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Base Erosion and Profit Shifting

Base Erosion and Profit Shifting (BEPS)

Proposed BEPS-related Changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries.

(Report by Coordinator – Ms Carmel Peters)

Background:

The Subcommittee on Base Erosion Profit Shifting (BEPS) has undertaken work to propose modifications to the United Nations Model Double Taxation Convention between Developed and Developing Countries (the Model) to make it more effective in light of recent developments, including a greater awareness of BEPS issues and the OECD/G20 work in this area. The Subcommittee has therefore had the dual function of:

(i) keeping a communication channel open between the developing and developed components of the UN membership in order to create greater awareness of BEPS issues, and responses to them that work for developing countries, especially the least developed; and;

(ii) proposing revisions to the United Nations Model in order to take account of developments in the area of international tax policies relevant to developed and developing countries. In 2014 the Subcommittee commenced work on possible changes to the Model to address BEPS issues that arise out of, or were emphasised by, the work of the G20 and OECD or relate specifically to issues that arose in respect of the Model.

Main Proposed Modifications to the United Nations Model

The main differences between the articles of the Model, as it is proposed to be amended, and the previous version agreed in 2011 and published in 2012 are as follows:

- A modified title of the Model and a new Preamble;
- A new version of Article 1 that includes a principal purpose test, a third state permanent establishment rule, and a savings clause;
- A modified version of Article 4 that includes a new tie breaker rule for determining the treaty residence of dual-resident persons other than individuals;
- A modified version of Article 5 to prevent the avoidance of permanent establishment status;
- A modified Article 10 to change the circumstances in which a lower rate applies for dividends on direct ownership of shares above a 25% threshold;
- A new Article to provide for source taxation of fees for technical services (a separate Committee agenda item);
- A new version of Article 13, paragraph 4 to modify the scope of the land-rich company rule;
- A modified version of Article 13, paragraph 5 for consistency with Article 13, paragraph 4.

There have been changes to the Commentaries on the Articles to reflect the changes referred to above. There are aspects of the proposals that need further refinement and the discussions at the twelfth session of the Committee will be especially helpful in this regard. In view of the importance to countries generally of combatting BEPS it was thought best to raise some relevant issues in an unrefined form for discussion rather than to fail to address them.

The Mandate:

The Subcommittee was mandated to draw upon its own experience and engage with other relevant bodies, particularly the OECD, with a view to monitoring developments on base erosion and profit shifting issues and communicating on such issues with officials in developing countries (especially the less developed) directly and through regional and inter-regional organisations. This communication was to be done with a view to:

- helping inform developing countries on such issues;
- helping facilitate the input of developing country experiences and views into the ongoing UN work, as appropriate; and
- helping facilitate the input of developing country experiences and views into the OECD/G20 Action Plan on Base Erosion and Profit Shifting (BEPS).

The Subcommittee was further mandated to report to the Committee, beginning at the eleventh annual session of the Committee in 2015, on:

- proposed updates to the United Nations Model relating to matters addressed as part of the BEPS Action Plan, with a particular emphasis on the next such update; and
- other possible work relating to base erosion and profit shifting issues that the Committee may wish to undertake or request the Secretariat to undertake.

Subcommittee Members

This Subcommittee is composed of the following Committee Members:

- Ms. Carmel Peters (Coordinator, New Zealand)
- Ms. Liselott Kana (Chile)
- Mr. Eric Nii Yarboi Mensah (Ghana)
- Mr. Ignatius Kawaza Mvula (Zambia)
- Ms. Pragya S. Saksena (India)
- Mr. Stig B. Sollund (Norway)
- Ms. Ingela Willfors (Sweden)

Structure of this Report

This document is largely comprised of two substantive Annexes:

- **Annex 1** contains the proposed changes to:
    - The Title and the Preamble of the United Nations Model, as well as to the following articles:
        - Article 1
        - Article 4
        - Article 10; and
        - Article 13
- **Annex 2** contains proposed changes to various aspects of Article 5 of the United Nations Model.

The Committee is asked to consider the proposals with a particular focus on changes that might be made as part of the forthcoming update on the Model for the benefit of those using it for guidance in their bilateral treaty negotiations and administration.

