any event, whatever the phrase chosen, the requesting State is not obliged to demonstrate its need for the requested information before the obligation to provide that information arises.

22. The standard of "foreseeably relevant" is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Contracting States are not at liberty to engage in "fishing expeditions" or to request information about a particular taxpayer that is highly unlikely to be relevant to the tax

affairs of that taxpayer. In the context of information exchange upon request, the standard requires that at the time a request is made there is a reasonable possibility that the requested information will be relevant; whether the information, once provided, actually proves to be relevant is immaterial. A request may therefore not be declined in cases where a definite assessment of the pertinence of the information to an ongoing investigation can only be made following the receipt of the information. The competent authorities should consult in situations in which the content of the request, the circumstances that led to the request, or the foreseeable relevance of requested information are not clear to the requested State. However, once the requesting State has provided an explanation as to the foreseeable relevance of the requested information, the requested State may not decline a request or withhold requested information because it believes that the information lacks relevance to the underlying investigation or examination. Where the requested State becomes aware of facts that call into question whether part of the information requested is foreseeably relevant, the competent authorities should consult and the requested State may ask the requesting State to clarify foreseeable relevance in the light of those facts. At the same time, paragraph 1 does not obligate the requested State to provide information in response to requests that are "fishing expeditions", that is, speculative requests that have no apparent nexus to an open inquiry or investigation.

23. A request for information does not constitute a fishing expedition solely because it does not provide the name or address (or both) of the taxpayer under examination or investigation. The same holds true where names are spelt differently or information on names and addresses is presented using a different format. However, in cases in which the requesting State does not provide the name or address (or both) of the taxpayer under examination or investigation, the requesting State must include other information sufficient to identify the taxpayer. Similarly, paragraph 1 does not necessarily require the request to include the name or address of the person believed to be in possession of the information. In fact, the question of how specific a request has to be with respect to such person is typically an issue falling within the scope of paragraphs 3(*a*) and 3(*b*) of Article 26.

24. The standard of "foreseeable relevance" can be met both in cases dealing with one taxpayer (whether identified by name or otherwise) or several taxpayers (whether identified by name or otherwise). Where a

Contracting State undertakes an investigation into a particular group of taxpayers in accordance with its laws, any request related to the investigation will typically serve "the administration or enforcement" of its domestic tax laws and thus comply with the requirements of paragraph 1, provided it meets the standard of "foreseeable relevance". However, where the request relates to a group of taxpayers not individually identified, it will often be more difficult to establish that the request is not a fishing expedition, as the requesting State cannot point to an ongoing investigation into the affairs of a particular taxpayer which in most cases would by itself dispel the notion of the request being random or speculative. In such cases it is therefore necessary that the requesting State provide a detailed description of the group and the specific facts and circumstances that have led to the request, an explanation of the applicable law and why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law supported by a clear factual basis. It further requires a showing that the requested information would assist in determining compliance by the taxpayers in the group. As illustrated in example (*h*) of paragraph 33 below, in the case of a group request a third party will usually, although not necessarily, have actively contributed to the non-compliance of the taxpayers in the group, in which case such circumstance should also be described in the request. Furthermore, and as illustrated in example (*a*) of paragraph 34 below, a group request that merely describes the provision of financial services to non-residents and mentions the possibility of non-compliance by the non-resident customers does not meet the standard of foreseeable relevance.

25. Contracting States may agree to an alternative formulation of the standard of foreseeable relevance that is consistent with the scope of the Article and is therefore understood to require an effective exchange of information. For example, they might replace "foreseeably relevant" with "necessary" or "relevant" or "may be relevant" if those terms are understood to require an effective exchange of information. In the interest of conformity with the OECD usage, the Committee decided to adopt the term "foreseeably relevant", although some members of the Committee preferred the term "may be relevant" on the ground that its meaning was clearer.

26. The information covered by paragraph 1 is not limited to taxpayer-specific information. The competent authorities may also

exchange other sensitive information related to tax administration and compliance improvement; for example, they might provide information about risk analysis techniques or tax avoidance or evasion schemes. They may also share information they have obtained about aggressive or abusive tax avoidance schemes, such as those promoted by some international accounting firms. In addition, the competent authorities may exchange information relating to a whole economic sector (e.g. the oil, fishing or pharmaceutical industry, the banking sector, etc.) and not to particular taxpayers.

27. The scope of the obligation to exchange information is not limited by Articles 1 or 2. That is, the obligation applies not only with respect to information relevant to the proper application of the Convention or to the administration or enforcement of domestic taxes mentioned in Article 2, but also to all other domestic taxes, including subnational taxes. In this respect, the UN Model and the OECD Model are identical.

28. Some members of the Committee expressed concern that sharing of information with respect to all taxes, particularly subnational taxes, might prove burdensome or might raise constitutional and political issues for them. They suggested that the obligation to provide information might be limited to taxes covered by the Convention, plus one or two important taxes, such as the value-added tax (VAT). To accomplish that outcome, the following language might be substituted for paragraph 1:

> 1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws of the Contracting States concerning taxes covered by the Convention and *[insert specific taxes]* of a Contracting State, insofar as the taxation thereunder is not contrary to the Convention.

29. The obligation to provide requested information applies whether or not the person, with respect to whom the information is requested, is a resident of either Contracting State or is engaged in economic activity in either Contracting State. For example, a Contracting State may request information about the bank deposits of an individual who is resident in some third State.

30. The obligation imposed under paragraph 1 is for an *effective* exchange of information. A Contracting State may not avoid its obligations under paragraph 1 through unreasonable time delays, by imposing unreasonable or burdensome procedural barriers, or by intentionally taking steps that prevent it from having certain information otherwise subject to exchange under paragraph 1.

31. The examples provided in paragraphs 32, 33 and 34 below seek to illustrate the application of paragraph 1 of Article 26 of the Convention in particular cases. Some of these examples are drawn from, but are not identical to, the examples provided in paragraphs 6, 7, 8 and 8.1 of the Commentary on Article 26 of the 2017 OECD Model. In all of the examples provided in paragraphs 32 and 33 below, the requested State (the Contracting State that has been asked for information) has the obligation, under paragraph 1 of Article 26 of the Convention, to provide the requested information. In the examples provided in paragraph 34 below and assuming no further information is provided by the requesting State (the Contracting State that has asked for information), the requested State is not obligated to provide information in response to a request for information. The examples are for illustrative purposes only. They should be read in the light of the overarching purpose of Article 26 not to restrict the scope of exchange of information but to allow information exchange "to the widest possible extent".

32. Application of the Convention between State A and State B: the information must be provided [the text of the specific examples found in subparagraphs *a*) to *e*) of paragraph 7 of the Commentary on Article 26 of the 2017 OECD Model has been omitted].

33. Implementation of domestic laws: the information must be provided, for example, in the following cases [the text of the specific examples found in subparagraphs *a*) to *c*) of paragraph 8 of the Commentary on Article 26 of the 2017 OECD Model has been omitted]:

[…]

(*d*) A resident of State A holds a bank account in State B, and the income from that account is exempt from tax under the domestic laws of State B. State A may request that State B provide information on the amount of interest income earned on that account.

(*e*) The tax authorities of State A conduct a tax investigation into the affairs of Mr. X. Based on this investigation the tax authorities have indications that Mr. X holds one or several undeclared bank accounts with Bank B in State B. However, State A has experienced that, in order to avoid detection, it is not unlikely that the bank accounts may be held in the name of relatives of the beneficial owner. State A therefore requests information on all accounts with Bank B of which Mr. X is the beneficial owner and all accounts held in the names of his spouse E and his children K and L.

(*f*) A financial intermediary invests money of its account holders in State A, earning therein dividends and interest. State A requires that the financial intermediary keep records of the beneficial owners of the accounts but does not routinely request those records in enforcing its domestic laws. State B suspects that some of the beneficiaries of the account holders of the financial intermediary are its residents and are properly taxable under its domestic laws. State B may request that State A obtain for it information on identified taxpayers from the financial intermediary.

(*g*) State A has obtained information on all transactions involving foreign credit cards carried out in its territory in a certain year. State A has processed the data and launched an investigation that identified all credit card numbers where the frequency and pattern of transactions and the type of use over the course of that year suggest that the cardholders were tax residents of State A. State A cannot obtain the names by using regular sources of information available under its internal taxation procedure, as the pertinent information is not in the possession or control of persons within its jurisdiction. The credit card numbers identify an issuer of such cards to be Bank B in State B. Based on an open inquiry or investigation, State A sends a request for information to State B, asking for the name, address and date of birth of the holders of the particular cards identified during its investigation and any other person that has signatory authority over those cards. State A supplies the relevant individual credit card numbers and further provides the above information to demonstrate the foreseeable relevance of the requested information to its investigation

and more generally to the administration and enforcement of its tax law.

(*h*) Financial service provider B is established in State B. The tax authorities of State A have discovered that B is marketing a financial product to State A residents using misleading information suggesting that the product eliminates the State A income tax liability on the income accumulated within the product. The product requires that an account be opened with B through which the investment is made. State A's tax authorities have issued a taxpayer alert, warning all taxpayers about the product and clarifying that it does not achieve the suggested tax effect and that income generated by the product must be reported. Nevertheless, B continues to market the product on its website, and State A has evidence that it also markets the product through a network of advisors. State A has already discovered several resident taxpayers that have invested in the product, all of whom had failed to report the income generated by their investments. State A has exhausted its domestic means of obtaining information on the identity of its residents that have invested in the product. State A requests information from the competent authority of State B on all State A residents that (i) have an account with B and (ii) have invested in the financial product. In the request, State A provides the above information, including details of the financial product and the status of its investigation.

(*i*) A company resident of State A is the parent company of companies located in State B and State C. State B believes that the company doing business in its territory has been skimming profits into the company located in State C. State B may request that State A provide it with information about the profits and expenses of the company located in State C. Domestic law of State A obliges the parent company to keep records of transactions of its foreign subsidiaries.

(*j*) Company A, resident of State A, is owned by foreign unlisted Company B, resident of State B. The tax authorities of State A suspect that managers X, Y and Z of Company A directly or indirectly own Company B. If that were the case, the dividends received by Company B from Company A would be taxable in

their hands as resident shareholders under country A's controlled foreign company rules. The suspicion is based on information provided to State A's tax authorities by a former employee of Company A. When confronted with the allegations, the three managers of Company A deny having any ownership interest in Company B. The State A tax authorities have exhausted all domestic means of obtaining ownership information on Company B. State A now requests from State B information on whether X, Y and Z are shareholders of Company B. Furthermore, considering that ownership in such cases is often held through, for example, shell companies and nominee shareholders it requests information from State B on whether X, Y and Z indirectly hold an ownership interest in Company B. If State B is unable to determine whether X, Y or Z holds such an indirect interest, information is requested on the shareholder(s) so that it can continue its investigations. [108]

34. Implementation of domestic laws: in the following cases, no information must be provided by the requested State, assuming no further information is provided by the requesting State:

(*a*) Bank B is a bank established in State B. State A taxes its residents on the basis of their worldwide income. The competent authority of State A requests that the competent authority of State B provide the names, date and place of birth, and account balances (including information on any financial assets held in such accounts) of residents of State A that have an account with, hold signatory authority over, or a beneficial interest in an account with Bank B in State B. The request states that Bank B is known to have a large group of foreign account holders but does not contain any additional information.

(*b*) Company B is a company established in State B. State A requests the names of all shareholders in Company B resident of State A and information on all dividend payments made to such

108 For cases where State B becomes aware of facts that call into question whether part of the shareholder information is foreseeably relevant, the competent authorities should consult and State B may ask State A to clarify foreseeable relevance in light of those facts, as discussed in paragraph 22 of this Commentary.

shareholders. The requesting State A points out that Company B has significant business activity in State A and is therefore likely to have shareholders resident of State A. The request further states that it is well known that taxpayers often fail to disclose foreign source income or assets.

Paragraph 2

35. A Contracting State cannot be expected to provide confidential financial information to another Contracting State unless it has confidence that the information will not be disclosed to unauthorized persons. The confidentiality rules of paragraph 2 apply to all types of information received under paragraph 1, including both information provided in a request and information transmitted in response to a request. Hence, the confidentiality rules cover, for instance, competent authority letters, including the letter requesting information. At the same time, it is understood that the requested State can disclose the minimum information contained in a competent authority letter (but not the letter itself) necessary for the requested State to be able to obtain or provide the requested information to the requesting State, without frustrating the efforts of the requesting State. If, however, court proceedings or the like under the domestic laws of the requested State necessitate the disclosure of the competent authority letter itself, the competent authority of the requested State may disclose such a letter unless the requesting State otherwise specifies. To provide the assurance of secrecy required for effective information exchange, paragraph 2 provides that information communicated under the provisions of the Convention shall be treated as secret in the receiving State in the same manner as information obtained under the domestic laws of that State. Sanctions for the violation of such secrecy in that State will be governed by the administrative and penal laws of that State. In situations in which the requested State determines that the requesting State does not comply with its duties regarding the confidentiality of the information exchanged under this Article, the requested State may suspend assistance under this Article until such time as proper assurance is given by the requesting State that those duties will indeed be respected. If necessary, the competent authorities may enter into specific arrangements or memoranda of understanding regarding the confidentiality of the information exchanged under this Article.

36. Of course, the information received under Article 26 would be useless, or nearly so, to the requesting State (the Contracting State requesting the information) if the prohibition against disclosure were absolute. Paragraph 2 provides that information received under Article 26 can be disclosed to persons and authorities involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes mentioned in paragraph 1. In addition, it is understood that the information may also be communicated to the taxpayer, his proxy or witnesses in a civil or criminal proceeding.

37. As stated in paragraph 36 above, the information obtained can be communicated to the persons and authorities mentioned and, on the basis of the second-to-last sentence of paragraph 2 of the Article, can be disclosed by them in court sessions held in public or in decisions which reveal the name of the taxpayer. Once information is used in public court proceedings or in court decisions and thus rendered public, it is clear that from that moment such information can be quoted from the court files or decisions for other purposes even as possible evidence. But this disclosure to the public does not mean that the persons and authorities mentioned in paragraph 2 are allowed to provide on request additional information received.

38. If either or both of the Contracting States object to information obtained under Article 26 being made public by courts, or, once the information has been made public in this way, to the information being used for other purposes, they should state this objection expressly in their Convention.

39. In general, the information received by a Contracting State may be used only for the purposes mentioned in paragraph 1. If the information appears to be of value to the receiving State for purposes other than those referred to in that paragraph, that State may not use the information for such other purposes without the authorization of the competent authority of the supplying State. That authorization should not be unreasonably withheld.

40. In some cases, a Contracting State may prosecute a taxpayer for tax evasion and also for an additional crime, such as money-laundering, that arises out of the same set of facts. In such circumstances, the receiving State may want to use the information provided for both purposes.

41. Similarly, the information received by a Contracting State may not be disclosed to a third country unless there is an express provision in the bilateral treaty between the Contracting States allowing such disclosure.

42. Information exchanged for tax purposes may be of value to the receiving State for purposes in addition to those referred to in the first and second sentences of paragraph 2 of Article 26. The last sentence of paragraph 2 therefore allows the Contracting States to share information received for tax purposes provided two conditions are met: first, the information may be used for other purposes under the laws of both States and, second, the competent authority of the supplying State authorizes such use. It allows the sharing of tax information by the tax authorities of the receiving State with other law enforcement agencies and judicial authorities in that State on certain high priority matters (e.g. to combat money laundering, corruption, terrorism financing). When a receiving State desires to use the information for an additional purpose (i.e. non-tax purpose), the receiving State should specify to the supplying State the other purpose for which it wishes to use the information and confirm that the receiving State can use the information for such other purpose under its laws. Where the supplying State is in a position to do so, having regard to, amongst others, international agreements or other arrangements between the Contracting States relating to mutual assistance between other law enforcement agencies and judicial authorities, the competent authority of the supplying State would generally be expected to authorize such use for other purposes if the information can be used for similar purposes in the supplying State. Law enforcement agencies and judicial authorities receiving information under the last sentence of paragraph 2 must treat that information as confidential consistent with the principles of paragraph 2.

43. It is recognized that Contracting States may wish to achieve the overall objective inherent in the last sentence of paragraph 2 in other ways and they may do so by replacing the last sentence of paragraph 2 with the following text:

> The competent authority of the Contracting State that receives information under the provisions of this Article may, with the written consent of the Contracting State that provided the information, also make available that information to be used for

other purposes allowed under the provisions of a mutual legal assistance treaty in force between the Contracting States that allows for the exchange of tax information.

44. Paragraph 2 of Article 25 of the OECD Model was amended in 2005 to allow the sharing of information obtained under Article 26 with persons charged with the oversight of the persons allowed to obtain such information. That change was also made to paragraph 2 of the UN Model.

45. The disclosure should be limited to information necessary for those bodies to fulfil their oversight duties. Such oversight bodies include authorities that supervise tax administration and enforcement authorities as part of the general administration of the Government of a Contracting State. Such sharing is permitted only if the persons engaged in oversight activities are subject to confidentiality requirements at least as strict as those applicable to tax administration and enforcement officials. The competent authorities may want to agree as to the bodies that constitute an oversight body within the meaning of this paragraph.

Paragraph 3

46. Paragraph 3 of Article 26 contains provisions that limit the obligation of the requested State under paragraph 1. The limitations provided in paragraph 3, however, may be superseded by the provisions contained in paragraphs 4 and 5. The provisions of paragraph 3, read in conjunction with the provisions of paragraphs 4 and 5, should not be read in a way that would prevent an effective exchange of information between the Contracting States. In addition, a Contracting State should disclose to the other Contracting State before it enters into a convention any specific provisions of its laws and administrative practice that it believes entitle it to avoid an obligation otherwise imposed by paragraph 1.

47. Paragraph 3(*a*), subject to the limitations provided in paragraphs 4 and 5, contains the clarification that a Contracting State is not bound to go beyond its own internal laws and administrative practice in putting information at the disposal of the other Contracting State. For example, if a requested State is not permitted under its laws or administrative practice to seize private papers from a taxpayer without

court authorization, it is not required to make such a seizure without court authorization on behalf of a requesting State even if the requesting State could make such a seizure without court authorization under its own laws or administrative practice. The purpose of this rule is to prevent Article 26 from creating an unintentional conflict between a Contracting State's obligation under Article 26 and its obligations under domestic law.

48. Domestic provisions requiring that information obtained by the tax authorities be kept secret should not be interpreted as constituting an obstacle to the exchange of information under paragraph 3(*a*) because the tax authorities of the requesting State are obligated under paragraph 2 to observe secrecy with regard to information received under this Article.

49. Paragraph 1 obligates a requested State to provide information with respect to all of the taxes of the requesting State, even if the requested State does not have a comparable tax. Paragraph 3(*a*) does not remove the obligation to provide information relating to taxes that the requested State does not impose. For instance, a requested State cannot avoid its obligation to provide information helpful to the requesting State in the enforcement of its value-added tax merely because the requested State does not have a value-added tax. Of course, the requested State may avoid the obligation to supply such information if it cannot obtain that information under its normal administrative procedures, within the meaning of paragraph 3(*b*).

50. The purpose of paragraph 3(*a*) is to avoid traps for the unwary, not to create such traps. A Contracting State that believes that it is not required to obtain certain types of information on behalf of the other Contracting State because of its own laws or administrative practice (including the laws and administrative practice of its subnational governments) should disclose that position in writing prior to entering into a convention containing Article 26. It should also disclose the likely effects of that position on its ability to provide an effective exchange of information. For instance, if a Contracting State believes that one of its laws prevents it from providing the other Contracting State with information as to the beneficial owners of its resident companies or other juridical persons, it should give written notice of that position during the negotiation of the convention, with an explanation of the impact of

that law on its obligations in relation to mutual assistance. Depending on the facts and circumstances of the particular case, a failure to disclose may eliminate the right of a Contracting State to invoke paragraph 3(*a*) to avoid its obligations under paragraph 1.

51. A Contracting State that changes its laws or administrative practice after entering into a convention containing paragraph 3(*a*) must disclose that change to the other Contracting State in timely fashion. Depending on the facts and circumstances of the case, such a change may constitute a material breach of the convention. In any event, a failure to provide timely notice of such a change may eliminate the right of a Contracting State to invoke paragraph 3(*a*) to avoid its obligations arising under paragraph 1.

52. A Contracting State that wishes to expand the scope of the limitation currently provided in paragraph 3(*a*) might modify that paragraph as follows:

(*a*) To carry out administrative measures at variance with the laws and administrative practice of that Contracting State or of the other Contracting State even if that Contracting State knows and fails to disclose that specific provisions of its laws or administrative practice are likely to prevent an effective exchange of information.

53. Some countries are required by law to notify the person supplying information or the taxpayer subject to an enquiry prior to the release of that information to another country. Such notification procedures may be an important aspect of the rights provided under domestic law. In some cases, notification should help prevent mistakes (e.g. in cases of mistaken identity) and should facilitate exchange (by allowing taxpayers who are notified to cooperate voluntarily with the tax authorities in the requesting State). Notification procedures may not be applied, however, in a manner that, in the particular circumstances of the request, would frustrate the efforts of the requesting State to prevent avoidance or evasion of taxes. That is, they should not prevent or unduly delay an effective exchange of information. For instance, notification procedures should permit exceptions from prior notification in cases in which the information request is of a very urgent nature or the notification is likely to undermine the chance of success of the investigation conducted by the requesting State.

54. A Contracting State that, under its domestic law, is required to notify the person who provided the information or the taxpayer that an exchange of information is proposed should inform its treaty partners in writing that it has this requirement and what the consequences are for its obligations in relation to mutual assistance. Such information should be provided to the other Contracting State before a convention is concluded and thereafter whenever the relevant rules are modified. Depending on the facts and circumstances of the particular case, a failure to disclose may eliminate the right of a Contracting State to invoke paragraph 3(*a*) to avoid its obligations under paragraph 1.

55. In general, the requested State is not obligated to carry out administrative measures on behalf of the requesting State that are not permitted under the laws or administrative practice of the requesting State. The purpose of this rule is to prevent a requesting State from using the administrative measures of the requested State to avoid limitations imposed on the requesting State by its own Government.

56. Different countries will necessarily have different mechanisms for obtaining and providing information. Variations in laws and administrative practice may not be used as a basis for the requested State to deny a request for information unless the effect of these variations would be to limit in a significant way the requesting State's legal authority to obtain and provide the information if the requesting State itself received a legitimate request from the requested State. It is worth noting that if a Contracting State applies, under paragraph 5, measures not normally foreseen in its domestic law or practice, such as to access and exchange bank information, that State is equally entitled to request similar information from the other Contracting State. [109]

109 The corresponding language in paragraph 15 of the Commentary on Article 26 of the 2017 OECD Model contains the following additional sentence: "This would be fully in line with the principle of reciprocity which underlies subparagraphs *a*) and *b*) of paragraph 3." A member of the Committee suggested adding that sentence to the United Nations Commentary. The sentence was not added, however, because it may be read to suggest that paragraph 3 requires that each of the Contracting States receive reciprocal benefits under Article 26. Such a reading would not be consistent with the UN Model's broader approach to reciprocity. The clarification itself that "if a Contracting State applies, under paragraph 5, measures not normally foreseen in its domestic

57. The general rule of paragraph 55 above has no application when the legal system or administrative practice of only one country provides for a specific procedure. For instance, a Contracting State requested to provide information about an administrative ruling or advance pricing agreement (APA) it has granted cannot point to the absence of a ruling or APA regime in the requesting State to avoid its obligation under paragraph 1 to provide such information.

58. Most countries recognize under their domestic laws that information cannot be obtained from a person to the extent that such person can claim the privilege against self-incrimination. A requested State, therefore, may decline to provide information if its self-incrimination rules preclude it from obtaining that information or if the self-incrimination rules of the requesting State would preclude it from obtaining such information under similar circumstances. In practice, however, the privilege against self-incrimination should have little, if any, application in connection with most information requests. The privilege against self-incrimination is personal and cannot be claimed by an individual who himself is not at risk of criminal prosecution. In the overwhelming majority of information requests, the objective is to obtain information from third parties such as banks, intermediaries, or the other party to a contract, and not from the individual under investigation. Furthermore, the privilege against self-incrimination generally does not attach to persons other than natural persons.

59. Paragraph 3(*b*) allows a requested State to avoid an obligation otherwise imposed by paragraph 1 when it cannot obtain the requested items of information in the normal course of its administration or when the other Contracting State could not have obtained that information in the normal course of its administration. The purpose of this rule is to prevent the requesting State from imposing unreasonable burdens on the requested State.

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law or practice, such as to access and exchange bank information, that State is equally entitled to request similar information from the other Contracting State" is nonetheless as useful and relevant in the context of the UN Model as it is in the context of the OECD Model, given that under the UN Model's broader approach to reciprocity, the relevant Contracting State would also be equally entitled to request information from the other Contracting State.

60. Information is deemed to be obtainable in the normal course of administration if the information is in the possession of the tax authorities or can be obtained by them in the normal procedure of tax determination, which may include special investigations or a special examination of the business accounts kept by the taxpayer or other persons. For instance, if the requested State, as part of its audit policies, obtains information about the appropriateness of the transfer prices used by its taxpayers in dealings with associated enterprises, it is deemed to be able to obtain similar information about its taxpayers and associated enterprises on behalf of a requesting State. The paragraph assumes, of course, that tax authorities have the powers and resources necessary to facilitate effective information exchanges. For instance, assume that a Contracting State requests information in connection with an investigation into the tax affairs of a particular taxpayer and specifies in the request that the information might be held by one of a few service providers identified in the request and established in the other Contracting State. In this case, the requested State would be expected to be able to obtain and provide such information to the extent that such information is held by one of the service providers identified in the request. In responding to a request, the requested State should be guided by the overarching purpose of Article 26 which is to permit information exchange "to the widest possible extent" and may consider the importance of the requested information to the requesting State in relation to the administrative burden of the requested State.

61. Unless otherwise agreed to by the Contracting States, it should be assumed that the information requested by a Contracting State could be obtained by that State in a similar situation unless that State has informed the other Contracting State to the contrary.

62. It is often presumed, when a convention is entered into between a developed country and a developing country, that the developed country will have a greater administrative capacity than the developing country. Such a difference in administrative capacity does not provide a basis under paragraph 3(*b*) for either Contracting State to avoid an obligation to supply information under paragraph 1. That is, paragraph 3 does not require that each of the Contracting States receive reciprocal benefits under Article 26. In freely adopting a convention, the Contracting States presumably have concluded that the convention, viewed as a whole,

provides each of them with reciprocal benefits. There is no necessary presumption that each of the articles, or each paragraph of each article, provides a reciprocal benefit. On the contrary, it is commonplace for a Contracting State to give up some benefit in one Article in order to obtain a benefit in another article.

63. Although paragraphs 3(*a*) and 3(*b*) do not explicitly provide for reciprocity in benefits, the Commentary on Article 26 of the 2017 OECD Model has taken the position that a reciprocity requirement can be inferred from the language of paragraphs 3(*a*) and 3(*b*), of which the latter, inter alia, limits the obligation of a Contracting State to supply information obtainable in the normal course of administration of that other Contracting State. In effect, the OECD Commentary is reading the term "obtainable" to mean that the other Contracting State has the actual administrative capacity to obtain that information. The alternative reading is that "obtainable" means that the tax administration has the authority to obtain the information, whether or not it has the capacity to exercise that authority. Countries may wish to make clear in their treaty that the Contracting States are obligated to exchange information even if one of the Contracting States has a significantly less advanced capacity for obtaining information about taxpayers. To achieve that result, they might amend paragraph (*b*) to read as follows:

(*b*) to supply information that cannot be obtained in the normal course of the administration of that Contracting State or is not obtainable under the laws of that Contracting State or of the other Contracting State;

64. Paragraphs 3(*a*) and 3(*b*) do not permit the requested State to decline a request where paragraph 4 or 5 applies. Paragraph 5 would apply, for instance, in situations in which the requested State's inability to obtain the information was specifically related to the fact that the requested information was believed to be held by a bank or other financial institution. Thus, the application of paragraph 5 includes situations in which the tax authorities' information gathering powers with respect to information held by banks and other financial institutions are subject to different requirements than those that are generally applicable with respect to information held by persons other than banks or other financial institutions. This would, for example, be the case where the tax authorities can only exercise their information gathering powers with

respect to information held by banks and other financial institutions in instances where specific information on the taxpayer under examination or investigation is available. This would also be the case where, for example, the use of information gathering measures with respect to information held by banks and other financial institutions requires a higher probability that the information requested is held by the person believed to be in possession of the requested information than the degree of probability required for the use of information gathering measures with respect to information believed to be held by persons other than banks or financial institutions.

65. In general, a requested State may decline, under paragraph 3(*c*), to disclose information that constitutes a confidential communication between an attorney, solicitor, or other admitted legal representative in his role as such and his client to the extent that the communication is protected from disclosure under domestic law.

66. The scope of protected confidential communications should be narrowly defined. Such protection does not attach to documents or records delivered to an attorney, solicitor, or other admitted legal representative in an attempt to protect such documents or records from disclosure required by law. Also, information on the identity of a person such as a director or beneficial owner of a company is not protected from disclosure. Although the scope of protection afforded under domestic law to confidential communications may differ among States, the protection provided under paragraph 3(*c*) does not extend so broadly so as to hamper the effective exchange of information.

67. Notwithstanding the provisions of domestic law in the requested State, that State may decline to supply requested communications between attorneys, solicitors or other admitted legal representatives and their clients only if, and to the extent that, such representatives act in their capacity as attorneys, solicitors or other admitted legal representatives and not in a different capacity, such as nominee shareholders, trustees, settlors, company directors, or accountants, or under a power of attorney to represent a company in its business affairs. More specifically, the communication must have been produced in good faith for the purpose of seeking or providing legal advice or for use in existing or contemplated legal proceedings.

68. In no event may a requested State decline to disclose communications between attorneys, solicitors or other admitted legal representatives and their clients if those persons have themselves participated with their clients in a plan to commit tax evasion or avoidance.

69. A claim that information is protected as a confidential communication between an attorney, solicitor or other admitted legal representative and its client should be adjudicated exclusively in the Contracting State under the laws of which the claim arises. Thus, it is not intended that the courts of the requested State should adjudicate claims based on the laws of the requesting State.

70. Paragraph 3(*c*) also permits a requested State to decline to provide information if the disclosure of that information would reveal any trade, business, industrial, commercial or professional secret or trade process. Before invoking this provision, a Contracting State should carefully weigh if the interests of the taxpayer really justify its application. Secrets mentioned in this paragraph should not be taken in too wide a sense. A wide interpretation of the provision in many cases would be inconsistent with the purpose of Article 26 because it would render ineffective the exchange of information provided for in that Article.

71. A trade or business secret or trade process is generally understood to mean information which has considerable economic importance and which can be exploited practically and the unauthorized use of which may lead to serious damage (e.g. may lead to severe financial hardship). The purpose of the secrecy exception is to prevent an exchange of information from imposing unfair hardship on taxpayers by revealing to their competitors or potential competitors valuable secret information and thereby significantly diminishing the commercial value of that information. Secret information that once had substantial commercial value may be disclosed if that information does not have substantial commercial value at the time the information is requested. Information is not secret within the meaning of paragraph 3(*c*) simply because the disclosure of it would embarrass the taxpayer or a third party or may result in the taxpayer having to pay additional taxes or losing income on account of bad publicity. A Contracting State may decide to supply requested information when it finds that there is no reasonable basis for assuming that the taxpayer involved may suffer adverse consequences incompatible with information exchange.

72. Secret information may be disclosed to the requesting State if the requested State determines that the risk of disclosure to the public or to competitors is unlikely due to the confidentiality requirements set forth in paragraph 2. A document that is protected from full disclosure because it contains protected secret information may be disclosed if the secret information is removed.

73. Financial information, including books and records, does not by its nature constitute a trade, business or other secret. In certain limited cases, however, the disclosure of financial information might reveal a trade, business or other secret. For instance, a request for information on certain purchase records may raise such an issue if the disclosure of such information would reveal the proprietary formula used in the manufacture of a product. The protection of such information may also extend to information in the possession of third persons. For instance, a bank might hold a pending patent application for safe keeping, or a secret trade process or formula might be described in a loan application or in a contract held by a bank. In such circumstances, details of the trade, business or other secret should be excised from the documents and the remaining financial information exchanged accordingly.

74. Paragraph 3(*c*) includes a limitation with regard to information that concerns the vital interests of the State itself. Under that limitation, Contracting States do not have to supply information the disclosure of which would be contrary to public policy (*ordre public*). This limitation should become relevant only in extreme cases. For instance, such a case could arise if a tax investigation in the requesting State were motivated by political, racial or religious persecution. The limitation may also be invoked when the information constitutes a State secret. For instance, there is no disclosure requirement when sensitive information is held by secret services, the disclosure of which would be contrary to the vital interests of the requested State. Thus, issues of public policy (*ordre public*) rarely arise in the context of information exchanges between treaty partners.

75. As discussed above, paragraph 3 may give a requested State the right to refuse to supply information under some circumstances. It is not required, however, to invoke any of the limitations of that paragraph. If the requested State declines to exercise its right under paragraph 3 and supplies the requested information, the information exchanged remains

within the framework of Article 26. Consequently, the information is subject to the confidentiality rules of paragraph 2. In addition, the affected taxpayer or other third party has no ground for contending that the tax authorities in the requested State have failed to observe the obligation to secrecy imposed on them by domestic law.

76. Article 26 does not require the existence of criminal activity in either of the Contracting States for the obligation to exchange information to arise. Some treaties, nevertheless, do require the existence of such criminal activity. In such treaties, it may be important to provide that criminality in the requesting State is sufficient for the obligation to exchange information to arise. As a cautionary measure, some States that do not limit their exchange of information to criminal matters may wish to state specifically in their treaty that dual criminality is not required. To eliminate the possibility of a dual criminality requirement being read into a treaty, the following paragraph might be added as paragraph 6, with the current paragraph 6 renumbered as paragraph 7:

> 6. The obligation to exchange information arises under paragraph 1 whether or not a person under investigation is suspected of criminal activity. In no case shall the provisions of this Article be construed to permit a Contracting State to decline to supply information solely because the conduct being investigated would not constitute a crime under the laws of that Contracting State if such conduct occurred in that Contracting State.

Paragraph 4

77. Paragraph 4 was added to the UN Model in 2011. It is taken directly from the comparable provision in the OECD Model. As a result, the Committee considers that the Commentary on paragraph 4 of Article 26 of the 2017 OECD Model is applicable to the interpretation of paragraph 4 of Article 26 of this Model. The position taken in the OECD Commentary is that the addition of this paragraph was intended to assist in the interpretation of Article 26 and does not result in a substantive change in the obligations implicit in the prior version of Article 26.

78. According to paragraph 4, a requested State must use its information gathering measures to obtain requested information even though those measures are invoked solely to provide information to the other Contracting State and irrespective of whether the information could still be gathered or used for domestic tax purposes in the requested Contracting State. Thus, for instance, any restrictions on the ability of a requested Contracting State to obtain information from a person for domestic tax purposes at the time of a request (for example, because of the expiration of a statute of limitations under the requested State's domestic law or the prior completion of an audit) must not restrict its ability to use its information gathering measures for information exchange purposes. The term "information gathering measures" means laws and administrative or judicial procedures that enable a Contracting State to obtain and provide the requested information. That is, a requested State does not need to have a domestic tax interest in obtaining the requested information for the obligation to supply information under paragraph 1 to apply. Paragraph 4 does not oblige a requested Contracting State to provide information in circumstances where it has attempted to obtain the requested information but finds that the information no longer exists following the expiration of a domestic record retention period. However, where the requested information is still available notwithstanding the expiration of such retention period, the requested State cannot decline to exchange the information available. Contracting States should ensure that reliable accounting records are kept for five years or more.

79. As stated in the second sentence of paragraph 4, the obligation imposed by that paragraph generally is subject to the limitations contained in paragraph 3. An exception applies, however, that prevents a requested State from avoiding an obligation to supply information due to domestic laws or practices that include a domestic tax interest requirement. Thus, a requested State cannot avoid an obligation to supply information on the ground that its domestic laws or practices only permit it to supply information in which it has an interest for its own tax purposes.

80. For many countries, the combination of paragraph 4 and their domestic law provides a sufficient basis for using their information gathering measures to obtain the requested information even in the absence of a domestic tax interest in the information. Other countries,

however, may wish to clarify expressly in the Convention that Contracting States must ensure that their competent authorities have the necessary powers to do so. Contracting States wishing to clarify this point may replace paragraph 4 with the following text:

> 4. In order to effectuate the exchange of information as provided in paragraph 1, each Contracting State shall take the necessary measures, including legislation, rulemaking, or administrative arrangements, to ensure that its competent authority has sufficient powers under its domestic law to obtain information for the exchange of information, regardless of whether that Contracting State may need such information for its own tax purposes.

Paragraph 5

81. Paragraph 5 was added to the UN Model in 2011. It is taken directly from the comparable provision in the OECD Model. As a result, the Committee considers that the Commentary on paragraph 5 of Article 26 of the 2017 OECD Model is applicable to the interpretation of paragraph 5 of Article 26 of this Model. The discussion below of secrecy limitations draws heavily from the OECD Commentary. The position taken in the OECD Commentary is that the addition of this paragraph was intended to assist in the interpretation of Article 26 and does not result in a substantive change in the obligations implicit in the prior version of Article 26.

82. Paragraph 1 imposes a positive obligation on a Contracting State to exchange all types of information. Paragraph 5 is intended to ensure that the limitations of paragraph 3 cannot be used to prevent the exchange of information held by banks, other financial institutions, nominees, agents and fiduciaries, as well as ownership information.

83. Paragraph 5 states that a requested State shall not decline to supply information to a requesting State solely because the information requested is held by a bank or other financial institution. Thus, paragraph 5 overrides paragraph 3 to the extent that paragraph 3 would otherwise permit a requested Contracting State to decline to supply information on grounds of domestic bank secrecy laws. Access to information held by banks or other financial institutions may be by direct means or indirectly through a judicial or administrative process. The procedure

for indirect access should not be so burdensome and time-consuming as to act as an impediment to access to bank information.

84. Paragraph 5 also provides that a Contracting State shall not decline to supply information solely because the information is held by persons acting in an agency or fiduciary capacity. For instance, if a Contracting State has a law under which all information held by a fiduciary is treated as a "professional secret" merely because it was held by a fiduciary, such State could not use such law as a basis for declining to provide the information held by the fiduciary to the other Contracting State. A person acts in a "fiduciary capacity" when the business which the person transacts, or the money or property which the person handles, is not its own or for its own benefit but is held for the benefit of another person and when the fiduciary stands in a relationship to that other person implying and necessitating confidence and trust on the one part and good faith on the other part. A trustee is a common example of a person acting in a fiduciary capacity. The term "agency" is very broad and includes all forms of corporate service providers (e.g. company formation agents, trust companies, registered agents, lawyers).