Attachment 1:

Proposed changes of the United Nations Model Double Taxation Convention between Developed and Developing Countries to prevent the granting of treaty benefits in inappropriate circumstances

Subcommittee on Base Erosion and Profit Shifting

Contents

Title and Preamble

Comment

It is proposed that the title be amended and a text for the preamble of the United Nations Model Convention be inserted to clarify that treaties are not intended to be used to produce situations of double non-taxation. These proposed changes would be important in relation to the interpretation of the provisions contained in the treaty.

Currently, the preamble should be drafted according to the constitutional procedures of the Contracting States but it is proposed that this be replaced by a model preamble.

Note that there are overlapping sections in the United Nations Model Convention Commentary and further work will be required to refine the proposed changes to the commentary and ensure that areas of overlap are sufficiently considered.

Proposed change to the title and preamble of the United Nations Model Convention

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***[1]

PREAMBLE OF THE CONVENTION[2]

(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

[1] States wishing to do so may follow the widespread practice of including in the title a reference to either the avoidance of double taxation or to both the avoidance of double taxation and the prevention of fiscal evasion.

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

arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)

Have agreed as follows:

Proposed change to United Nations Model Convention Commentary

Introduction

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[3] and the follow up Doha Declaration on Financing for Development of 2008[4] together 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 United Nations Model Convention 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.

[3]United Nations 2002, A/CONF.198/11

[4]United Nations 2008, A/CONF.212/L.1/Rev.1

6.1 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.

10. In 2005 the Ad Hoc Group of Experts was upgraded by conversion into a Committee structure, which remains its current form. The 25 members 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 now directly reports to the ECOSOC**.** ~~and it now meets every year rather than every second year.~~

11. ***In 2013, 25 new members were appointed to the Committee of Experts.*** At the time of completion of this updated version of the United Nations Model Convention, the members of the Committee were as follows:[5]

~~Armando Lara Yaffar (Mexico) Chairperson of the Committee; Tizhong Liao (China) First Vice-Chairperson; Anita Kapur (India) Second Vice-Chairperson; Henry John Louie (United States of America) Third Vice-Chairperson; Bernell L. Arrindell (Barbados); Claudine Devillet (Belgium); Marcos Aurelio Pereira Valadao (Brazil); Iskra Georgieva Slavcheva (Bulgaria); Amr El Monayer (Egypt); Liselott Kana (Chile); Wolfgang Lasars (Germany); Kwame Adjei-Djan (Ghana); Enrico Martino (Italy); Keiji Aoyama (Japan); Mansor Hassan (Malaysia); , Noureddine Bensouda (Morocco); Robin Moncrieff Oliver (New Zealand); Ifueko Omoigui-Okauru (Nigeria); Stig Sollund (Norway); Farida Amjad (Pakistan); Sae Joon Ahn (Republic of Korea); El Hadji Ibrahima Diop (Senegal); Ronald van der Merwe (South Africa), Julia Martinez Rico (Spain), Jürg Giraudi (Switzerland).~~

[List of current members of Committee of Experts to be inserted]

[…]

16. The current revision of the United Nations Model Convention ***continues*** ~~is the beginning of~~ an ongoing process of review, which the Committee hopes will result in more frequent updates of particular Articles and Commentaries to keep up with developments, including in country practice, new ways of doing business, and new challenges. It will therefore operate as a process of continuous improvement. This means that some articles have not yet been substantively reviewed by the Committee.

17. The main objectives of this revision of the United Nations Model Convention have been to take account of developments in the area of international tax policies relevant for developing and developed countries. ~~The Committee also identified treaty policy~~ ***The Committee identified a number of*** issues that require further work***. In particular*** ~~and~~ it mandated one Subcommittee to address the issue of the taxation treatment of services in general and in a broad way including all related aspects and issues. Furthermore, ***it was also agreed that*** the issue of taxation of fees for technical services should also be addressed.

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

17.1 In addition, the Committee has undertaken work on base erosion and profit shifting issues. Initially, the focused on its own experiences and engaged with other relevant bodies, with a view to monitoring developments on base erosion and profit shifting issues with and communicating on such issues with officials in developing countries (especially the less developed) directly and through regional and inter-regional organisations. This communication was done with a view to help inform developing countries on such issues, help facilitate the input of developing country experiences and views into the ongoing United Nations work and help facilitate the input of developing country experiences and views into the OECD/G20 Action Plan on Base Erosion and Profit Shifting. In 2014 the Committee commenced work on changes to the United Nations Model Tax Convention to address base erosion and profit shifting issues that arise out of the work of the G20 and OECD or relate specifically to issues that arose in respect of the Convention.

~~It was recognized that this was the initiation of extensive work and it was agreed that there would not be any results ready for incorporation into this version of the Model Convention. In the future, if the Committee so decides, any potential conclusions that could be useful may therefore be presented as a Committee Report which may shape the next revision of the United Nations Model Convention. The work programme of the Committee, including that on services, will be made available as it develops on the Committee's website.~~[6]

C. MAIN FEATURES OF THIS REVISION OF THE UNITED NATIONS MODEL CONVENTION

18. The main differences between the Articles of this version of the United Nations Model Convention and the previous version ~~revised in 1999 and published in 2001~~ ***published in 2012*** are as follows:

- ***A modified title of the convention and a new preamble of the convention;***
- ***A new version of Article 1 that includes a principal purpose test, a third state permanent establishment rule, and a savings clause;***
- ***A modified version of Article 4 that includes a new tie breaker rule for determining the treaty residence of dual-resident persons other than individuals;***
- ***A modified version of Article 5 to prevent the avoidance of permanent establishment status;***
- ***A modified Article 10 to change the circumstances in which a lower rate applies for dividends on direct ownership of shares above a 25% threshold;***
- ***A new Article [ ] to provide for source taxation of fees for technical services;***
- ***A new version of Article 13, paragraph 4 to modify the scope of the land-rich company rule;***
- ***A modified version of Article 13, paragraph 5 for consistency with Article 13, paragraph 4.***

~~A modified version of Article 13, paragraph 5 to address possible abuses;~~

~~An optional version of Article 25 that provides for mandatory binding arbitration when a dispute cannot be solved under the usual Mutual Agreement Procedure;~~

~~A new version of Article 26 that confirms and clarifies the importance of exchange of information under the United Nations Model Convention, along the lines of the current OECD Model Convention provision; and~~

~~A new Article 27 on Assistance in the Collection of Taxes, along the lines of the current OECD Model Convention provision.~~

19. There have been changes to the Commentaries on the Articles to reflect the changes referred to above~~, as well as~~:

~~Additions to the Commentary on Article 1 addressing the improper use of tax treaties (paragraphs 8-103);~~

~~A generally updated Commentary on Article 5;~~

~~Alternative text in the Commentary on Article 5 for cases where countries delete Article 14 and rely on Articles 5 and 7 to address cases previously covered by that Article (paragraphs 15.1-15.25);~~

~~An addition to the text of the Commentary on Article 7, noting that the OECD approach to Article 7 evidenced in the 2010 OECD Model Convention Commentary (and deriving from the 2008 OECD Report on the Attribution of Profits to Permanent Establishments) has not been adopted in relation to the significantly different United Nations Model Convention Article (paragraph 1) ;~~

~~Incorporation of revised text on beneficial ownership drawn from the OECD Model Convention in the Commentaries on Article 10 (paragraph 13), Article 11 (paragraph 18) and Article 12 (paragraph 5);~~

~~New text in the Commentary on Article 11 on the treatment of certain instruments which, while technically not interest bearing loans, are treated in the same fashion for treaty purposes. This is especially relevant for the treatment of certain Islamic financial instruments (paragraph 19.1-19.4); and~~

~~Revisions to the Commentaries on a number of Articles to quote wording from more recent versions of OECD Model Convention Commentaries, where these are considered as helpful in interpreting provisions based on the United Nations Model Convention.~~

Article 1

Improper use of tax treaties

8. Provisions of tax treaties are drafted in general terms and taxpayers may be tempted to apply these provisions in a narrow technical way 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. ***In the 2017 update, the Committee clarified through the addition of an amended title and text for a preamble and an amendment to the title of the United Nations Model Convention that tax treaties are not intended to create opportunities for non-taxation or reduced taxation through tax avoidance and evasion.***

9. The Committee considers 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 recognizes 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.

9.1 In the 2017 update, the Committee decided to include a principal purpose test in Article 1. This along with specific treaty anti-abuse rules included in tax treaties are aimed at transactions and arrangements entered into for the purpose of obtaining treaty benefits in inappropriate circumstances.

[. . .]

The interpretation of tax treaty provisions

38. 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 treaty's object and purpose as well as the obligation to interpret these provisions in good faith.[7] As already noted, 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. As noted in paragraph 9.3 of the Commentary on Article 1 of the OECD Model Convention:

> Other States prefer to view some abuses as being abuses of the convention itself, as opposed to abuses of domestic law. These States, however, then consider that a proper construction of tax conventions allows them to disregard abusive transactions, 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*).