85. Paragraph 5 states that a Contracting State shall not decline to supply information solely because the requested information relates to an ownership interest in a person, which includes companies and partnerships, foundations or similar organizational structures. Information requests cannot be declined merely because domestic laws or practices may treat ownership information as a trade or other secret.

86. Although paragraph 5 limits the ability of a requested State to rely on paragraph 3 to refuse to supply information held by a bank, financial institution, a person acting in an agency or fiduciary capacity or to refuse to supply information relating to ownership interests, that paragraph does not eliminate all protection under paragraph 3. The requested State may continue to refuse to supply such information if that refusal is based on substantial reasons unrelated to the status of the holder of the requested information as a bank, financial institution, agent, fiduciary or nominee, or to the fact that the information relates to ownership interests.

87. A requested State is not necessarily prevented by paragraph 5 from declining under paragraph 3(*b*) to supply information constituting

a confidential communication between an attorney, solicitor, or other admitted legal representative and his client even if that person is acting in an agency capacity. To qualify for protection under paragraph 3(*b*), however, a requested State must demonstrate that the communication between the attorney, solicitor, or other admitted legal representative and his client meets all the requirements of that paragraph, including that the communication is protected from disclosure under domestic law, that the refusal is unrelated to the status of the legal representative as an agent, fiduciary, or nominee, that any documents at issue were not delivered to the legal representative to avoid disclosure, and that non-disclosure would not frustrate an effective exchange of information.

88. Contracting States wishing to refer expressly to the protection afforded to confidential communications between a client and an attorney, solicitor or other admitted legal representative may do so by adding the following text at the end of paragraph 5:

> Nothing in the above sentence shall prevent a Contracting State from declining to obtain or provide information which would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative where such communications are protected from disclosure under paragraph 3 (*b*) and when the claim for protection under that paragraph is unrelated to the status of the legal representative as an agent, fiduciary, or nominee.

89. The following examples illustrate the application of paragraph 5:

(a) Company X owns a majority of the stock in a subsidiary company Y, and both companies are incorporated under the laws of State A. State B is conducting a tax examination of business operations of company Y in State B. In the course of this examination the question of both direct and indirect ownership in company Y becomes relevant, and State B makes a request to State A for ownership information of any person in company Y's chain of ownership. In its reply, State A should provide to State B ownership information for both company X and company Y.

(b) An individual subject to tax in State A maintains a bank account with Bank B in State B. State A is examining the income tax return of the individual and makes a request to State B for all bank account income and asset information held by Bank B in

order to determine whether there were deposits of untaxed earned income. State B should provide the requested bank information to State A.

(c) Bank A in State A is suspected of entering into secret letters of agreement with some of its depositors that direct the bank to pay interest earned by those depositors to an unrelated offshore bank. State B requests that State A provide it with copies of those secret letters of agreement. Bank A asserts that the letters of agreement are legal documents protected from disclosure under the lawyer-client privilege. State A should provide the requested documents.

Paragraph 6

90. The language of paragraph 6 was taken, with some changes, from the last sentence of paragraph 1 of the UN Model before its amendment in 2011. Paragraph 6 specifically grants to the competent authorities the authority to establish procedures for an effective exchange of information. The OECD Model does not contain paragraph 6 or an equivalent. The position taken in the Commentary on Article 26 of the OECD Model is that this authority is implicit in Article 26.

91. To carry out the exchange of information in accordance with the preceding paragraphs of Article 26, paragraph 6 provides that the competent authorities of the Contracting States shall work together to establish procedures for the exchange of information, including routine exchanges, typically in electronic form. Although paragraph 6 does not require them to make such arrangements in advance of the need for particular exchanges of information, this is strongly advisable to achieve an effective exchange of information.

92. Some States may wish to make explicit in their treaty that the competent authorities are obligated not only to exchange information on request but also to establish measures for automatic and spontaneous exchanges of information. Those countries may wish to add the following language at the end of paragraph 6:

> In addition to responding to specific requests for information, the competent authorities shall exchange information on a routine and spontaneous basis. They shall agree from time to time on

the types of information or documents which shall be furnished on a routine basis.

93. Some members of the Committee have expressed a concern that information requests from a developed country to a developing country could place excessive burdens on the tax department in the developing country, due to the different capacity of their tax administrations to obtain and provide information. That concern might be alleviated by making the requesting State responsible for material extraordinary costs associated with a request for information. In this context, the question of whether an extraordinary cost of obtaining requested information is material could be determined not by reference to some absolute amount but by reference to the cost relative to the total budget of the tax department being asked to provide information. For example, a small absolute cost might be material for a tax department with very limited resources, whereas a larger absolute cost might not be material for a well-funded department.

94. Countries concerned about imposing substantial costs on developing countries might include the following language at the end of paragraph 6:

> Extraordinary costs incurred in providing information shall be borne by the Contracting Party which requests the information. The competent authorities of the Contracting Parties shall consult with each other in advance if the costs of providing information with respect to a specific request are expected to be extraordinary.

95. Countries may wish to improve the speediness and timeliness of exchange of information under this Article by agreeing on time limits for the provision of information. Countries may do so by adding the following language at the end of paragraph 6:

> The competent authorities of the Contracting States may agree on time limits for the provision of information under this Article. In the absence of such an agreement, the information shall be supplied as quickly as possible and, except where the delay is due to legal impediments, within the following time limits:
>
> (*a*) Where the tax authorities of the requested Contracting State are already in possession of the requested information, such information shall be supplied to the competent authority of

the other Contracting State within two months of the receipt of the information request.

(*b*) Where the tax authorities of the requested Contracting State are not already in the possession of the requested information, such information shall be supplied to the competent authority of the other Contracting State within six months of the receipt of the information request.

Provided that the other conditions of this Article are met, information shall be considered to have been exchanged in accordance with the provisions of this Article even if it is supplied after these time limits.

96. The provisions of subparagraphs (*a*) and (*b*) of the optional language proposed in the preceding paragraph set a default standard for time limits that would apply where the competent authorities have not made a different agreement on longer or shorter time limits. The default standard time limits are two months from the receipt of the information request if the requested information is already in the possession of the tax authorities of the requested Contracting State and six months in all other cases. Notwithstanding the default standard time limits or time limits otherwise agreed, competent authorities may come to different agreements on a case-by-case basis, for example, when they both agree more time is appropriate. This may arise where the request is complex in nature. In such a case, the competent authority of a requesting Contracting State should not unreasonably deny a request by the competent authority of a requested Contracting State for more time.

97. If a requested Contracting State is unable to supply the requested information within the prescribed time limit because of legal impediments (for example, because of ongoing litigation regarding a taxpayer's challenge to the validity of the request or ongoing litigation regarding a domestic notification procedure of the type described in paragraph 53 above), it would not be in violation of the time limits.

98. The last part of the optional language proposed in paragraph 95 above, according to which "[p]rovided that the other conditions of this Article are met, information shall be considered to have been exchanged in accordance with the provisions of this Article even if it is supplied

after these time limits", makes it clear that no objection to the use or admissibility of information exchanged under this Article can be based on the fact that the information was exchanged after the time limits agreed to by the competent authorities or the default time limits provided for in the paragraph.

C. Inventory of exchange mechanisms

99. Paragraphs 6 to 25 of the Commentary on Article 26 of the 1999 UN Model, as set out below with some editorial changes, could be included in a handbook that deals with exchange mechanisms.

> **Routine transmittal of information**
>
> 6. A method of exchange of information is that of the routine or automatic flow of information from one treaty country to another.[110] The following are various aspects that the competent authorities should focus on in developing a structure for such routine exchanges. In considering routine exchanges of information, it should be recognized that some countries not desiring to receive such information in a routine fashion (or unable to receive it routinely because the transmitting countries do not routinely collect such information) may desire to obtain information of this type under a specific request. Hence, in these situations, items mentioned in the present section should be considered as available for coverage under the next section, entitled "Transmittal on specific request".
>
> *Items covered*
>
> 7. *Regular sources of income.* The items covered under a routine transmittal or exchange of information may extend to regular sources of income flowing between countries, such as dividends, interest, compensation (including wages, salaries, fees and commissions), royalties, rents and other possible items whose regular flow between the two countries is significant. It

110 The term "transmitting country" refers to the country transmitting information, and the term "receiving country" refers to the country receiving information.

should be recognized that at present a few countries are not in a position to supply routine information of this type because their tax collection procedures do not provide the needed data.

Transactions involving taxpayer activity. A routine exchange of information may cover certain significant transactions involving taxpayer activity:

(*a*) Transactions relevant to the treaty itself:

- Claims for refund of the transmitting country tax made by residents of the receiving country.
- Claims for exemption or particular relief from the transmitting country tax made by residents of the receiving country.

(*b*) Transactions relevant to the special aspects of the legislation of the transmitting country: items of income derived by residents of the receiving country that receive exemption or partial relief under special provisions of the national law of the transmitting country.

(*c*) Transactions relating to activities in the transmitting country of residents of the receiving country:

- Opening and closing by receiving country residents of a branch, office, etc. in the transmitting country.
- Creation or termination by receiving country residents of a corporation in the transmitting country.
- Creation or termination by receiving country residents of a trust in the transmitting country.
- Opening and closing by receiving country residents of bank accounts in the transmitting country.
- Property in the transmitting country acquired by residents of the receiving country by inheritance, bequest or gift.
- Ancillary probate proceedings in the transmitting country concerning receiving country residents.

(*d*) General information:

- Tax laws, administrative procedures, etc. of the transmitting country.

— Changes in regular sources of income flowing between countries, especially as they affect the treaty, including administrative interpretations of and court decisions on treaty provisions and administrative practices or developments affecting application of the treaty.
— Activities that affect or distort application of the treaty, including new patterns or techniques of evasion or avoidance used by residents of the transmitting or receiving country.
— Activities that have repercussions regarding the tax system of the receiving country, including new patterns or techniques of evasion or avoidance used by residents of either country that significantly affect the receiving country's tax system.

General operational aspects to be considered

8. The competent authorities should consider various factors that may have a bearing on the operational character of the routine exchange, including its effectiveness. For example:

(*a*) Countries that are more interested in receiving information on a specific request basis than on a routine basis, in their consideration of the specific request area, should keep in mind items mentioned in this inventory under the heading of routine information.

(*b*) A minimum floor amount may be fixed to limit minor data.

(*c*) The routine source of income items may be rotated from year to year, for example, dividends only in one year, interest in another, etc.

(*d*) The information to be exchanged routinely need not be reciprocal in all items. Country A may be interested in receiving information on some items but not others; the preferences of country B may extend to different items; it is not necessary for either country to receive items in which it is not interested, nor should either country refuse to transmit information on certain items simply because it is not interested in receiving information on those items.

(*e*) While the information to be exchanged on income items may not always be significant in itself as regards the income flows escaping tax, the routine exchange may provide indications respecting the degree to which the capital or other assets producing the income flows are escaping tax.

(*f*) Whether the information on items of income should cover the payee only or also the payer is a further point to be taken into account.

(*g*) Another factor to be considered is whether the information should cover only residents of the receiving country or also those domiciled therein or citizens thereof, or be limited to any of these categories.

(*h*) The degree of detail involved in the reporting, for example, name of taxpayer or recipient, profession, address, etc., may need to be taken into account.

(*i*) The form and the language in which the information should be provided is a further point to be considered.

Factors to be considered by the transmitting country

9. The transmitting country may wish to give consideration to factors affecting its ability to fulfil the requirements of a routine exchange of information. Such a consideration would presumably lead to a more careful selection of the information to be routinely exchanged rather than to a decision not to exchange information that could be of practical use.

10. Among the factors to be considered are the administrative ability of the transmitting country to obtain the information involved. This, in turn, is governed by the general effectiveness of its administrative procedures, its use of withholding taxes, its use of information returns from payers or others, and the overall costs of obtaining the information involved.

Factors to be considered by the receiving country

11. The receiving country may wish to give consideration to factors affecting its ability to use the information that could be received under a routine exchange of information, such

as the administrative ability of the receiving country to use the information on a reasonably current basis and effectively to associate such information with its own taxpayers, either routinely or on a sufficient scale to justify the routine receipt of the information.

Transmittal on specific request

12. A method of exchange of information that is in current use is that of a request for specific information made by one treaty country to another. The specific information may relate to a particular taxpayer and certain facets of his situation, or to particular types of transactions or activities, or to information of a more general character. The following are various aspects of the question that the competent authorities should focus on in developing a structure for such exchange of information pursuant to specific requests.

Items covered

13. *Particular taxpayers.* The information that may be desired from a transmitting country with respect to a receiving country taxpayer is essentially open-ended and depends on the factors involved in the situation of the taxpayer under the tax system of the receiving country and the relationship of the taxpayer and his activities to the transmitting country. A specific enumeration in advance of the type of information that may be within the scope of an exchange pursuant to specific request does not seem to be a fruitful or necessary task. The agreement to provide information pursuant to specific request may, thus, be open-ended as to the range, scope and type of information, subject to the overall constraints to be discussed herein.

14. The request for specific information may arise in a variety of ways. For example:

(*a*) Information needed to complete the determination of a taxpayer's liability in the receiving country when that liability depends on the taxpayer's worldwide income or assets; the nature of the stock ownership in the transmitting country of the receiving country company; the amount or type of expense incurred in

the transmitting country; and the fiscal domicile of an individual or company.

(*b*) Information needed to determine the accuracy of a taxpayer's tax return to the tax administration of the receiving country or the accuracy of the claims or proof asserted by the taxpayer in defence of the tax return when the return is regarded as suspect or is under actual investigation.

(*c*) Information needed to determine the true liability of a taxpayer in the receiving country when it is suspected that his reported liability is wrong.

Particular types of transactions or activities. The exchange on specific request need not be confined to requests regarding particular taxpayers but may extend to requests for information on particular types of transactions or activities. For example:

(*a*) Information on price, cost, commission or other such patterns in the transmitting country necessary to enable the tax administration of the receiving country either to determine tax liability in a particular situation or to develop standards for investigation of its taxpayers in situations involving possible under- or over-invoicing of exported or imported goods, the payment of commissions on international transactions and the like.

(*b*) Information on the typical methods by which particular transactions or activities are customarily conducted in the transmitting country.

(*c*) Information on whether a particular type of activity is being carried on in the transmitting country that may have effects on taxpayers or tax liabilities in the receiving country.

15. *Economic relationships between the countries.* The specific request may extend to requests for information regarding certain economic relationships between the countries which may be useful to a country as a check on the effectiveness of its tax administration activities, for example:

(*a*) The volume of exports from the transmitting country to the receiving country.

(*b*) The volume of imports into the transmitting country from the receiving country.

(*c*) Names of banks dealing in the transmitting country with branches, subsidiaries etc. of residents of the receiving country.

It should be noted that since items in this category, such as the volume of exports between the countries, are presumably not regarded as secret to the tax authorities in the transmitting country, they may be disclosed generally in the receiving country, as provided in Article 26.

Rules applicable to the specific request

16. The competent authorities should develop rules applicable to the transmission of specific requests by the receiving country and to the response by the transmitting country. These rules should be designed to facilitate a systematic operational procedure regarding such exchange that is both efficient and orderly. While the rules may be general in character in the sense that they set standards or guidelines governing the specific request procedures, the rules should also permit discussion between the competent authorities of special situations that either country believes require special handling. The rules should pertain to:

(*a*) The specificity of detail required in the request by the receiving country, the form of such request and the language of the request and reply;

(*b*) The extent to which the receiving country must pursue or exhaust its own administrative processes and possibilities before making a specific request; presumably the receiving country should make a bona fide effort to obtain the information for itself before resorting to the specific request procedure;

(*c*) The conditions affecting the nature and extent of the response by the transmitting country. This aspect should cover the ability of the transmitting country to provide documentary material when the receiving country needs material in that form for use in judicial or other proceedings, including the appropriate authentication of the documents.

Transmittal of information on discretionary initiative of the transmitting country (spontaneous exchange)

17. The competent authorities should determine whether, in addition to the routine and specific request methods of exchange of information under which a transmitting country is automatically transmitting information or systematically responding to specific requests by the receiving country, they desire a transmittal of information on the discretionary initiative of the transmitting country itself. Such a transmittal could occur when, in the course of its own activities, the tax administration of the transmitting country obtains information that it considers would be of importance to the receiving country. The information may relate to facets of a particular taxpayer's situation and the relationship of that situation to the taxpayer's liability in the receiving country or to the liability of other taxpayers in the receiving country. Or the information may relate to a pattern of transactions or conduct by various taxpayers or groups of taxpayers occurring in either country that is likely to affect the tax situation or tax administration of the receiving country in relation either to its national laws or to the treaty provisions.

18. The competent authorities will have to determine, under the standards governing the exchange of information developed pursuant to the treaty, whether it is the duty of a transmitting country affirmatively to develop a procedure and guidelines governing when such information is to be transmitted, whether such transmittal is to be considered by the transmitting country but is fully discretionary, or whether such transmittal need not even be considered by the transmitting country. Even if it is agreed that it is the duty of the transmitting country to develop a system for such transmittal, presumably the decision on when the conditions under that system have been met will rest on the discretionary judgement of the latter country.

Use of information received

19. The competent authorities will have to decide on the permissible use of the information received. The decisions on this matter basically depend on the legal requirements set forth in Article 26 itself. The extent of the use of information depends

primarily on the requirements of national law regarding the disclosure of tax information or on other "security requirements" regarding tax information. This being so, it is possible that the extent of the disclosure or the restrictions on disclosure may vary between the two countries. However, such possible variance need not be regarded as inappropriate or as negating exchanges of information that would otherwise occur if the countries involved are satisfied with such a consequence under Article 26 as adopted in their Convention.

Recipients of information received through exchange

20. The competent authorities will have to specify, either in detail or by reference to existing comparable rules in the receiving country, who the qualifying recipients of information in that country are. Under Article 26 the information can be disclosed, for example:

(*a*) To administrators of the taxes covered in the Convention.

(*b*) To enforcement officials and prosecutors for such taxes.

(*c*) To administrative tribunals for such taxes.

(*d*) To judicial tribunals for such taxes.

(*e*) In public court proceedings or in judicial decisions where it may become available to the public if considered appropriate.

(*f*) To the competent authority of another country (see the section below entitled "Consultation among several competent authorities").

The form in which information is provided

21. The permissible extent of the disclosure may affect the form in which the information is to be provided if it is to be useful to the receiving country. Thus, if the information may be used in judicial tribunals and if, to be so used, it must be of a particular character or form, then the competent authorities will have to consider how to provide for a transmittal that meets this need (see also the comment on documents in the section above dealing with rules applicable to the specific request).

Consultation among several competent authorities

22. Countries may wish to give consideration to procedures developed by the competent authorities for consultations covering more than the two competent authorities under a particular treaty. Thus, if countries A, B and C are joined in a network of treaties, the competent authorities of A, B and C might desire to hold a joint consultation. A joint meeting could be desired whether or not all three countries are directly intertwined by their treaty network. For example, the joint meeting might be desirable where there are A-B, A-C and B-C treaties, or where there are A-B and B-C treaties but not an A-C treaty. Countries desiring to have their competent authorities engage in such consultations should provide the legal basis for the consultations by adding the necessary authority in their treaties. Some countries may feel that Article 26 permits joint consultation where all three countries are directly linked by bilateral treaties. However, this view does not cover joint consultation where a link in the chain is not fully joined, as in the second situation described above. In such a case, it would be necessary to add a treaty provision allowing the competent authority of country B to provide information received from country A to the competent authority of country C. Such a treaty provision could include a safeguard that the competent authority of country A must consent to the action of the competent authority of country B. Presumably, it would so consent only where it was satisfied as to the provisions regarding protection of secrecy in the B-C treaty.

Overall factors

23. There are a variety of overall factors affecting the exchanges of information that the competent authorities will have to consider and decide upon, either as to their specific operational handling in the implementation of the exchange of information or as to their effect on the entire exchange process itself. Such overall factors include those set out below:

Factors affecting implementation of exchange of information

These include the following:

(*a*) The competent authorities should decide on the channels of communication for the different types of exchanges of

information. One method of communication that may be provided for is to permit an official of one country to go in person to the other country to receive the information from the competent authority and discuss it so as to expedite the process of exchange of information.

(*b*) Some countries may have decided that it is useful and appropriate for a country to have representatives of its own tax administration stationed in the other treaty country. Such an arrangement would presumably rest on authority, treaty or agreements other than that in the Article on Exchange of information of the envisaged double taxation treaty (although, if national laws of both countries permit, this Article would be treated as covering this topic) and the arrangement would determine the conditions governing the presence of such representatives and their duties. In this regard, it should be noted that it would not seem necessary that the process be reciprocal, so that it would be appropriate for country A to have its representatives in country B but not vice-versa if country A considered the process to be useful and country B did not. If arrangements do exist for such representatives, then the competent authorities may want to coordinate with those representatives where such coordination would make the exchange of information process more effective and where such coordination is otherwise appropriate.

(*c*) Some countries may decide it is appropriate to have a tax official of one country participate directly with tax officials of the other country in a joint or "team" investigation of a particular taxpayer or activity. The existence of the arrangement for most countries would presumably rest on authority, treaty or agreements other than that in the envisaged treaty Article on Exchange of information, although, if national laws of both countries permit, this Article could be treated by the countries as authorizing the competent authorities to sanction this arrangement. In either event, if the arrangement is made, it would be appropriate to extend to such an investigation the safeguards and procedures developed under the envisaged treaty Article on Exchange of information.

(*d*) The process of exchange of information should be developed so that it has the needed relevance to the effective implementation of the substantive treaty provisions. Thus, treaty provisions regarding intercompany pricing and the allocation of income and expenses produce their own informational requirements for effective implementation. The exchange of information process should be responsive to those requirements.

(*e*) The substantive provisions of the treaty should take account of and be responsive to the exchange of information process. Thus, if there is an adequate informational base for the exchange of information process to support allowing one country to deduct expenses incurred in another country, then the treaty should be developed on the basis of the substantive appropriateness of such deduction.

(*f*) The competent authorities will have to determine to what extent there should be cost-sharing or cost reimbursement with respect to the process of exchange of information.

Factors affecting the structure of the exchange of information process

24. These include the following:

(*a*) It should be recognized that the arrangements regarding exchange of information worked out by country A with country B need not parallel those worked out between country A and country C or between country B and country C. The arrangements should in the first instance be responsive to the needs of the two countries directly involved and need not be fully parallel in every case just for the sake of formal uniformity. However, it should be observed that prevention of international tax evasion and avoidance will often require international cooperation of tax authorities in a number of countries. As a consequence, some countries may consider it appropriate to devise procedures and treaty provisions that are sufficiently flexible to enable them to extend their cooperation to multi-country consultation and exchange arrangements.

(*b*) The competent authorities will have to weigh the effect of a domestic legal restriction on obtaining information in a country that requests information from another country not under a similar domestic legal restriction. Thus, suppose country A requests information from country B, and the tax authorities in country B are able to go to their financial institutions to obtain such information, whereas the tax authorities in country A are generally not able to go to their own financial institutions to obtain information for tax purposes. How should the matter be regarded in country B? It should be noted that Article 26 here permits country B to obtain the information from its financial institutions and transmit it to country A. Thus, country B is not barred by its domestic laws regarding tax secrecy if it decides to obtain and transmit the information. Thus, it becomes a matter of discretion in country B as to whether it should respond, and may perhaps become a matter for negotiation between the competent authorities. It should be noted that many countries in practice do respond in this situation and that such a course is indeed useful in achieving effective exchange of information to prevent tax avoidance. However, it should also be noted that country A, being anxious to obtain information in such cases from other countries, should also recognize its responsibility to try to change its domestic laws to strengthen the domestic authority of its own tax administration and to enable it to respond to requests from other countries. It should be noted that a country that has entered into a tax convention that includes paragraph 5 of Article 26 of the UN Model is required to provide information to its treaty partner notwithstanding its domestic bank secrecy laws.

(*c*) In addition to situations involving the legal imbalance discussed above, the competent authorities will have to weigh the effects of a possible imbalance growing out of a divergence in other aspects of tax administration. Thus, if country A cannot respond as fully to a request as country B can because of practical problems of tax administration in country A, then might the level of the process of exchange of information be geared to the

position of country A? Or, in general or in particular aspects, should country B be willing to respond to requests of country A even when country A would not be able to respond to requests of country B? This matter is similar to that discussed in the preceding paragraph and a similar response should be noted.

(*d*) It should be noted that Article 26 authorizes a transmitting country to use its administrative procedures solely to provide information to the requesting country, even when the person about whom information is sought is not involved in a tax proceeding in the transmitting country. Moreover, the transmitting country should, for the purpose of exchange of information, use its own administrative authority in the same way as if its own taxation were involved.

(*e*) The competent authorities will have to weigh the effect on the process of exchange of information of one country's belief that the tax system or tax administration of the other country, either in general or in particular situations, is discriminatory or confiscatory. It may be that further exploration of such a belief could lead to substantive provisions in the treaty or in national law that would eliminate the problems perceived by the first country and thereby facilitate a process of exchange of information. One possible example of this is the treatment of non-permanent residents.

(*f*) The competent authorities will have to weigh the effects that the process of exchange of information may have on the competitive position of taxpayers of the countries involved. Thus, if country A has a treaty with country B providing for exchange of information, country A will have to weigh the effect on the structure or process of that exchange of the fact that country C does not have a treaty with country B, so that firms of country C doing business in country B may be subject to a different tax posture in country B than firms of country A. Similarly, even if a treaty with an exchange of information Article exists between countries C and B, if the tax administration

of country A has more authority to obtain information (to be exchanged with country B) than does the tax administration of country C, or is otherwise more effective in its administration, and therefore, has more information, then a similar difference in tax posture may result. As a corollary, it seems clear that the adequate implementation of exchange of information provisions requires a universal effort of tax administrations to obtain and develop under national laws a capacity for securing information and a competence in utilizing information that is appropriate to a high level of efficient and equitable tax administration.

Periodic consultation and review

25. Since differences in interpretation and application, specific difficulties and unforeseen problems and situations are bound to arise, provision must be made for efficient and expeditious consultation between the competent authorities. Such consultation should extend both to particular situations and problems and to periodic review of the operations under the exchange of information provision. The periodic review should ensure that the process of exchange of information is working with the requisite promptness and efficiency, that it is meeting the basic requirements of treaty implementation and that it is promoting adequate compliance with treaty provisions and the national laws of the two countries.

Article 27

ASSISTANCE IN THE COLLECTION OF TAXES

Article 27 of this Model reproduces Article 27 of the OECD Model. The Committee considers that the following Commentary on Article 27 of the 2017 OECD Model is applicable to Article 27 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

1. This Article provides the rules under which Contracting States[1] may agree to provide each other assistance in the collection of taxes. In some States, national law or policy may prevent this form of assistance or set limitations to it. Also, in some cases, administrative considerations may not justify providing assistance in the collection of taxes to another State or may similarly limit it. During the negotiations each Contracting State will therefore need to decide whether and to what extent assistance should be given to the other State based on various factors, including:

- the stance taken in national law to providing assistance in the collection of other States' taxes;
- whether and to what extent the tax systems, tax administrations and legal standards of the two States are similar, particularly as concerns the protection of fundamental taxpayers' rights (e.g. timely and adequate notice of claims against the taxpayer, the right to confidentiality of taxpayer information, the right to appeal, the right to be heard and present arguments and evidence, the right to be assisted by a counsel of the taxpayer's choice, the right to a fair trial, etc.);
- whether assistance in the collection of taxes will provide balanced and reciprocal benefits to both States;
- whether each State's tax administration will be able to effectively provide such assistance;
- *[whether the cost of assistance is not too high for the requested State with regard to the money at stake;]*
- whether trade and investment flows between the two States are sufficient to justify this form of assistance;
- whether, for constitutional or other reasons, the taxes to which the Article applies should be limited.

The Article should only be included in the Convention where each State concludes that, based on these factors, they can agree to provide assistance in the collection of taxes levied by the other State.

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1 Throughout this Commentary on Article 27, the State making a request for assistance is referred to as the "requesting State" while the State from which assistance is requested is referred to as the "requested State".

2. The Article provides for comprehensive collection assistance. Some States may prefer to provide a more limited type of collection assistance. This may be the only form of collection assistance that they are generally able to provide or that they may agree to in a particular convention. For instance, a State may want to limit assistance to cases where the benefits of the Convention (e.g. a reduction of taxes in the State where income such as interest arises) have been claimed by persons not entitled to them. States wishing to provide such limited collection assistance are free to adopt bilaterally an alternative Article drafted along the following lines:

Article 27

Assistance in the collection of taxes

1. The Contracting States shall lend assistance to each other in the collection of tax to the extent needed to ensure that any exemption or reduced rate of tax granted under this Convention shall not be enjoyed by persons not entitled to such benefits. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.

2. In no case shall the provisions of this Article be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to carry out measures which would be contrary to public policy (*ordre public*).

Paragraph 1

3. This paragraph contains the principle that a Contracting State is obliged to assist the other State in the collection of taxes owed to it, provided that the conditions of the Article are met. Paragraphs 3 and 4 provide the two forms that this assistance will take.

4. The paragraph also provides that assistance under the Article is not restricted by Articles 1 and 2. Assistance must therefore be provided as regards a revenue claim owed to a Contracting State by any person, whether or not a resident of a Contracting State. Some Contracting States may, however, wish to limit assistance to taxes owed by residents of either Contracting State. Such States are free to restrict the scope of the Article by omitting the reference to Article 1 from the paragraph.

5. Article 26 applies to the exchange of information for purposes of the provisions of this Article. The confidentiality of information exchanged for purposes of assistance in collection is thus ensured.

6. The paragraph finally provides that the competent authorities of the Contracting States may, by mutual agreement, decide the details of the practical application of the provisions of the Article.

7. Such agreement should, in particular, deal with the documentation that should accompany a request made pursuant to paragraph 3 or 4. It is common practice to agree that a request for assistance will be accompanied by such documentation as is required by the law of the requested State, or has been agreed to by the competent authorities of the Contracting States, and that is necessary to undertake, as the case may be, collection of the revenue claim or measures of conservancy. Such documentation may include, for example, a declaration that the revenue claim is enforceable and is owed by a person who cannot, under the law of the requesting State, prevent its collection or an official copy of the instrument permitting enforcement in the requesting State. An official translation of the documentation in the language of the requested State should also be provided. It could also be agreed, where appropriate, that the instrument permitting enforcement in the requesting State shall, where appropriate and in accordance with the provisions in force in the requested State, be accepted, recognised, supplemented or replaced as soon as possible after the date of the receipt of the request for assistance, by an instrument permitting enforcement in the latter State.

8. The agreement should also deal with the issue of the costs that will be incurred by the requested State in satisfying a request made under paragraph 3 or 4. In general, the costs of collecting a revenue claim are charged to the debtor but it is necessary to determine which State will bear costs that cannot be recovered from that person. The usual practice, in this respect, is to provide that in the absence of an agreement specific to a particular case, ordinary costs incurred by a

State in providing assistance to the other State will not be reimbursed by that other State. Ordinary costs are those directly and normally related to the collection, that is, those expected in normal domestic collection proceedings. In the case of extraordinary costs, however, the practice is to provide that these will be borne by the requesting State, unless otherwise agreed bilaterally. Such costs would cover, for instance, costs incurred when a particular type of procedure has been used at the request of the other State or supplementary costs of experts, interpreters, or translators. Most States also consider as extraordinary costs the costs of judicial and bankruptcy proceedings. The agreement should provide a definition of extraordinary costs and consultation between the Contracting States should take place in any particular case where extraordinary costs are likely to be involved. It should also be agreed that, as soon as a Contracting State anticipates that extraordinary costs may be incurred, it will inform the other Contracting State and indicate the estimated amount of such costs so that the other State may decide whether such costs should be incurred. It is, of course, also possible for the Contracting States to provide that costs will be allocated on a basis different from what is described above; this may be necessary, for instance, where a request for assistance in collection is suspended or withdrawn under paragraph 7 or where the issue of costs incurred in providing assistance in collection is already dealt with in another legal instrument applicable to these States. *[Finally, the agreement shall take into account the differences in the development of the Contracting States. It could therefore be agreed that all costs, including ordinary costs, will be borne by one State only. In such a case, the Contracting States will have to agree on the costs. These could for instance be determined on the basis of a fixed amount.]*

9. In the agreement, the competent authorities may also deal with other practical issues such as:

— whether there should be a limit of time after which a request for assistance could no longer be made as regards a particular revenue claim;

— what should be the applicable exchange rate when a revenue claim is collected in a currency that differs from the one which is used in the requesting State;

— how should any amount collected pursuant to a request under paragraph 3 be remitted to the requesting State; or

— *[whether there should be a minimum threshold below which assistance will not be provided.]*

Paragraph 2

10. Paragraph 2 defines the term "revenue claim" for purposes of the Article. The definition applies to any amount owed in respect of all taxes that are imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, but only insofar as the imposition of such taxes is not contrary to the Convention or other instrument in force between the Contracting States. It also applies to the interest, administrative penalties and costs of collection or conservancy that are related to such an amount. Assistance is therefore not restricted to taxes to which the Convention generally applies pursuant to Article 2, as is confirmed in paragraph 1.

11. Some Contracting States may prefer to limit the application of the Article to taxes that are covered by the Convention under the general rules of Article 2. States wishing to do so should replace paragraphs 1 and 2 by the following:

> 1. The Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Article 1. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.
>
> 2. The term "revenue claim" as used in this Article means any amount owed in respect of taxes covered by the Convention together with interest, administrative penalties and costs of collection or conservancy related to such amount.

12. Similarly, some Contracting States may wish to limit the types of taxes to which the provisions of the Article will apply or to clarify the scope of application of these provisions by including in the definition a detailed list of the taxes. States wishing to do so are free to adopt bilaterally the following definition:

> The term "revenue claim" as used in this Article means an amount owed in respect of the following taxes imposed by the Contracting States, insofar as the taxation thereunder is not contrary to this Convention or any other instrument to which the Contracting States are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amount:
>
> *a*) (in State A): ___
>
> *b*) (in State B): ___

13. In order to make sure that the competent authorities can freely communicate information for purposes of the Article, Contracting

States should ensure that Article 26 is drafted in a way that allows exchanges of information with respect to any tax to which this Article applies.

14. Nothing in the Convention prevents the application of the provisions of the Article to revenue claims that arise before the Convention enters into force, as long as assistance with respect to these claims is provided after the treaty has entered into force and the provisions of the Article have become effective. Contracting States may find it useful, however, to clarify the extent to which the provisions of the Article are applicable to such revenue claims, in particular when the provisions concerning the entry into force of their convention provide that the provisions of that convention will have effect with respect to taxes arising or levied from a certain time. States wishing to restrict the application of the Article to claims arising after the Convention enters into force are also free to do so in the course of bilateral negotiations.

Paragraph 3

15. This paragraph stipulates the conditions under which a request for assistance in collection can be made. The revenue claim has to be enforceable under the law of the requesting State and be owed by a person who, at that time, cannot, under the law of that State, prevent its collection. This will be the case where the requesting State has the right, under its internal law, to collect the revenue claim and the person owing the amount has no administrative or judicial rights to prevent such collection.

16. In many States, a revenue claim can be collected even though there is still a right to appeal to an administrative body or a court as regards the validity or the amount of the claim. If, however, the internal law of the requested State does not allow it to collect its own revenue claims when appeals are still pending, the paragraph does not authorise it to do so in the case of revenue claims of the other State in respect of which such appeal rights still exist even if this does not prevent collection in that other State. Indeed, the phrase "collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State" has the effect of making that requested State's internal law restriction applicable to the collection of the revenue claim of the other State. Many States, however, may wish to allow collection assistance where a revenue claim may be collected in the requesting State notwithstanding the existence of appeal rights,

even though the requested State's own law prevents collection in that case. States wishing to do so are free to modify paragraph 3 to read as follows:

> When a revenue claim of a Contracting State is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of collection by the competent authority of the other Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State that met the conditions allowing that other State to make a request under this paragraph.

17. Paragraph 3 also regulates the way in which the revenue claim of the requesting State is to be collected by the requested State. Except with respect to time limits and priority (see the Commentary on paragraph 5), the requested State is obliged to collect the revenue claim of the requesting State as though it were the requested State's own revenue claim, even if, at the time, it has no need to undertake collection actions related to that taxpayer for its own purposes. As already mentioned, the phrase "in accordance with the provisions of its law applicable to the enforcement and collection of its own taxes" has the effect of limiting collection assistance to claims with respect to which no further appeal rights exist if, under the requested State's internal law, collection of that State's own revenue claims are not permitted as long as such rights still exist.

18. It is possible that the request may concern a tax that does not exist in the requested State. The requesting State shall indicate where appropriate the nature of the revenue claim, the components of the revenue claim, the date of expiry of the claim and the assets from which the revenue claim may be recovered. The requested State will then follow the procedure applicable to a claim for a tax of its own which is similar to that of the requesting State or any other appropriate procedure if no similar tax exists.

Paragraph 4

19. In order to safeguard the collection rights of a Contracting State, this paragraph enables it to request the other State to take measures of conservancy even where it cannot yet ask for assistance in collection,

for example, when the revenue claim is not yet enforceable or when the debtor still has the right to prevent its collection. This paragraph should only be included in conventions between States that are able to take measures of conservancy under their own laws. Also, States that consider that it is not appropriate to take measures of conservancy in respect of taxes owed to another State may decide not to include the paragraph in their conventions or to restrict its scope. In some States, measures of conservancy are referred to as "interim measures" and such States are free to add these words to the paragraph to clarify its scope in relation to their own terminology.

20. One example of measures to which the paragraph applies is the seizure or the freezing of assets before final judgement to guarantee that these assets will still be available when collection can subsequently take place. The conditions required for the taking of measures of conservancy may vary from one State to another but in all cases the amount of the revenue claim should be determined beforehand, if only provisionally or partially. A request for measures of conservancy as regards a particular revenue claim cannot be made unless the requesting State can itself take such measures with respect to that claim (see the Commentary on paragraph 8).

21. In making a request for measures of conservancy the requesting State should indicate in each case what stage in the process of assessment or collection has been reached. The requested State will then have to consider whether in such a case its own laws and administrative practice permit it to take measures of conservancy.

Paragraph 5

22. Paragraph 5 first provides that the time limits of the requested State, that is, time limitations beyond which a revenue claim cannot be enforced or collected, shall not apply to a revenue claim in respect of which the other State has made a request under paragraph 3 or 4. Since paragraph 3 refers to revenue claims that are enforceable in the requesting State and paragraph 4 to revenue claims in respect of which the requesting State can take measures of conservancy, it follows that it is the time limits of the requesting State that are solely applicable.