38.1 Earlier Committees have recognized the increasing practice of including titles and preambles to emphasise the purpose of bilateral tax treaties [reference required]. This practice will become more widespread following the recommendations of the G20 and OECD on treaty abuse to clarify that the facilitation of treaty abuse is not part of the general objectives of bilateral tax treaties.

38.2 As part of the 2017 update, the Committee decided to amend the title of the United Nations Model Convention and to include the text of a preamble based on those recommendations. The changes in this version expressly recognize that the purposes of the United Nations Model Convention are not limited to the elimination of double taxation and that the Contracting States do not intend the provisions of the United Nations Model Convention to create opportunities for non-taxation or reduced taxation through tax avoidance and evasion. While the amended title refers to treaty-shopping, the Committee

[7] As prescribed by Article 31 of the Vienna Convention on the Law of Treaties.

recognizes that treaty-shopping is just one example of the improper use of a tax treaty and notes that other examples can be found in paragraphs 40 to 99.

38.3 Since the title and preamble form part of the context of the United Nations Model Convention and constitute a general statement of the object and purpose of the United Nations Model Convention, they should play an important role in the interpretation of the provisions of the Convention.

39. Paragraphs 23 to 27 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.

Tax policy considerations

Comment

It is proposed that a section on tax policy considerations be inserted as new section C in the introduction of the commentary to the United Nations Model Convention and current section C be renamed D. This new section incorporates a 2014 United Nations paper by Ariane Pickering and the new section being inserted into the OECD Model Convention.

Proposed change to United Nations Model Convention Commentary

C. TAX POLICY CONSIDERATIONS THAT ARE RELEVANT TO THE DECISION OF WHETHER TO ENTER INTO A TAX TREATY OR AMEND AN EXISTING TREATY

17.1 In 2014, the United Nations published Papers on Selected Topics in Negotiation of Tax Treaties for Developing Countries, which contained a paper titled "Why negotiate tax treaties?" by Ariane Pickering ("the 2014 United Nations paper"). This paper provided a discussion on why countries may choose to enter into treaty negotiations. The 2014 United Nations paper examined 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.

17.2 Following the work by the OECD and G20 on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), a section was inserted into the Introduction to the OECD Model Convention on 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. The Committee recognizes that the considerations identified by the OECD are consistent with the discussion contained in the 2014 United Nations paper. The relevant section of the Commentary to the OECD Model Convention is 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 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.[1]

[Footnote to paragraph 15.6:] Available at http://www.oecd.org/ctp/exchange-of-tax-information/ENG-Amended-Convention.pdf

D.~~C.~~ MAIN FEATURES OF THIS REVISION OF THE UNITED NATIONS MODEL CONVENTION

Article 1

Comment

It is proposed that a principal purpose test be introduced into the United Nations Model Convention. At this stage it is proposed to be added as new paragraph 2 in Article.

It is also proposed that a "savings clause" be introduced as paragraph 3, to clarify that treaties do not prevent countries from taxing their own residents.

In addition, it is proposed that two paragraphs dealing with third-state PEs be added into Article 1.

It is proposed that the United Nations Model Convention Commentary be updated to take account of these additions, including removing paragraph 11 of the Commentary to Article 4, which deals with third-state PEs.

A "full" version of Article 1 is set out below containing all of the proposals and then each separate proposal is covered individually.

At the moment, the United Nations Model Convention Commentary on Article 1 falls under the subject "A. General considerations" because there is currently only one sentence in Article 1. Other Articles with more than one paragraph contain a second section titled "B. Commentary on the Paragraphs of Article [X]". With the addition of the PPT, the third-State PE rule, and possibly the savings clause, a new section B will be required for each of the new paragraphs. Existing parts of the Commentary could be shifted to subsections on the appropriate paragraphs in B. For example, paragraphs 36 and 37 (see below) are currently under the subheading "General anti-abuse rules found in tax treaties" - these could either be shifted to new commentary on paragraph 2, or left where it as and refer the reader to the paragraphs where there is a more detailed technical discussion on the PPT. This would be the same for the third-State PE rule.

Article 1

PERSONS COVERED

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

2. 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.

3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under [paragraph 3 of Article 7], paragraph 2 of Article 9 and Articles 19, 20, 23 A [23 B], 24 and 25 A [25 B] and 28.

4. Where

(a) 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

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

the benefits of the 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] 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.

The preceding provisions of this paragraph shall not apply if the income derived from the other State is derived in connection with 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).

Article 1, paragraph 2: principal purpose test

Comment
It is proposed that a general anti-abuse rule be inserted as Article 1, paragraph 2 into the United Nations Model Convention. For the most part, the proposed OECD Commentary on the provision is relevant for the United Nations Model Convention Commentary. For clarity, the OECD Commentary is reproduced in its entirety in this document, but where the OECD Commentary is not directly relevant (for example, because it relates to the limitation-on-benefits rule), it appears struck-out in this document, with contextual changes in red square brackets.

Proposed new Article 1, paragraph 2 of the United Nations Model Convention

2. 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.

Proposed change to United Nations Model Convention Commentary

Article 1 - A. General Considerations

36. ~~A country that does not feel confident that its~~ ***In the 2017 update, the Committee recognized that countries'*** domestic law***s*** and approach***es*** to the interpretation of tax treaties ~~would~~***may not*** allow ~~it~~ ***them*** to adequately address improper uses of its tax treaties ***and included a general anti-abuse rule in Article 1, by way of a principal purpose test.*** ~~could, of course, consider including a general anti-abuse rule in its treaties. The guiding principle referred to above could form the basis for such a rule, which could therefore be drafted along the following lines:~~

> ~~Benefits provided for by this Convention shall not be available where it may reasonably be considered that a main purpose for entering into transactions or arrangements has been to obtain these benefits and obtaining the benefits in these circumstances would be contrary to the object and purpose of the relevant provisions of this Convention.~~

When considering such a provision, some countries may prefer to replace the phrase "~~a main purpose~~***one of the principal purposes***" by "the ~~main~~ ***principal*** purpose" to make it clear that the provision should only apply to transactions that are, without any doubt, primarily tax-motivated. Other countries ***The Committee***, however, ~~may~~ consider***s*** that, based on their experience with similar general anti-abuse rules found in domestic law ***of many countries***, words such as "the ~~main~~ ***principal*** purpose" ***could***~~would~~ impose an unrealistically high threshold that would require tax administrations to establish that obtaining tax benefits is objectively more important than the combination of all other alleged purposes, which would

risk rendering the provision ineffective. ***It is for this reason the Committee considers that for the principal purpose test in Article 1 to apply, it is sufficient for one of the principal purposes of the arrangement or transaction to be to obtain treaty benefits***. ~~A State that wishes to include a general anti-abuse rule in its treaties will therefore need to adapt the wording to its own circumstances, particularly as regards the approach that its courts have adopted with respect to tax avoidance.~~

37. Many countries, however, will consider that including such a provision in their treaties could be interpreted as an implicit recognition that, absent such a provision, they cannot use other approaches to deal with improper uses of tax treaties. This would be particularly problematic for countries that have already concluded a large number of treaties that do not include such a provision. For that reason, the use of such a provision would probably be considered primarily by countries that have found it difficult to counter improper uses of tax treaties through other approaches.

Article 1 - B. Commentary on the paragraphs of Article 1

Paragraph 2

104. Until the 2017 update, the United Nations Model Convention did not include a general anti-abuse rule, but provided an optional text for inclusion in the Commentary to Article 1 in paragraph 36. As part of the 2017 Update, the Committee decided that a general anti-abuse rule should be included in the United nations Model Convention in Article 1.

105. The provision that appears in the United Nations Model Convention follows the recommendation of the OECD/G20 in the Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances). The Committee considers that the associated commentary is also relevant for the purposes of the United Nations Model Convention:

> ***1. Paragraph [2] mirrors the guidance in paragraphs 9.5, 22, 22.1 and 22.2 of the Commentary on Article 1. 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 [2] 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 paragraphs 22 and 22.1 of the Commentary on Article 1; it also confirms the application of these principles for States whose domestic law already allows them to address such cases.***
>
> ***2. The provisions of paragraph [2] 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.