23. Thus, as long as a revenue claim can still be enforced or collected (paragraph 3) or give rise to measures of conservancy (paragraph 4) in the requesting State, no objection based on the time limits provided under the laws of the requested State may be made to the application of paragraph 3 or 4 to that revenue claim. States which cannot agree to

disregard their own domestic time limits should amend paragraph 5 accordingly.

24. The Contracting States may agree that after a certain period of time the obligation to assist in the collection of the revenue claim no longer exists. The period should run from the date of the original instrument permitting enforcement. Legislation in some States requires renewal of the enforcement instrument, in which case the first instrument is the one that counts for purposes of calculating the time period after which the obligation to provide assistance ends.

25. Paragraph 5 also provides that the rules of both the requested (first sentence) and requesting (second sentence) States giving their own revenue claims priority over the claims of other creditors shall not apply to a revenue claim in respect of which a request has been made under paragraph 3 or 4. Such rules are often included in domestic laws to ensure that tax authorities can collect taxes to the fullest possible extent.

26. The rule according to which the priority rules of the requested State do not apply to a revenue claim of the other State in respect of which a request for assistance has been made applies even if the requested State must generally treat that claim as its own revenue claim pursuant to paragraphs 3 and 4. States wishing to provide that revenue claims of the other State should have the same priority as is applicable to their own revenue claims are free to amend the paragraph by deleting the words "or accorded any priority" in the first sentence.

27. The words "by reason of their nature as such", which are found at the end of the first sentence, indicate that the time limits and priority rules of the requested State to which the paragraph applies are only those that are specific to unpaid taxes. Thus, the paragraph does not prevent the application of general rules concerning time limits or priority which would apply to all debts (e.g. rules giving priority to a claim by reason of that claim having arisen or having been registered before another one).

Paragraph 6

28. This paragraph ensures that any legal or administrative objection concerning the existence, validity or the amount of a revenue claim of the requesting State shall not be dealt with by the requested State's courts and administrative bodies. Thus, no legal or administrative proceedings, such as a request for judicial review, shall be undertaken in the requested State with respect to these matters. The main purpose of this rule is to prevent administrative or judicial bodies of the

requested State from being asked to decide matters which concern whether an amount, or part thereof, is owed under the internal law of the other State. *[Any legal actions contesting the recovery measures taken by the requested State can, of course, be brought before the competent judicial authorities of that State.]* States in which the paragraph may raise constitutional or legal difficulties may amend or omit it in the course of bilateral negotiations.

Paragraph 7

29. This paragraph provides that if, after a request has been made under paragraph 3 or 4, the conditions that applied when such request was made cease to apply (e.g. a revenue claim ceases to be enforceable in the requesting State), the State that made the request must promptly notify the other State of this change of situation. Following the receipt of such a notice, the requested State has the option to ask the requesting State to either suspend or withdraw the request. If the request is suspended, the suspension should apply until such time as the State that made the request informs the other State that the conditions necessary for making a request as regards the relevant revenue claim are again satisfied, or that it withdraws its request.

Paragraph 8

30. This paragraph contains certain limitations to the obligations imposed on the State which receives a request for assistance.

31. The requested State is at liberty to refuse to provide assistance in the cases referred to in the paragraph. However, if it does provide assistance in these cases, it remains within the framework of the Article and it cannot be objected that this State has failed to observe the provisions of the Article.

32. In the first place, the paragraph contains the clarification that a Contracting State is not bound to go beyond its own internal laws and administrative practice or those of the other State in fulfilling its obligations under the Article. Thus, if the requesting State has no domestic power to take measures of conservancy, the requested State could decline to take such measures on behalf of the requesting State. Similarly, if the seizure of assets to satisfy a revenue claim is not permitted in the requested State, that State is not obliged to seize assets when providing assistance in collection under the provisions of the Article. However, types of administrative measures authorised for the purpose of the requested State's tax must be utilised, even though

invoked solely to provide assistance in the collection of taxes owed to the requesting State.

33. Paragraph 5 of the Article provides that a Contracting State's time limits will not apply to a revenue claim in respect of which the other State has requested assistance. Subparagraph *a*) is not intended to defeat that principle. Providing assistance with respect to a revenue claim after the requested State's time limits have expired will not, therefore, be considered to be at variance with the laws and administrative practice of that or of the other Contracting State in cases where the time limits applicable to that claim have not expired in the requesting State.

34. Subparagraph *b*) includes a limitation to carrying out measures contrary to public policy (*ordre public*). As is the case under Article 26 (see [*paragraph 74 of the Commentary on Article 26 of this Model]*), it has been felt necessary to prescribe a limitation with regard to assistance which may affect the vital interests of the State itself.

35. Under subparagraph *c*), a Contracting State is not obliged to satisfy the request if the other State has not pursued all reasonable measures of collection or conservancy, as the case may be, available under its laws or administrative practice.

36. Finally, under subparagraph *d*), the requested State may also reject the request for practical considerations, for instance if the costs that it would incur in collecting a revenue claim of the requesting State would exceed the amount of the revenue claim.

37. Some States may wish to add to the paragraph a further limitation, already found in the joint Council of Europe-OECD multilateral Convention on Mutual Administrative Assistance in Tax Matters, which would allow a State not to provide assistance if it considers that the taxes, with respect to which assistance is requested, are imposed contrary to generally accepted taxation principles.

Article 28

MEMBERS OF DIPLOMATIC MISSIONS AND CONSULAR POSTS

Article 28 of this Model reproduces Article 28 of the OECD Model. The Committee considers that the following Commentary on Article 28 of the 2017 OECD Model is applicable to Article 28 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

1. The aim of the provision is to secure that members of diplomatic missions and consular posts shall, under the provisions of a double taxation convention, receive no less favourable treatment than that to which they are entitled under international law or under special international agreements.

2. The simultaneous application of the provisions of a double taxation convention and of diplomatic and consular privileges conferred by virtue of the general rules of international law, or under a special international agreement may, under certain circumstances, have the result of discharging, in both Contracting States, tax that would otherwise have been due. As an illustration, it may be mentioned that, for example, a diplomatic agent who is accredited by State A to State B and derives royalties, or dividends from sources in State A will not, owing to international law, be subject to tax in State B in respect of this income and may also, depending upon the provisions of the bilateral convention between the two States, be entitled as a resident of State B to an exemption from, or a reduction of, the tax imposed on the income in State A. In order to avoid tax reliefs that are not intended, the Contracting States are free to adopt bilaterally an additional provision which may be drafted on the following lines:

> Insofar as, due to fiscal privileges granted to members of diplomatic missions and consular posts under the general rules of international law or under the provisions of special international agreements, income or capital are not subject to tax in the receiving State, the right to tax shall be reserved to the sending State.

3. In many OECD member countries, the domestic laws contain provisions to the effect that members of diplomatic missions and consular posts whilst abroad shall for tax purposes be deemed to be residents of the sending State. In the bilateral relations between member countries in which provisions of this kind are operative internally, a further step may be taken by including in the Convention specific rules that establish, for purposes of the Convention, the sending State as the State of residence of the members of the diplomatic missions and consular posts of the Contracting States. The special provision suggested here could be drafted as follows:

> Notwithstanding the provisions of Article 4, an individual who is a member of a diplomatic mission or a consular post of a Contracting State which is situated in the other Contracting State or in a third State shall be deemed for the purposes of the Convention to be a resident of the sending State if:
>
> *a)* in accordance with international law he is not liable to tax in the receiving State in respect of income from sources outside that State or on capital situated outside that State, and
>
> *b)* he is liable in the sending State to the same obligations in relation to tax on his total income or on capital as are residents of that State.

4. By virtue of paragraph 1 of Article 4[111] the members of diplomatic missions and consular posts of a third State accredited to a Contracting State, are not deemed to be residents of the receiving State if they are only subject to a limited taxation in that State *[(see paragraph 9 of the Commentary on Article 4 of this Model as well as paragraph 8.1 of the Commentary on Article 4 of the 2017 OECD Model quoted therein]*). This consideration also holds true of the international organisations established in a Contracting State and their officials as they usually benefit from certain fiscal privileges either under the convention or treaty establishing the organisation or under a treaty between the organisation and the State in which it is established. Contracting States wishing to settle expressly this question, or to prevent undesirable tax reliefs, may add the following provision to this Article:

> The Convention shall not apply to international organisations, to organs or officials thereof and to persons who are members

111 *[This sentence does not apply to those bilateral agreements which omit the second sentence of paragraph 1 of Article 4.]*

of a diplomatic mission or a consular post of a third State, being present in a Contracting State and not treated in either Contracting State as residents in respect of taxes on income or on capital.

This means that international organisations, organs or officials who are liable in a Contracting State in respect only of income from sources therein should not have the benefit of the Convention.

5. Although honorary consular officers cannot derive from the provisions of the Article any privileges to which they are not entitled under the general rules of international law (there commonly exists only tax exemption for payments received as consideration for expenses honorary consuls have on behalf of the sending State), the Contracting States are free to exclude, by bilateral agreement, expressly honorary consular officers from the application of the Article.

Article 29

ENTITLEMENT TO BENEFITS

A. Preliminary remarks

1. As explained in the footnote to the Article, Article 29 reflects the intention of the Contracting States, incorporated in the preamble of the Convention, to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements. This intention and the wording of the Article correspond to the minimum standard that was agreed to by participating States as part of the OECD/G20 Base Erosion and Profit Shifting Project and that is described in paragraph 22 of the final report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[112] of the OECD/G20 BEPS Project. As indicated in that report, the drafting of the Article will depend on how Contracting States that are seeking consistency with that minimum standard decide to implement it. Depending on their own circumstances, States may wish to adopt only the general anti-abuse rule of paragraph 9 of the Article, may prefer instead to adopt paragraphs 1 to 7 of the Article, which they would supplement by a mechanism that would address conduit arrangements not otherwise dealt with by the provisions of the Convention, or may prefer to include both approaches in their treaty.

2. A State may prefer the last approach described above because it combines the flexibility of a general rule that can prevent a large number of abusive transactions with the certainty of a more "automatic" rule that prevents transactions that are known to cause treaty-shopping concerns and that can be easily described by reference to certain features (such as the foreign ownership of an entity). Such a combination should not be construed in any way as restricting the scope of the general anti-abuse rule of paragraph 9: a transaction or arrangement should not be considered to be outside the scope of paragraph 9 simply because the specific anti-abuse rules of paragraphs 1 to 7, which only deal with certain cases of treaty shopping that can be easily identified by certain of their features, are not applicable.

112 See footnote 7 above.

3. As indicated above, however, a State may prefer to deal with treaty shopping without the general anti-abuse rule of paragraph 9, relying instead on the specific anti-abuse rules of paragraphs 1 to 7, together with a mechanism that will address conduit arrangements that would escape the application of these paragraphs. This may be the case of a State the domestic law of which includes strong anti-abuse rules that are sufficient to deal with other forms of treaty abuses.

4. Whereas the version of paragraphs 1 to 7 of Article 29 that was incorporated into the 2017 OECD Model refers to both the "simplified" and "detailed" versions of these paragraphs that are provided in the Commentary on the Article, the Committee decided that Article 29 of the UN Model would adopt only the detailed version, concluding that the detailed version would provide the tax conventions concluded by developing countries with a more robust protection against treaty-shopping abuses.

5. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which describes the detailed version of that Article, is applicable to paragraphs 1 to 7 of Article 29 of this Model:

> 4. This Article contains provisions that prevent various forms of treaty shopping through which persons who are not residents of a Contracting State might establish an entity that would be a resident of that State in order to reduce or eliminate taxation in the other Contracting State through the benefits of the tax treaty concluded between these two States. Allowing persons who are not directly entitled to treaty benefits (such as the reduction or elimination of withholding taxes on dividends, interest or royalties) to obtain these benefits indirectly through treaty shopping would frustrate the bilateral and reciprocal nature of tax treaties. If, for instance, a State knows that its residents can indirectly access the benefits of treaties concluded by another State, it may have little interest in granting reciprocal benefits to residents of that other State through the conclusion of a tax treaty. Also, in such a case, the benefits that would be indirectly obtained may not be appropriate given the nature of the tax system of the former State; if, for instance, that State does not levy an income tax on a certain type of income, it would be inappropriate for its residents to benefit from the provisions of a tax treaty concluded between two other States that grant a reduction or elimination of source taxation for that type of income

and that were designed on the assumption that the two Contracting States would tax such income.

5. The provisions of paragraphs 1 to 7 seek to deny treaty benefits in the case of structures that typically result in the indirect granting of treaty benefits to persons that are not directly entitled to these benefits whilst recognising that in some cases, persons who are not residents of a Contracting State may establish an entity in that State for legitimate business reasons. Although these provisions apply regardless of whether or not a particular structure was adopted for treaty-shopping purposes, the Article allows the competent authority of a Contracting State to grant treaty benefits where the other provisions of the Article would otherwise deny these benefits but the competent authority determines that the structure did not have as one of its principal purposes the obtaining of benefits under the Convention.

6. The Article restricts the general scope of the other provisions of the Convention, including those of Article 1 according to which the Convention applies to persons who are residents of a Contracting State. Paragraph 1 of the Article provides that a resident of a Contracting State shall not be entitled to the benefits of the Convention unless it constitutes a "qualified person" under paragraph 2 or unless benefits are granted under the provisions of paragraphs 3, 4, 5 or 6. Paragraph 2 determines who constitutes a "qualified person" by reference to the nature or attributes of various categories of persons; any person to which that paragraph applies is entitled to all the benefits of the Convention. Under paragraph 3, a person is entitled to the benefits of the Convention with respect to an item of income even if it does not constitute a "qualified person" under paragraph 2 as long as that item of income emanates from, or is incidental to, the active conduct of a business in that person's State of residence (subject to certain exceptions). Paragraph 4 is a "derivative benefits" provision that allows certain entities owned by residents of third States to obtain treaty benefits provided that these residents would have been entitled to equivalent benefits if they had invested directly. Paragraph 5 is a "headquarters company" provision under which a company that is not eligible for benefits under paragraph 2 may nevertheless qualify for benefits with respect to particular items of income. Paragraph 6 includes the provisions that allow the competent authority of a Contracting State to grant treaty benefits where the other provisions of the Article would otherwise deny these benefits. Paragraph 7 includes a number of definitions that apply for the purposes of the Article.

B. Commentary on the paragraphs of Article 29

Paragraph 1: provision denying treaty benefits to a resident of a Contracting State who is not a "qualified person"

6. Paragraph 1 provides that a resident of a Contracting State, as defined under Article 4, will be entitled to the benefits otherwise accorded to residents of a Contracting State under the Convention only if it constitutes a "qualified person" under paragraph 2 or unless benefits are otherwise granted under paragraphs 3, 4, 5 or 6. The benefits otherwise accorded to a resident of a Contracting State under the Convention include all limitations to the Contracting States' taxing rights under Articles 6 through 22, the elimination of double taxation provided by Article 23 and the protection afforded to residents of a Contracting State under Article 24. The Article does not, however, restrict the availability of treaty benefits under paragraph 2 of Article 9, Article 25 or under the few provisions of the Convention that do not require that a person be a resident of Contracting State in order to enjoy the benefits of those provisions (e.g. the provisions of paragraph 1 of Article 24, to the extent that they apply to nationals who are not residents of either Contracting State).

7. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which includes additional explanations on paragraph 1, is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 8. Paragraph 1 does not extend in any way the scope of the benefits granted by the other provisions of the Convention. Thus, a resident of a Contracting State who constitutes a "qualified person" under paragraph 2 must still meet the conditions of the other provisions of the Convention in order to obtain these benefits (e.g. that resident must be the beneficial owner of dividends in order to benefit from the provisions of paragraph 2 of Article 10) and these benefits may be denied or restricted under applicable anti-abuse rules such as the rules in paragraphs 8 and 9.

9. Paragraph 1 applies at any time when the Convention would otherwise provide a benefit to a resident of a Contracting State. Thus, for example, it applies at the time when income to which Article 6 applies is derived by a resident of a Contracting State, at the time that dividends to which Article 10 applies are paid to a resident of a Contracting State or at any time when profits to which Article 7 applies are made. The paragraph requires that, in order to be entitled to the benefit provided by the relevant provision of the Convention, the resident of the Contracting State must be a "qualified person", within the meaning of paragraph 2, at the relevant time. In some cases, however, the definition of "qualified person" requires that a resident of a Contracting State must satisfy certain conditions over a period of time in order to constitute a "qualified person" at a given time.

10. Since the definition of "equivalent beneficiary" that would be used for the purpose of paragraph 4 of the detailed version dealing with derivative benefits would exclude persons who, under another convention, are entitled to relief from taxation by the State of source that is not as favourable as the relief provided under the Convention, that definition would have the so-called "cliff" effect of denying all treaty benefits even if the difference in the relief provided by the two conventions is relatively minor. In that case, some States consider that it is appropriate to provide relief from taxation by the State of source that is similar to the relief that would be provided under the other convention. This treatment may be achieved through the alternative provisions included in paragraph 147 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted in paragraph 27 below of the Commentary on Article 29 of this Model]* that relate to the taxation of *[income from the operation of ships or aircraft in international traffic,]* dividends, interest*[,]* royalties, *[fees for services, income from automated digital services and insurance premiums]*, which are provisions that alleviate the so-called "cliff effect" when a potential equivalent beneficiary is, under another convention, entitled to restrictions on taxation by the State of source that are not as favourable as those provided by the Convention. Instead of denying all treaty benefits with respect to such income, these provisions grant limited benefits that broadly correspond to those that would have been available under the other convention. In order to ensure that paragraph 1 does not deny the benefits granted under these alternative provisions, which would be contrary to the purpose of these provisions, these States should adopt a different version of paragraph 1 that would be drafted as follows:

> Except as otherwise provided in this Article and in reference to the paragraphs of Articles *[8,]* 10, 11*[,]* 12*[, 12AA, 12B and 12C]* that relate to the so-called "cliff effect", a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25), unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.

Paragraph 2: situations where a resident is a "qualified person"

8. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which provides additional explanations on paragraph 2, is applicable to the equivalent provision of this Model (the modification that appears in italics between square brackets, which is not part of the Commentary on the OECD Model, has been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 11. Each of the subparagraphs of paragraph 2 *[…]* describes a category of residents that are qualified persons at the time when the relevant treaty benefits are claimed.
>
> 12. It is intended that the provisions of paragraph 2 will be self-executing. Unlike the provisions of paragraph *[6]*, discussed below, claiming benefits under paragraph 2 does not require advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed.

Subparagraph (a): individuals

9. Under paragraph 2(*a*), any individual who is a resident of a Contracting State is a qualified person.

Subparagraph (b): Contracting States, political subdivisions and their agencies and instrumentalities

10. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains paragraph 2(*b*), is applicable to the equivalent provision of this Model (the modification that appears in italics between square brackets, which

is not part of the Commentary on the OECD Model, has been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 14. Subparagraph *b*) *[…]* provides that the Contracting States and any political subdivision or local authority thereof constitute qualified persons. These words apply to any part of a State, such as a separate fund established by the State that does not constitute, and is not owned by, a separate person. Under the last part of the subparagraph, a separate legal person which is a resident of a Contracting State and is an agency or instrumentality of a Contracting State, or a political subdivision or local authority thereof, will also be a qualified person and, therefore, will be entitled to all the benefits of the Convention whilst it qualifies as such. The concept of "agency or instrumentality" is restricted to entities set up by a State (or a political subdivision or local authority thereof) to perform exclusively functions of a governmental nature; it does not apply, for example, to a company that acts as an agent of the State for certain purposes but that was not set up by the State to perform functions of a governmental nature. The wording of the subparagraph may need to be adapted to reflect the different legal nature that State-owned entities, such as sovereign wealth funds, may have in the Contracting States as well as the different views that these States may have concerning the application of Article 4 to these entities (see paragraphs 50 to 53 of the Commentary on Article 1 *[of the 2017 OECD Model]* and paragraphs 8.5 and 8.11 of the Commentary on Article 4 *[of the 2017 OECD Model]*).

Subparagraph (c): publicly-traded companies and entities

11. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the OECD detailed version of paragraph 2(*c*), is applicable to the equivalent provision of this Model:

> 16. Subparagraph *c*) recognises that, as a general rule, because the shares of publicly-traded companies and of some entities are generally widely-held, these companies and entities are unlikely to be established for treaty-shopping purposes.

17. Subparagraph *c*) provides that a company or entity resident in a Contracting State constitutes a qualified person at a time when a benefit is provided by the Convention if, throughout the taxable

period that includes that time, the principal class of its shares, and any disproportionate class of shares, is regularly traded on one or more recognised stock exchanges, provided that the company or entity also satisfies at least one of the following additional requirements: first, the company's or entity's principal class of shares is primarily traded on one or more recognised stock exchanges located in the Contracting State of which the company or entity is a resident or, second, the company's or entity's primary place of management and control is in its State of residence. These additional requirements take account of the fact that whilst a publicly-traded company or entity may be technically resident in a given State, it may not have a sufficient relationship with that State to justify allowing such a company or entity to obtain the benefits of treaties concluded by that State. Such a sufficient relationship may be established by the fact that the shares of the publicly-traded company or entity are primarily traded in recognised stock exchanges situated in the State of residence of the company or entity; given the fact that the globalisation of financial markets means that shares of publicly-listed companies that are residents of some States are often traded on foreign stock exchanges, the alternative test provides that this sufficient relationship may also be established by the fact that the company or entity is primarily managed and controlled in its State of residence.

18. A company or entity whose principal class of shares is regularly traded on a recognised stock exchange will nevertheless not qualify for benefits under subparagraph *c*) of paragraph 2 if it has a disproportionate class of shares that is not regularly traded on a recognised stock exchange.

19. The terms "recognised stock exchange", "shares", "principal class of shares" and "disproportionate class of shares" are defined in paragraph 7. As indicated in these definitions, the term "shares" covers comparable interests in entities, other than companies, to which the subparagraph applies; this includes, for example, publicly-traded units of a trust.

20. The regular trading requirement can be met by the trading of issued shares on any recognised exchange or exchanges located in either State. Trading on one or more recognised stock exchanges may be aggregated for purposes of this requirement; a company or entity could therefore satisfy this requirement if its shares are regularly traded, in whole or in part, on a recognised stock exchange located in the other Contracting State.

21. Subdivision (i) includes the additional requirement that the shares of the company or entity be primarily traded on one or more recognised stock exchanges located in the State of residence of the company or entity. In general, the principal class of shares of a company or entity is "primarily traded" on one or more recognised stock exchanges located in the State of residence of that company or entity if, during the relevant taxation year, the number of shares in the company's or entity's principal class of shares that are traded on these stock exchanges exceeds the number of shares in the company's or entity's principal class of shares that are traded on established securities markets in any other State. Some States, however, consider that the fact that shares of a company or entity resident in a Contracting State are primarily traded on recognised stock exchanges situated in other States (e.g. in a State that is part of the European Economic Area within which rules relating to stock exchanges and securities create a single market for securities trading) constitutes a sufficient safeguard against the use of that company or entity for treaty-shopping purposes; States that share that view may modify subdivision (i) accordingly.

22. Subdivision (ii) provides the alternative requirement applicable to a company or entity whose principal class of shares is regularly traded on recognised stock exchanges but not primarily traded on recognised stock exchanges situated in the State of residence of the company or entity. Such a company or entity may claim treaty benefits if its "primary place of management and control" (as defined in paragraph 7) is in its State of residence.

23. The conditions of subparagraph *c*) must be satisfied throughout the taxable period of the company or entity. This does not require that the shares of the company or entity be traded on the relevant stock exchanges each day of the relevant period. For shares to be considered as regularly traded on one or more stock exchanges throughout the taxable period, it is necessary that more than a very small percentage of the shares be actively traded during a sufficiently large number of days included in that period. The test would be met, for example, if 10 per cent of the average number of outstanding shares of a given class of shares of a company were traded during 60 days of trading taking place in the taxable period of the company. The phrase "taxable period" in subparagraphs *c*), *d*) and *f*) refers to the period for which an annual tax return must be filed in the State of residence of the company or entity. If the Contracting States have a concept corresponding to "taxable period" in their domestic law, such as "taxable year", they are free to replace the reference to taxable period by that other concept.

Subparagraph (d): affiliates of publicly-traded companies and entities

12. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains paragraph 2(*d*), is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences between the provisions of the OECD Model and those of this Model):

> 24. Subparagraph *d*) extends the principle underlying subparagraph *c*) (i.e. that publicly-traded companies and entities are unlikely to be established for treaty-shopping purposes) to some companies in which five or fewer publicly-traded companies and entities own a majority interest, subject to additional conditions.
>
> 25. In order for a company resident of a Contracting State to be entitled to all the benefits of the Convention under subparagraph *d*) at a given time, that company must satisfy two conditions applicable to the taxable period that includes that time.
>
> 26. First, under subdivision (i), the company must satisfy an ownership test. Under that test, five or fewer publicly-traded companies or entities described in subparagraph *c*) must be, throughout that taxable period, the direct or indirect owners of at least 50 per cent of the aggregate vote and value of the company's shares (and at least 50 per cent of any disproportionate class of shares). If the publicly-traded companies or entities are indirect owners, however, each of the intermediate companies or entities must either be a resident of the Contracting State from which a benefit under this Convention is being sought or be a "qualifying intermediate owner". The term "qualifying intermediate owner" is defined in paragraph 7; under that definition, a qualifying intermediate owner also includes a resident of the same Contracting State as the company claiming benefits under subparagraph *d*).
>
> 27. Thus, for example, a company resident of a Contracting State satisfies the requirements of subdivision (i) if it is wholly owned by a company that is a resident of the same State and that satisfies the requirements of subparagraph *c*). Furthermore, if a publicly-traded parent company in the other Contracting State indirectly owns the company through a chain of subsidiaries, each such subsidiary in the

chain, as an intermediate owner, must be a resident of the Contracting State from which a benefit under this Convention is being sought or a qualifying intermediate owner in order for the company to meet the ownership test in subdivision (i).

28. The phrase "50 per cent of the aggregate vote and value of the shares", which is used in subparagraphs *d*) and *f*) and in other parts of paragraphs 1 to 7, refers to a participation that represents both at least 50 per cent of all the voting rights in the relevant company or entity and at least 50 per cent of the value of all the shares in that company or entity. That test would therefore not be satisfied in the case of a participation that would satisfy the vote condition without satisfying the value condition (or vice versa).

29. Under the second condition, included in subdivision (ii), the company must also satisfy a base erosion test with respect to any treaty benefits that it claims (other than a benefit with respect to dividends under Article 10). That base erosion test is satisfied if

— less than 50 per cent of the company's gross income (and less than 50 per cent of the tested group's gross income if there is a tested group), for the taxable period that includes the time when the benefits are claimed, is paid or accrued, directly or indirectly, in the form of payments to ineligible persons that are deductible, for tax purposes, in computing the company's tax in its State of residence, and

— less than 50 per cent of the tested group's gross income (if there is a tested group), for the taxable period that includes the time when the benefits are claimed, is paid or accrued, directly or indirectly, in the form of payments to ineligible persons that are deductible, for tax purposes, in computing the tax of any member of the tested group in the State of residence of the company claiming the treaty benefits.

30. The term "ineligible persons" used in the previous paragraph refers to any persons other than the residents of each Contracting State who are entitled to the benefits of this Convention under subparagraph *a*), *b*), *c*) or *e*) of paragraph 2. Entities that are residents of the Contracting States and that are entitled to the benefits of this Convention under this subparagraph or under subparagraph *f*) of paragraph 2 are, therefore, ineligible persons; this ensures that these entities are not used in arrangements that could allow third country investors to accumulate indirectly a significant amount of the base eroding payments made by a company seeking benefits under this

subparagraph. Paragraph 7 includes the definition of the terms "tested group" and "gross income" which are used in subdivision (ii).

31. For the purpose of the base erosion test, deductible payments do not include arm's-length amounts paid or accrued in the ordinary course of business for services or tangible property. To the extent they are deductible from the taxable base, trust distributions are deductible payments. Depreciation and amortisation deductions, which do not represent payments or accruals to other persons, are disregarded for this purpose. Furthermore, in the case of a tested group, deductible payments do not include intra-group payments. Finally, payments of interest are not arm's-length amounts paid or accrued in the ordinary course of business for services or tangible property, and would therefore be taken into account if made to an ineligible person.

32. The following examples illustrate the application of the base erosion test of subdivision (ii) of subparagraph *d*) by a Contracting State (referred to in the examples as the "first-mentioned State"), taking into account the definitions of "tested group" and "gross income" in paragraph 7:

— *Example A*: Assume that at all relevant times, R3 is a company wholly owned by another company, R2, which in turn is wholly owned by R1, a publicly-traded company that satisfies the requirements of subparagraph *c*). R3, R2 and R1 are all residents of the other Contracting State under Article 4 and are all members of the same tax consolidation group. The ownership test in subdivision (i) of subparagraph *d*) is satisfied because R1, a company satisfying the requirements of subparagraph *c*), indirectly owns at least 50 per cent of the aggregate vote and value of R3 (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares of R3), and R2, which is an intermediate owner, is a resident of the other Contracting State and is therefore a qualifying intermediate owner.

During the taxable period that includes the time when the benefit would otherwise be accorded by the first-mentioned State, R3 derives: first, 200 of dividends from a company resident in a third State that are excluded from gross income of R3 in the other Contracting State; and, second, 100 of interest arising in the first-mentioned State, for which R3 is seeking the benefits of Article 11 of the Convention. R3 makes a base eroding payment of 49 to an ineligible person and pays a dividend of 51 to R2. In addition to the 51 dividend that it receives from R3, R2

receives additional gross receipts of 100 from persons outside the tested group. R2 makes a base eroding payment of 51 to an ineligible person.

In this example, the tested group, as defined in paragraph 7, consists of R3, R2 and R1, because the three companies participate in a tax consolidation regime. In order to be eligible for benefits with respect to the interest arising in the first-mentioned State, R3 and the tested group must each meet the base erosion test of subdivision (ii).

R3's gross income, as defined in paragraph 7, is 100 (the interest arising in the first-mentioned State), since the 200 dividend paid to R3 from a third-State company is excluded. Thus, for the taxable period for which R3 seeks benefits, less than 50 of R3's gross income is in the form of base eroding payments to ineligible persons. R3 has made only 49 in base eroding payments and would therefore satisfy the part of the base erosion test that applies to it.

The tested group's gross income computed under the tax law of the other Contracting State excludes the 200 dividend paid to R3 from a third-State company as well as intragroup transactions (i.e. the 51 dividend from R3 to R2). The tested group's gross income is, therefore, 200 (the 100 interest arising in the first-mentioned State plus the 100 R2 received from persons outside the tested group). Thus, during the taxable period in question, the tested group must make less than 100 in base eroding payments to ineligible persons in order to satisfy the base erosion test of subdivision (ii).

In this example, R3 does not satisfy the requirements of subparagraph d). Although R3's 49 of base eroding payments to ineligible persons does not exceed the allowable limit of less than 50, the tested group's total base eroding payments to ineligible persons of 100 (49 + 51), exceeds the tested group's allowable limit of base eroding payments to ineligible persons, which was less than 100.

— *Example B*: Assume the same facts as in Example A, except that R3 derives 100 of dividends paid by a company resident of the first-mentioned State rather than interest arising in that State, and has no other gross income in the taxable period. Since the only treaty benefit that R3 is seeking is under Article 10 with respect to the dividends, R3 is not required to apply the base erosion test

under subdivision (ii). Accordingly, R3 will be a qualified person with respect to the dividend under subparagraph *d*) because it satisfies the ownership requirement of subdivision (i).

— *Example C*: Assume that at all relevant times, P2 (the relevant company) is a company that is wholly owned by P1, a publicly-traded company that satisfies the requirements of subparagraph *c*). P2 and P1 are residents of the other Contracting State.

During the taxable year in question, P2's only items of income are interest of 100 arising in the first-mentioned State for which P2 seeks to claim the benefits of Article 11. P2 makes a deductible interest payment of 100 to P1, a person that satisfies subparagraph *c*). P1 makes a deductible payment during the same taxable period of 100 to ThirdCo, a company resident in State Y. P2, through P1, has indirectly made a base eroding payment of 100 to an ineligible person. In this example, the base erosion test under subdivision (ii) is not satisfied and P2 will not be a qualified person.

33. As indicated in the Commentary on Article 1, some States consider that provisions should be included in their tax treaties in order to deny the application of specific treaty provisions with respect to income that is paid to connected persons (as defined in paragraph 7) that benefit from regimes that constitute "special tax regimes" (see paragraphs 85 to 100 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*) and to deny the application of Article 11 to interest that is paid to connected persons that benefit from domestic law provisions that provide for a notional deduction with respect to equity (see paragraph 107 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*). These States may want to modify the base-erosion test of subdivision (ii) in order to include in the category of "ineligible persons" persons who, although they are residents of one of the Contracting States, benefit from such special tax regimes or notional deductions with respect to deductible payments made or accruing to them. This could be done by amending subdivision (ii) as follows:

(ii) with respect to benefits under this Convention other than under Article 10, less than 50 per cent of the company's gross income, and less than 50 per cent of the tested group's gross income, for the taxable period that includes that time, is paid or accrued,

directly or indirectly, in the form of payments that are deductible in that taxable period for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions)

A) to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph *a*), *b*), *c*) or *e*);

B) to persons that are connected to the person described in this subparagraph and that benefit from a special tax regime, as defined in [reference to the paragraph of the convention that includes the definition of "special tax regime"] of this Convention, with respect to the deductible payment; or

C) with respect to a payment of interest, to persons that are connected to the person described in this subparagraph and that benefit from notional deductions described in [reference to the paragraph of Article 11 that relates to notional deductions for equity].

34. The following example illustrates the application of the alternative formulation of the base erosion test included in the previous paragraph:

— *Example*: Assume the same facts as in Example B in paragraph 32 above, except that R3's only items of income are 100 of royalties arising in the State from which the treaty benefits are sought, for which R3 seeks to claim the benefits of Article 12. R3 makes a deductible royalty payment of 100 to R1. At all relevant times, R1 benefits from a special tax regime (as defined in that Convention) with respect to royalties.

The ownership condition of subdivision (i) of subparagraph *d*) is satisfied because R1, a company satisfying the requirements of subparagraph *c*), indirectly owns at least 50 per cent of the aggregate vote and value of R3 and R2 is a qualifying intermediate owner. However, even though R1 is a person that satisfies subparagraph *c*), the deductible royalty payment made to R1 by R3 is a base eroding payment because R1 is an ineligible person. R1 is a connected person with respect to R3 and benefits from a special tax regime with respect to the royalty income. In this example, R3 does not satisfy the base erosion test under subdivision (ii) because R3 has made 100 of base eroding payments to a person who benefits from a special tax regime and

the amount, 100, exceeds R3's allowable limit of base eroding payments to ineligible persons (that limit being exceeded if the total of these payments is not lower than 50).

35. Some other States, however, may consider that there is no need to impose the base-erosion condition of subdivision (ii) in the case of companies that are primarily owned by publicly-traded companies or entities. These States may therefore wish to omit subparagraph *d*) and use the following version of subparagraph *c*) which would deal both with publicly-traded companies or entities and with companies in which five or fewer publicly-traded companies and entities own a majority interest (States following this approach should also renumber the subsequent subparagraphs of paragraph 2 and replace the references to "subparagraph *c*)" by references to "subdivision (i) of subparagraph *c*)" in the wording of the ["]ownership/base erosion," "derivative benefits" and ["]headquarters company["] rules in order to avoid the problem described in paragraph 30 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted above]*):

c) a company or other entity, if, throughout the taxable period that includes that time

(i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognised stock exchanges, and either:

A) its principal class of shares is primarily traded on one or more recognised stock exchanges located in the Contracting State of which the company or entity is a resident; or

B) the company's or entity's primary place of management and control is in the Contracting State of which it is a resident;

(ii) at least 50 per cent of the aggregate vote and value of the shares (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares) in the company or entity is owned directly or indirectly by five or fewer companies or entities entitled to benefits under subdivision (i) of this subparagraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of the Contracting State from which a benefit under this Convention is being sought or is a qualifying intermediate owner;

Subparagraph (e): non-profit organisations and recognized pension funds

13. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the OECD detailed version of paragraph 2(*e*), is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 39. Subparagraph *e*) of the detailed version provides rules under which certain non-profit organisations (to the extent that they qualify as residents of a Contracting State, as explained in paragraph 8.11 of the Commentary on Article 4 *[of the 2017 OECD Model, as quoted in paragraph 5 of the Commentary on Article 4 of this Model]*) and *[…]* recognized pension funds *[as defined in paragraph 1(i) of Article 3]* will be entitled to all the benefits of the Convention.
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> 40. Entities that would be described in subdivision (i) automatically qualify for treaty benefits without regard to the residence of their beneficiaries or members. These entities would generally correspond to those that do not pay tax in their State of residence and that are constituted and operated exclusively to fulfil certain social functions (e.g. charitable, scientific, artistic, cultural, or educational). The description of such entities that will be included in subdivision (i) with respect to each State will typically refer to the provisions of the domestic law of that State that describe these entities or to the domestic law factors that allow the identification of these entities. Depending on the wording used, States may also want to amend subdivision (i) in order to allow their competent authorities to agree subsequently to amend or supplement the description provided.

14. The reference, in subdivision (ii), to "recognized pension funds as defined in paragraph 1(*i*) of Article 3" ensures that these pension funds will be entitled to the benefits of the Convention regardless of whether the beneficial interest in such funds are held by individuals who are residents of the State in which they are established or are residents of other States. As indicated in paragraph 19 of the Commentary on Article 3, however, some States may prefer to restrict the definition of recognized pension fund to address possible treaty-shopping concerns

arising from that aspect of the definition. This would be done by adopting the alternative formulation of the definition found in that paragraph of the Commentary on Article 3.

15. Not all States, however, include the definition of "recognized pension fund" in their tax conventions. States that do not include that definition may wish to amend Article 29 so as to ensure that if a pension fund otherwise qualifies as a resident of a Contracting State, it will constitute a "qualified person" if it satisfies the conditions provided for in the alternative definition in paragraph 19 of the Commentary on Article 3 as regards the holding of beneficial interests in the pension fund by persons who are either residents of a Contracting State or, possibly, equivalent beneficiaries.