3. Paragraph [2] supplements and does not restrict in any way the scope or application of the provisions of ~~paragraphs 1 to 6 (~~the limitation-on-benefits rule~~):~~ a benefit that is denied in accordance with these paragraphs is not a "benefit under the Convention" that paragraph [2] would also deny. ~~Moreover, the guidance provided in the Commentary on paragraph 7 should be used to interpret paragraphs 1 to 6 and vice-versa.~~

4. Conversely, the fact that a person is entitled to benefits under ~~paragraphs 1 to 6~~[a limitation-on-benefits rule] does not mean that these benefits cannot be denied under paragraph [2]. ~~Paragraphs 1 to 6 are rules that~~ [Limitation-on-benefits rules] 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.

5. Paragraph [2] must be read in the context ~~of paragraphs 1 to 6 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 recognized 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, e.g. because a majority of the shareholders in that company are not residents of the same State. The object and purpose of subparagraph 2 c) 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 7 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 7 would apply to deny that benefit because subparagraph 2 c), 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 authorizing treaty-shopping transactions entered into by public companies.~~

6. The provisions of paragraph [2] 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, i.e. 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.

7. 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 dividends, interest or royalties arising in that State, and paid to a resident of the other State (who is the beneficial owner) under Article 10, 11 or 12. 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.

8. 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 6. 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.

9. 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 [2] may apply.

10. To determine whether or not one of the principal purposes of any person concerned with 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.

11. 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.

12. The reference to "one of the principal purposes" in paragraph [2] 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 [2] could apply notwithstanding the fact that there may also be other principal purposes for changing the residence, such as facilitating the sale of the property or the re-investment of the proceeds of the alienation.

13. 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.

14. The following examples illustrate the application of the paragraph (the examples included in paragraph 19 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 3 a) 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 [2]. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph [2] 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 [2] 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 [2] would otherwise apply (see also example F in paragraph 15 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 [2] 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. 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.

15. 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 [2] is only applied after approval at a senior level within the administration.

16. Also, some States consider that where a person is denied a treaty benefit in accordance with paragraph [2], 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 [2]. In order to allow that possibility, such States are free to include the following additional paragraph in their bilateral treaties:

> ***8. Where a benefit under this Convention is denied to a person under paragraph [2], 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 [2]. 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.***

17. 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 [2] 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.

18. 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 10 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 [2], 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.

~~***19. For various reasons, some States may be unable to accept the rule included in paragraph [2]. 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 6 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, 10, 11, 12 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 maturity of the preferred shares is 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 State 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 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 trade or 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.*~~

Article 1, paragraph 3: savings clause

Comment

It is proposed that a "savings clause" be introduced as paragraph 3, to clarify that treaties do not prevent countries from taxing their own residents. The following provision is based on the OECD provision, which includes a reference to Article 7, paragraph 3 of the OECD Model Convention. Article 7, paragraph 3 of the OECD Model Convention deals with correlative adjustments - the United Nations Model Convention does not include this provision in Article 7. However, Article 9 does refer to an adjustment in paragraph 2.

The reference to paragraph 3 of Article 7 appears in red and in square brackets in both the proposed amendments to the United Nations Model Convention and its Commentary, so that the matter can be discussed.

Adjustments have also been made to the proposed Commentary to take account of the fact that the United Nations Model Convention contains two options for Article 5. These adjustments are indicated in red.

Proposed new Article 1, paragraph 3 of the United Nations Model Convention

3. This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under [paragraph 3 of Article 7], paragraph 2 of Article 9 and Articles 19, 20, 23 A [23 B], 24 and 25 A [25 B] and 28.

Proposed change to United Nations Model Convention Commentary

B. Commentary on the paragraphs of Article 1

Paragraph 3

106. In the 2017 update, the Committee decided to introduce a so-called "savings clause" as paragraph 3 to Article 1. This follows the new provision included in the OECD Model Convention following the recommendations of the OECD/G20 in the Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), which is based on a similar provision included in the US model . The intent of the savings clause is to put at 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 savings clause in the United Nations Model Convention puts the matter beyond doubt.

107. The OECD Commentary on the issue reads as follows:

> ***26.17 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 23 above, which addresses the case of controlled foreign companies provisions).***
>
> ***26.18 Paragraph 3 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.***
>
> ***26.19 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 3 of Article 7, which requires a Contracting State to grant to an enterprise of that State a correlative adjustment following an***

initial adjustment made by the other Contracting State, in accordance with paragraph 2 of Article 7, to the amount of tax charged on the profits of a permanent establishment of the enterprise.]

• 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.

• 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**s* ***25 A and 25 B, which allow**~~s~~* ***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.