Subparagraph (f): ownership/base erosion

16. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the OECD detailed version of paragraph 2(*f*), is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 46. Subparagraph *f*) *[…]* provides an additional method to qualify for treaty benefits that applies to any form of legal entity that is a resident of a Contracting State. The test provided in subparagraph *f*), the so-called ownership and base erosion test, is a two-part test; both parts must be satisfied for the resident to be entitled to treaty benefits under subparagraph *f*).
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> 47. Under subdivision (i), which is the ownership part of the test, 50 per cent or more of the aggregate vote and value of the outstanding shares (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares) in the person must be owned, directly or indirectly, at the time when the relevant treaty benefit otherwise would be accorded and on at least half the days of a twelve-month period that includes that time, by persons who are residents of the Contracting State of which that person is a resident and that are themselves entitled to treaty benefits under subparagraphs *a*), *b*), *c*) or *e*). In the case of indirect owners, however, each of the intermediate owners must be

a qualifying intermediate owner. The term "qualifying intermediate owner" is defined in paragraph 7; under that definition, a qualifying intermediate owner also includes a resident of the same Contracting State as the company claiming benefits under subparagraph *f*).

48. Whilst subparagraph *f*) will typically be relevant in the case of private companies, it may also apply to an entity such as a trust that is a resident of a Contracting State and that otherwise satisfies the requirements of the subparagraph. According to the definition of shares in paragraph 7, the reference to "shares", in the case of entities that are not companies, means interests that are comparable to shares; this would generally be the case of the beneficial interests in a trust. For the purposes of subdivision (i), the beneficial interests in a trust will be considered to be owned by its beneficiaries in proportion to each beneficiary's actuarial interest in the trust. The interest of a beneficiary entitled to the remaining part of a trust will be equal to 100 per cent less the aggregate percentages held by income beneficiaries. A beneficiary's interest in a trust will not be considered to be owned by a person entitled to benefits under subparagraphs *a*), *b*), *c*) or *e*) if it is not possible to determine the beneficiary's actuarial interest. Consequently, if it is not possible to determine the actuarial interest of the beneficiaries in a trust, the ownership test under subdivision (i) cannot be satisfied, unless all possible beneficiaries are persons entitled to benefits under subparagraphs *a*), *b*), *c*) or *e*).

49. Subdivision (ii) constitutes the base erosion part of the test, which is broadly similar to the base erosion test in subdivision (ii) of subparagraph *d*) except for the fact that, unlike that other test, it also applies to a person that is seeking benefits under Article 10. That base erosion test is satisfied if

— less than 50 per cent of the person's gross income (and less than 50 per cent of the tested group's gross income if there is a tested group), for the taxable period that includes the time when the benefits are claimed, is paid or accrued, directly or indirectly, in the form of payments to ineligible persons that are deductible, for tax purposes, in computing the company's tax in its State of residence, and

— less than 50 per cent of the tested group's gross income (if there is a tested group), for the taxable period that includes the time when the benefits are claimed, is paid or accrued, directly or indirectly, in the form of payments to ineligible persons that are deductible, for tax purposes, in computing the tax of any member of the

tested group in the State of residence of the company claiming the treaty benefits.

50. The term "ineligible persons" used in the previous paragraph refers to any persons other than the residents of each Contracting State who are entitled to the benefits of this Convention under subparagraph *a*), *b*), *c*) or *e*) of paragraph 2. Also, paragraph 7 includes the definition of the terms "tested group" and "gross income" which are used in subdivision (ii).

51. The base erosion test of subdivision (ii), unlike that of subparagraph *d*), applies if a person wishes to obtain the benefits of Article 10. Such a person shall, for the purpose of subdivision (ii), include in its gross income any dividends received even if the dividends are effectively exempt from tax in that person's State of residence. This is provided for in subdivision (i) of the definition of "gross income" in paragraph 7.

52. As in the case of the base erosion test in subparagraph *d*), for the purpose of applying the test in subdivision (ii), deductible (i.e. base-eroding) payments do not include arm's-length amounts paid or accrued in the ordinary course of business for services or tangible property. To the extent they are deductible from the taxable base under the tax law of the person's State of residence, trust distributions constitute such base-eroding payments. Depreciation and amortisation deductions, which do not represent payments or accruals to other persons, are not taken into account for the purposes of subdivision (ii). Furthermore, in the case of a tested group, deductible payments do not include intra-group payments. Finally, payments of interest are not arm's-length amounts paid or accrued in the ordinary course of business for services or tangible property, and would therefore be taken into account if made to an ineligible person.

53. As explained in paragraph 33 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted in paragraph 12 above]*, which is applicable to the base erosion test of subparagraph *d*), States that want to deny the application of specific treaty provisions with respect to income that is paid to connected persons that benefit from regimes that constitute "special tax regimes" and to deny the application of Article 11 to interest that is paid to connected persons that benefit from domestic law provisions that provide for a notional deduction with respect to equity, may also want to modify the base erosion test of subdivision (ii) in order to include in the category of "ineligible persons" persons who, although they are residents of one of the Contracting States, benefit

from such special tax regimes or notional deductions with respect to deductible payments made or accruing to them. This could be done by amending subdivision (ii) as follows:

> (ii) less than 50 per cent of the company's gross income, and less than 50 per cent of the tested group's gross income, for the taxable period that includes that time, is paid or accrued, directly or indirectly, in the form of payments that are deductible in that taxable period for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions)
>
> A) to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph *a*), *b*), *c*) or *e*); to persons that benefit from a, as defined in, with respect to the deductible payment.
>
> B) to persons that are connected to the person described in this subparagraph and that benefit from a special tax regime, as defined in [reference to the paragraph of the convention that includes the definition of "special tax regime"] of this Convention, with respect to the deductible payment; or
>
> C) with respect to a payment of interest, to persons that are connected to the person described in this subparagraph and that benefit from notional deductions described in [reference to the paragraph of Article 11 that relates to notional deductions for equity];

54. The following examples illustrate the application of the base erosion test of subdivision (ii) of subparagraph *f*) by a Contracting State (referred to in the examples as the "first-mentioned State"), taking into account the definitions of "tested group" and "gross income" in paragraph 7:

— *Example A*: Assume that at all relevant times, R2 (the entity seeking treaty benefits under subparagraph *f*)) is a wholly owned subsidiary of R1, which in turn is wholly owned by Z, an individual. R1, R2 and Z are all residents of the other Contracting State under Article 4. R2 and R1 are both members of the same tax consolidation group. The ownership test in subdivision (i) of subparagraph *f*) is satisfied because Z, a qualified person

under subparagraph *a*), owns indirectly at least 50 per cent of the aggregate vote and value of R2, and R1 is a qualifying intermediate owner.

During the relevant taxable period, R2 has 50 of exempt dividends paid by a company resident of a third State and 50 of interest arising in the first-mentioned State. R2 makes a deductible interest payment of 24 to an ineligible person and pays a 51 dividend to R1. In addition to the 51 dividend that it receives from R2, R1 receives additional income of 100 from persons outside the tested group. R1 makes a deductible interest payment of 51 to an ineligible person. R2 is seeking to claim the benefits of Article 11 of the Convention, but not of Article 10. For purposes of applying the tested group base erosion test, the tested group consists of R1 and R2. The tested group's gross income for this purpose is 150 (50 of interest arising in the first-mentioned State plus 100 of additional income from persons outside of the tested group). R2 has made a base eroding payment of 24 and R1 has made a base eroding payment of 51 to ineligible persons. The base eroding payments of the tested group total 75 (24 + 51), which is not less than 50 per cent of the tested group's gross income of 150. Therefore, the base erosion test is not satisfied and R2 is not a qualified person under subparagraph *f*).

— *Example B*: Assume the same facts as Example A above, except that the income with respect to which R2 seeks to be a qualified person is 50 of dividends paid by a company resident of the first-mentioned State instead of 50 of interest arising in that State. For this purpose, R2's gross income is 100 (the 50 of dividends paid by a company resident of a third State and the 50 of dividends paid by a company of the first-mentioned State). The gross income of the tested group is 200 (R2's gross income of 100 plus R1's income of 100 from persons outside the tested group). R2 has made a base eroding payment of 24 and R1 has made a base eroding payment of 51. The base eroding payments of R2 equal 24, which is less than 50 per cent of R2's gross income of 100. In addition, the base eroding payments of the tested group total 75 (24 + 51), which is less than 50 per cent of the tested group's gross income of 200. Therefore, under this example, the base erosion test of subdivision (ii) is satisfied and R2 shall be a qualified person under subparagraph *f*) for purposes of obtaining a lower rate of taxation on the dividend paid by the company resident of the first-mentioned State.

Subparagraph (g): Collective investment vehicles

17. Collective investment vehicles that would be covered by specific provisions included in paragraph 4 of Article 1 (see the section on "Collective Investment" in the Commentary on Article 1) would logically be included in the definition of "qualified person" because any treaty-shopping concerns related to residents of third states investing in such vehicles should be dealt with through the drafting of such provisions (as explained in paragraphs 37 to 46 of the Commentary on Article 1).

Paragraph 3: active conduct of a business

18. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains paragraph 3, is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 68. Paragraph 3 *[…]* sets forth an alternative test under which a resident of a Contracting State may receive treaty benefits with respect to certain items of income that are connected to an active business conducted in its State of residence. This paragraph recognises that where an entity resident of a Contracting State actively carries on business activities in that State, including activities conducted by connected persons, and derives income from the other Contracting State that emanates from, or is incidental to, such business activities, granting treaty benefits with respect to such income does not give rise to treaty-shopping concerns regardless of the nature and ownership of the entity. The paragraph will provide treaty benefits in a large number of situations where benefits would otherwise be denied under paragraph 1 because the entity is not a "qualified person" under paragraph 2.
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> 69. A resident of a Contracting State may qualify for benefits under paragraph 3 regardless of the fact that it is not a qualified person under paragraph 2. Under the active-conduct test of paragraph 3, a person (typically a company) will be eligible for treaty benefits if it satisfies two conditions: first, it is engaged in the active conduct of a business in its State of residence and second, the payment for which benefits are sought is related to the business. In certain cases, an additional

requirement that the business be substantial in size relative to the activity in the State of source generating the income must be met.

70. Subparagraph *a*) sets forth the general rule that a resident of a Contracting State engaged in the active conduct of a business in that State may obtain the benefits of the Convention with respect to an item of income derived from the other Contracting State. The item of income, however, must emanate from, or be incidental to, that business.

71. The term "business" is not defined (except for the limited purpose of clarifying that it includes the performance of professional services and of other activities of an independent character; see subparagraph h) of paragraph 1 of Article 3) and, under the general rule of paragraph 2 of Article 3, must therefore be given the meaning that it has under domestic law. An entity generally will be considered to be engaged in the active conduct of a business only if persons through whom the entity is acting (such as officers or employees of a company) conduct substantial managerial and operational activities.

72. Subdivisions (i) through (iv) of subparagraph *a*) identify specific functions that, either on their own or in combination, will be considered, for purposes of paragraph 3, not to constitute the active conduct of a business in a Contracting State, even when all such functions are conducted in the same State. These are: (i) operating as a holding company; (ii) providing overall supervision or administration of a group of companies; (iii) providing group financing (including cash pooling); and (iv) making or managing investments, unless these activities are carried on by a regulated bank (or financial institution agreed to by the Contracting States), insurance company or registered securities dealer in the ordinary course of its business as such.

73. This list of activities is intended to clarify that the administrative support functions of multinationals, as well as the activities of operating as a holding company, do not constitute the active conduct of a business and, therefore, income that emanates from, or is incidental to, such activities cannot be entitled to treaty benefits under paragraph 3. Some States consider, however, that some or all of the activities listed in subdivisions (i) through (iv) should be included in what constitutes the active conduct of a business and these States may therefore wish to adopt a different formulation of subparagraph *a*).

74. Whether an item of income emanates from the company's active conduct of a business in the State of residence must be determined based on facts and circumstances. In general, an item of income emanates from the active conduct of a business in the State of residence if there

is a factual connection between the actively conducted business and the item of income for which benefits are sought. For example, if a company conducts research and development in its State of residence and develops a patent for a new process, royalties from licensing the patent would be factually connected to the actively conducted business in the State of residence. In the case of dividends or interest paid to a parent company, the activities of the paying company will be relevant in determining whether the dividend or interest emanates from the parent's actively conducted business in its State of residence.

75. For the purposes of determining whether the activities of the paying company in the State of source have the required factual connection with the actively conducted business in the State of residence, it will be important to compare the lines of business in each State. The line of business in the State of source may be upstream or downstream to the activity conducted in the State of residence. Thus, the line of business in the State of source may provide inputs for a manufacturing process that occurs in the State of residence, or the line of business in the State of source may sell the output of the manufacturing process conducted by a resident. The following examples illustrate these principles:

— *Example A*: ACO is a company resident of State A and is engaged in the active conduct of a business in that State consisting in manufacturing product X. ACO owns 100 per cent of the shares of BCO, a company resident of State B. BCO acquires product X from ACO and distributes it to customers in State B. Since the distribution activity by BCO of product X is factually connected to ACO's manufacturing of that product, dividends paid by BCO to ACO will be treated as emanating from ACO's business.

— *Example B*: ACO is a company resident of State A that operates a large research and development facility in State A that develops intellectual property that it licenses to affiliates worldwide, including BCO. ACO owns 100 per cent of the shares of BCO, a company resident of State B. BCO manufactures and markets the ACO-designed products in State B. Since the activities conducted by BCO are factually connected to ACO's actively conducted business in State A, royalties paid by BCO to ACO for the use of its intellectual property will be treated as emanating from ACO's business.

— *Example C*: ACO is a company resident of State A and is engaged in State A in the active conduct of a manufacturing business that requires the use of commodity X. ACO owns 100 per cent of the

shares of BCO, a company resident of State B, which contains a large supply of commodity X. BCO extracts commodity X and sells it to ACO, which uses the commodity to manufacture goods that it sells in the open market. Since the business activity conducted by BCO provides upstream inputs to ACO for use in manufacturing its goods, BCO's business is factually connected to ACO's manufacturing activities in State A. Dividends paid by BCO to ACO will be treated as emanating from ACO's business.

76. An item of income derived from the State of source is "incidental to" the business carried on in the State of residence if production of the item facilitates the conduct of the business in the State of residence. An example of incidental income is income derived from the temporary investment of working capital of a person in the State of residence in securities issued by persons in the State of source.

77. Subparagraph *b*) of paragraph 3 states a further condition to the general rule in subparagraph *a*) in cases where the business generating the item of income in question is carried on either by the person deriving the income or by a connected person in the State of source. Subparagraph *b*) states that the business carried on in the State of residence, under these circumstances, must be substantial in relation to the activity in the State of source. The determination of substantiality is based upon all the facts and circumstances, including the comparative sizes of the businesses in each Contracting State, the relative sizes of the economies and markets in the two States, the nature of the activities performed in each State, and the relative contributions made to that business in each State.

78. The determination of whether subparagraph *b*) applies is made separately for each item of income derived from the State of source, with reference to the business in the State of residence from which the item of income in question emanates. It is therefore possible that a person would be entitled to the benefits of the Convention with respect to one item of income but not with respect to another. If a resident of a Contracting State is entitled to treaty benefits with respect to a particular item of income under paragraph 3, the resident is entitled to all the benefits of the Convention insofar as they affect the taxation of that item of income in the State of source.

79. The substantiality requirement under subparagraph *b*) will not apply, however, if the business generating the item of income in question is not carried on in the State of source by the resident seeking benefits or by a connected person in the State of source. For example,

if a small research firm in one State develops a process that it licenses to a very large pharmaceutical manufacturer in another State that is not a connected person with respect to the small research firm, the size of the business activity of the research firm in the first State would not have to be tested against the size of the business activity of the manufacturer. Similarly, a small bank of one State that makes a loan to a very large company that is not a connected person and that is operating a business in the other State would not have to pass a substantiality test to be eligible for treaty benefits under paragraph 3.

80. Subparagraph *c*) provides attribution rules in the case of activities conducted by connected persons for purposes of applying the substantive rules of subparagraphs *a*) and *b*). Thus, these rules apply for purposes of determining whether a person meets the requirement in subparagraph *a*) that it be engaged in the active conduct of a business and that the item of income emanates from that active business, and for making the comparison required by the "substantiality" requirement in subparagraph *b*). The term "connected person" is defined in paragraph 7.

81. The following examples illustrate the application of paragraph 3 in relation to activities conducted by connected persons:

— *Example A*: PARENTCO is a resident of a third State and is the parent of HOLDCO, which itself is the parent of OPCO1 and OPCO2. OPCO1 and HOLDCO are residents of State A. OPCO2 is a resident of State B. OPCO1 and OPCO2 are engaged in the business of manufacturing the same product in their respective States of residence. HOLDCO manages the investments of the group and is considered not to be engaged in the active conduct of a business. HOLDCO receives dividends from OPCO2. Under subparagraph *c*), HOLDCO is deemed to be engaged in the active conduct of a business because it is deemed to conduct the activities of OPCO1, which is engaged in the active conduct of a business. Therefore, HOLDCO is treated as engaged in the active conduct of a business in State A. Nevertheless, the fact that HOLDCO's deemed business is the same as the business of OPCO2 is not sufficient to demonstrate that the dividends paid by OPCO2 are factually connected to HOLDCO's actively conducted business. Accordingly, such dividends will not enjoy by virtue of paragraph 3 the reduced rates of withholding of Article 10 of the convention between States A and B.

— *Example B*: ACO is a company resident of State A and is engaged in State A in the active conduct of a manufacturing business that

requires the use of commodity X. All the shares of ACO are owned by HOLDCO, also a resident of State A, which also owns 100 per cent of the shares of BCO, a company resident of State B where there is a large supply of commodity X. BCO extracts commodity X and sells it to ACO, which uses the commodity to manufacture goods that it sells in the open market. HOLDCO is considered to be engaged in the active conduct of a business because it is deemed under subparagraph *c*) to conduct the activities of ACO. Since the business activity conducted by BCO provides upstream inputs for use in HOLDCO's deemed active conduct of a business, BCO's business is considered be factually connected to HOLDCO's deemed manufacturing business. Dividends paid by BCO to HOLDCO will therefore emanate from HOLDCO's deemed active conduct of a business.

Paragraph 4: derivative benefits

19. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the OECD detailed version of paragraph 4, is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 83. The drafting of the derivative benefits paragraph *[…]* depends on the views of the Contracting States concerning treaty-shopping opportunities that might arise from such a paragraph with respect to residents of States whose tax system includes certain preferential features.
>
> 84. As indicated in the Commentary on Article 1, some States consider that provisions should be included in their tax treaties in order to deny the application of specific treaty provisions with respect to income that is paid to connected persons (as defined in paragraph 7) that benefit from regimes that constitute "special tax regimes" (see paragraphs 85 to 100 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*) and to deny the application of Article 11 to interest that is paid to connected persons that benefit from domestic law provisions that provide for a notional deduction with respect to equity (see paragraph 107 of the Commentary on Article 1 *[of the 2017 OECD*

Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]). These States may want to ensure that any derivative benefits provisions included in their conventions do not allow base eroding payments to be made to such connected persons even if they qualify as equivalent beneficiaries. States that share these views are likely to want to adopt a derivative benefits paragraph drafted as follows:

> 4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded by this Convention if:
>
> *a*) at the time when the benefit otherwise would be accorded and on at least half of the days of any twelve-month period that includes that time, at least 95 per cent of the aggregate vote and value of its shares (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is a qualifying intermediate owner, and
>
> *b*) less than 50 per cent of the person's gross income, and less than 50 per cent of the tested group's gross income for the taxable period that includes that time, as determined in the person's Contracting State of residence, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions)
>
> (i) to persons that are not equivalent beneficiaries;
>
> (ii) to persons that are equivalent beneficiaries only by reason of paragraph 5 of this Article or of a substantially similar provision in the relevant comprehensive convention for the avoidance of double taxation;
>
> (iii) to persons that are equivalent beneficiaries that are connected persons with respect to the company described in this paragraph and that benefit from a special tax regime, as defined in [reference to

the paragraph of the convention that includes the definition of "special tax regime"] of this Convention, with respect to the deductible payment, provided that if the relevant comprehensive convention for the avoidance of double taxation does not contain a definition of a special tax regime analogous to the definition of that term included in this Convention, the principles of that definition shall apply, but without regard to the requirement in subdivision (v) of that definition; or

(iv) with respect to a payment of interest, to persons that are equivalent beneficiaries that are connected persons with respect to the company described in this paragraph and that benefit from notional deductions of the type described in [reference to the paragraph of Article 11 that relates to notional deductions for equity].

85. States that do not consider that provisions on special tax regimes and notional deductions with respect to equity should be included in their tax treaties, however, may prefer to use the following version of the derivative benefits paragraph:

4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded by this Convention if:

a) at the time when the benefit otherwise would be accorded and on at least half of the days of any twelve-month period that includes that time, at least 95 per cent of the aggregate vote and value of its shares (and at least 50 per cent of the aggregate vote and value of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is a qualifying intermediate owner, and

b) less than 50 per cent of the person's gross income, and less than 50 per cent of the tested group's gross income for the taxable period that includes that time, as determined in the person's Contracting State of residence, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered

by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions)

(i) to persons that are not equivalent beneficiaries; or

(ii) to persons that are equivalent beneficiaries only by reason of paragraph 5 of this Article or of a substantially similar provision in the relevant comprehensive convention for the avoidance of double taxation.

86. Some States, however, may consider that the provisions of a derivative benefits paragraph drafted along the lines of the provision included in the previous paragraph create unacceptable risks of treaty shopping with respect to payments that are deductible in the State of source. Instead of not providing any derivative benefits, these States might prefer to restrict the scope of that provision to dividends, which are typically not deductible. States that share that view are free to amend the first part of the alternative provision so that it reads as follows:

4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded under Article 10 if:

87. Whether drafted as suggested in paragraph 84 or in paragraph 85 *[of the Commentary on Article 29 of the 2017 OECD Model quoted above]*, paragraph 4 on derivative benefits sets forth an alternative test under which a resident of a Contracting State that is not a qualified person under paragraph 2 may receive treaty benefits with respect to certain items of income. In general, this derivative benefits test entitles a company that is a resident of a Contracting State to treaty benefits if 95 per cent of the vote and value of its shares are owned, directly or indirectly, by seven or fewer equivalent beneficiaries and the company satisfies a base erosion test. The requirement that at least 95 per cent of the vote and value of the company seeking treaty benefits under paragraph 4 be owned, directly or indirectly, by seven or fewer equivalent beneficiaries is intended to avoid the administrative burden of having to determine whether a large number of shareholders are equivalent beneficiaries; it is also consistent with the objective of the derivative benefits test to provide benefits for holding companies of a multinational group in the situations contemplated by the provision.

88. Subparagraph *a*) sets forth the ownership test. Under this test, seven or fewer equivalent beneficiaries must own, directly or indirectly, shares representing at least 95 per cent of the aggregate vote and value of the company and at least 50 per cent of any disproportionate class of shares on at least half of the days of any twelve-month period that includes the date when benefits would otherwise be accorded. In the case of indirect ownership, each intermediate owner must be a qualifying intermediate owner. The term "qualifying intermediate owner" is defined in paragraph 7 (see paragraphs 151 to 154 *[of the Commentary on Article 29 of the 2017 OECD Model quoted below]*); the following example illustrates the application of that definition in the context of paragraph 4:

— *Example*: HOLDCO, a company resident of State A, is a wholly owned direct subsidiary of ZCO, a company resident of State Z, which itself is a wholly owned direct subsidiary of XCO, a resident of State X. XCO's principal class of shares is primarily and regularly traded on the stock exchange in State X. HOLDCO is not entitled to benefits under paragraph 2 of the treaty between States A and B because it is a subsidiary of a company resident and publicly traded in a third State. HOLDCO is not engaged in the conduct of an active business in State A, and therefore it is not entitled to any benefits under paragraph 3. HOLDCO derives and beneficially owns interest arising in State B that would otherwise be entitled to the benefits of Article 11 of the treaty between States A and B. Assume that by virtue of the provisions of the income tax convention between State B and State X, XCO qualifies as an equivalent beneficiary under the definition of that term included in the treaty between States A and B.

Although XCO indirectly owns all the shares of HOLDCO, ZCO, as an intermediate owner, must satisfy the definition of "qualifying intermediate owner" in paragraph 7 of the treaty between States A and B in order for HOLDCO to be eligible for the benefits of Article 11 of the treaty between States A and B with respect to the interest that it received from State B. If State Z does not have in effect a comprehensive convention for the avoidance of double taxation (or, if the definition of qualifying intermediate owner is drafted as suggested in paragraph 153 *[of the Commentary on Article 29 of the 2017 OECD Model quoted below]*, such a convention is in effect but ZCO benefits from either a "special tax regime" or notional deductions with respect to equity), ZCO will not be a qualifying intermediate owner and

the requirements of subparagraph *a*) will not be satisfied with the result that HOLDCO will not be eligible, under paragraph 4, for the benefits of the convention.

89. Subparagraph *b*) sets forth the base erosion test applicable for purposes of paragraph 4. That test is broadly similar to the base erosion test in subdivision (ii) of subparagraph *f*) of paragraph 2 except that the list of ineligible persons is different (see below). The base erosion test of subparagraph *b*) is satisfied if

— less than 50 per cent of the company's gross income (and less than 50 per cent of the tested group's gross income if there is a tested group), for the taxable period that includes the time when the benefits are claimed, is paid or accrued, directly or indirectly, in the form of payments to ineligible persons that are deductible, for tax purposes, in computing the company's tax in its State of residence, and

— less than 50 per cent of the tested group's gross income (if there is a tested group), for the taxable period that includes the time when the benefits are claimed, is paid or accrued, directly or indirectly, in the form of payments to ineligible persons that are deductible, for tax purposes, in computing the tax of any member of the tested group in the State of residence of the company claiming the treaty benefits.

90. Paragraph 7 includes the definition of the terms "tested group" and "gross income" which are used in subparagraph *b*). Also, the term "ineligible persons" used in the previous paragraph refers to:

— if paragraph 4 is drafted as indicated in paragraph 84 *[of the Commentary on Article 29 of the 2017 OECD Model quoted above]*, persons who are not equivalent beneficiaries under the definition of that term in paragraph 7 as well as persons who are equivalent beneficiaries under that definition but fall within one of the three following categories:

1. they are equivalent beneficiaries solely by reason of being a headquarters company under paragraph 5 of this Convention or of the relevant convention;

2. they are connected persons (as defined in paragraph 7) with the company seeking treaty benefits under paragraph 4 and benefit from a special tax regime with respect to the payment, or

3. with respect to a payment of interest, they are connected persons (as defined in paragraph 7) with the company seeking treaty benefits under paragraph 4 and benefit from notional deductions with respect to equity.

— if paragraph 4 is drafted as indicated in paragraph 85 *[of the Commentary on Article 29 of the 2017 OECD Model quoted above]*, persons who are not equivalent beneficiaries under the definition of that term in paragraph 7 as well as persons who are equivalent beneficiaries under that definition solely by reason of being a headquarters company under paragraph 5 of this Convention or of the relevant convention.

91. The following illustrates the base erosion test of paragraph 4:

— *Example*: Company X, a resident of State X, owns Company Y, a resident of State Y. Company Y owns Company B, a resident of State B that seeks benefits of the treaty between States A and B under paragraph 4. Company X is an equivalent beneficiary and Company Y is a qualifying intermediate owner under the definitions of these terms in paragraph 7 of the treaty between States A and B. Accordingly, Company B would satisfy the ownership requirement of subparagraph *a*) because, first, Company X, an equivalent beneficiary, indirectly owns shares representing at least 95 per cent of the aggregate vote and value of Company B and at least 50 per cent of any disproportionate class of shares (as defined in paragraph 7), and, second, each intermediate owner (i.e. Company Y) is a qualifying intermediate owner.

— Company B's gross income for the taxable period in question consists of 100 of interest arising in State A and 200 of dividends from a third State which is exempt from tax under the law of State B. Company B seeks treaty benefits with respect to the 100 of interest. Under the law of State B, Company B, Company Y and Company X are not allowed to participate in a common tax consolidation or other regime that would allow the three companies to share profits or losses nor is there any loss sharing regime available. Accordingly, in this example, there is no tested group. Company B's gross income is 100 (the interest arising in State A). Company B will fail the base erosion test of subparagraph *b*) if Company B makes base eroding payments of at least 50 to ineligible persons described in the previous paragraph.

Paragraph 5: headquarters company

20. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the OECD detailed version of paragraph 5, is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 92. Paragraph 5 sets forth an alternative test under which a resident of a Contracting State that is a headquarters company and that is not a qualified person under paragraph 2 may receive treaty benefits with respect to dividends and interest paid by members of the company's multinational corporate group. A headquarters company's multinational corporate group means the company and its direct and indirect subsidiaries (and does not include upper-tier companies).
>
> 93. A company seeking to qualify for benefits as a headquarters company must satisfy six conditions. First, under subparagraph *a*), the headquarters company's primary place of management and control, as defined in paragraph 7, must be in the Contracting State of which it is a resident. The same test is applied for publicly-traded companies. Subdivision (ii) of the definition of "primary place of management and control" allows the possibility that, in certain limited cases, the management of a subgroup (such as a subgroup responsible for a regional area) may be exercised more by a company that is not the top-tier company for the entire group of connected companies, and in certain narrow cases a lower-tier company may satisfy the headquarters company test.
>
> 94. Second, under subparagraph *b*), the multinational corporate group must consist of companies resident of, and engaged in the active conduct of a business (as defined in paragraph 3) in, at least four States (including either Contracting State), and the businesses carried on in each of the four States (or four groupings of States) must generate at least 10 per cent of the gross income of the group. The application of this requirement is illustrated by the following example:
>
> — *Example*: Company X is resident of State X and is a member of a multinational corporate group consisting of itself and its direct and indirect subsidiaries resident in States X, A, B, C, D, E and F. The gross income generated by each of these companies for year 01 and year 02 is as follows:

State	Year 01	Year 02
X	45	60
A	25	12
B	10	20
C	10	12
D	7	10
E	10	9
F	5	7
Total	112	130

For year 01, 10 per cent of the gross income of this group is equal to 11.20. Only the companies in States X and A satisfy the requirement of subparagraph *b*) for that year. The other States may be aggregated into groupings to meet this requirement. Since States B and C have a total gross income of 20, and States D, E and F have a total gross income of 22, these two groupings of countries may be treated as the third and fourth members of the group for purposes of subparagraph *b*).

For year 02, 10 per cent of the gross income is 13. Only the companies in States X and B satisfy this requirement. Since States A and C have a total gross income of 24, and States D, E and F have a total gross income of 26, these two groupings of countries may be treated as the third and fourth members of the group for purposes of subparagraph *b*). The fact that State A replaced State B in a group is not relevant for this purpose. The composition of the grouping may change annually.

95. Third, under subparagraph *c*), the businesses of the multinational corporate group that are carried on in any one State other than the Contracting State of residence of such company must generate less than 50 per cent of the gross income (as defined in paragraph 7) of the group. A company whose multinational corporate group generates 50 per cent or more of the group's gross income in the Contracting State of source does not meet this condition.

96. Fourth, under subparagraph *d*), no more than 25 per cent of the company's gross income can be derived from the other Contracting State. Unlike the third condition described in the previous paragraph, this condition looks only at the gross income earned by the company

seeking status as a headquarters company rather than the gross income earned by members of its multinational corporate group.

97. Fifth, under subparagraph *e*), such company must be subject to the same income taxation rules in its Contracting State of residence as persons described in paragraph 3. Therefore, such company must be subject to the general corporate taxation rules for companies that are engaged in the active conduct of a business in the Contracting State of residence, and not to a regime for headquarters companies.

98. Sixth, under subparagraph *f*), such company must satisfy a base erosion test that is broadly similar to the base erosion test in subdivision (ii) of subparagraph *f*) of paragraph 2 except that base eroding payments do not include payments in respect of financial obligations to a bank that is not a connected person with respect to the company. For example, unlike the base erosion test in subparagraph *f*) of paragraph 2, interest payments made by a company to a bank that is not a connected person to the company will not be treated as a base eroding payment for purposes of applying the base erosion test under paragraph 5. Paragraph 7 includes the definition of the terms "tested group" and "gross income" which are used for the purposes of this base erosion test.

99. As explained in paragraph 33 *[of the Commentary on Article 29 of the 2017 OECD Model quoted in paragraph 12 above]* which is applicable to the base erosion test of subparagraph *d*) of paragraph 2, States that want to deny the application of specific treaty provisions with respect to income that is paid to connected persons that benefit from regimes that constitute "special tax regimes" and to deny the application of Article 11 to interest that is paid to connected persons that benefit from domestic law provisions that provide for a notional deduction with respect to equity, may also want to modify the base erosion test of subparagraph *f*) in order to include in the category of "ineligible persons" persons who, although they are residents of one of the Contracting States, benefit from such special tax regimes or notional deductions with respect to deductible payments made or accruing to them. This could be done by amending subparagraph *f*) as follows:

f) less than 50 per cent of such company's gross income, and less than 50 per cent of the tested group's gross income, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for

services or tangible property or payments in respect of financial obligations to a bank that is not a connected person with respect to such company, and in the case of a tested group, not including intra-group transactions):

(i) to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph *a*), *b*), *c*) or *e*) of paragraph 2;

(ii) to persons that are connected persons with respect to such company and that benefit from a special tax regime as defined in [reference to the paragraph of the convention that includes the definition of "special tax regime"] with respect to the deductible payment; or

(iii) with respect to a payment of interest, to persons that are connected persons with respect to the company referred to in this paragraph and that benefit from notional deductions of the type described in [reference to the paragraph of Article 11 that relates to notional deductions for equity].

100. The six conditions of paragraph 5 must be tested with respect to the taxable year in which the company received the dividends or interest for which it is seeking benefits under the Convention. A company that does not satisfy the second, third or fourth conditions described above for the relevant taxable year may still be treated as a headquarters company if it satisfies such conditions by averaging the required ratios for the preceding four taxable periods (which does not include the taxable period that includes the payment for which a treaty benefit is being sought).

Paragraph 6: discretionary relief

21. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the OECD detailed version of paragraph 6, is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

101. Paragraph *[…]* 6 *[…]* provide*[s]* that where, under the previous paragraphs of the Article, a resident of a Contracting State is not entitled to benefits of the Convention, that resident may request that

the competent authority of the State in which benefits are denied under these paragraphs grant these benefits. *[…]*

102. Where a request is made under *[…]* paragraph 6 *[…]*, the competent authority to which that request is made may grant the benefits of this Convention, or benefits with respect to a specific item of income or capital, taking into account the object and purpose of this Convention, but only if the person who made the request demonstrates to the satisfaction of the competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under this Convention. Thus, persons that establish operations in one of the Contracting States with a principal purpose of obtaining the benefits of the Convention will not be granted benefits of the Convention under the paragraph.

103. In order to be granted benefits under the paragraph, a person must establish, to the satisfaction of the competent authority of the State from which benefits are being sought, that, first, there were clear non-tax business reasons for its formation, acquisition, or maintenance and for the conduct of its operations and, second, that the allowance of benefits would not otherwise be contrary to the object and purpose of the Convention. For the purposes of determining that neither the establishment, acquisition or maintenance, nor the conduct of the operations, of a resident of a Contracting State had as one of its principal purposes the obtaining of benefits under the Convention, one of the factors that the competent authority will typically take into account is whether or not the resident has a substantial non-tax nexus to its State of residence. For example, in the case of a resident subsidiary company with a parent in a third State, the fact that the relevant withholding rate provided in the Convention is at least as low as the corresponding withholding rate in the income tax convention between the State of source and the third State is not by itself evidence of a nexus or relationship to the other Contracting State. Similarly, a relationship or nexus to the treaty State cannot be established by a desire to take advantage of favourable domestic laws of the treaty State, including the existence of a network of tax treaties.

104. Also, discretionary benefits typically will not be granted if the benefit requested would result in no or minimal tax imposed on the item of income in both the State of residence of the applicant and the State of source, taking into account the domestic law of both Contracting States as well as the provisions and the object and purpose of the Convention. For example, double non-taxation may occur

through the use of a hybrid instrument that generates a deduction in the State of source where the income from that instrument is treated as exempt in the State of residence. On the other hand, the fact that there is no or minimal tax in both States may not be inconsistent with the object and purpose of the Convention in the case of dividends paid by a company resident of one State to a company resident of the other State that owns a substantial part of the shares of the paying company where the provisions of the Convention reveal that the Contracting States intended these dividends to be subject to low or no taxation in both States.

105. Whilst it is impossible to provide a detailed list of all the facts and circumstances that would be relevant to the application of the paragraph, examples of such facts and circumstances include the history, structure, ownership and operations of the resident that makes the request, whether that resident is a long-standing entity that was recently acquired by non-residents for non-tax reasons, whether the resident carries on substantial business activities, whether the resident's income for which the benefits are requested is subject to double taxation and whether the establishment or use of the resident gives rise to non-taxation or reduced taxation of the income.

106. The reference to "one of its principal purposes" in the paragraph means that obtaining benefits under a tax treaty needs (*sic*) not be the sole or dominant purpose for the establishment, acquisition or maintenance of the person and the conduct of its operations. It is sufficient that at least one of the principal purposes was to obtain treaty benefits. Where the competent authority determines, having regard to all relevant facts and circumstances, that obtaining benefits under the Convention was not a principal consideration and would not have justified the establishment, acquisition or maintenance of the person and the conduct of its operations, it may grant that person these benefits, or benefits with respect to a specific item of income or capital. Where, however, the establishment, acquisition or maintenance of the person and the conduct of its operations is carried on for the purpose of obtaining similar benefits under a number of treaties, it should not be considered that obtaining benefits under other treaties will prevent the obtaining of benefits under one treaty from being considered a principal purpose for these operations.

107. Although a request under the paragraph will usually be made by a resident of a Contracting State to the competent authority of the other Contracting State, there may be cases in which a resident of a Contracting State may request the competent authority of its own

State of residence to grant relief under the paragraph. This would be the case if the treaty benefits that are requested are provided by the State of residence, such as the benefits of the provisions of Articles 23 A and 23 B concerning the elimination of double taxation.

108. The paragraph grants broad discretion to the competent authority and, as long as the competent authority has exercised that discretion in accordance with the requirements of the paragraph, it cannot be considered that the decision of the competent authority is an action that results in taxation not in accordance with the provisions of the Convention (see paragraph 1 of Article 25). The paragraph does require, however, that the competent authority must consider the relevant facts and circumstances before reaching a decision and must consult the competent authority of the other Contracting State before granting or denying a request to grant benefits made by a resident of that other State. The first requirement seeks to ensure that the competent authority will consider each request on its own merits whilst the requirement that the competent authority of the other Contracting State be consulted should ensure that Contracting States treat similar cases in a consistent manner and can justify their decision on the basis of the facts and circumstances of the particular case. This consultation process does not, however, require that the competent authority to which the request has been presented obtain the agreement of the competent authority that is consulted.

109. The competent authority to which a request is made under the paragraph may grant benefits but it may then grant all of the benefits of the Convention to the taxpayer making the request, or it may grant only certain benefits. For instance, it may grant benefits only with respect to a particular item of income in a manner similar to paragraph 3. Further, the competent authority may establish conditions, such as setting time limits on the duration of any relief granted.

110. The request for a determination under the paragraph may be presented before (e.g. through a ruling request) or after the establishment, acquisition or maintenance of the person for whom the request is made. The request must be presented, however, before benefits may be claimed. If the competent authority determines that benefits are to be allowed, it is expected that benefits will be allowed retroactively to the later of the time of entry into force of the relevant treaty provision or to the time of the establishment or acquisition of the person for whom the request is made, assuming that all relevant facts and circumstances justify granting the retroactive application of benefits.

111. The competent authority that receives a request for relief under the paragraph should process that request expeditiously.

112. To reduce the resource implications of having to consider requests for discretionary relief, and to discourage vexatious requests, a Contracting State may find it useful to publish guidelines on the types of cases that it considers will and will not qualify for discretionary relief. However, any administrative conditions that a Contracting State imposes on applicants should not deter persons from making requests where they consider that they have a reasonable prospect of satisfying a competent authority that benefits should be granted.

Paragraph 7: definitions

22. The Committee considers that the following paragraph of the Commentary on Article 29 of the 2017 OECD Model, which explains the role of the OECD detailed version of paragraph 7, is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 113. Paragraph *[…]* 7 of *[Article 29]* include*[s]* a number of definitions that apply for the purposes of *[paragraph 7 itself]* as well as the previous paragraphs of the Article. These definitions supplement the definitions included in Articles 3, 4 and 5 of the Convention, which apply throughout the Convention.

Subparagraph (a): definition of "recognised stock exchange"

23. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "recognised stock exchange" in the OECD detailed version of paragraph 7(*a*), is applicable to the equivalent provision of this Model:

> 116. The definition of "recognised stock exchange" *[…]* includes, in subdivision (i), stock exchanges that both Contracting States agree to identify at the time of the signature of the Convention. Although this would typically include stock exchanges established in the Contracting States on which shares of publicly listed companies and entities that are residents of these States are actively traded, the stock exchanges

to be identified in the definition need not be established in one of the Contracting States. This recognises that the globalisation of financial markets and the prominence of some large financial centres have resulted in the shares of many public companies being actively traded on more than one stock exchange and on stock exchanges situated outside the State of residence of these companies.

117. The list to be included in subdivision (i) may include the names of specific stock exchanges. It may also include a generic description of a number of stock exchanges that would each constitute a "recognised stock exchange". For example, in the case of the United States, such a generic description could read "any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934". If the Contracting States wish to cover European Union stock exchanges that are officially recognised as such, such a generic description could read "any stock exchange established in States that are members of the European Union or are party to the Agreement on the European Economic Area and that are regulated by the European Union Markets in Financial Instruments Directive (Directive 2004/39/EC as amended) or by any successor Directive".

118. Subdivision (ii) of the definition allows the competent authorities of the Contracting States to supplement, through a subsequent agreement, the list of stock exchanges identified in the definition at the time of signature of the Convention.

119. The stock exchanges to be included in the definition should impose listing requirements that ensure that shares of entities listed on that stock exchange are genuinely publicly traded. The following factors should be considered when determining whether a stock exchange should be listed in the definition or subsequently added to that list through the competent authority agreement referred to in the preceding paragraph:

— What are the requirements/standards with respect to listing a company on the stock exchange?

— What are the requirements/standards in order to continue to be listed on the stock exchange, including minimum financial standards?

— What are the annual/interim disclosure and/or filing requirements for companies whose shares are traded on the stock exchange?

— What is the volume of shares traded on the stock exchange in a calendar year?

- Do the rules governing the stock exchange ensure active trading of listed stocks? If so, how?
- Are the companies listed on the stock exchange required to disclose on an ongoing basis financial information and information on events that may have a material impact on their financial situations?
- Is information on the trading volume and overall shareholding of the companies listed on the stock exchange publicly available?
- Does the stock exchange impose any minimum size requirements, such as minimum capitalisation or number of employees, for companies whose shares are traded on the exchange?
- Does the stock exchange impose a required minimum percentage of public ownership? If so, what is the minimum amount?
- For a company to be listed on the stock exchange, are the shares of companies required to be freely negotiable and fully paid for?
- Is the stock exchange required to disclose the share prices of its listed companies within a certain timeframe?
- Is the stock exchange regulated or supervised by a government authority of the State in which it is located?
- [In the case of a new stock exchange to be added to an existing list:] Why would a company prefer to list on the new exchange rather than on another exchange, including those exchanges that are already "recognised stock exchanges" in the tax treaty? For example, are there lesser corporate governance and financial disclosure requirements?
- [In the case of a new stock exchange to be added to an existing list:] Does the new stock exchange provide a more efficient vehicle for raising capital and, if so, why?

Subparagraph (b): definition of "shares"

24. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "shares" in paragraph 7*b*), is applicable to the equivalent provision of this Model:

> 120. *[Subparagraph (b) of paragraph 7 does not contain]* an exhaustive definition of the term "shares", which, under paragraph 2 of Article 3, should generally have the meaning which it has under the domestic law of the State that applies the Article. Subparagraph *b*), however,

provides that the term "shares", when used with respect to entities that do not issue shares (e.g. trusts), refers to interests that are comparable to shares. These will typically be beneficial interests that entitle their holders to a share of the income or assets of the entity.

Subparagraph (c): definition of "principal class of shares"

25. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "principal class of shares" in the OECD detailed version of paragraph 7*c*), is applicable to the equivalent provision of this Model:

> 122. *The […]* definition of the term "principal class of shares" refers to the ordinary or common shares of a company or entity but only if these shares represent the majority of the voting rights as well as of the value of the company or entity. If a company or entity has only one class of shares, that class of shares will naturally constitute its "principal class of shares". If a company or entity has more than one class of shares, it is necessary to determine which class or classes constitute the "principal class of shares", which will be the class of shares, or any combination of classes of shares, that represent, in the aggregate, a majority of the aggregate vote and value of the company or entity. If a company or entity does not have a class of ordinary or common shares representing the majority of its aggregate vote and value, then the "principal class of shares" shall be any combination of classes of shares that represent, in the aggregate, a majority of the vote and value of the company or entity. Although in a particular case involving a company with several classes of shares it is conceivable that more than one group of classes could be identified that would represent the majority of the aggregate vote and value of the company, it is only necessary to identify one such group that meets the conditions of subparagraph *c*) of paragraph 2 in order for the company to be entitled to treaty benefits under that provision (benefits will not be denied to the company or entity even if a second group of shares representing the majority of the aggregate vote and value of the company or entity, but not satisfying the conditions of subparagraph *c*) of paragraph 2, could be identified).
>
> 123. In a few States, certain publicly-listed traded companies are governed by a dual listed company arrangement and these States may wish to address expressly the situation of these companies in order to ensure that they are not inadvertently denied the benefits of conventions because of the definition of "principal class of shares". The term "dual listed company arrangement" refers to an arrangement, adopted by

certain publicly-listed companies, that reflects a commonality of management, operations, shareholders' rights, purpose and mission through a series of agreements between two parent companies, each with its own stock exchange listing, together with special provisions in their respective Articles of association including in some cases, for example, the creation of special voting shares. Under these structures, the position of the parent company's shareholders is, as far as possible, the same as if they held shares in a single company, with the same dividend entitlement and same rights to participate in the assets of the dual listed companies in the event of a winding up. States wishing to address the situation of such companies may therefore wish to add the following sentence to the definition of "principal class of shares":

> In the case of a company participating in a dual listed company arrangement, the principal class of shares will be determined after excluding the special voting shares which were issued as a means of establishing that dual listed company arrangement.

124. This additional sentence would be supplemented by the addition of the following definition of "dual listed company arrangement":

> the term "dual listed company arrangement" means an arrangement pursuant to which two publicly listed companies, while maintaining their separate legal entity status, shareholdings and listings, align their strategic directions and the economic interests of their respective shareholders through:
>
> *(i)* the appointment of common (or almost identical) boards of directors, except where relevant regulatory requirements prevent this;
>
> *(ii)* management of the operations of the two companies on a unified basis;
>
> *(iii)* equalised distributions to shareholders in accordance with an equalisation ratio applying between the two companies, including in the event of a winding up of one or both of the companies;
>
> *(iv)* the shareholders of both companies voting in effect as a single decision-making body on substantial issues affecting their combined interests; and
>
> *(v)* cross-guarantees as to, or similar financial support for, each other's material obligations or operations except where the effect of the relevant regulatory requirements prevents such guarantees or financial support.

125. Other States, however, may prefer not to include any specific reference to dual listed company arrangements in the Article because of possible concerns about the use of similar arrangements for avoidance purposes and may therefore prefer to address legitimate dual listed arrangements on a case-by-case basis through the other provisions of the Article, including the discretionary relief provision of paragraph 6.

Subparagraph (d): definition of "connected persons"

26. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "connected persons" in paragraph 7*d*), is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

126. The term "connected person" is used in *[…]* various parts of *[paragraphs 1 to 7 of Article 29]*. Although the definition is somewhat similar to the definition of "closely related" in Article 5, a main difference is that a direct or indirect ownership of exactly 50 per cent of the beneficial interests could result in a person being "connected" to another person whilst the definition of "closely related" requires a direct or indirect ownership of more than 50 per cent of the beneficial interests.

127. As indicated in paragraph 33 *[of the Commentary on Article 29 of the 2017 OECD Model quoted in paragraph 12 above]*, some States consider that provisions should be included in their tax treaties in order to deny the application of specific treaty provisions with respect to income that is paid to connected persons that benefit from regimes that constitute "special tax regimes" (see paragraphs 85 to 100 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*) and to deny the application of Article 11 to interest that is paid to connected persons that benefit from domestic law provisions that provide for a notional deduction with respect to equity (see paragraphs 107 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*). If such provisions are included in the Convention, the Contracting States may consider it more appropriate to include the definition of "connected person" in Article 3, which includes definitions that apply throughout the Convention.

Subparagraph (e): definition of "equivalent beneficiary"

27. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "equivalent beneficiary" in paragraph 7*e*), is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 131. The definition of "equivalent beneficiary" *[…]* is relevant for the purposes of the derivative benefits test in paragraph 4 but may also be relevant for the purposes of subparagraph *g*) of paragraph 2 dealing with collective investment vehicles, depending on how *[paragraph 4 of Article 1 is drafted (see paragraphs 29 to 46 of the Commentary on Article 1 of this Model)]*.
>
> 132. The definition recognises three different categories of persons who qualify as "equivalent beneficiary".
>
> 133. The first category (subdivision (i) of the definition) covers residents of third States that would be entitled to all of the benefits of a comprehensive income tax convention between that person's State of residence and the State from which benefits are sought (referred to below as the "tested convention") under provisions that are substantially similar to the rules in subparagraph *a*), *b*), *c*) or *e*) of paragraph 2. A company may also be an equivalent beneficiary under subdivision (i) if it is entitled to benefits under a convention pursuant to a headquarters company test under the tested convention that is substantially similar to paragraph 5, but only if the benefits being sought by the company are with respect to interest or dividends paid by a member of the equivalent beneficiary's multinational corporate group. If the tested convention does not have a comprehensive limitation-on-benefits Article the requirements of clause A) of subdivision (i) are also met if the resident of the third State applies the tested convention as if such convention included the provisions of subparagraphs *a*), *b*), *c*) or *e*) of paragraph 2 (including the relevant definitions for purposes of applying the provisions of such subparagraphs), and would have satisfied one of the limitation-on-benefits provisions by reason of one of the incorporated subparagraphs.
>
> 134. The following examples illustrate the application of subdivision (i) of the definition:

— *Example A*: HOLDCO, a resident of State R, is a wholly owned direct subsidiary of XCO, a resident of State X. XCO's principal class of shares is primarily and regularly traded on the X Stock Exchange, a stock exchange located in State X. HOLDCO is not entitled to benefits under paragraph 2 of the convention between States S and R because it is a subsidiary of a company resident of, and publicly traded in, a third State. HOLDCO is not engaged in the conduct of an active business in State R, and therefore it is not entitled to any benefits under paragraph 3. HOLDCO derives and beneficially owns interest arising in State S that would otherwise be subject to the 10 per cent rate of Article 11 of the convention between States S and R. In order to determine if HOLDCO is entitled to benefits under the derivative benefits test of paragraph 4 of that convention, it is necessary to determine whether XCO satisfies the definition of equivalent beneficiary in paragraph 7. The income tax convention between States S and X contains a comprehensive limitation on benefits provision, including a rule for companies whose principal class of shares is primarily and regularly traded on the X Stock Exchange that is substantially similar to subparagraph *c*) of paragraph 2. Therefore, XCO satisfies the requirement of clause A) of subdivision (i) of the definition of equivalent beneficiary. The convention between States S and X would also subject interest arising in either State to the 10 per cent rate of Article 11, so XCO satisfies the requirement of clause B) of subdivision (i) of the definition of equivalent beneficiary. Accordingly, XCO is an equivalent beneficiary.

— *Example B*: Assume the same facts as in Example A, except that the income tax convention between States S and X does not include a comprehensive limitation-on-benefits provision. Accordingly, for the purpose of determining whether XCO is an equivalent beneficiary, that convention shall be applied as if it contained the provisions of subparagraphs *a*), *b*), *c*) or *e*) of paragraph 2 (including the relevant definitions for purposes of applying these subparagraphs) of this Convention. If this Convention defines a recognised stock exchange to include the X Stock Exchange, the principal class of XCO's shares would be primarily traded on a recognised stock exchange located in XCO's State of residence. Therefore XCO would satisfy subparagraph *c*) of paragraph 2 and would be an equivalent beneficiary. If however, the X Stock Exchange is not included in this Convention as a recognised stock exchange, XCO would not be an equivalent beneficiary.

135. A third-State resident cannot be an equivalent beneficiary if the person only satisfies:

— a test for affiliates of publicly traded companies substantially similar to subparagraph *d*) of paragraph 2;

— an ownership and base erosion test *[…]* substantially similar to subparagraph *f*) of paragraph 2;

— a test for collective investment vehicles substantially similar to what may be included in *[paragraph 4 of Article 1 of this Model]*;

— an active business test substantially similar to paragraph 3;

— a derivative benefits test substantially similar to paragraph 4;

— a discretionary relief provision substantially similar to paragraph 6, or

— any other limitation on benefits provision of the tested convention that is not a test under this Convention,

because such resident would not be a qualified person under provisions substantially similar to subparagraph *a*), *b*), *c*) or *e*) of paragraph 2 of this Article.

136. Some States may wish to restrict and in some cases deny treaty benefits to individuals who are liable to tax on a remittance basis or taxed on a fixed-fee/forfait basis. If the Convention between the Contracting States does so, these States may also wish to prevent such individuals resident of third States from qualifying as an "equivalent beneficiary". This could be done by amending clause A) of subdivision (i) as follows:

A) the resident is entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that State and the Contracting State from which the benefits of this Convention are sought, under provisions substantially similar to subparagraph *a*), *b*), *c*) or *e*) of paragraph 2 or, when the benefit being sought is with respect to interest or dividends paid by a member of the resident's multinational corporate group, the resident is entitled to benefits under provisions substantially similar to paragraph 5 of this Article in such convention, provided that, if such convention does not contain a detailed limitation on benefits article, the resident would be entitled to the benefits of this Convention by reason of subparagraph *a*), *b*), *c*) or *e*) of paragraph 2 if such resident were a resident of one of the Contracting States under Article 4. Notwithstanding the preceding sentence, an individual

1) who is liable to tax in that individual's State of residence with respect to foreign source income or gains only on a remittance or similar basis, or

2) whose tax is determined in that State, in whole or in part, on a fixed-fee, "forfait" or similar basis,

shall not be considered an equivalent beneficiary; and

137. Subclause B) 1) of subdivision (i) requires an equivalent beneficiary to be entitled to a rate of tax on the type of income derived by the company seeking benefits under paragraph 4 under either the tested convention, domestic law or any international agreement that is less than or equal to the rate of tax applicable under this Convention to the company seeking benefits under paragraph 4. Thus, the rates to be compared are: first, the rate of tax that the State of source could impose under the Convention on income paid to that company if it qualified for the benefits; and, second, the rate of tax that the State of source could have imposed if the potential equivalent beneficiary had derived the income directly from the State of source.

138. As described above, subclause B) 1) provides that any reduced rates of taxation that are available under domestic law or any international agreement will be taken into account. This rule recognises that withholding taxes on many inter-company dividends, interest and royalties may be eliminated, for example, pursuant to provisions such as those of the Parent-Subsidiary and Interest and Royalties Directives[1] of the European Union, rather than by an income tax convention. This is illustrated by the following example:

— *Example:* EUCO1, a company resident of State EU1, wholly owns ACO, a resident of State A. ACO wholly owns EUCO2, a resident of State EU2, and derives interest arising in State EU2. The income tax convention between States A and EU2 contains the detailed version's definition of equivalent beneficiary and exempts interest from source taxation. States EU1 and EU2 are both members of the European Union. Under the Interest and Royalties Directive, interest paid by EUCO2 to EUCO1 may not be taxed by State EU2. Therefore, EUCO1 satisfies subclause B) 1) of subdivision (i) of the definition of equivalent beneficiary in the income tax convention between States A and EU2 even if the income tax convention between States EU1 and EU2 allows the source taxation of interest.

1 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of

different Member States, as amended; Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

139. Subclause B) 1) (I) of subdivision (i) provides a rule, applicable with respect to dividends, that allows an individual to be treated as a company for purposes of the rate comparison test of subclause B) 1). Since dividends beneficially owned by individuals are not entitled to the lower rate provided for by subparagraph a) of paragraph 2 of Article 10, whereas a company may be entitled to that lower rate if certain conditions are met, absent this provision, individual shareholders of a company seeking derivative benefits under paragraph 4 generally would not qualify as equivalent beneficiaries in the case of dividends derived from substantial participations in other companies. By treating individuals as companies for purposes of the rate comparison test, this rule allows a company seeking derivative benefits under paragraph 4 to take into account the shares owned, directly or indirectly, by the individual as if such shares were owned by a company described in subparagraph *c*) of paragraph 2 for purposes of determining whether the company seeking derivative benefits under paragraph 4 is 95 per cent owned by equivalent beneficiaries.

140. To be eligible to apply the rule in subclause B) 1) I), the company seeking derivative benefits under paragraph 4 must be engaged in the active conduct of a business in its State of residence. The rule treats an individual shareholder who otherwise meets the requirements of subclause A) of subparagraph (i) as if it were a company described in subparagraph *c*) of paragraph 2 but only if the company seeking derivative benefits under paragraph 4 is engaged in the active conduct of a business in its State of residence that is both substantial in relation to, and similar or complementary, to the business that generated the earnings from which the dividend is paid. The test in subclause B) 1) I) is similar to the active conduct of a business test under paragraph 3, but is not exactly the same because it does not require that the income from the State of source "emanate" from the business actively conducted by the company seeking derivative benefits under paragraph 4. The phrase "active conduct of a business" has the same meaning as in subparagraph *a*) of paragraph 3, and therefore does not include the activities described in subdivisions (i) through (iv) of that subparagraph. For purposes of determining if the company seeking derivative benefits under paragraph 4 is engaged in the active conduct of a business in a Contracting State, activities conducted by a person connected to that company shall be deemed to be conducted by the company. The phrase "substantial in relation to" has the same meaning

as in subparagraph *b*) of paragraph 3. That substantiality requirement, however, must be applied regardless of whether the dividend is derived from a connected person. On the other hand, the dividend derived from the other Contracting State does not have to emanate from the active business of the company seeking derivative benefits under paragraph 4, as is required under subparagraph *a*) of paragraph 3, in order to obtain benefits, because the active business conducted in the Contracting State of residence for purposes of subclause B) 1) I) needs (*sic*) only be "similar or complementary" to the active business conducted in the State of source, and not "the same or complementary" to that active business conducted in the State of source.

141. The following example illustrates the application of subclause B) 1) I):

— *Example:* RCO is a company resident of State R. RCO is engaged in the active conduct of a business in State R that is similar to the business of SCO, a company resident of State S. RCO has been a resident of State R for 13 months and has also held 25 per cent of the capital of SCO for 13 months. Individual Y is the sole shareholder of RCO and is a resident of State Y. Paragraph 2 of Article 10 of the income tax conventions between States S and Y and between States S and R is identical to the corresponding provision of the OECD Model Tax Convention. RCO, therefore, satisfies the requirements set forth in subparagraph *a*) of paragraph 2 of Article 10 *[of the OECD Model]* for purposes of the lower rate applicable to dividends. Absent subclause B) 1) I), however, RCO would not be entitled to that lower rate because individual Y would only have been entitled to the 15 per cent rate (under subparagraph *a*) of paragraph 2 of Article 10 *[of the OECD Model]*) if he had received the dividends directly from SCO. By virtue of subclause B) 1) I), however, Y shall be treated as a company within the meaning of subparagraph *c*) of paragraph 2 of the income tax convention between States S and R for the purposes of the rate comparison test, which means that RCO will satisfy the rate comparison requirement. Therefore, assuming all other requirements (such as the base erosion test and the beneficial ownership requirement of Article 10) are satisfied, RCO will be entitled to the lower rate in Article 10 of the income tax convention between States S and R with respect to the dividends paid by SCO.

142. Subclause B) 1) II) provides the rule for determining the percentage of the capital of a company paying a dividend that a

potential equivalent beneficiary will be deemed to hold for purposes of the rate comparison test, which, like subclause B) 1) I), will affect the entitlement to the lower rate of tax, under subparagraph *a*) of paragraph 2 of Article 10, of the equivalent beneficiary, had it derived the dividend directly. For these purposes, when applying the rate comparison test described in subclause B) 1), the potential equivalent beneficiary's indirect holding of the capital of the company paying the dividends shall be treated as a direct holding. The following example illustrates the application of subclause B) 1) II):

— *Example*: XCO and YCO each own directly 50 per cent of RCO, a company resident of State R. For 13 months, RCO has held 25 percent of the capital of SCO and been a resident of State R. State S has income tax conventions with States R, X and Y; paragraph 2 of Article 10 of these income tax conventions is identical to the corresponding provision of the OECD Model Tax Convention. XCO is a resident of State X and would have qualified person status under subparagraph *c*) of paragraph 2 of the income tax convention between States S and R. YCO is a resident of State Y and would also have qualified person status under subparagraph *c*) of paragraph 2 of the income tax convention between States S and R. Both XCO and YCO, therefore, would satisfy subclause A) of the definition of equivalent beneficiary. For purposes of determining the rate of tax on dividends paid by SCO that XCO and YCO would have been entitled to under their respective tax treaties with State S, however, XCO and YCO are each treated, under subclause B) 1) II), as holding directly 12.5 per cent of the capital of SCO (50 per cent of the 25 per cent shareholding in SCO is equal to 12.5 per cent, the amount of XCO's and YCO's respective indirect holdings in the capital of SCO that is treated as a direct holding). XCO and YCO, therefore, would not be entitled to the lower rate of tax of subparagraph *a*) of paragraph 2 of Article 10 and would not, therefore, be considered equivalent beneficiaries because they fail to meet the rate comparison test under subclause B) 1) (see, however, paragraph 147 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted below]* concerning alternative provisions that would allow RCO to benefit from the 15 per cent rate of subparagraph *b*) of paragraph 2 of Article 10 of the income tax convention between States S and R).

143. Subclause B) 2) of subdivision (i) provides derivative benefits rules for items of income that fall within Articles 7, 13 or 21. The

potential equivalent beneficiary must be entitled to a benefit under the tested convention that is at least as favourable as that which would apply under the Convention to such business profits, gains or other income. Thus, the benefits to be compared are: first, the benefits that the State of source would grant to the company seeking derivative benefits under paragraph 4 if it qualified for benefits with respect to the relevant item of income and, second, the benefits that the State of source would grant to the potential equivalent beneficiary if it derived the income directly. The following example illustrates the application of subclause B) 2):

— *Example*: RCO is a company resident in State R, which is wholly owned by XCO, a publicly traded company resident in State X. RCO has a contract to construct a major office complex in State S. Under the terms of the income tax convention between States S and R, a construction site constitutes a permanent establishment only if it lasts for more than twelve months. Under the terms of the income tax convention between States S and X, however, a construction site constitutes a permanent establishment only if it lasts more than six months. If the construction site lasts more than six months but less than 12 months, XCO would not be an equivalent beneficiary because it would not be entitled to the same protection, under Article 5 of the income tax convention between States S and X, that a qualifying person would be entitled to under Article 5 of the income tax convention between States S and R.

144. Subclause C) of subdivision (i) provides an additional limitation where the item of income has been derived through an entity that is treated as fiscally transparent under the laws of the Contracting State of residence of the company seeking derivative benefits under paragraph 4. In such case, notwithstanding that the resident may satisfy the requirements of subclauses A) or B) based on a comparison of the terms of the tested convention with the terms of the convention under which the company is seeking derivative benefits, the resident will not meet the requirements of this subclause if the relevant item of income would not be treated as the income of that resident under a provision analogous to paragraph 2 of Article 1 had it, rather than the company seeking derivative benefits under paragraph 4, been paid the item of income for which that company is claiming benefits. The following example illustrates the application of subclause C):

— *Example*: RCO, a publicly traded company resident of State R, owns shares of SCO, a company resident of State S, through P,

a partnership organised in State S. P is fiscally transparent under the domestic tax law of State S and is treated as a company under the domestic tax law of State R. Accordingly, under the provisions of paragraph 2 of Article 1, dividends paid by SCO through P would not be considered derived by RCO, and thus would not be eligible for a reduction from source taxation in State S under Article 10. RCO interposes XCO, a resident of State X, between itself and P. Under the domestic tax law of State X, P is fiscally transparent, and therefore, XCO is considered to derive dividends paid by SCO to P.

The income tax convention between States S and X contains *[…]* paragraphs 1 to 7 of Article 29. In order to enjoy the dividend withholding tax reductions provided in that convention, XCO must satisfy the derivative benefits test. Although the dividend rates under paragraph 2 of Article 10 of the convention between States S and X are the same as those under Article 10 of the convention between States S and R, and subclause A) of subdivision (i) would be satisfied, dividends would not be considered derived by RCO if RCO, and not XCO, had owned SCO through the partnership P. Accordingly, by virtue of subclause C), RCO is not an equivalent beneficiary, and for that reason, XCO is not entitled to derivative benefits under paragraph 4 with respect to the dividends paid by SCO through P.

145. The second category of persons who qualify as "equivalent beneficiary" (subdivision (ii) of the definition) applies to persons who are residents of the same Contracting State as the company seeking derivative benefits under paragraph 4. Such persons will be equivalent beneficiaries if they are eligible for benefits by reason of subparagraph *a*), *b*), *c*) or *e*) of paragraph 2, or under paragraph 5 as a headquarters company. A headquarters company, however, will solely be an equivalent beneficiary of the company seeking derivative benefits under paragraph 4 if the company seeking derivative benefits receives interest or dividends from a member of the headquarters company's multinational corporate group. A rate comparison test applies, however, for any resident satisfying the headquarters company test in paragraph 5 that derives dividends or interest from the other Contracting State. That requirement is intended to ensure that the headquarters company is entitled to at least the same treaty benefits with respect to dividends or interest as the company seeking derivative benefits under paragraph 4 so that if, for instance, Article 11 of the Convention generally exempts interest from source taxation but does

not do so with respect to interest paid to a headquarters company by a member of that company's multinational group, the headquarters company will not be an equivalent beneficiary of a company that would otherwise be entitled to the treaty exemption from source taxation applicable to a similar interest payment.

146. The third category of persons who qualify as "equivalent beneficiary" (subdivision (iii) of the definition), applies to persons who are residents of the Contracting State of source. Such persons will be equivalent beneficiaries if they are eligible for benefits by reason of subparagraph *a*), *b*), *c*) or *e*) of paragraph 2, provided that such residents' ownership of the aggregate vote and value of the shares (and any disproportionate class of shares as defined in paragraph 7) of the company that requests the derivative benefits does not exceed 25 per cent. Under the ownership requirement in subparagraph *a*) of paragraph 4, ownership may be direct or indirect, but in the case of indirect ownership, each intermediate owner must be a "qualifying intermediate owner" under the definition of that term in paragraph 7 (see below).

147. As explained in paragraph 10 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted in paragraph 7 above]*, where paragraph 4 on derivative benefits applies, the definition of equivalent beneficiary will exclude persons who, under another convention, are entitled to relief from taxation by the State of source that is not as favourable as the relief provided under the Convention. Some States may want to address the resulting so-called "cliff" effect of denying all treaty benefits even if the difference in the relief provided by the two conventions is relatively minor by providing relief from taxation by the State of source that is similar to the relief that would have been provided under the other convention. This treatment could be achieved through the alternative provisions below that relate to the taxation of *[income from the operation of ships or aircraft in international traffic,]* dividends, interest*[,]* royalties*[, fees for services, income from automated digital services and insurance premiums]* and that grant limited benefits that broadly correspond to those that would have been available under the other convention:

> ***[Provision on international shipping and air transport to be added to Article 8 (Alternative A)]***
>
> *Notwithstanding the provisions of paragraphs 1 and 2 of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 regarding income from the operation of ships or aircraft in international traffic, if such company fails*

to satisfy the criteria of that paragraph solely by reason of the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph e) of paragraph 7 of Article 29, such company may be taxed in the Contracting State in which the income from the operation of ships or aircraft in international traffic arises and according to the laws of that State, except that the tax so charged shall not exceed the highest rate among the rates of tax to which persons described in the definition of the term "equivalent beneficiary" in subparagraph e) of paragraph 7 of Article 29 (notwithstanding the requirement of clause B) of subdivision (i) of that definition) would have been entitled if such persons had received the income from the operation of ships or aircraft in international traffic directly. For purposes of this paragraph, a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph e) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the income from the operation of ships or aircraft in international traffic.]

Provision on dividends to be added to Article 10

Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 4 of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 of this Convention regarding a dividend, if such company fails to satisfy the criteria of that paragraph solely by reason of:

a) the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29; or

b) the requirement, in subdivision (ii) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29, that a person entitled to benefits under paragraph 5 of Article 29 would be entitled to a rate of tax with respect to the dividend that is less than or equal to the rate applicable under paragraph 2 of this Article;

such company may be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that Contracting State. In these cases, however,

the tax so charged shall not exceed the highest rate among the rates of tax to which persons described in the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 (notwithstanding the requirements referred to in subparagraphs *a*) and *b*) of this paragraph) would have been entitled if such persons had received the dividend directly. For purposes of this paragraph:

c) such persons' indirect ownership of the voting stock of the company paying the dividends shall be treated as direct ownership, and

d) a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the dividends.

Provision on interest to be added to Article 11

Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 4 of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 regarding a payment of interest, if such company fails to satisfy the criteria of that paragraph solely by reason of:

a) the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29; or

b) the requirement in subdivision (ii) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 that a person entitled to benefits under paragraph 5 of Article 29 would be entitled to a rate of tax with respect to the interest that is less than or equal to the rate applicable under paragraph 2 of this Article;

such company may be taxed by the Contracting State in which the interest arises according to the laws of that State. In these cases, however, the tax so charged shall not exceed the highest rate among the rates of tax to which persons described in the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 (notwithstanding the requirements referred to in subparagraphs *a*) and *b*) of this paragraph) would have been entitled if such persons had received the interest

directly. For purposes of this paragraph, a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the interest.

Provision on royalties to be added to Article 12

Notwithstanding the provisions of paragraphs 1 *[and 2]* but subject to the provisions of paragraph *[4]* of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 regarding royalties, if such company fails to satisfy the criteria of that paragraph solely by reason of the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29, such company may be taxed in the Contracting State in which the royalty arises and according to the laws of that State, except that the tax so charged shall not exceed the highest rate among the rates of tax to which persons described in the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 (notwithstanding the requirement of clause B) of subdivision (i) of that definition) would have been entitled if such persons had received the royalty directly. For purposes of this paragraph, a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph *e*) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the royalties.

[Provision on fees for services to be added to Article 12AA]

[Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 4 of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 of this Convention regarding fees for services, if such company fails to satisfy the criteria of that paragraph solely by reason of the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29, such company may be taxed in the Contracting State in which such fees arise and according to the laws of that Contracting State. In these cases, however, the tax so charged shall not exceed the highest rate among the rates of tax to

which persons described in the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29 (notwithstanding the requirements referred to in subparagraphs (a) and (b) of this paragraph) would have been entitled if such persons had received the fees for services directly. For purposes of this paragraph, a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the fees for services.]

[Provision on income from automated digital services to be added to Article 12B]

[Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 8 of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 of this Convention regarding payments underlying income from automated digital services, if such company fails to satisfy the criteria of that paragraph solely by reason of the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29, such company may be taxed in the Contracting State in which such payments arise and according to the laws of that Contracting State. In these cases, however, the tax so charged shall not exceed the highest rate among the rates of tax to which persons described in the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29 (notwithstanding the requirements referred to in subparagraphs (a) and (b) of this paragraph) would have been entitled if such persons had received the payments directly. For purposes of this paragraph, a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the payments underlying income from digital services.]

[Provision on insurance premiums to be added to Article 12C]

[Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 4 of this Article, in the case of a company seeking to satisfy the requirements of paragraph 4 of Article 29 of this Convention regarding insurance premiums, if

such company fails to satisfy the criteria of that paragraph solely by reason of the requirement in clause B) of subdivision (i) of the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29, such company may be taxed in the Contracting State in which such payments arise and according to the laws of that Contracting State. In these cases, however, the tax so charged shall not exceed the highest rate among the rates of tax to which persons described in the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29 (notwithstanding the requirements referred to in subparagraphs (a) and (b) of this paragraph) would have been entitled if such persons had received the payments directly. For purposes of this paragraph, a person described in subdivision (iii) of the definition of the term "equivalent beneficiary" in subparagraph (e) of paragraph 7 of Article 29 shall be treated as entitled to the limitation of tax to which such person would be entitled if such person were a resident of the same Contracting State as the company receiving the payments underlying income from digital services.]

Subparagraph (f): definition of "disproportionate class of shares"

28. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "disproportionate class of shares" in paragraph 7*f*), is applicable to the equivalent provision of this Model:

> 148. Under the definition of the term "disproportionate class of shares", which is used in the ownership tests in various parts of the Article, a company or entity has a disproportionate class of shares if it has outstanding shares that are subject to terms or other arrangements that entitle the holder of these shares to a larger portion of the company's or entity's income derived from the other Contracting State than that to which the holder would be entitled in the absence of such terms or arrangements. Thus, for example, a company resident in one Contracting State has a "disproportionate class of shares" if some of the outstanding shares of that company are "tracking shares" that pay dividends based upon a formula that approximates the company's return on its assets employed in the other Contracting State. This is illustrated by the following example:
>
> — *Example*: ACO is a company resident of State A. ACO has issued common shares and preferred shares. The common shares are listed and regularly traded on the principal stock exchange of

State A. The preferred shares have no voting rights and only entitle their holders to receive dividends equal in amount to interest payments that ACO receives from unrelated borrowers in State B. The preferred shares are owned entirely by a single shareholder who is a resident of a third State with which State B does not have a tax treaty. The common shares account for more than 50 per cent of the value of ACO and for 100 per cent of the votes. Since the owner of the preferred shares is entitled to receive payments corresponding to ACO's interest income arising in State B, the preferred shares constitute a "disproportionate class of shares" and because these shares are not regularly traded on a recognised stock exchange, ACO will not qualify for benefits under subparagraph *c*) of paragraph 2.

Subparagraph (g): definition of "primary place of management and control"

29. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "primary place of management and control" in paragraph 7*g*), is applicable to the equivalent provision of this Model:

> 149. The term "primary place of management and control" is relevant for the purposes of subparagraph *c*) of paragraph 2 and of paragraph 5 of the detailed version. This term must be distinguished from the concept of "place of effective management", which was used before 2017 in paragraph 3 of Article 4 and in various provisions, including Article 8, applicable to the operation of ships and aircraft. The concept of "place of effective management" was interpreted by some States as being ordinarily the place where the most senior person or group of persons (for example a board of directors) made the key management and commercial decisions necessary for the conduct of the company's business. The concept of the primary place of management and control, by contrast, refers to the place where the day-to-day responsibility for the management of the company or entity (and its direct and indirect subsidiaries) is exercised.
>
> 150. A company's or entity's primary place of management and control will be situated in the State of residence of that company or entity only if the following two conditions are satisfied:
>
> — First, under subdivision (i), the executive officers and senior management employees *[of the company or entity]* exercise day-to-day responsibility for more of the strategic, financial and

operational policy decision making for the company or entity and for its direct and indirect subsidiaries, and the staff that support such management in preparing for and making those decisions conduct more of their necessary day-to-day activities, in that State than in the other State or any third State. Thus, the test looks to the overall activities of the relevant persons to see where those activities are conducted. In most cases, it will be a necessary, but not a sufficient, condition that the chief executive officer and other top executives normally are in the Contracting State of which the company is a resident.

— Second, the executive officers and senior management employees *[of the company or entity]* exercise day-to-day responsibility for more of the strategic, financial and operational policy decision-making for the company and its direct and indirect subsidiaries, and the staff that support such management in making those decisions conduct more of their necessary day-to-day activities, than the officers or employees of any other company or entity.

Subparagraph (h): definition of "qualifying intermediate owner"

30. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "qualifying intermediate owner" in paragraph 7*h*), is applicable to the equivalent provision of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 151. The definition of "qualifying intermediate owner" *[…]* is relevant for the purposes of the ownership tests found in subparagraphs *d*) and *f*) of paragraph 2 as well as the derivative benefits rule of paragraph 4.
>
> 152. Under subdivision (i) of that definition, a qualifying intermediate owner is an entity resident of a third State that has in effect a comprehensive income tax convention with the Contracting State from which a treaty benefit is sought.
>
> 153. As indicated in the Commentary on Article 1, some States consider that provisions should be included in their tax treaties in order to deny the application of specific treaty provisions with respect to income benefiting from regimes that constitute "special tax regimes"

(see paragraphs 85 to 100 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*) and to deny the application of Article 11 to interest that is paid to connected persons that benefit from domestic law provisions that provide for a notional deduction with respect to equity (see paragraph 107 of the Commentary on Article 1 *[of the 2017 OECD Model, as quoted in paragraph 161 of the Commentary on Article 1 of this Model]*). These States may want to restrict the scope of subdivision (i) so that it would only apply to residents of third States with which the State from which treaty benefits are sought has concluded comprehensive income tax conventions, and that do not benefit from a special tax regime or from notional interest deductions. This could be done by amending subdivision (i) as follows:

(i) a resident of a State that has in effect with the Contracting State from which a benefit under this Convention is being sought a comprehensive convention for the avoidance of double taxation and that does not benefit from either

A) a special tax regime, provided that if the relevant comprehensive convention for the avoidance of double taxation does not contain a definition of special tax regime analogous to the provisions included in [reference to the paragraph of the convention that includes the definition of "special tax regime"], the principles of the definition provided in this Convention shall apply, but without regard to the requirement in clause (v) of that definition; or

B) notional deductions of the type described in [reference to the paragraph of Article 11 that relates to notional deductions for equity]; or

154. Under subdivision (ii) of the definition, a qualifying intermediate owner also includes a resident of the same Contracting State as the company to which the relevant ownership test is applied under subparagraph *d*) or *f*) of paragraph 2 or under the derivative benefits rule of paragraph 4.

Subparagraph (i): definition of "tested group"

31. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "tested group" in paragraph 7*i*), is applicable to the equivalent provision of this Model:

155. This subparagraph defines the term "tested group" for purposes of the base erosion rules in subdivision (ii) of subparagraphs *d*) and *f*) of paragraph 2 and in paragraphs 4 and 5. The tested group shall consist of the tested company to which the relevant base erosion rule is applied (which is referred to as the "tested resident") and any company *[or permanent establishment]* that either participates as a member with that tested resident in a tax consolidation regime, fiscal unity or similar regime that allows members of the group to share profits or losses, or any company *[or permanent establishment]* that, during the relevant taxable period, shares losses with the tested resident pursuant to a group relief or other loss sharing regime. If there is no tested group, then the relevant base erosion test applicable to a tested group does not apply.

Subparagraph (j): definition of "gross income"

32. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which explains the definition of "gross income" in paragraph 7*j*), is applicable to the equivalent provision of this Model:

156. This subparagraph defines the term "gross income" for purposes of the base erosion rules in subdivision (ii) of subparagraphs *d*) and *f*) of paragraph 2 and in paragraphs 4 and 5. The starting point for calculating gross income is gross receipts as determined in the relevant entity's Contracting State of residence for the taxable period that includes the time when the benefit would be accorded. If the entity is engaged in a business that includes the manufacture, production or sale of goods, "gross income" means gross receipts reduced by the cost of goods sold. If the tested entity is engaged in a business of providing non-financial services, "gross income" means such gross receipts reduced by the direct costs of generating such receipts.

157. Subdivision (i) of the definition further provides that except for determining benefits with respect to dividends under Article 10, gross income shall not include the portion of any dividends that are effectively exempt from tax in the person's Contracting State of residence, whether through deductions or otherwise, regardless of the State of residence of the company paying these dividends. Subdivision (ii) provides that, except with respect to the portion of any dividend that is taxable, a tested group's gross income will not take into account any transactions between companies within the tested group.

Paragraph 8

33. The Committee considers that the following part of the Commentary on Article 29 of the 2017 OECD Model, which provides additional explanations on paragraph 8 of that Article, is applicable to paragraph 8 of Article 29 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations or to reflect the differences between the provisions of the OECD Model and those of this Model):

> 161. As mentioned in paragraph 32 of the Commentary on Article 10 *[of the 2017 OECD Model, as quoted in paragraph 21 of the Commentary on Article 10 of this Model]*, paragraph 25 of the Commentary on Article 11 *[of the 2017 OECD Model]* and paragraph 21 of the Commentary on Article 12 *[of the 2017 OECD Model]*, potential abuses may result from the transfer of shares, debt claims, rights or property*[, or activities]* to permanent establishments set up solely for that purpose in countries that do not tax, or offer preferential tax treatment to, the income from such assets *[or activities]*. Where the State of residence exempts the profits attributable to such permanent establishments situated in third jurisdictions, the State of source should not be expected to grant treaty benefits with respect to such income. The paragraph, which applies where a Contracting State exempts the income of enterprises of that State that are *(sic)* attributable to permanent establishments situated in third jurisdictions, provides that treaty benefits will not be granted in such cases. That rule, however, does not apply if
>
> — the income bears a significant level of tax in the State in which the permanent establishment is situated, or
>
> — the income emanates from, or is incidental to, the active conduct of a business through the permanent establishment, excluding an investment business that is not carried on by a bank, insurance enterprise or registered securities dealer.
>
> 162. Under subparagraph *c*), in any case where benefits are denied under this paragraph, the resident of a Contracting State who derives the relevant income may request that the competent authority of the other Contracting State grant these benefits. The competent authority who receives such a request may, at its discretion, grant these benefits if it determines that doing so would be justified; it shall, however, consult with the competent authority of the other Contracting State before granting or denying the request.

163. The following example illustrates the type of situation in which the paragraph is intended to apply. An enterprise of a Contracting State sets up a permanent establishment in a third jurisdiction that imposes no or low tax on the profits of the permanent establishment. The profits attributable to the permanent establishment are exempt from tax by the first-mentioned State either pursuant to a provision similar to Article 23 A included in a tax convention between that State and the jurisdiction where the permanent establishment is located or pursuant to the first-mentioned State's domestic law. The enterprise derives interest arising from the other Contracting State which is included in the profits attributable to the permanent establishment. Assuming that the conditions for the application of Article 11 are met, the State in which the interest arises would, in the absence of paragraph 8, be obliged to grant the benefits of the limitation of tax provided for in paragraph 2 of Article 11 despite the fact that the interest is exempt from tax in the first-mentioned State and is subject to little or no tax in the third jurisdiction in which the permanent establishment is situated. In that situation, the benefits of the Convention will be denied with respect to that income unless the exception of subparagraph *b*) applicable to income that emanates from, or is incidental to, the active conduct of a business applies to the relevant income or unless these benefits are granted, under the discretionary relief provision of subparagraph *c*), by the competent authority of the State in which the interest arises.

164. The reference to the word "income" in subdivision (i) means that the provision applies regardless of whether the relevant income constitutes business profits. The rule therefore applies where an enterprise of a Contracting State derives income from the other Contracting State and the first-mentioned State treats the right or property in respect of which the income is paid as effectively connected with a permanent establishment situated in a third jurisdiction (including under a provision such as paragraph 2 of Article 21 in a treaty between the first-mentioned State and the third jurisdiction).

165. Where the conditions of subdivisions (i) and (ii) are met, subparagraph *a*) denies the benefits that otherwise would apply under the other provisions of the Convention if the relevant item of income is treated as being part of the profits of the permanent establishment situated in the third jurisdiction and the amount of tax levied on that item of income in that third jurisdiction is less than the lower of the following two amounts: *a*) the amount of that item of income multiplied by the minimum rate that the Contracting States have determined bilaterally for the purposes of the paragraph, and b) 60 per cent of the

amount of tax that would be imposed on that item of income in the State of the enterprise if that permanent establishment were situated in that State.

166. The phrase "the amount of that item of income" refers to the amount of the relevant income after the deduction of all expenses relevant to that item of income that are deductible under the law of the relevant jurisdiction. Thus, for the purposes of determining the tax in the third jurisdiction that relates to that item of income, the overall tax applicable to the profits of the permanent establishment situated in that jurisdiction will first be computed after deducting all expenses that are deductible, in accordance with the law of that jurisdiction, in determining the taxable profits attributable to the permanent establishment. The tax that applies to the relevant amount of the item of income would then be determined by multiplying that overall tax applicable to the profits of the permanent establishment by the ratio of the net amount of the item of income (i.e. the gross amount of the item of income less the deduction of the expenses deducted in computing the taxable profits of the permanent establishment that relate specifically or proportionally to that item of income) to the taxable profits of the permanent establishment. A similar computation will be made for the purposes of determining the tax that would be imposed on that item of income in the Contracting State of the enterprise if the permanent establishment were situated in that State; in that case, the expenses that will be deducted are those that are deductible in accordance with the law of that State.

167. For the purposes of the exception included in subparagraph *b*), the reference to income that "emanates from, or is incidental to, the active conduct of a business" should be interpreted as indicated in paragraphs 74 to 76 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted in paragraph 18 above]*.

168. Instead of adopting the wording of paragraph 8, some States may prefer a more comprehensive solution that would not be restricted to situations where an enterprise of a Contracting State is exempt from tax, in that State, on the profits attributable to a permanent establishment situated in a third jurisdiction, that would not include the exception applicable to income that emanates from, or is incidental to, the active conduct of a business and that would not require an evaluation of the tax that would have been paid in the State of the enterprise if the permanent establishment had been situated in that State. In such a case, the rule would be applicable in any case where income derived from one Contracting State that is attributable to a

permanent establishment situated in a third jurisdiction is subject to combined taxation, in the State of the enterprise and the jurisdiction of the permanent establishment, at an effective rate that is less than the lower of a rate to be determined bilaterally and 60 per cent of the general rate of corporate tax in the State of the enterprise. The following is an example of a rule that could be used for that purpose:

> Where an enterprise of a Contracting State derives income from the other Contracting State and the first-mentioned *[…]* State treats that income as profits attributable to a permanent establishment situated in a third jurisdiction, the benefits of this Convention shall not apply to that income if that income is subject to a combined aggregate effective rate of tax in the first-mentioned *[…]* State and the jurisdiction in which the permanent establishment is situated that is less than the lesser of [rate to be determined bilaterally] or 60 per cent of the general statutory rate of company tax applicable in the first-mentioned *[…]* State. If benefits under this Convention are denied pursuant to the preceding sentence with respect to an item of income derived by a resident of a Contracting State, the competent authority of the other Contracting State may, nevertheless, grant these benefits with respect to that item of income if, in response to a request by such resident, such competent authority determines that granting such benefits is justified in light of the reasons such resident did not satisfy the requirements of this paragraph (such as the existence of losses). The competent authority of the Contracting State to which a request has been made under the preceding sentence shall consult with the competent authority of the other Contracting State before either granting or denying the request.

Paragraph 9

34. Until the 2017 update, the UN Model did not include a general anti-abuse rule but paragraph 36 of the Commentary on Article 1 of the 2011 UN Model provided an optional text for the inclusion of such a rule in a bilateral convention. As part of the 2017 Update, the Committee decided that a general anti-abuse rule should be included in the UN Model as paragraph 9 of Article 29. Therefore, paragraphs 60 to 72 of the Commentary on Article 1 are relevant primarily for those bilateral tax treaties that do not contain a general anti-abuse rule similar to this paragraph.

35. Paragraph 9 of Article 29 corresponds to the general anti-abuse rule that was recommended in the final report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[113] of the OECD/G20 BEPS Project and that was added to the OECD Model as paragraph 9 of Article 29. Therefore, the Committee considers that the following part of the Commentary on paragraph 9 of Article 29 of the 2017 OECD Model is applicable to paragraph 9 of Article 29 of this Model (the modifications that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to provide additional explanations and to reflect the differences between the provisions of the OECD Model and those of this Model):

> 169. Paragraph 9 mirrors the guidance in paragraphs *[64 to 66]* of the Commentary on Article 1 *[of this Model]*. According to that guidance, the benefits of a tax convention should not be available where one of the principal purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention. Paragraph 9 incorporates the principles underlying these paragraphs into the Convention itself in order to allow States to address cases of improper use of the Convention even if their domestic law does not allow them to do so in accordance with paragraph*[s 83 to 89]* of the Commentary on Article 1 *[of this Model]*; it also confirms the application of these principles for States whose domestic law already allows them to address such cases.
>
> 170. The provisions of paragraph 9 have the effect of denying a benefit under a tax convention where one of the principal purposes of an arrangement or transaction that has been entered into is to obtain a benefit under the convention. Where this is the case, however, the last part of the paragraph allows the person to whom the benefit would otherwise be denied the possibility of establishing that obtaining the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.
>
> 171. Paragraph 9 supplements and does not restrict in any way the scope or application of the provisions of paragraphs 1 to 7 (the limitation-on-benefits rule) and of paragraph 8 (the rule applicable to a permanent establishment situated in a third jurisdiction): a benefit that is denied in accordance with these paragraphs is not a "benefit

113 See footnote 7 above.

under the Convention" that paragraph 9 would also deny. Moreover, the guidance provided in the Commentary on paragraph 9 should not be used to interpret paragraphs 1 to 8 and vice-versa.

172. Conversely, the fact that a person is entitled to benefits under paragraphs 1 to 7 does not mean that these benefits cannot be denied under paragraph 9. Paragraphs 1 to 7 are rules that focus primarily on the legal nature, ownership in, and general activities of, residents of a Contracting State. As illustrated by the example in the next paragraph, these rules do not imply that a transaction or arrangement entered into by such a resident cannot constitute an improper use of a treaty provision.

173. Paragraph 9 must be read in the context of paragraphs 1 to 7 and of the rest of the Convention, including its preamble. This is particularly important for the purposes of determining the object and purpose of the relevant provisions of the Convention. Assume, for instance, that a public company whose shares are regularly traded on a recognised stock exchange in the Contracting State of which the company is a resident derives income from the other Contracting State. As long as that company is a "qualified person" as defined in paragraph 2, it is clear that the benefits of the Convention should not be denied solely on the basis of the ownership structure of that company, for example, because a majority of the shareholders in that company are not residents of the same State. The object and purpose of subparagraph *c*) of paragraph 2 is to establish a threshold for the treaty entitlement of public companies whose shares are held by residents of different States. The fact that such a company is a qualified person does not mean, however, that benefits could not be denied under paragraph 9 for reasons that are unrelated to the ownership of the shares of that company. Assume, for instance, that such a public company is a bank that enters into a conduit financing arrangement intended to provide indirectly to a resident of a third State the benefit of lower source taxation under a tax treaty. In that case, paragraph 9 would apply to deny that benefit because subparagraph *c*) of paragraph 2, when read in the context of the rest of the Convention and, in particular, its preamble, cannot be considered as having the purpose, shared by the two Contracting States, of authorising treaty-shopping transactions entered into by public companies.

174. The provisions of paragraph 9 establish that a Contracting State may deny the benefits of a tax convention where it is reasonable to conclude, having considered all the relevant facts and circumstances, that one of the principal purposes of an arrangement or transaction

was for a benefit under a tax treaty to be obtained. The provision is intended to ensure that tax conventions apply in accordance with the purpose for which they were entered into, that is, to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.

175. The term "benefit" includes all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of source under Articles 6 through 22 of the Convention, the relief from double taxation provided by Article 23, and the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations. This includes, for example, limitations on the taxing rights of a Contracting State in respect of *[income from the operation of ships or aircraft in international traffic,]* dividends, interest*[,]* royalties*[, fees for services, income from automated digital services or insurance premiums]* arising in that State, and paid to a resident of the other State (who is the beneficial owner) under Article *[8,]* 10, 11*[,]* 12*[, 12AA, 12B or 12C]*. It also includes limitations on the taxing rights of a Contracting State over a capital gain derived from the alienation of movable property located in that State by a resident of the other State under Article 13. When a tax convention includes other limitations (such as a tax-sparing provision), the provisions of this Article also apply to that benefit.

176. The phrase "that resulted directly or indirectly in that benefit" is deliberately broad and is intended to include situations where the person who claims the application of the benefits under a tax treaty may do so with respect to a transaction that is not the one that was undertaken for one of the principal purposes of obtaining that treaty benefit. This is illustrated by the following example:

> TCO, a company resident of State T, has acquired all the shares and debts of SCO, a company resident of State S, that were previously held by SCO's parent company. These include a loan made to SCO at 4 per cent interest payable on demand. State T does not have a tax convention with State S and, therefore, any interest paid by SCO to TCO is subject to a withholding tax on interest at a rate of 25 per cent in accordance with the domestic law of State S. Under the State R–State S tax convention, however, there is no withholding tax on interest paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State; also, that treaty does not include provisions similar to paragraphs 1 to 7. TCO decides to transfer

the loan to RCO, a subsidiary resident of State R, in exchange for three promissory notes payable on demand on which interest is payable at 3.9 per cent.

In this example, whilst RCO is claiming the benefits of the State R–State S treaty with respect to a loan that was entered into for valid commercial reasons, if the facts of the case show that one of the principal purposes of TCO in transferring its loan to RCO was for RCO to obtain the benefit of the State R–State S treaty, then the provision would apply to deny that benefit as that benefit would result indirectly from the transfer of the loan.

177. The terms "arrangement or transaction" should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable. In particular they include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence. An example of an "arrangement" would be where steps are taken to ensure that meetings of the board of directors of a company are held in a different country in order to claim that the company has changed its residence. One transaction alone may result in a benefit, or it may operate in conjunction with a more elaborate series of transactions that together result in the benefit. In both cases the provisions of paragraph 9 may apply.

178. To determine whether or not one of the principal purposes of an arrangement or transaction is to obtain benefits under the Convention, it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it. What are the purposes of an arrangement or transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case-by-case basis. It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the arrangement or transaction was to obtain the benefits of the tax convention. It should not be lightly assumed, however, that obtaining a benefit under a tax treaty was one of the principal purposes of an

arrangement or transaction and merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes. Where, however, an arrangement can only be reasonably explained by a benefit that arises under a treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit.

179. A person cannot avoid the application of this paragraph by merely asserting that the arrangement or transaction was not undertaken or arranged to obtain the benefits of the Convention. All of the evidence must be weighed to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose. The determination requires reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

180. The reference to "one of the principal purposes" in paragraph 9 means that obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction. It is sufficient that at least one of the principal purposes was to obtain the benefit. For example, a person may sell a property for various reasons, but if before the sale, that person becomes a resident of one of the Contracting States and one of the principal purposes for doing so is to obtain a benefit under a tax convention, paragraph 9 could apply notwithstanding the fact that there may also be other principal purposes for changing residence, such as facilitating the sale of the property or the re-investment of the proceeds of the alienation.

181. A purpose will not be a principal purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was not a principal consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. In particular, where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit. Where, however, an arrangement is entered into for the purpose of obtaining similar benefits under a number of treaties, it should not be considered that obtaining benefits under other treaties will prevent obtaining one benefit under one treaty from being considered a principal purpose for that arrangement. Assume, for example, that a taxpayer resident of State A enters into a conduit arrangement with a financial institution resident of State B in order for that financial institution to invest, for

the ultimate benefit of that taxpayer, in bonds issued in a large number of States with which State B, but not State A, has tax treaties. If the facts and circumstances reveal that the arrangement has been entered into for the principal purpose of obtaining the benefits of these tax treaties, it should not be considered that obtaining a benefit under one specific treaty was not one of the principal purposes for that arrangement. Similarly, purposes related to the avoidance of domestic law should not be used to argue that obtaining a treaty benefit was merely accessory to such purposes.

182. The following examples illustrate the application of the paragraph (the examples included in paragraph 187 [*[of the Commentary on Article 29 of the 2017 OECD Model, as quoted below]* should also be considered when determining whether and when the paragraph would apply in the case of conduit arrangements) *[…]*:

— *Example A:* TCO, a company resident of State T, owns shares of SCO, a company listed on the stock exchange of State S. State T does not have a tax convention with State S and, therefore, any dividend paid by SCO to TCO is subject to a withholding tax on dividends of 25 per cent in accordance with the domestic law of State S. Under the State R-State S tax convention, however, there is no withholding tax on dividends paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State. TCO enters into an agreement with RCO, an independent financial institution resident of State R, pursuant to which TCO assigns to RCO the right to the payment of dividends that have been declared but have not yet been paid by SCO.

  In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the arrangement under which TCO assigned the right to the payment of dividends to RCO was for RCO to obtain the benefit of the exemption from source taxation of dividends provided for by the State R-State S tax convention and it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement.

— *Example B:* SCO, a company resident of State S, is the subsidiary of TCO, a company resident of State T. State T does not have a tax convention with State S and, therefore, any dividend paid by SCO to TCO is subject to a withholding tax on dividends of 25 per cent in accordance with the domestic law of State S. Under the State R-State S tax convention, however, the applicable rate

of withholding tax on dividends paid by a company of State S to a resident of State R is 5 per cent. TCO therefore enters into an agreement with RCO, a financial institution resident of State R and a qualified person under subparagraph *c*) of paragraph 2 of this Article, pursuant to which RCO acquires the usufruct of newly issued non-voting preferred shares of SCO for a period of three years. TCO is the bare owner of these shares. The usufruct gives RCO the right to receive the dividends attached to these preferred shares. The amount paid by RCO to acquire the usufruct corresponds to the present value of the dividends to be paid on the preferred shares over the period of three years (discounted at the rate at which TCO could borrow from RCO).

In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the arrangement under which RCO acquired the usufruct of the preferred shares issued by SCO was to obtain the benefit of the 5 per cent limitation applicable to the source taxation of dividends provided for by the State R-State S tax convention and it would be contrary to the object and purpose of the tax convention to grant the benefit of that limitation under this treaty-shopping arrangement.

— *Example C:* RCO, a company resident of State R, is in the business of producing electronic devices and its business is expanding rapidly. It is now considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs. After a preliminary review, possible locations in three different countries are identified. All three countries provide similar economic and political environments. After considering the fact that State S is the only one of these countries with which State R has a tax convention, the decision is made to build the plant in that State.

In this example, whilst the decision to invest in State S is taken in the light of the benefits provided by the State R-State S tax convention, it is clear that the principal purposes for making that investment and building the plant are related to the expansion of RCO's business and the lower manufacturing costs of that country. In this example, it cannot reasonably be considered that one of the principal purposes for building the plant is to obtain treaty benefits. In addition, given that a general objective of tax conventions is to encourage cross-border investment, obtaining the benefits of the State R-State S convention for the investment

in the plant built in State S is in accordance with the object and purpose of the provisions of that convention.

— *Example D:* RCO, a collective investment vehicle resident of State R, manages a diversified portfolio of investments in the international financial market. RCO currently holds 15 per cent of its portfolio in shares of companies resident of State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30 per cent to 10 per cent.

RCO's investment decisions take into account the existence of tax benefits provided under State R's extensive tax convention network. A majority of investors in RCO are residents of State R, but a number of investors (the minority investors) are residents of States with which State S does not have a tax convention. Investors' decisions to invest in RCO are not driven by any particular investment made by RCO, and RCO's investment strategy is not driven by the tax position of its investors. RCO annually distributes almost all of its income to its investors and pays taxes in State R on income not distributed during the year.

In making its decision to invest in shares of companies resident of State S, RCO considered the existence of a benefit under the State R-State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 9. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 9 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCO's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R-State S tax treaty to RCO.

— *Example E:* RCO is a company resident of State R and, for the last 5 years, has held 24 per cent of the shares of company SCO, a resident of State S. Following the entry-into-force of a tax treaty between States R and S (Article 10 of which is identical to Article 10 of this Model), RCO decides to increase to 25 per cent its ownership of the shares of SCO. The facts and circumstances reveal that the decision to acquire these additional shares has been made primarily in order to obtain the benefit of the lower rate of tax provided by Article 10(2)*a*) of the treaty.

In that case, although one of the principal purposes for the transaction through which the additional shares are acquired is clearly to obtain the benefit of Article 10(2)*a*), paragraph 9 would not apply because it may be established that granting that benefit in these circumstances would be in accordance with the object and purpose of Article 10(2)*a*). That subparagraph uses an arbitrary threshold of 25 per cent for the purposes of determining which shareholders are entitled to the benefit of the lower rate of tax on dividends and it is consistent with this approach to grant the benefits of the subparagraph to a taxpayer who genuinely increases its participation in a company in order to satisfy this requirement.

— *Example F:* TCO is a publicly-traded company resident of State T. TCO's information technology business, which was developed in State T, has grown considerably over the last few years as a result of an aggressive merger and acquisition policy pursued by TCO's management. RCO, a company resident of State R (a State that has concluded many tax treaties providing for no or low source taxation of dividends and royalties), is the family-owned holding company of a group that is also active in the information technology sector. Almost all the shares of RCO are owned by residents of State R who are relatives of the entrepreneur who launched and developed the business of the RCO group. RCO's main assets are shares of subsidiaries located in neighbouring countries, including SCO, a company resident of State S, as well as patents developed in State R and licensed to these subsidiaries. TCO, which has long been interested in acquiring the business of the RCO group and its portfolio of patents, has made an offer to acquire all the shares of RCO.

In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that the principal purposes for the acquisition of RCO are related to the expansion of the business of the TCO group and do not include the obtaining of benefits under the treaty between States R and S. The fact that RCO acts primarily as a holding company does not change that result. It might well be that, after the acquisition of the shares of RCO, TCO's management will consider the benefits of the tax treaty concluded between State R and State S before deciding to keep in RCO the shares of SCO and the patents licensed to SCO. This, however, would not be a purpose related to the relevant transaction, which is the acquisition of the shares of RCO.

— *Example G:* TCO, a company resident of State T, is a publicly-traded company resident of State T. It owns directly or indirectly a number of subsidiaries in different countries. Most of these companies carry on the business activities of the TCO group in local markets. In one region, TCO owns the shares of five such companies, each located in different neighbouring States. TCO is considering establishing a regional company for the purpose of providing group services to these companies, including management services such as accounting, legal advice and human resources; financing and treasury services such as managing currency risks and arranging hedging transactions, as well as some other non-financing related services. After a review of possible locations, TCO decides to establish the regional company, RCO, in State R. This decision is mainly driven by the skilled labour force, reliable legal system, business friendly environment, political stability, membership of a regional grouping, sophisticated banking industry and the comprehensive double taxation treaty network of State R, including its tax treaties with the five States in which TCO owns subsidiaries, which all provide low withholding tax rates.

  In this example, merely reviewing the effects of the treaties on future payments by the subsidiaries to the regional company would not enable a conclusion to be drawn about the purposes for the establishment of RCO by TCO. Assuming that the intra-group services to be provided by RCO, including the making of decisions necessary for the conduct of its business, constitute a real business through which RCO exercises substantive economic functions, using real assets and assuming real risks, and that business is carried on by RCO through its own personnel located in State R, it would not be reasonable to deny the benefits of the treaties concluded between State R and the five States where the subsidiaries operate unless other facts would indicate that RCO has been established for other tax purposes or unless RCO enters into specific transactions to which paragraph 9 would otherwise apply (see also example F in paragraph 187 *[of the Commentary on Article 29 of the 2017 OECD Model, as quoted below]* with respect to the interest and other remuneration that RCO might derive from its group financing activities).

— *Example H:* TCO is a company resident of State T that is listed on the stock exchange of State T. It is the parent company of a multinational enterprise that conducts a variety of business

activities globally (wholesaling, retailing, manufacturing, investment, finance, etc.).

Issues related to transportation, time differences, limited availability of personnel fluent in foreign languages and the foreign location of business partners make it difficult for TCO to manage its foreign activities from State T. TCO therefore establishes RCO, a subsidiary resident of State R (a country where there are developed international trade and financial markets as well as an abundance of highly-qualified human resources), as a base for developing its foreign business activities. RCO carries on diverse business activities such as wholesaling, retailing, manufacturing, financing and domestic and international investment. RCO possesses the human and financial resources (in various areas such as legal, financial, accounting, taxation, risk management, auditing and internal control) that are necessary to perform these activities. It is clear that RCO's activities constitute the active conduct of a business in State R.

As part of its activities, RCO also undertakes the development of new manufacturing facilities in State S. For that purpose, it contributes equity capital and makes loans to SCO, a subsidiary resident of State S that RCO established for the purposes of owning these facilities. RCO will receive dividends and interest from SCO.

In this example, RCO has been established for business efficiency reasons and its financing of SCO through equity and loans is part of RCO's active conduct of a business in State R. Based on these facts and in the absence of other facts that would indicate that one of the principal purposes for the establishment of RCO or the financing of SCO was the obtaining of the benefits of the treaty between States R and S, paragraph 9 would not apply to these transactions.

— *Example I:* RCO, a company resident of State R, is one of a number of collective management organisations that grant licenses on behalf of neighbouring right and copyright holders for playing music in public or for broadcasting that music on radio, television or the Internet. SCO, a company resident of State S, carries on similar activities in State S. Performers and copyright holders from various countries appoint RCO or SCO as their agent to grant licenses and to receive royalties with respect to the copyrights and neighbouring rights that they hold; RCO and SCO distribute to each right holder the amount of royalties that

they receive on behalf of that holder minus a commission (in most cases, the amount distributed to each holder is relatively small). RCO has an agreement with SCO through which SCO grants licenses to users in State S and distributes royalties to RCO with respect to the rights that RCO manages; RCO does the same in State R with respect to the rights that SCO manages. SCO has agreed with the tax administration of State S that it will process the royalty withholding tax on the payments that it makes to RCO based on the applicable treaties between State S and the State of residence of each right holder represented by RCO based on information provided by RCO since these right holders are the beneficial owners of the royalties paid by SCO to RCO.

In this example, it is clear that the arrangements between the right holders and RCO and SCO, and between SCO and RCO, have been put in place for the efficient management of the granting of licenses and collection of royalties with respect to a large number of small transactions. Whilst one of the purposes for entering into these arrangements may well be to ensure that withholding tax is collected at the correct treaty rate without the need for each individual right holder to apply for a refund on small payments, which would be cumbersome and expensive, it is clear that such purpose, which serves to promote the correct and efficient application of tax treaties, would be in accordance with the object and purpose of the relevant provisions of the applicable treaties.

— *Example J:* RCO is a company resident of State R. It has successfully submitted a bid for the construction of a power plant for SCO, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months. The first contract is concluded with RCO and the second contract is concluded with SUBCO, a recently incorporated wholly-owned subsidiary of RCO resident of State R. At the request of SCO, which wanted to ensure that RCO would be contractually liable for the performance of the two contracts, the contractual arrangements are such that RCO is jointly and severally liable with SUBCO for the performance of SUBCO's contractual obligations under the SUBCO-SCO contract.

In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the conclusion of the separate

contract under which SUBCO agreed to perform part of the construction project was for RCO and SUBCO to each obtain the benefit of the rule in paragraph 3 of Article 5 of the State R-State S tax convention *[assuming that the paragraph is identical to paragraph 3 of Article 5 of the OECD Model]*. Granting the benefit of that rule in these circumstances would be contrary to the object and purpose of that paragraph as the time limitation of that paragraph would otherwise be meaningless.

— *Example K:* RCO, a company resident of State R, is a wholly-owned subsidiary of Fund, an institutional investor that is a resident of State T and that was established and is subject to regulation in State T. RCO operates exclusively to generate an investment return as the regional investment platform for Fund through the acquisition and management of a diversified portfolio of private market investments located in countries in a regional grouping that includes State R. The decision to establish the regional investment platform in State R was mainly driven by the availability of directors with knowledge of regional business practices and regulations, the existence of a skilled multilingual workforce, State R's membership of a regional grouping and the extensive tax convention network of State R, including its tax convention with State S, which provides for low withholding tax rates. RCO employs an experienced local management team to review investment recommendations from Fund and performs various other functions which, depending on the case, may include approving and monitoring investments, carrying on treasury functions, maintaining RCO's books and records, and ensuring compliance with regulatory requirements in States where it invests. The board of directors of RCO is appointed by Fund and is composed of a majority of State R resident directors with expertise in investment management, as well as members of Fund's global management team. RCO pays tax and files tax returns in State R.

RCO is now contemplating an investment in SCO, a company resident of State S. The investment in SCO would constitute only part of RCO's overall investment portfolio, which includes investments in a number of countries in addition to State S which are also members of the same regional grouping. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30 per cent to 5 per cent. Under the tax convention between State S and State T, the withholding tax rate on dividends is 10 per cent.

In making its decision whether or not to invest in SCO, RCO considers the existence of a benefit under the State R-State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 9. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 9 applies to an investment, it is necessary to consider the context in which the investment was made, including the reasons for establishing RCO in State R and the investment functions and other activities carried out in State R. In this example, in the absence of other facts or circumstances showing that RCO's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R-State S tax convention to RCO.

— *Example L:* RCO, a securitisation company resident of State R, was established by a bank which sold to RCO a portfolio of loans and other receivables owed by debtors located in a number of jurisdictions. RCO is fully debt-funded. RCO has issued a single share which is held on trust and has no economic value. RCO's debt finance was raised through the issuance of notes that are widely-held by third-party investors. The notes are listed on a recognised stock exchange, which allows for their trading on the secondary market, and are held through a clearing system. To comply with regulatory requirements, the bank has also retained a small percentage of the listed, widely-held debt securities issued by RCO. RCO currently holds 60 per cent of its portfolio in receivables of small and medium sized enterprises resident in State S, in respect of which RCO receives regular interest payments. The bank is a resident of a State T which has a tax treaty with State S that provides benefits equivalent to those provided under the State R-State S tax treaty. Under the tax treaty between State R and State S, the withholding tax rate on interest is limited to 10 per cent (the domestic law of State S provides for a withholding tax of 30 per cent).

In establishing RCO, the bank took into account a large number of issues, including State R's robust securitisation framework, its securitisation and other relevant legislation, the availability of skilled and experienced personnel and support services in State R and the existence of tax benefits provided under State R's extensive tax convention network. Investors' decisions to invest

in RCO are not driven by any particular investment made by RCO and RCO's investment strategy is not driven by the tax position of the investors. RCO is taxed in State R on income earned and is entitled to a full deduction for interest payments made to investors.

In making its decision to sell receivables owed by enterprises resident in State S, the bank and RCO considered the existence of a benefit under the State R–State S tax convention with respect to interest, but this alone would not be sufficient to trigger the application of paragraph 9. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 9 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, in the absence of other facts or circumstances showing that RCO's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R–State S tax convention to RCO.

— *Example M:* Real Estate Fund, a State C partnership treated as fiscally transparent under the domestic tax law of State C, is established to invest in a portfolio of real estate investments in a specific geographic area. Real Estate Fund is managed by a regulated fund manager and is marketed to institutional investors, such as pension schemes and sovereign wealth funds, on the basis of the fund's investment mandate. A range of investors resident in different jurisdictions commit funds to Real Estate Fund. The investment strategy of Real Estate Fund, which is set out in the marketing materials for the fund, is not driven by the tax positions of the investors, but is based on investing in certain real estate assets, maximising their value and realising appreciation through the disposal of the investments. Real Estate Fund's investments are made through a holding company, RCO, established in State R. RCO manages all of Real Estate Fund's immovable property assets and holds these assets indirectly through wholly-owned companies resident of the States where the immovable property assets are situated; it also provides debt and/or equity financing to these local companies, which directly own the underlying investments. RCO is established for a number of commercial and legal reasons, such as to protect Real Estate Fund from the liabilities of and potential claims against the fund's immovable property assets, and to facilitate debt

financing (including from third-party lenders) and the making, management and disposal of investments. It is also established for the purposes of administering the claims for relief of withholding tax under any applicable tax treaty. This is an important function of RCO as it is administratively simpler for one company to get treaty relief rather than have each institutional investor process its own claim for relief, especially if the treaty relief to which each investor would be entitled as regards a specific item of income is a small amount. After a review of possible locations, Real Estate Fund decided to establish RCO in State R. This decision was mainly driven by the political stability of State R, its regulatory and legal systems, lender and investor familiarity, access to appropriately qualified personnel and the extensive tax convention network of State R, including its treaties with other States within the specific geographic area targeted for investment. RCO, however, does not obtain treaty benefits that are better than the benefits to which its investors would have been entitled if they had made the same investments directly in these States and had obtained treaty benefits under the treaties concluded by their States of residence.

In this example, whilst the decision to locate RCO in State R is taken in light of the existence of benefits under the tax conventions between State R and the States within the specific geographic area targeted for investment, it is clear that RCO's immovable property investments are made for commercial purposes consistent with the investment mandate of the fund. Also RCO does not derive any treaty benefits that are better than those to which its investors would be entitled and each State where RCO's immovable property investments are made is allowed to tax the income derived directly from such investments. In the absence of other facts or circumstances showing that RCO's investments are part of an arrangement, or relate to another transaction, undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the tax treaties between RCO and the States in which RCO's immovable property investments are located.

[The Committee considers that the following additional example, which does not appear in the Commentary on Article 29 of the 2017 OECD Model, also illustrates the application of paragraph 9:

— *Example N: TCO, a resident of State T, is a member of a multinational group of companies that provides various cleaning*

and waste management services to businesses in State T and also in other States. TCO enters into a contract with SCO, a company resident of State S, to provide its services at three of SCO's business facilities in State S for a period of 180 working days. Subsequently, at a time when TCO has spent 150 working days in State S, TCO and SCO begin negotiations to extend the contract for an additional 90 days. As allowed by the amended contract, TCO assigns its rights and obligations under the contract to SUBCO, a wholly-owned subsidiary of TCO and also a resident of State T. SUBCO performs the required services to SCO for 90 days under the amended contract with the assistance of personnel supplied by TCO. The tax convention between State T and State S contains a provision identical to paragraph 3(b) of Article 5 of this Model. Both TCO and SUBCO claim the benefit of paragraph 3(b) of Article 5 on the basis that neither of them furnishes services in State S for more than 183 days in any twelve-month period.

In this example, the facts and circumstances may reveal that a principal purpose of limiting the services provided by TCO in State S to 180 days was to avoid having a permanent establishment in State S and to obtain the benefit of the time threshold in paragraph 3(b) of Article 5. However, the general anti-abuse rule in paragraph 9 of the Article would not apply in this example if TCO's services in State S were limited to 180 days because granting the benefit of paragraph 3(b) of Article 5 in this situation is in accordance with its object and purpose. Paragraph 3(b) of Article 5 establishes a bright-line time threshold of more than 183 working days in any twelve-month period for the existence of a permanent establishment and it is consistent with this object and purpose to grant the benefit of the subparagraph to a taxpayer who limits its activities of performing services in a country to less than the threshold. This result is consistent with the result in Example E above.

However, on the basis of the assignment of TCO's rights and obligations under the extension of the contract to SUBCO and in the absence of any other relevant facts and circumstances, it would be reasonable to conclude that one of the principal purposes for the assignment to SUBCO is to obtain the benefit of the time threshold for both TCO and SUBCO. If TCO had continued to provide services in State S under the extension of the contract, TCO would have exceeded the time threshold in paragraph 3(b) of Article 5 and would have been deemed to have a PE in State S. It would be contrary to the object and purpose of the convention

to grant the benefit of paragraph 3(b) of Article 5 to TCO and SUBCO under such an artificial contract-splitting arrangement.]

183. In a number of States, the application of the general anti-abuse rule found in domestic law is subject to some form of approval process. In some cases, the process provides for an internal acceleration of disputes on such provisions to senior officials in the administration. In other cases, the process allows for advisory panels to provide their views to the administration on the application of the rule. These types of approval processes reflect the serious nature of disputes in this area and promote overall consistency in the application of the rule. States may wish to establish a similar form of administrative process that would ensure that paragraph 9 is only applied after approval at a senior level within the administration.

184. Also, some States consider that where a person is denied a treaty benefit in accordance with paragraph 9, the competent authority of the Contracting State that would otherwise have granted this benefit should have the possibility of treating that person as being entitled to this benefit, or to different benefits with respect to the relevant item of income or capital, if such benefits would have been granted to that person in the absence of the transaction or arrangement that triggered the application of paragraph 9. In order to allow that possibility, such States are free to include the following additional paragraph in their bilateral treaties:

> 10. Where a benefit under this Convention is denied to a person under paragraph 9, the competent authority of the Contracting State that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement referred to in paragraph 9. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State.

185. For the purpose of this alternative provision, the determination that benefits would have been granted in the absence of the transaction or arrangement referred to in paragraph 9 and the determination of

the benefits that should be granted are left to the discretion of the competent authority to which the request is made. The alternative provision grants broad discretion to the competent authority for the purposes of these determinations. The provision does require, however, that the competent authority must consider the relevant facts and circumstances before reaching a decision and must consult the competent authority of the other Contracting State before rejecting a request to grant benefits if that request was made by a resident of that other State. The first requirement seeks to ensure that the competent authority will consider each request on its own merits whilst the requirement that the competent authority of the other Contracting State be consulted if the request is made by a resident of that other State should ensure that Contracting States treat similar cases in a consistent manner and can justify their decision on the basis of the facts and circumstances of the particular case. This consultation process does not, however, require that the competent authority to which the request was presented obtain the agreement of the competent authority that is consulted.

186. The following example illustrates the application of this alternative provision. Assume that an individual who is a resident of State R and who owns shares in a company resident of State S assigns the right to receive dividends declared by that company to another company resident of State R which owns more than *[25]* per cent of the capital of the paying company for the principal purpose of obtaining the reduced rate of source taxation provided for in subparagraph *a*) of paragraph 2 of Article 10. In such a case, if it is determined that the benefit of that subparagraph should be denied pursuant to paragraph 9, the alternative provision would allow the competent authority of State S to grant the benefit of the reduced rate provided for in subparagraph *b*) of paragraph 2 of Article 10 if that competent authority determined that such benefit would have been granted in the absence of the assignment to another company of the right to receive dividends.

187. For various reasons, some States may be unable to accept the rule included in paragraph 9. In order to effectively address all forms of treaty shopping, however, these States will need to supplement the limitation-on-benefits rule of paragraphs 1 to 7 by rules that will address treaty-shopping strategies commonly referred to as "conduit arrangements" that would not be caught by these paragraphs. These rules would deal with such conduit arrangements by denying the benefits of the provisions of the Convention, or of some of them (e.g. those of Articles 7, *[8,]* 10, 11, 12*[, 12AA, 12B, 12C]* and 21),

in respect of any income obtained under, or as part of, a conduit arrangement. They could also take the form of domestic anti-abuse rules or judicial doctrines that would achieve a similar result. The following are examples of conduit arrangements that would need to be addressed by such rules as well as examples of transactions that should not be considered to be conduit arrangements for that purpose:

— *Example A:* RCO a publicly-traded company resident of State R, owns all of the shares of SCO, a company resident of State S. TCO, a company resident of State T, which does not have a tax treaty with State S, would like to purchase a minority interest in SCO but believes that the domestic withholding tax on dividends levied by State S would make the investment uneconomic. RCO proposes that SCO instead issue to RCO preferred shares paying a fixed return of 4 per cent plus a contingent return of 20 per cent of SCO's net profits. The preferred shares mature in 20 years. TCO will enter into a separate contract with RCO pursuant to which it will pay to RCO an amount equal to the issue price of the preferred shares and will receive from RCO after 20 years the redemption price of the shares. During the 20 years, RCO will pay to TCO an amount equal to 3.75 per cent of the issue price plus 20 per cent of SCO's net profits.

  This arrangement constitutes a conduit arrangement that should be addressed by the rules referred to above because one of the principal purposes for RCO participating in the transaction was to achieve a reduction of the withholding tax for TCO.

— *Example B:* SCO, a company resident of State S, has issued only one class of shares that is 100 per cent owned by RCO, a company resident of State R. RCO also has only one class of shares outstanding, all of which is owned by TCO, a company resident of State T, which does not have a tax treaty with State S. RCO is engaged in the manufacture of electronics products, and SCO serves as RCO's exclusive distributor in State S. Under paragraph 3 of the limitation-of-benefits rule, RCO will be entitled to benefits with respect to dividends received from SCO, even though the shares of RCO are owned by a resident of a third country.

  This example refers to a normal commercial structure where RCO and SCO carry on real economic activities in States R and S. The payment of dividends by subsidiaries such as SCO is a normal business transaction. In the absence of evidence showing that one of the principal purposes for setting up that structure was to

flow-through dividends from SCO to TCO, this structure would not constitute a conduit arrangement.

— *Example C:* TCO, a company resident of State T, which does not have a tax treaty with State S, loans 1 000 000 to SCO, a company resident of State S that is a wholly-owned subsidiary of TCO, in exchange for a note issued by SCO. TCO later realises that it can avoid the withholding tax on interest levied by State S by assigning the note to its wholly-owned subsidiary RCO, a resident of State R (the treaty between States R and S does not allow source taxation of interest in certain circumstances). TCO therefore assigns the note to RCO in exchange for a note issued by RCO to TCO. The note issued by SCO pays interest at 7 per cent and the note issued by RCO pays interest at 6 per cent.

The transaction through which RCO acquired the note issued by SCO constitutes a conduit arrangement because it was structured to eliminate the withholding tax that TCO would otherwise have paid to State S.

— *Example D:* TCO, a company resident of State T, which does not have a tax treaty with State S, owns all of the shares of SCO, a company resident of State S. TCO has for a long time done all of its banking with RCO, a bank resident of State R which is unrelated to TCO and SCO, because the banking system in State T is relatively unsophisticated. As a result, TCO tends to maintain a large deposit with RCO. When SCO needs a loan to fund an acquisition, TCO suggests that SCO deal with RCO, which is already familiar with the business conducted by TCO and SCO. SCO discusses the loan with several different banks, all on terms similar to those offered by RCO, but eventually enters into the loan with RCO, in part because interest paid to RCO would not be subject to withholding tax in State S pursuant to the treaty between States S and R, whilst interest paid to banks resident of State T would be subject to tax in State S.

The fact that benefits of the treaty between States R and S are available if SCO borrows from RCO, and that similar benefits might not be available if it borrowed elsewhere, is clearly a factor in SCO's decision (which may be influenced by advice given to it by TCO, its 100 per cent shareholder). It may even be a decisive factor, in the sense that, all else being equal, the availability of treaty benefits may swing the balance in favour of borrowing from RCO rather than from another lender. However,

whether the obtaining of treaty benefits was one of the principal purposes of the transaction would have to be determined by reference to the particular facts and circumstances. In the facts presented above, RCO is unrelated to TCO and SCO and there is no indication that the interest paid by SCO flows through to TCO one way or another. The fact that TCO has historically maintained large deposits with RCO is also a factor that indicates that the loan to SCO is not matched by a specific deposit from TCO. On the specific facts as presented, the transaction would therefore likely not constitute a conduit arrangement.

If, however, RCO's decision to lend to SCO was dependent on TCO providing a matching collateral deposit to secure the loan so that RCO would not have entered into the transaction on substantially the same terms in the absence of that deposit, the facts would indicate that TCO was indirectly lending to SCO by routing the loan through a bank of State R and, in that case, the transaction would constitute a conduit arrangement.

— *Example E:* RCO, a publicly-traded company resident of State R, is the holding company for a manufacturing group in a highly competitive technological field. The manufacturing group conducts research in subsidiaries located around the world. Any patents developed in a subsidiary are licensed by the subsidiary to RCO, which then licenses the technology to its subsidiaries that need it. RCO keeps only a small spread with respect to the royalties it receives, so that most of the profit goes to the subsidiary that incurred the risk with respect to developing the technology. TCO, a company located in a State with which State S does not have a tax treaty, has developed a process that will substantially increase the profitability of all of RCO's subsidiaries, including SCO, a company resident of State S. According to its usual practice, RCO licenses the technology from TCO and sub-licenses the technology to its subsidiaries. SCO pays a royalty to RCO, substantially all of which is paid to TCO.

In this example, there is no indication that RCO established its licensing business in order to reduce the withholding tax payable in State S. Because RCO is conforming to the standard commercial organisation and behaviour of the group in the way that it structures its licensing and sub-licensing activities and assuming the same structure is employed with respect to other subsidiaries carrying out similar activities in countries which have treaties which offer similar or more favourable benefits, the

arrangement between SCO, RCO and TCO does not constitute a conduit arrangement.

— *Example F:* TCO is a publicly-traded company resident of State T, which does not have a tax treaty with State S. TCO is the parent of a worldwide group of companies, including RCO, a company resident of State R, and SCO, a company resident of State S. SCO is engaged in the active conduct of a business in State S. RCO is responsible for coordinating the financing of all of the subsidiaries of TCO. RCO maintains a centralised cash management accounting system for TCO and its subsidiaries in which it records all intercompany payables and receivables. RCO is responsible for disbursing or receiving any cash payments required by transactions between its affiliates and unrelated parties. RCO enters into interest rate and foreign exchange contracts as necessary to manage the risks arising from mismatches in incoming and outgoing cash flows. The activities of RCO are intended (and reasonably can be expected) to reduce transaction costs and overhead and other fixed costs. RCO has 50 employees, including clerical and other back office personnel, located in State R; this number of employees reflects the size of the business activities of RCO. TCO lends to RCO 15 million in currency A (worth 10 million in currency B) in exchange for a 10-year note that pays 5 per cent interest annually. On the same day, RCO lends 10 million in currency B to SCO in exchange for a 10-year note that pays 5 per cent interest annually. RCO does not enter into a long-term hedging transaction with respect to these financing transactions, but manages the interest rate and currency risk arising from the transactions on a daily, weekly or quarterly basis by entering into forward currency contracts.

In this example, RCO appears to be carrying on a real business performing substantive economic functions, using real assets and assuming real risks; it is also performing significant activities with respect to the transactions with TCO and SCO, which appear to be typical of RCO's normal treasury business. RCO also appears to be bearing the interest rate and currency risk. Based on these facts and in the absence of other facts that would indicate that one of the principal purposes for these loans was the avoidance of withholding tax in State S, the loan from TCO to RCO and the loan from RCO to SCO do not constitute a conduit arrangement.

36. As indicated in paragraphs 162 and 163 of the Commentary on Article 1, the Committee recognizes the general importance of proper mechanisms for the administration and interpretation of tax treaties to minimize the risks of tax abuse. These mechanisms are especially important with respect to general anti-abuse rules in both domestic law and tax conventions. Inevitably, general anti-abuse rules involve an element of uncertainty, which may have a negative impact on legitimate cross-border trade and investment. Countries may wish to consider reducing the uncertainty for taxpayers in various ways, such as the application of the Article only after approval by senior officials of the tax administration as discussed in paragraph 183 of the Commentary on Article 29 of the 2017 OECD Model quoted in paragraph 35 above, an advance rulings procedure, or the provision of guidance by the tax administration to taxpayers as to how it intends to apply paragraph 9 of the Article. Similarly, as noted in paragraph 165 of the Commentary on Article 1, a strong independent judicial system will help to provide taxpayers with the assurance that the Article is applied objectively. Similarly, an effective application of the mutual agreement procedure will ensure that disputes concerning the application of paragraph 9 of the Article will be resolved according to internationally accepted principles so as to maintain the integrity of tax treaties.

Commentary on chapter VII

FINAL PROVISIONS

Articles 30 and 31

ENTRY INTO FORCE AND TERMINATION

Articles 30 and 31 of the United Nations Model reproduce Articles 31 and 32 of the OECD Model. The Committee therefore considers that the following part of the Commentary on Articles 31 and 32 of the 2017 OECD Model is applicable to Articles 30 and 31 of this Model (the modification that appears in italics between square brackets, which is not part of the Commentary on the OECD Model, has been inserted to reflect the differences between the provisions of the OECD Model and those of this Model):

1. The present provisions on the procedure for entry into force, ratification and termination are drafted for bilateral conventions and correspond to the rules usually contained in international treaties.

2. Some Contracting States may need an additional provision in the first paragraph of Article *[30]* indicating the authorities which have to give their consent to the ratification. Other Contracting States may agree that the Article should indicate that the entry into force takes place after an exchange of notes confirming that each State has completed the procedures required for such entry into force.

3. It is open to Contracting States to agree that the Convention shall enter into force when a specified period has elapsed after the exchange of the instruments of ratification or after the confirmation that each State has completed the procedures required for such entry into force.

4. No provisions have been drafted as to the date on which the Convention shall have effect or cease to have effect, since such provisions would largely depend on the domestic laws of the Contracting States concerned. Some of the States assess tax on the income received during the current year, others on the income received during the previous year, others again have a fiscal year which differs from the calendar year. Furthermore, some conventions provide, as regards taxes levied by deduction at the source, a date for the application or termination which differs from the date applying to taxes levied by assessment.

5. As it is of advantage that the Convention should remain in force at least for a certain period, the Article on termination provides that notice of termination can only be given after a certain year, to be fixed by bilateral agreement. It is open to the Contracting States to decide upon the earliest year during which such notice can be given or even to agree not to fix any such year, if they so desire.

ANNEX CONTAINING FORMER ARTICLES 12A AND 14 (WITH COMMENTARIES)

In 2025, the Committee of Experts agreed to adopt new Article 12AA and to delete former Articles 12A and 14. However, because those former articles have historical relevance, the Committee also decided to preserve them in an Annex to the UN Model. The text of each article, followed by its Commentary as it read in 2021, is set out below.

Article 12A

FEES FOR TECHNICAL SERVICES

1. Fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, notwithstanding the provisions of Article 14 and subject to the provisions of Articles 8, 16 and 17, fees for technical services arising in a Contracting State may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ____ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the fees.

3. The term "fees for technical services" as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:

(*a*) to an employee of the person making the payment;

(*b*) for teaching in an educational institution or for teaching by an educational institution; or

(*c*) by an individual for services for the personal use of an individual.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for technical services, being a resident of a Contracting

State, carries on business in the other Contracting State in which the fees for technical services arise through a permanent establishment situated in that other State, or performs in the other Contracting State independent personal services from a fixed base situated in that other State, and the fees for technical services are effectively connected with:

(*a*) such permanent establishment or fixed base, or

(*b*) business activities referred to in (*c*) of paragraph 1 of Article 7.

In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. For the purposes of this Article, subject to paragraph 6, fees for technical services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment or fixed base.

6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State or performs independent personal services through a fixed base situated in that other State and such fees are borne by that permanent establishment or fixed base.

7. Where, by reason of a special relationship between the payer and the beneficial owner of the fees for technical services or between both of them and some other person, the amount of the fees, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Commentary on Article 12A

FEES FOR TECHNICAL SERVICES

A. General considerations

1. Article 12A was added to the United Nations Model Tax Convention in 2017 to allow a Contracting State to tax fees for certain technical services paid to a resident of the other Contracting State on a gross basis at a rate to be negotiated by the Contracting States. Under this Article, a Contracting State is entitled to tax fees for technical services if the fees are paid by a resident of that State or by a non-resident with a permanent establishment or fixed base in that State and the fees are borne by the permanent establishment or fixed base; it is not necessary for the technical services to be provided in that State. Fees for technical services are defined to mean payments for services of a managerial, technical or consultancy nature.

2. Until the addition of Article 12A, income from services derived by an enterprise of a Contracting State was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a permanent establishment in the other State (the source State) or provided professional or independent personal services through a fixed base in the source State. With the rapid changes in modern economies, particularly with respect to cross-border services, it is now possible for an enterprise resident in one State to be substantially involved in another State's economy without a permanent establishment or fixed base in that State and without any substantial physical presence in that State. In particular, with the advancements in means of communication and information technology, an enterprise of one Contracting State can provide substantial services to customers in the other Contracting State and therefore maintain a significant economic presence in that State without having any fixed place of business in that State and without being present in that State for any substantial period. The final report on Action 1 (Addressing the Tax Challenges of the Digital Economy) [114] of the OECD/G20 Base Erosion and Profit

114 OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit

Shifting (BEPS) Project illustrates the difficulties faced by tax policy makers and tax administrations in dealing with the new digital business models made available through the digital economy. The Report did not recommend a withholding tax on digital transactions (which include digital cross-border services); nor did it recommend a new nexus for taxation in the form of a significant economic presence test. However, it was recognized that countries were free to include such provisions in their tax treaties, among other additional safeguards against BEPS.

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

4. Furthermore, under Article 12 of the United Nations Model Tax Convention, fees for technical services paid by a resident of one Contracting State to a resident of the other Contracting State cannot generally be taxed as royalties by the State in which the payer is resident. However, some countries take the view that the expression "information concerning industrial, commercial or scientific experience" includes certain technical services, as noted in paragraph 5 below. Article 12 permits a Contracting State in which royalties arise to tax the gross amount of the royalty payments at a rate to be negotiated between the Contracting States. Royalties are defined in paragraph 3 of Article 12 to mean payments for the use of, or the right to use, any copyright, patent, trademark, design, plan, secret formula or process, any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. In other words, royalties are payments for the use of, or the right to use, intellectual property or equipment or for know-how (information concerning industrial, commercial or scientific experience). Thus, royalties involve the transfer of the use of, or the right to use, property or the transfer of know-how.

Shifting Project, OECD Publishing, Paris, available at http://dx.doi.org/10.1787/9789264241046-en, accessed on 10 May 2021.

In contrast, when an enterprise provides services to a customer, it does not typically transfer its property or know-how or experience to the customer; instead, the enterprise simply performs work for the customer. Under a so-called "mixed contract," an enterprise may provide both services and the right to use property or know-how to a customer. In such situations, in accordance with paragraph 13 of the Commentary on Article 12 (quoting paragraph 11.6 of the Commentary on Article 12 of the 2017 OECD Model Tax Convention), the payments under the contract must be disaggregated into separate elements of payments for services and royalties unless one element is only ancillary and largely unimportant. The negotiation of a rate of tax for fees for technical services under Article 12A that is the same as the rate for royalties in Article 12 may help to alleviate difficulties with mixed contracts, may be useful for developing countries with scarce administrative resources and may also reduce potential conflicts in applying the article.

5. In addition, countries have different interpretations of the meaning of the expression "information concerning industrial, commercial or scientific experience" in paragraph 3 of Article 12 of the United Nations Model Tax Convention (the same wording is contained in paragraph 2 of Article 12 of the OECD Model Tax Convention). Some countries take the position that the provision of brain-work and technical services is covered by this phrase, and therefore payments for such services are in general taxable under Article 12 (see paragraphs 31 to 60 of the Commentary on Article 12.)

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

7. Fees for technical services may also result in the erosion of the tax base of countries that are prevented from taxing such fees by the provisions of the United Nations Model Tax Convention. Fees for technical services are usually deductible against a country's tax base if the payer is a resident of the country or a non-resident with a permanent establishment or fixed base in the country. The reduction or erosion

of a country's tax base by deductible fees for technical services is not generally objectionable. If the payer is an enterprise, the payments are legitimate expenses incurred by the payer for the purpose of earning income and should be deductible (assuming, of course, that the amount of the payments is reasonable). If the country is entitled to tax the non-resident service provider on the fees earned for the technical services, the reduction of the country's tax base by the deductible payments is offset by the country's tax on those fees.

8. Where technical services are provided by an enterprise of one Contracting State to an associated enterprise in the other Contracting State, there is the possibility that the payments may be more or less than the arm's length price of the services. Within a multinational group, fees for technical services may sometimes be used to shift profits from a profitable group company resident and operating in one country to another group company resident in a low-tax country. Assume, for example, that Company B, an enterprise resident in Country B, a low-tax country, provides managerial, technical or consultancy services to Company A, an associated enterprise resident in Country A, a high-tax country. Assuming that the tax treaty between Country A and Country B contains provisions following those of the United Nations Model Tax Convention, Company B can avoid having a permanent establishment in Country A by not establishing a fixed place of business in Country A and by not furnishing services in Country A for more than 183 days in any twelve-month period. Thus, before the adoption of Article 12A, even if Company B was subject to tax on its income from services provided to Company A under the domestic tax law of Country A, the income would not have been taxable by Country A as a result of the tax treaty between Country A and Country B. If, for whatever reason, Company B is not taxable by Country B on that income, or is subject to a low rate of tax on such income, the multinational enterprise will have effectively shifted profits from a relatively high-tax country (Country A) to a relatively low-tax country (Country B).

9. In addition, ordinarily the fees paid by Company A to Company B for the services would be deductible by Company A in computing its income subject to tax by Country A. This deduction reduces the tax base of Country A and, before the adoption of Article 12A, Country A would not have been able to impose tax on the payments by Company A

to Company B, as discussed in paragraph 8, to offset the effect of the deduction. However, under Article 12A, if the fees for technical services were paid by a resident of Country A or a non-resident of Country A with a permanent establishment or fixed base in Country A, Country A would be entitled to tax those fees.

10. The base erosion and profit shifting illustrated in the example above raise serious concerns for both developed and developing countries. However, the problem is especially serious from the perspective of developing countries, because they are disproportionately importers of technical services and often lack the administrative capacity to control or limit such base erosion and profit shifting through anti-avoidance rules in their domestic law and tax treaties.

11. The inability of countries to tax fees for technical services provided by non-resident service providers under the provisions of the United Nations Model Tax Convention before the addition of Article 12A may have given non-resident service providers, in certain circumstances, a tax advantage over domestic service providers. Fees for technical services provided by domestic service providers are subject to domestic tax at the ordinary rate applicable to business profits. In contrast, as indicated above, non-resident service providers would not have been subject to any domestic tax if they did not have a permanent establishment or fixed base in that country, and they might have been subject only to low taxes (or no tax at all) on the fees earned in their country of residence.

12. As a result of these considerations, the Committee identified fees for technical services as a matter of priority to be dealt with as part of its larger project on the taxation of income from services under the United Nations Model Tax Convention. After considerable study and debate, having due regard to all the arguments for and against the expansion of taxing rights with regard to services, the Committee decided to add a new Article to the United Nations Model Tax Convention expanding the taxing rights for States from which fees for technical services are paid.

13. The majority of the members of the Committee rejected the position that a State should be entitled to tax income from services derived by a resident of the other Contracting State only if the services are provided in the first State. In particular, the majority rejected the

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

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

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

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

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

18. The other argument advanced for the inclusion of Article 12A is that payments for services are deductible and hence erode the tax base of the payer's State. However, in the view of the members opposed to Article 12A, mere deductibility of a commercially justified payment cannot be equated to harmful base erosion, and is therefore not a sufficient reason for taxing that payment in the same State.

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

20. In the view of those members of the Committee that did not agree with the inclusion of Article 12A, a further problem with taxation of fees for technical services on a gross basis is that it can lead to double taxation. The imposition of a tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection

with the provision of the services, which would be deductible if tax were imposed on a net basis. Thus, it is possible that the residence State's remedies for relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State.

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

22. These members were also concerned that the inclusion of Article 12A would lead to trade distortions as the taxation of goods and services would operate on a different basis. The reason for this is that the profits of an exporter of goods are taxable only in its State of residence, whereas, under Article 12A, what is in effect an import tariff would be applied to technical services.

23. In summary, these members did not accept the analysis in paragraphs 2 to 15 above, and regarded any expanded taxing jurisdiction on fees for technical services as an unjustified shift of the balance of taxation from the place where services are provided to the place where services are consumed. Countries sharing these concerns may wish not to include Article 12A in their bilateral tax treaties.

24. Alternatively, countries that wish to obtain additional taxing rights on fees for technical services, but are concerned with the broad scope of Article 12A, may consider agreeing to amend Article 12 (Royalties) to permit taxation of certain "fees for included services," an approach that is found in a number of bilateral tax treaties between developing and developed countries. The underlying policy rationale for this narrower approach is that, in order to justify taxation by the State

from which the payment is made even in cases where the services are not performed in that State, fees for services must be directly related to the enjoyment of property for which a royalty as otherwise defined in Article 12 is paid. Wording for this narrower alternative approach is set forth in paragraphs 33 and 34 of the Commentary on Article 12.

25. However, a majority of the members of the Committee was of the view that the alternative referred to in paragraph 24 is not an acceptable alternative to Article 12A for developing countries because, in essence, those members considered that there is no principled justification for restricting the taxation of fees for technical services to services directly related to property producing royalties. Moreover, those members took the view that the alternative supported by a minority of the members of the Committee contains many vague terms of uncertain meaning, which may lead to frequent disputes about the interpretation of that provision.

26. Instead, countries concerned about the scope of Article 12A and the uncertainty associated with the definition of "fees for technical services" in Article 12A, paragraph 3 might consider an alternative version of Article 12A under which Article 12A would potentially apply to all fees for services (technical and other services) provided in a Contracting State, and also to fees for services provided outside that State by closely related persons, other than payments expressly excluded under paragraphs 3(*a*), (*b*), and (*c*). Under this alternative provision, paragraphs 1, 2, 4, and 7 of Article 12A would remain unchanged except that the term "fees for technical services" in those paragraphs would be replaced by the term "fees for services." However, paragraphs 3, 5 and 6 would be replaced by the following paragraphs:

> 3. The term "fees for services" as used in this Article means any payment in consideration for any service, unless the payment is made:
>
> (*a*) to an employee of the person making the payment;
>
> (*b*) for teaching in an educational institution or for teaching by an educational institution; or
>
> (*c*) by an individual for services for the personal use of an individual.
>
> 5. For the purposes of this Article, fees for services shall be deemed to arise in a Contracting State if:

(*a*) the services are performed in that State; or

(*b*) the payer is a resident of that State and the fees are paid to a closely related enterprise or person unless the payer carries on business in the other Contracting State through a permanent establishment situated in that State, or performs independent personal services through a fixed base situated in the other Contracting State and such fees are borne by that permanent establishment or fixed base; or

(*c*) the payer has in that State a permanent establishment or a fixed base in connection with which the obligation to pay the fees for services was incurred, and such fees are borne by such permanent establishment or fixed base, and are paid to a closely related enterprise or person.

6. For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise. For the purposes of this Article, an individual shall be a closely related person with respect to another individual if the individual is related to that other individual by blood relationship, marriage or adoption.

27. Under this alternative, a country would be entitled to impose tax under paragraph 2 of Article 12A up to the maximum agreed rate on fees for services paid by a resident of that country or by a non-resident with a permanent establishment or fixed base in that country to a resident of the other Contracting State if the fees for services arise in the first country. Fees for services would be deemed to arise in a country in accordance with paragraph 5 if:

1. the services are provided in that country or
2. the services are provided outside that country by a person who is closely related to the payer of the fees.

Thus, this alternative provision would eliminate any disputes about whether the relevant services are within the definition of "fees for technical services" in Article 12A, paragraph 3 because it applies to all fees for services except those payments excluded by paragraphs 3(*a*) to (*c*). Under this alternative provision, a Contracting State would not be entitled to tax fees for services paid to service providers resident in the other Contracting State that are not closely related to the payer for services performed outside the first State. In contrast, under Article 12A, fees for technical services paid to non-closely related service providers resident in the other Contracting State for services provided outside the first State would be taxable by the first State. However, under the alternative provision, a Contracting State would be entitled to tax fees for services provided outside that State if the services are provided by persons closely related to the payer. In many cases, such closely-related party services present the most serious risk of eroding a country's tax base. In 2021, the Committee agreed to the inclusion of Article 12B in the United Nations Model Tax Convention to address the taxation of income from automated digital services. Because there could be overlap between the alternative provision described in this paragraph and Article 12B, countries should consider carefully whether to include both in their treaties and, if so, whether any modifications to the provisions are necessary in order to avoid overlaps in coverage, particularly if the limitations on source State taxation are different under Articles 12A and 12B.

28. For purposes of the alternative provision, paragraph 6 of the alternative version of Article 12A proposed in paragraph 26 above provides rules for determining whether a person is closely related to an enterprise and whether an individual is closely related to another individual. The concept of a closely related person is to be distinguished from the concept of "associated enterprises" which is used for the purposes of Article 9; although the two concepts overlap to a certain extent, they are not intended to be equivalent.

29. A person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both

are under the control of the same persons or enterprises. This general rule would cover, for example, situations where a person or enterprise controls an enterprise by virtue of a special arrangement that allows that person to exercise rights that are similar to those that it would hold if it possessed directly or indirectly more than 50 per cent of the beneficial interests in the enterprise. As in most cases where the plural form is used, the reference to the "same persons or enterprises" at the end of the first sentence of paragraph 6 covers cases where there is only one such person or enterprise.

30. The second sentence of paragraph 6 of the alternative version of Article 12A provides that the definition of "person closely related to an enterprise" is automatically satisfied in certain circumstances. A person is considered to be closely related to an enterprise if either one possesses directly or indirectly more than 50 per cent of the beneficial interests in the other or if a third person possesses directly or indirectly more than 50 per cent of the beneficial interests in both the person and the enterprise. In the case of a company, this condition is satisfied where a person holds directly or indirectly more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company.

31. The final sentence of paragraph 6 of the alternative version of Article 12A provides that individuals are closely related if they are related by blood relationship, marriage or adoption. This rule is necessary for situations where an individual pays for services (other then services for the personal use of an individual) provided by another individual who is not carrying on an enterprise. For this purpose, the terms "blood relationship," "marriage" and "adoption" take their meaning from the domestic law of the country applying the treaty in accordance with paragraph 2 of Article 3.

32. Article 12A allows fees for technical services to be taxed by a Contracting State on a gross basis. Many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents. A withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents. Such

a method of taxation may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns.

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

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

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

36. There is no overlap between Article 12A and Articles 15, 18 and 19 dealing with income from employment, pensions and government services respectively because the definition of "fees for technical services" in paragraph 3 of Article 12A expressly excludes payments, including pension payments, to employees. Thus, for example, payments received by an employee from an employer resident in a country for employment services exercised outside that country would not be taxable by that country under paragraph 2 of Article 12A even if the payments are fees for technical services.

37. Since paragraph 2 of Article 12A is subject to the provisions of Articles 8 (International shipping and air transport), 16 (Directors' fees and remuneration of top-level managerial officials) and 17 (Artistes and sportspersons), Article 12A does not apply to fees for technical services to which the provisions of those Articles apply. In general, the taxing rights of a country under Article 8, 16 or 17 are unlimited, whereas the taxing rights under paragraph 2 of Article 12A are limited to the maximum percentage of the gross fees for technical services agreed to in that provision. The relationship between paragraph 2 of Article 12A and Articles 8, 16 and 17 is discussed further in the Commentary on paragraph 2.

37.1 Paragraph 7 of Article 12B provides that the provisions of Article 12B shall not apply if the payments underlying the income from automated digital services qualify as "fees for technical services" under Article 12A. Accordingly, Article 12B will not apply to any amount within the scope of Article 12A.

B. Commentary on the paragraphs of Article 12A

Paragraph 1

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

39. In most cases, the person who provides technical services will receive fees for those services. If the person who receives the fees for technical services is not the person who provides those services, it is a

matter of domestic law as to who is the proper taxpayer with respect to those fees. If fees for technical services are paid to a person, other than the person who provides the services, Article 12A applies to the fees as long as the recipient is a resident of the other Contracting State.

40. The expression "fees for technical services" is defined in paragraph 3 to mean any "payment" for managerial, technical or consulting services. The term "payment" has a broad meaning consistent with the meaning of the related term "paid" in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the 2017 OECD Model Tax Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the 2017 OECD Model Tax Convention), the concept of payment means the fulfilment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

41. Article 12A deals only with fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to fees for technical services arising in a third State. Paragraph 5 and paragraph 6 specify when fees for technical services are deemed to arise in a Contracting State and deemed not to arise in a Contracting State, respectively. Under paragraph 5, fees for technical services are considered to arise in a Contracting State if they are paid by a resident of that State or if they are borne by a permanent establishment or fixed base in that State of a person resident in another State. However, under paragraph 6, fees for technical services paid by a resident of a Contracting State are deemed not to arise in that State if they are borne by a permanent establishment or fixed base that the resident has in the other Contracting State.

Paragraph 2

42. This paragraph lays down the principle that the Contracting State in which fees for technical services arise may tax those payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the fees is a resident of the other Contracting State, the amount of tax imposed by the State in which the fees for technical services arise may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the payments.

43. When considered in conjunction with Article 23 (Methods for the elimination of double taxation), paragraph 2 establishes the primary right of the country in which fees for technical services arise to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the fees is a resident of the other Contracting State). Accordingly, the country in which the recipient of the fees is resident is obligated to prevent double taxation of those fees. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption from tax of the fees for technical services or the granting of a credit against tax payable to the residence country on the fees for technical services for any tax imposed on those fees by the other Contracting State in accordance with Article 12A. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under paragraph 2 of Article 23 A with respect to items of income taxable under Article 10, 11, 12, 12A or 12B.

44. The decision not to recommend a maximum rate of tax on fees for technical services is consistent with Articles 10, 11 and 12 of the United Nations Model Tax Convention dealing with dividends, interest and royalties, respectively. This decision can be justified under current treaty practice. The withholding rates on fees for technical services adopted in bilateral tax treaties between developed and developing countries vary widely. Thus, the maximum rate of tax on fees for technical services is to be established through the bilateral negotiations of the Contracting States.

45. A precise level of withholding tax on fees for technical services should take into account several factors, including the following:

— The possibility that a high rate of withholding tax imposed by a country might cause non-resident service providers to pass on the cost of the tax to customers in the country, which would mean that the country would increase its revenue at the expense of its own residents rather than the non-resident service providers.

— The possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment.

— The possibility that some non-resident service providers may incur high costs in providing technical services, so that a high rate of withholding tax on the gross fees may result in

an excessive effective tax rate on the net income derived from the services.

— The potential benefit of applying the same rate of withholding tax to both royalties under Article 12 and fees for technical services under Article 12A (see example 6 in paragraphs 97 and 98 below).

— The fact that a reduction of the withholding rate has revenue and foreign-exchange consequences for the country imposing withholding tax, and

— The relative flows of fees for technical services (e.g. from developing to developed countries).

46. Paragraph 2 applies notwithstanding the provisions of Article 14. Under Article 14, income from the performance of professional or other independent personal services by a person who is a resident of a Contracting State is taxable by the other Contracting State only if the services are performed through a fixed base in the other Contracting State that is regularly available to the person or if the person stays in that State for 183 days or more in any twelve-month period commencing or ending in the relevant fiscal period.

47. Under paragraph 4, if a resident of a Contracting State performs independent personal services (that are technical services) in the other Contracting State through a fixed base that is regularly available to the resident and receives fees for technical services within the meaning of paragraph 3 of Article 12A, Article 14 will apply to those payments in priority to Article 12A. However, if a resident of a Contracting State provides independent personal services (that are technical services) that arise in the other Contracting State, but those services are not provided through a fixed base in that other State, the fees for those services are taxable by that other State under paragraph 2 of Article 12A.

48. Paragraph 2 applies in priority to Article 7 as a result of paragraph 6 of Article 7. Thus, the conditions for the taxation of the business profits of an enterprise under Article 7 do not apply to fees for technical services covered by paragraph 2. Fees for technical services are taxable by a Contracting State under paragraph 2 if the fees arise in that State irrespective of whether the enterprise providing the services has a permanent establishment in that State, provides services that are similar to those effected through the permanent establishment or provides the

technical services in that State. However, by virtue of paragraph 4, if an enterprise of a Contracting State provides technical services through a permanent establishment in the other Contracting State and receives fees for those technical services within the meaning of paragraph 3, Article 7 will apply to those payments in priority to paragraph 2 of Article 12A.

49. The application of paragraph 2 is expressly subject to the provisions of Article 8. Certain payments for international shipping and air transport under Article 8 could be within the definition of "fees for technical services" in paragraph 3. This might be the case with respect to auxiliary activities that are closely connected to the direct operation of ships and aircraft, as discussed in paragraph 13 of the Commentary on Article 8 of this Model. To eliminate any uncertainty in this regard, paragraph 2 explicitly provides that in any situation in which both Article 12A and Article 8 apply to the same services, the provisions of Article 8 prevail. Thus, any fees for technical services that result from the operation of ships or aircraft in international traffic in accordance with the terms of Article 8 are taxable exclusively in accordance with that Article.

50. Similarly, paragraph 2 is subject to the provisions of Article 16 dealing with directors' fees and the remuneration of top-level managerial officials. Therefore, where directors' fees or remuneration of top-level managerial officials are taxable, under Article 16, by the Contracting State in which the company paying the fees or remuneration is resident, Article 12A cannot apply to the fees or remuneration because paragraph 2 is expressly subject to the provisions of Article 16. The taxing rights of a Contracting State under Article 16 are unlimited, whereas the taxing rights under Article 12A are limited to the maximum rate of tax agreed to in paragraph 2. If, however, the payments are outside the scope of Article 16 (because, for example, the payments are made with respect to services provided by the individual in a capacity other than that of a director or top-level managerial official of the company, such as an independent contractor), the other State is entitled to tax the payments in accordance with paragraph 2.

51. Similarly, paragraph 2 is expressly subject to the provisions of Article 17 dealing with entertainment or sports activities. Although it may be unlikely that such activities would be within the definition of

"fees for technical services" in paragraph 3, it is important to provide certainty in this regard. Therefore, if an overlap between the provisions of paragraph 2 and Article 17 does occur, Article 17 takes precedence over Article 12A. If, however, an artiste or sportsperson resident in one Contracting State receives fees for technical services from a person resident in the other Contracting State and those fees are outside the scope of Article 17 (because, for example, although the fees are in consideration for personal activities as an artiste or sportsperson, those activities take place outside the country in which the payer is resident), the first Contracting State is entitled to tax the fees under paragraph 2.

52. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over fees for technical services merely because those fees were paid directly to a resident of another State with which the first State had concluded a convention.

53. Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[115]), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

54. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the

115 For example, where the trustees of a discretionary trust do not distribute fees for technical services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such fees for the purposes of Article 12A even if they are not the beneficial owners under the relevant trust law.

concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

55. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" [116] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

56. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the fees for technical services is not the "beneficial owner" because that recipient's right to use and enjoy the fees is constrained by a contractual or legal obligation to pass on the fees received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the fees by the direct recipient such as an obligation

116 Reproduced at page R(6)-1 of Volume II of the full-length version of the 2017 OECD Model, available at https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1833, accessed on 10 May 2021.

that is not dependent on the receipt of the fees and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of fees for technical services does have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person, the recipient is the "beneficial owner" of those fees.

57. The fact that the recipient of fees for technical services is considered to be the beneficial owner of those fees does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on fees for technical services to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

58. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments [117] that

117 See, for example, Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012, updated in 2020), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 117): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate

concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of paragraph 2(*a*) of Article 10 which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, 12A and 12B, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends, interest, royalties and services rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[118]

59. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State.

60. The paragraph lays down nothing about the mode of taxation in the State in which fees for technical services arise. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax

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Governance, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

> In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

118 See the Financial Action Task Force's definition quoted in the previous footnote.

either by deduction at source or individual assessment. As with other provisions of the United Nations Model Tax Convention, procedural questions are not dealt with in the Article. Each State is able to apply the procedure provided in domestic law.

Paragraph 3

61. This paragraph specifies the meaning of the phrase "fees for technical services" for purposes of Article 12A. The definition of "fees for technical services" in paragraph 3 is exhaustive. "Fees for technical services" are limited to the payments described in paragraph 3; other payments for services are not included in the definition and are not dealt with in Article 12A (see the examples in paragraphs 87 to 103 below).

62. Article 12A applies only to fees for technical services, and not to all payments for services. Paragraph 3 defines "fees for technical services" as payments for managerial, technical or consultancy services. Given the ordinary meanings of the terms "managerial," "technical" and "consultancy," the fundamental concept underlying the definition of fees for technical services is that the services must involve the application by the service provider of specialized knowledge, skill or expertise on behalf of a client or the transfer of knowledge, skill or expertise to the client, other than a transfer of information covered by the definition of "royalties" in paragraph 3 of Article 12. Services of a routine nature that do not involve the application of such specialized knowledge, skill or expertise are not within the scope of Article 12A.

63. The ordinary meaning of the term "management" involves the application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Thus, if the management of all or a significant part of an enterprise is contracted out to persons other than the directors, officers or employees of the enterprise, payments made by the enterprise for those management services would be fees for technical services within the meaning of paragraph 3. Similarly, payments made to a consultant for advice related to the management of an enterprise (or of the business of an enterprise) would be fees for technical services.

64. The ordinary meaning of the term "technical" involves the application of specialized knowledge, skill or expertise with respect

to a particular art, science, profession or occupation. Therefore, fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering and dentistry would be fees for technical services within the meaning of paragraph 3. Thus, if an individual receives payments for professional services referred to in paragraph 2 of Article 14 from a resident of a Contracting State, those payments would be fees for technical services. If the payments arise in that Contracting State because they are made by a resident of that State or borne by a permanent establishment or fixed base in that State, the payments would be subject to tax by that State in accordance with paragraph 2 irrespective of the fact that the services are not performed in that State through a fixed base in that State.

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

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

67. The terms "management," "technical" and "consultancy" do not have precise meanings and may overlap. Thus, for example, services of a technical nature may also be services of a consultancy nature and management services may also be considered to be services of a consultancy nature.

68. The definition of "fees for technical services" does not include a reference to the domestic law of a Contracting State. The lack of any reference to domestic law is justified because:

(*a*) the definition generally covers most types of services that are regarded as technical services under the domestic law of the countries that tax such services;

(*b*) such a reference would introduce a large element of uncertainty;

(*c*) future changes in a country's domestic law with respect to the taxation of fees for technical services could otherwise have an effect on the Convention; and

(*d*) in the United Nations Model Tax Convention, reference to domestic laws should be avoided as far as possible.

It would be inconsistent with the definition of "fees for technical services" for the meaning of terms used in the definition, especially the terms "management", "technical" and "consultancy", to be determined in accordance with the domestic law of the country applying the treaty under Article 3, paragraph 2.

69. As expressly provided in paragraph 3(*a*), fees for technical services for purposes of Article 12A do not include payments of salary, wages or other remuneration to an employee of the payer. Where such payments are made by an employer resident in one Contracting State to an employee resident in the other Contracting State, they are covered by Article 15 or Article 19 (Government service) of the Convention. In addition, since pensions arise in respect of prior employment, they are excluded from Article 12A and are dealt with by Article 18 (Pensions and social security payments) even if the employment involved the provision of technical services to the employer.

70. As expressly provided in paragraph 3, the definition of fees for technical services does not include payments for teaching in an educational institution or teaching by an educational institution. Thus, if an educational institution established in one Contracting State pays for teaching services provided by an individual or an enterprise resident in the other Contracting State that are otherwise considered to be fees for technical services, the payments made by the educational institution for those teaching services are excluded from the definition of "fees for technical services" by paragraph 3(*b*). Further, if an educational institution established in one Contracting State receives payments from an enterprise resident in the other Contracting State for teaching services provided by that institution to some of the enterprise's employees, the payments received by the educational institution for those teaching services (to the extent that they would otherwise be considered to be fees for technical services) would not be fees for technical services subject to Article 12A because of the specific exclusion in paragraph 3(*b*). There

is no definition of the term "educational institution" for purposes of paragraph 3(*b*). Consequently, in accordance with paragraph 2 of Article 3 of the Convention, the term would have its meaning under the law of the State applying the Convention. The meaning of the term would generally include universities, colleges and other post-secondary educational institutions. Countries in which the term "educational institution" has a very broad or unusual meaning may wish to clarify the meaning of the term in their treaties.

71. Some countries may be concerned that the exclusion in paragraph 3(*b*) is excessively broad and uncertain and may be subject to abuse. These countries may wish to omit the exclusion in paragraph 3(*b*) entirely or limit that exclusion to teaching services that are provided as part of a degree program offered by an educational institution. These countries are free to do so by adding the words "as part of a degree granting program" or similar words to paragraph 3(*b*). In this case, payments received by an educational institution for teaching services of a managerial, technical or consultancy nature that are not part of a degree program would be fees for technical services within the meaning of paragraph 3.

72. As expressly provided in paragraph 3(*c*), the definition of "fees for technical services" does not include payments by individuals for services for personal use. Such payments would not normally be deductible by those individuals for tax purposes, and therefore the payments would not cause any erosion of the tax base of the State in which the fees for technical services arise. Moreover, the imposition of withholding tax obligations on such payments by individuals under domestic law would be difficult to enforce and might cause serious compliance problems for individuals utilizing technical services supplied remotely by non-residents.

73. The definition of "fees for technical services" in paragraph 3 does not exclude profits from international shipping and air transport, directors' fees and remuneration of top-level managerial officials, and income from entertainment and sports activities. However, such income (even if it is within the definition of "fees for technical services") is not subject to tax by a country under paragraph 2 if it is taxable under Article 8 (International shipping and air transport), 16 (Directors' fees and remuneration of top-level managerial officials) or 17 (Artistes and

sportspersons), as the case might be, because paragraph 2 is expressly subject to the provisions of Article 8, 16 and 17.

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

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

76. First, a person may be reimbursed for expenses incurred in connection with providing technical services, but may not receive any fee for those services. For example, an individual resident in one Contracting State might be invited to speak at a conference or participate in a meeting in the other Contracting State and might be reimbursed for his or her travel expenses, but not receive any fee. In these circumstances, it seems difficult to justify the application of withholding tax to the reimbursement. However, unless reimbursements are explicitly excluded from the definition of "fees for technical services", paragraph 2 would permit the State in which the fees arise to impose withholding tax on the reimbursement at the rate specified in the treaty.

77. Second, a non-resident service provider may be paid a fee and separately reimbursed for all the expenses incurred in providing the services. In these circumstances, if reimbursements are excluded from the definition of fees for technical services, the tax imposed by the State in which the fees arise would be limited to the amount of the fee. On these facts, the fee represents the non-resident's entire net profit from

the performance of the technical services. However, the maximum limit on the tax imposed under paragraph 2 is based on the gross amount of the payments, and the rate of withholding tax specified in Article 12A may have been established on the assumption that the fees represent the non-resident's gross revenue. As a result, if reimbursements are excluded from the definition of fees for technical services, the rate of withholding agreed to by the Contracting States may be too low. Moreover, the exclusion of reimbursements from the definition of fees for technical services might lead to abuses. For example, in order to reduce the source country's withholding tax, non-resident service providers might receive payments labelled as reimbursements that are actually fees, or might be reimbursed for expenses for which they would not ordinarily be reimbursed. Preventing these types of abuses would impose a significant administrative burden on the tax authorities.

78. Third, a non-resident service provider might not be reimbursed for any of the expenses incurred in providing the services. In this case, the amount of the payment received by the non-resident service provider will be greater than the amount of the service provider's net profit. The maximum rate of withholding tax in paragraph 2 may have been agreed to on the assumption that some of a non-resident's expenses would be reimbursed. On this assumption, the maximum rate of withholding tax may be established at a higher rate than it otherwise would be in order to approximate tax on the net profit. Therefore, if reimbursements are excluded from the definition of "fees for technical services", the rate established in the treaty might be too high for a non-resident service provider that receives no reimbursement for expenses.

79. The issues discussed in paragraphs 77 and 78 above are illustrated in the example in paragraph 80 below, which shows that the effect of a gross-based withholding tax on fees for technical services depends, in part, on whether payments in reimbursement of expenses are subject to withholding tax and the extent to which service providers are reimbursed for their expenses.

80. *Example:* X, a resident of Country A, is a management consultant, who provides advice to companies concerning best practices for corporate governance. X enters into a contract to provide services to BCo, a public company resident in Country B, for a period of 60 days for fees of 5,000 per day plus the reimbursement of reasonable expenses

incurred in providing the services. X receives fees of 300,000 from BCo and a payment of 250,000 in reimbursement for expenses. Thus, in this situation, X's net profit from the services provided to BCo is 300,000. Assume that Country A and Country B have entered into a tax treaty with provisions identical to those of Article 12A of the United Nations Model Tax Convention which allows the imposition of withholding tax on fees for technical services at a maximum rate of 5 per cent. On these facts, assuming that the payment in reimbursement for X's expenses is not considered to be fees for technical services, Country B would be entitled to impose tax of 15,000 of the fees received by X, which represents a relatively low tax rate of 5 percent on X's net profit. Alternatively, assuming that the payment in reimbursement of X's expenses is subject to withholding tax under Article 12A, Country B would be entitled to impose tax of 27,500, which represents a tax rate of over 9 per cent on X's net profit. If X did not receive any reimbursement for his expenses, Country B's tax would be 15,000 representing a tax rate of 30 percent on X's net profit irrespective of whether payments in reimbursement of expenses are subject to withholding tax under Article 12A as fees for technical services.

81. It appears to be extremely difficult to predict to what extent, on average, non-resident service providers are reimbursed for their expenses. As a result, any single rule for the treatment of reimbursements will operate improperly in some situations. On the one hand, if reimbursements are excluded from the definition of "fees for technical services", the rate agreed to in the treaty might be too low where most or all of a non-resident's expenses are reimbursed, but too high where none of the expenses are reimbursed. Also, taxpayers might try to disguise part of their fees as reimbursements of expenses and it might be difficult for the tax authorities to detect such abuses. On the other hand, if reimbursements are not excluded, the rate agreed to in the treaty might be too high where a non-resident's expenses are reimbursed, but too low where they are not reimbursed.

82. As a result of the difficulties described in the foregoing paragraphs, the solution that has been adopted is to omit any reference to the reimbursement of expenses in the definition of "fees for technical services" in paragraph 3 of Article 12A. However, countries are encouraged to deal with the problem in their domestic laws and to

take the issue into account in establishing the maximum rate of tax under paragraph 2 of Article 12A.

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

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

85. It is often necessary to distinguish between fees for services, including fees for technical services, and royalties in order to determine whether Article 12 or another Article of the Convention (Article 12A in the case of "fees for technical services") is applicable. The distinction between fees for services and royalties is clear in principle. Under paragraph 3 of Article 12, royalties are payments for the use, or the right to use, certain types of property or for information concerning industrial, commercial or scientific experience (so-called know-how). In contrast, the performance of services does not involve any transfer of the use of, or the right to use, property. However, in practice it is often difficult to distinguish between royalties and fees for services, including technical services, especially with respect to so-called mixed contracts. Guidance with respect to the distinction between fees for services and royalties is provided in paragraph 13 of the Commentary on Article 12 of this Model, which reproduces paragraphs 11.2 – 11.6 of the Commentary on Article 12 of the 2017 OECD Model Tax Convention (see also paragraphs 100 to 103 below).

86. The following examples illustrate the application of the definition of "fees for technical services" in paragraph 3.

87. *Example 1:* X is a resident of State R and a heart surgeon. X's practice is carried on primarily in State R, although X occasionally travels to other countries to provide heart surgery. X performs surgery in State R on an individual resident of State S. The tax treaty between State R and State S contains a provision identical to Article 12A of the United Nations Model Tax Convention. Although the payments made by the patient, a resident of State S, to X would be considered to be fees for technical services that arise in State S, they are explicitly excluded from the definition by subparagraph (*c*) of paragraph 3. As a result, the payments would not be taxable by State S in accordance with paragraph 2 of Article 12A.

88. The result in Example 1 would be the same if X travelled to State S and provided the surgery in State S unless X provided the services through a fixed base regularly available to X in State S, in which case Article 14 would apply.

89. *Example 2:* X is a resident of State R and a heart surgeon. X's practice is carried on primarily in State R, although X occasionally travels to other countries to provide heart surgery. X enters into a contract with a health services company resident of State S under which X agrees to provide heart surgery on patients referred to him by the health services corporation. X is not an employee of the health services company. The surgeries are provided both in State S and in State R. The tax treaty between State R and State S contains a provision identical to Article 12A of the United Nations Model Tax Convention. Under paragraph 3 of Article 12A, the payments made by the health services company, a resident of State S, to X would be considered to be fees for technical services that arise in State S, irrespective of whether the surgery is provided in State S, State R or a third State. As a result, the payments would be taxable by State S in accordance with paragraph 2. If X were an employee of the health services company, the payments to X would be excluded from the definition of "fees for technical services" by paragraph 3(*a*).

90. *Example 3:* R Company is a resident of State R. R Company's business is the collection, organization and maintenance of various

databases. R Company sells access to these databases to its clients. One of R Company's clients is Company S, a resident of State S. State R and State S have entered into a tax treaty that contains a provision identical to Article 12A of the United Nations Model Tax Convention. The payments that R Company receives from S Company for access to its databases would not be fees for technical services within the meaning of paragraph 3. Although R Company used its knowledge, skill and expertise in creating the database, the services that R Company provides to S Company – access to the database – are routine services that do not involve the application of R Company's knowledge, skill and expertise for the benefit of S Company. Accordingly, Article 12A would not apply to the payments.

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

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

93. In Example 4, if R Company writes customized insurance contracts dealing with special risks for some clients in State S, the insurance premiums derived by R Company may be considered to be fees for technical services within the meaning of paragraph 3. However,

R Company would be deemed to have a permanent establishment in State S under paragraph 6 of Article 5 to the extent that it collects premiums or insures risks in State S other than through an agent of independent status. Therefore, by virtue of paragraph 4, the income derived from R Company's insurance activities in State S would be taxable by State S in accordance with Article 7 and Article 12A would not apply.

94. *Example 5:* R Company is a financial institution resident of State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, credit and debit cards, payment and transmission services, bankers drafts, guarantees, foreign exchange, negotiable instruments, derivative products, investment research and advisory services. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty that is identical to the United Nations Model Tax Convention, including as regards the contents of Article 12A.

95. Whether the payments received for services provided by a financial institution constitute fees for technical services within the meaning of paragraph 3 depends on the nature of the particular services. Many services provided by financial institutions do not involve the application of any specialized knowledge, skill and expertise on behalf of a particular client. Instead, the financial institution uses its knowledge, skill and expertise to develop general products, services or practices that are made available to its clients routinely in consideration for fees. This would be the case, for example, with respect to payment and transmission services, banker's drafts, foreign exchange, debt and credit card services and negotiable instruments.

96. However, where a financial institution uses its knowledge, skill and expertise to provide research, analysis or advice to a specific client related to that client's particular circumstances, the payments received by the financial institution for those services could be fees for technical services within the meaning of paragraph 3. This would be the case, for example, if, in Example 5, R Company provides advice to S Company, resident of State S, with respect to a potential merger or acquisition involving S Company. As a result, the payments for such advice would be fees for technical services taxable by State S in accordance with

paragraph 2. If, however, R Company provides the services through a permanent establishment located in State S, the fees received for those services would be taxable by State S in accordance with Article 7 rather than Article 12A by virtue of paragraph 4 of Article 12A (see paragraph 93 above).

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

— provide the production procedures and assist S Company in carrying out those procedures and

— provide specifications concerning the necessary materials, tools, and containers used in the production process.

R Company also agrees to use its best efforts to ensure that S Company is able to produce the industrial substance in the quantities and with the characteristics that S Company expects. State S and State R have entered into a tax treaty with provisions identical to those of the United Nations Model Tax Convention, including those of Article 12A.

98. In Example 6, the payments by S Company to R Company for the right to use the patented formula would be royalties within the meaning of paragraph 3 of Article 12. However, the payments for the services provided by R Company to S Company would not be royalties because R Company is not transferring its specialized knowledge, skill or experience to S Company. On the facts of Example 6, R Company is using its specialized knowledge, skill and experience on behalf of S Company and guaranteeing the result of S Company's use of the patented chemical formula. Consequently, the payments made by S Company to R Company for the services are fees for technical services within the meaning of paragraph 3 and State S would be entitled to impose tax on those fees under paragraph 2.

99. As noted in paragraphs 4 and 5 above, under the United Nations Model Tax Convention as it read before 2017, it was difficult, but

important, to determine if certain payments were royalties or fees for services. If the payments were royalties, they would have been taxable by the Contracting State in which they arose in accordance with Article 12 subject to the limitation on the rate of tax in paragraph 2 of Article 12. On the other hand, if the payments were fees for services, they would have been taxable by a Contracting State only if the service provider had a permanent establishment or fixed base in that State and the payments were attributable to that permanent establishment or fixed base in accordance with Article 7 or Article 14. Thus, the tax consequences varied significantly depending on whether payments were characterised as royalties or fees for services. The determination of the nature of payments as royalties or fees for services was especially difficult with respect to mixed contracts involving the transfer of the use of or the right to use information concerning industrial, commercial or scientific experience and the performance of services.

100. The addition of Article 12A to the United Nations Model Tax Convention in 2017 has had the potential effect of reducing the significance of the distinction between royalties and fees for technical services if the limits on the rate of tax in paragraph 2 of Article 12 and paragraph 2 of Article 12A are the same. If these rates of tax are the same, it will not matter whether payments under mixed contracts are considered to be royalties for the transfer of know-how or fees for technical services. However, if the maximum rates of tax in the two Articles are different, it will be important to determine if a particular payment is a royalty taxable in accordance with Article 12, fees for technical services under Article 12A, or some other type of payment.

101. The following example illustrates the distinction between payments for the transfer of know-how and fees for technical services. The considerations to be taken into account in making this distinction are discussed in paragraph 13 of the Commentary on Article 12.

102. *Example 7:* S Company, a resident of Country S, enters into a contractual arrangement with R Company, a resident of Country R, to acquire the use of a secret formula or process developed by R Company. The contract requires R Company to provide the information to S Company subject to strict confidentiality conditions and to use its specialized knowledge and expertise to train employees of S Company with respect to the use of the secret formula or process. State R and

State S have entered into a tax treaty with provisions identical to those of the United Nations Model Tax Convention, including those of Articles 12 and 12A.

103. In Example 7 the payments made by S Company to R Company for the right to use the secret formula or process would be payments for "information concerning industrial, commercial or scientific experience" within the meaning of the definition of "royalty" in paragraph 3 of Article 12. This would be the case even if the information represents know-how that is not patented or otherwise protected by intellectual property laws. Similarly, the payments made by S Company to R Company for the training of S Company's employees would also be payments for "information concerning industrial, commercial or scientific experience" within the meaning of the definition of "royalty" in paragraph 3 of Article 12 since the training is necessary to transfer R Company's know-how to S Company. Therefore, irrespective of whether the payments for the training are provided for separately from the payments for the secret formula or process or whether the contract provides for a single payment for both, the payments for the training would be considered royalties under Article 12 rather than fees for technical services under Article 12A. However, if the training provided by R Company was not necessary to transfer the secret formula or process to S Company and S Company could obtain such training from other sources, the training would not be considered to be a transfer of know-how and the payments for the services would be considered fees for technical services assuming that they fit within the definition of "fees for technical services" in paragraph 3 of Article 12A.

Paragraph 4

104. This paragraph provides that paragraphs 1 and 2 do not apply to fees for technical services if the person who provides the services has a permanent establishment or fixed base in the State in which the fees arise and the fees are effectively connected with that permanent establishment or fixed base. In this regard, paragraph 4 is similar to paragraph 4 of Articles 10, 11 and 12 as well as paragraph 8 of Article 12B. Thus, if a resident of one Contracting State provides technical services through a permanent establishment or fixed base located in the other Contracting State, the fees received for those services will be taxable by the State in which the permanent establishment or fixed base is located

in accordance with Article 7 or Article 14, rather than in accordance with Article 12A.

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

106. The paragraph does not define the meaning of the expression "effectively connected." As a result, whether fees for technical services are effectively connected with a permanent establishment, fixed base or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, fees for technical services would be considered to be effectively connected with a permanent establishment or fixed base if the technical services are closely related to or connected with the permanent establishment or fixed base. Also, fees for technical services would be effectively connected with business activities referred to in paragraph 1(*c*) of Article 7 where the technical services are provided by an enterprise as part of that enterprise's business activities carried on in a Contracting State where a permanent establishment of that enterprise is situated and these activities are of the same or similar kind as the business activities performed through that permanent establishment.

107. Where paragraph 4 applies, fees for technical services are taxable by the State in which the fees arise as part of the profits attributable to the permanent establishment in accordance with Article 7 or the income attributable to the fixed base in accordance with Article 14. Thus, paragraph 4 relieves the State in which the fees for technical services arise from the limitations on its taxing rights imposed by Article 12A. Where Article 7 applies as a result of the application of paragraph 4, most countries consider that the State in which the permanent establishment is located is allowed to tax only the net profits from the technical services attributable to the permanent establishment. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis, but a Contracting State must not discriminate against

residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination). Similarly, where Article 14 applies, most countries consider that the State in which the fixed base is located is allowed to tax only the net income derived from the technical services. However, it may be useful for countries to clarify these issues during the negotiation of the treaty (see paragraphs 9 and 10 of the Commentary on Article 14).

Paragraphs 5 and 6

108. Paragraph 5 lays down the principle that the State in which fees for technical services arise for purposes of Article 12A is the State of which the payer of the fees is a resident or the State in which the payer has a permanent establishment or fixed base if the fees for technical services are borne by the permanent establishment or fixed base. It is not necessary for the services to be provided in the Contracting State in which the payer is resident or has a permanent establishment or fixed base. Whether a person is a resident of a Contracting State for purposes of Article 12A is determined in accordance with the provisions of Article 4 of the Convention.

109. Where there is an obvious economic link between technical services being provided and the permanent establishment or fixed base of the payer to which the services are provided, the fees for technical services are considered to arise in the Contracting State in which the permanent establishment or fixed base is situated. This result applies irrespective of the residence of the person to which the permanent establishment or fixed base belongs, even where that person resides in a third State.

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

111. Paragraph 5 is subject to paragraph 6, which provides an exception to the source rule in paragraph 5. Paragraph 6 deems fees for technical services paid by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in the other Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for technical services under paragraph 2.

112. The phrase "borne by" must be interpreted in the light of the underlying purpose of paragraphs 5 and 6, which is to provide source rules for fees for technical services. A Contracting State is entitled to tax fees for technical services under paragraph 2 only if the fees arise in that State. The basic source rule in paragraph 5 is that fees for technical services arise in a Contracting State if the payer is a resident of that State or the payer has a permanent establishment or fixed base in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. However, the basic rule is limited by the deeming rule in paragraph 6 where the payer is a resident of a Contracting State but the fees for technical services are borne by a permanent establishment or fixed base that the payer has in the other Contracting State.

113. Where fees for technical services are incurred for the purpose of a business carried on through a permanent establishment or for the purpose of independent personal services performed through a fixed base, those fees will usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7 or the income attributable to the fixed base under Article 14. The deductibility of the fees for technical services provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment or fixed base is situated.

114. The fact that the payer has, or has not, actually claimed a deduction for the fees for technical services in computing the profits of the permanent establishment or the income of the fixed base is not necessarily conclusive, since the proper test is whether any deduction

available for those fees should be taken into account in determining the profits attributable to the permanent establishment or the income attributable to the fixed base. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment or fixed base being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the fees for technical services are not deductible for some reason other than the fact that the fees for technical services should not be allocated to the permanent establishment or fixed base.

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

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

117. In Example 8, since the payments are made by S Company, a resident of State S, and are not borne by a permanent establishment of S Company in State R, the fees for technical services would be considered to arise in State S in accordance with paragraph 5. Therefore, State S would be entitled to tax the fees for technical services under paragraph 2.

118. *Example 9:* The facts are the same as in Example 8, except that the fees for technical services are borne by S Company's permanent establishment in State R.

119. In Example 9, since the fees for technical services are borne by a permanent establishment of S Company situated in State R, paragraph 6 applies to deem the fees for technical services not to arise in State S. Consequently, the fees for technical services are not taxable by State S under paragraph 2 but are taxable exclusively by State R under paragraph 1 of Article 12A.

120. In Example 9, Article 12A of the Convention denies State S the right to tax the fees for technical services despite the fact that the fees are paid by a resident of State S. This result is justified because the fees relate to a business carried on by a resident of State S in State R. In such a situation, where fees for technical services are deductible in computing the profits of a business attributable to a permanent establishment situated in the other Contracting State or in computing the income from independent personal services furnished through a fixed base situated in the other Contracting State, those payments have a closer economic connection to the activities carried on in that other State than to State S.

121. *Example 10:* T Enterprise is carried on by a resident of State T. T Enterprise carries on business through a permanent establishment situated in State S. T Enterprise pays R Company, a resident of State R, for technical services provided by R Company for T Enterprise in connection with its income-earning activities carried on in State S. The payments made by T Enterprise to R Company for the technical services are deductible in computing the profits attributable to the permanent establishment of T Enterprise in State S. The tax treaty between State S and State T is identical to the United Nations Model Tax Convention including as regards the contents of Article 12A.

122. In Example 10, although the fees for technical services are not paid by a resident of State S, the fees are borne by the permanent establishment that T Enterprise has in State S. In these circumstances, the fees for technical services have a close economic connection to the income-earning activities of T Enterprise carried on in State S. Thus, the fees are deemed to arise in State S in accordance with paragraph 5 and State S is entitled to tax the payments in accordance with paragraph 2.

123. In the case of interest and royalties, paragraph 21 of the Commentary on Article 11 and paragraph 19 of the Commentary on Article 12 of the United Nations Model Tax Convention indicate that countries might substitute a rule that would identify the source of interest or royalties as the State in which the loan giving rise to the interest or the property or right giving rise to the royalties was used. A similar source rule might be substituted for purposes of Article 12A. Similarly, as suggested in the Commentary on Articles 11 and 12, where, in bilateral negotiations, the parties differ on the appropriate rule, a

possible solution would be a rule that, in general, would accept the payer's place of residence as the source of fees for technical services, but where the technical services are used or consumed in a State having a place-of-use rule, the payment would be deemed to arise in that State.

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

— The Contracting States might decide not to include paragraph 6. If paragraph 6 were omitted from Article 12A, fees for technical services would be considered to arise in the State in which the payer is resident, even where those fees are incurred for purposes of a permanent establishment or fixed base of the payer situated outside the payer's State of residence.

— The Contracting States might decide not to include paragraph 6 and to revise paragraph 5 so that fees for technical services could be considered to arise in a Contracting State only if the payer is a resident of that State and the technical services are used or consumed by the payer in that State; or if the payer is not a resident of a Contracting State, the payer has a permanent establishment or fixed base situated in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In this case, technical services used or consumed by a resident of a Contracting State outside that State would not be considered to arise in that State, and that State would not be entitled to tax fees for such services under Article 12A. Paragraph 6 would be unnecessary because technical services used or consumed outside a Contracting State would include any technical services incurred for the purposes of a resident's permanent establishment or fixed base situated outside that State.

— Fees for technical services could be considered to arise in a Contracting State only if the payer is a resident of that State and the technical services are provided in that State or if the payer, not being a resident of a Contracting State, has a permanent establishment or fixed base situated in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In this case, a Contracting State would be entitled to tax fees for technical services paid by

its residents to residents of the other Contracting State if the technical services are provided in the State. In this situation, paragraph 6 would be unnecessary.

125. Paragraph 6 provides no solution for the case where the beneficiary and the payer are residents of the Contracting States, but the fees for technical services were incurred for the benefit of a permanent establishment or fixed base of the payer situated in a third State and the fees for technical services are borne by that permanent establishment or fixed base. In such a case, the fees for technical services are deemed to arise in the Contracting State of which the payer is a resident under paragraph 5 and not in the third State in which the permanent establishment or fixed base is situated. Thus, the fees for technical services will be taxed both in the Contracting State of which the payer is a resident and in the Contracting State of which the beneficiary is a resident. Although double taxation will be avoided between these two States, it will not be avoided between them and the third State if the third State taxes the fees for technical services because they are borne by the permanent establishment or fixed base in its territory. Paragraph 6 is consistent in this regard with paragraph 5 of Article 11 and paragraph 5 of Article 12.

126. As explained in paragraph 27 of the Commentary on Article 11 (quoting paragraphs 29 and 30 of the Commentary on Article 11 of the 2017 OECD Model Tax Convention), if the third State did not subject the fees for technical services to tax, there could be attempts to avoid taxation in the Contracting State of which the payer is a resident through the use of a permanent establishment or fixed base situated in such a third State. States for which this is not a concern and that wish to address the issue described in paragraph 125 above may do so by agreeing, in their bilateral convention, to the alternative formulation of paragraph 6 suggested in paragraph 127 below.

127. As mentioned in paragraph 126, the State of which the beneficiary is a resident and the State of which the payer of fees for technical services is a resident may avoid the double taxation described in paragraph 125 above by agreeing to the following wording of paragraph 6:

> 6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the

other Contracting State or a third State through a permanent establishment situated in that other State or the third State, or performs independent personal services through a fixed base situated in that other State or the third State and such fees are borne by that permanent establishment or fixed base.

This wording would have the effect of ensuring that paragraphs 1 and 2 would not apply to the fees for technical services because they would not arise in a Contracting State. As a result, such fees for technical services would typically fall under Article 7 or 14.

Paragraph 7

128. The purpose of paragraph 7 is to restrict the operation of the provisions concerning the taxation of fees for technical services in cases where, by reason of a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person, the amount of the fees paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length. Paragraph 7 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the fees for technical services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

129. It is clear from the text that in order for this paragraph to apply the fees for technical services held to be excessive must be due to a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person. There may be cited as examples of such a special relationship cases where fees for technical services are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the payer or is subordinate to a group having common interest with the payer. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

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

131. With regard to the taxation treatment to be applied to the excess part of the fees for technical services, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike paragraph 6 of Article 11, which, because of the limiting phrase "having regard to the debt claim for which it is paid," permits only the adjustment of the rate at which interest is charged, paragraph 7 permits the reclassification of the fees for technical services in such a way as to give them a different character. This paragraph can affect not only the recipient of the fees, but also the payer of excessive fees for technical services; if the law of the State where the payer is resident or has a permanent establishment or a fixed base permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the fees for technical services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 7, as long as they do not alter its general purport.

132. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of fees for technical services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

Article 14

INDEPENDENT PERSONAL SERVICES

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

(*a*) if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

(*b*) if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Commentary on Article 14

INDEPENDENT PERSONAL SERVICES

1. Paragraph 1(*a*) and paragraph 2 of Article 14 of the United Nations Model Tax Convention reproduce the essential provisions of Article 14 of the 1997 version of the OECD Model Tax Convention. The whole of Article 14 and the Commentary thereon were deleted from the OECD Model Tax Convention on 29 April 2000. Paragraph 1(*b*) allows the country of source to tax income from independent personal services in one additional situation not covered by paragraph 1 of Article 14 of the 1997 OECD Model Tax Convention: while the former OECD Model Tax Convention allowed the source country to tax income from independent personal services only if the income was attributable to a

fixed base of the taxpayer, the United Nations Model Tax Convention also allows taxation at source if the taxpayer is present in that country for more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

2. In the discussion of Article 14, some former Group of Expert's members from developing countries expressed the view that taxation by the source country should not be restricted by the criteria of existence of a fixed base and length of stay and that the source of income should be the only criterion. Some members from developed countries, on the other hand, felt that the exportation of skills, like the exportation of tangible goods, should not give rise to taxation in the country of destination unless the person concerned has a fixed base in that country comparable to a permanent establishment. They therefore supported the fixed base criterion, although they also accepted that taxation in the source country is justified by continued presence in that country of the person rendering the service. Some members from developing countries also expressed support for the fixed base criterion. Other members from developing countries expressed preference for the criterion based on length of stay.

3. In developing the 1980 Model, several members from developing countries had proposed a third criterion, namely, the amount of remuneration. Under that criterion, remuneration for independent personal services could be taxed by the source country if it exceeded a specified amount, regardless of the existence of a fixed base or the length of stay in that country.

4. As a compromise, the 1980 Model included three alternative criteria found in subparagraphs (*a*) to (*c*) of paragraph 1, the satisfaction of any one of which would give the source country the right to tax the income derived from the performance of personal activities by an individual who is a resident of the other State. However, in 1999, the former Group of Experts decided to omit the third criterion, which was mentioned in subparagraph (*c*), namely the amount of remuneration, therefore retaining the first two criteria in subparagraphs (*a*) and (*b*).

5. Subparagraph (*a*), which reproduces the sole criterion found in the 1997 OECD Model Tax Convention, provides that the income may be taxed if the individual has a fixed base regularly available to him for

performing his activities. Though the presence of a fixed base gives the right to tax, the amount of income that is subject to tax is limited to that which is attributable to the fixed base.

6. Subparagraph (*b*), as amended in 1999, extends the source country's right to tax by providing that the source country may tax if the individual is present in the country for a period or periods aggregating at least 183 days in any twelve-month period commencing or ending in the fiscal year concerned, even if there is no fixed base. Only income derived from activities exercised in that country, however, may be taxed. Prior to the amendment, the requirement of minimum stay in the Contracting State was a "period or periods amounting to or exceeding in the aggregate 183 days in the fiscal year concerned". A member from a developed country, however, expressed a preference for retaining the previous wording for technical reasons. By virtue of the amendment, the provisions of paragraph 1(*b*) of Article 14 have been brought on a par with those of paragraph 2(*b*) of Article 15 relating to the minimum period of stay in the other Contracting State.

7. Prior to its deletion, subparagraph (*c*) provided a further criterion for source country tax when neither of the two conditions specified in subparagraphs (*a*) and (*b*) is met. It was provided that if the remuneration for the services performed in the source country exceeds a certain amount (to be determined in bilateral negotiations), the source country may tax, but only if the remuneration is received from a resident of the source country or from a permanent establishment or fixed base of a resident of any other country which is situated in that country.

8. It was observed that any monetary ceiling limit fixed for this purpose would become meaningless over a period of time due to inflation and would only have the effect of limiting the amount of potentially valuable services that the country will be able to import. Moreover, the provisions of subparagraph (*c*) appeared only in 6 per cent of the bilateral tax treaties finalized between 1980 and 1997.[119] It was accordingly decided to delete paragraph 1(*c*) of Article 14.

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119 See W.F.G Wijnen and J.J.P de Goede, "United Nations – The UN Model in Practice 1997–2013", IBFD *Bulletin for International Taxation*, 2014 (Volume 68), No. 3, section 2.16.4.2.

9. The former Group of experts discussed the relationship between Article 14 and paragraph 3(*b*) of Article 5. It was generally agreed that remuneration paid directly to an individual for the performance of activities in an independent capacity was subject to the provisions of Article 14. Payments to an enterprise in respect of the furnishing by that enterprise of the activities of employees or other personnel are subject to Articles 5 and 7. The remuneration paid by the enterprise to the individual who performed the activities is subject either to Article 14 (if he is an independent contractor engaged by the enterprise to perform the activities) or Article 15 (if he is an employee of the enterprise). If the parties believe that further clarification of the relationship between Article 14 and Articles 5 and 7 is needed, they may make such clarification in the course of negotiations.

10. Since Article 14 of the United Nations Model Tax Convention contains all the essential provisions of Article 14 of the 1997 OECD Model Tax Convention, the Committee considers that the following part of the Commentary on Article 14 of the 1997 OECD Model Tax Convention is applicable to Article 14 of this Model:

> 1. The Article is concerned with what are commonly known as professional services and with other activities of an independent character. This excludes industrial and commercial activities and also professional services performed in employment, for example, a physician serving as a medical officer in a factory. It should, however, be observed that the Article does not concern independent activities of artistes and sportsmen, these being covered by Article 17.
>
> 2. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. Difficulties of interpretation which might arise in special cases may be solved by mutual agreement between the competent authorities of the Contracting States concerned.
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> 3. The provisions of the Article are similar to those for business profits and rest in fact on the same principles as those of Article 7. The provisions of Article 7 and the Commentary thereon could therefore be used as guidance for interpreting and applying Article 14. Thus the principles laid down in Article 7 for instance as regards allocation of profits between head office and permanent establishment could be applied also in apportioning income between the State of residence

> of a person performing independent personal services and the State where such services are performed from a fixed base. Equally, expenses incurred for the purposes of a fixed base, including executive and general expenses, should be allowed as deductions in determining the income attributable to a fixed base in the same way as such expenses incurred for the purposes of a permanent establishment *[…]*. Also in other respects Article 7 and the Commentary thereon could be of assistance for the interpretation of Article 14, for example, in determining whether computer software payments should be classified as commercial income within Article 7 or 14 or as royalties within Article 12.
>
> 4. Even if Articles 7 and 14 are based on the same principles, it was thought that the concept of permanent establishment should be reserved for commercial and industrial activities. The term "fixed base" has therefore been used. It has not been thought appropriate to try to define it, but it would cover, for instance, a physician's consulting room or the office of an architect or a lawyer. A person performing independent personal services would probably not as a rule have premises of this kind in any other State than of his residence. But if there is in another State a centre of activity of a fixed or a permanent character, then that State should be entitled to tax the person's activities.

11. Some countries interpret Article 14 differently from the way the Article is interpreted in paragraphs 9 and 10 above. These countries may, therefore, wish to clarify their positions and agree bilaterally on the relevant aspects, if those have not already been dealt with.

12. Under paragraph 4 of Article 12A, if a resident of a Contracting State performs independent personal services (that are technical services within the meaning of paragraph 3 of Article 12A) in the other Contracting State through a fixed base that is regularly available to the resident and receives fees for those services, Article 14 will apply to those fees in priority to Article 12A. However, if a resident of one Contracting State provides independent personal services (that are technical services) that arise in the other Contracting State, but those services are not provided through a fixed base in that other State, the fees for those services are taxable by that other State under paragraph 2 of Article 12A.

13. Under paragraph 8 of Article 12B, if a resident of a Contracting State performs independent personal services (that are automated digital services within the meaning of paragraph 5 of Article 12B) in the other Contracting State through a fixed base that is regularly available to the resident and receives payments in consideration for those services, Article 14 will apply to those payments in priority to Article 12B. However, if a resident of one Contracting State provides independent personal services (that are automated digital services) that arise in the other Contracting State, but those services are not provided through a fixed base in that other State, the income derived from those services is taxable by that other State under Article 12B.

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