26.20 The list of exceptions included in paragraph 3 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. For instance, if the Contracting States agree, in accordance with paragraph 27 of the Commentary on Article 18, to include in their bilateral convention a provision according to which pensions and other payments made under the social security legislation of a Contracting State

shall be taxable only in that State, they should include a reference to that provision in the list of exceptions included in paragraph 3.

26.21 The term "resident", as used in paragraph 3 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 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.

Article 1, paragraph 4: third-state PEs

Comment

It is proposed that a new paragraph 4 be inserted into Article 1 of the United Nations Model Convention to deal with PEs situated in third states. This is based on the recommendation of the OECD/G20 Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), but has been updated to reflect further work undertaken on the provision. The OECD paragraph also allows competent authorities to grant discretionary relief, but this is being included as an optional provision in the United Nations Model Convention Commentary.

In addition, the OECD Commentary on Article 24 is being amended. The United Nations Model Convention Commentary largely replicates the OECD Commentary, so those changes should also be considered.

Proposed new Article 1, paragraph 4 of the United Nations Model Convention

4. Where

(a) 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

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

the benefits of the 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] 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.

The preceding provisions of this paragraph shall not apply if the income derived from the other State is derived in connection with 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).

Proposed change to United Nations Model Convention Commentary

Article 1 - A. General Considerations

Triangular Cases

58. 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 or royalties 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.[8]

59. Under the State R-State S tax treaty, State S has to apply the benefits of the treaty to such dividends, interest or royalties because these are derived by a resident of State R, even though they are not taxed in that State by reason of the exemption system applied by that State.

60. ***In the 2017 update, the Committee decided to insert in Article 1 an anti-abuse rule to deal with such triangular cases where income attributable to a permanent establishment in a third State is subject to a low rate of taxation. Further commentary on this provision can be found in paragraphs 108–110.*** ~~Paragraph 71 of the Commentary on Article 24 of the OECD Model Convention, which is reproduced in the Commentary on Article 24 below, discusses this situation and suggests that it may be dealt with through the inclusion of a specific provision in the treaty between States R and S:~~

> ~~[…] If the Contracting State of which the enterprise is a resident exempts from tax the profits of the permanent establishment located in the other Contracting State, there is a danger that the enterprise will transfer assets such as shares, bonds or patents to permanent establishments in States that offer very favourable tax treatment, and in certain circumstances the resulting income may not be taxed in any of the three States. To prevent such practices, which may be regarded as abusive, a provision can be included in the convention between the State of which the enterprise is a resident and the third State (the State of source) stating that an enterprise can claim the benefits of~~

[8] See page R(11)-3, paragraph 53 of the OECD Report *Triangular Cases*. Reproduced in volume II of the full-length version of the OECD Model Convention at page R(11)-1.

~~the convention only if the income obtained by the permanent establishment situated in the other State is taxed normally in the State of the permanent establishment.~~

~~61. A few treaties include a provision based on that suggestion.[9] If, however, similar provisions are not systematically included in the treaties that have been concluded by the State of source of such dividends, interest or royalties with countries that have an exemption system, there is a risk that the relevant assets will be transferred to associated enterprises that are residents of countries that do not have that type of provision in their treaty with the State of source.~~

B. Commentary on the paragraphs of Article 1

Paragraph 4

108. While the concern about triangular situations where income is attributable to a permanent establishment located in a third State and subject to a low rate of taxation is not a new issue, the Committee decided in 2017 to include an anti-abuse rule dealing with such situations in the United Nations Model Convention. Previously, the commentary to Article 1 contained a similar provision that countries could agree to include in their bilateral treaties to deal with such triangular situations.

109. This paragraph broadly follows paragraph 4 in Article 1 of the OECD Model Convention but omits the last two sentences which allow the competent authority to provide discretionary relief where it would otherwise be denied under the provisions of the paragraph. However, countries may agree in bilateral negotiations to include the following text at the end of paragraph 4:

> ***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 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. 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.***

110. The Committee generally agrees with the guidance in OECD Commentary as follows, with the commentary relating to the discretionary relief provision discussed in paragraph 109 appearing in square brackets:

> ***1. As mentioned in paragraph 32 of the Commentary on Article 10, paragraph 25 of the Commentary on Article 11 and paragraph 21 of the Commentary on Article 12, potential abuses may result from the transfer of shares, debt-claims, rights or property to permanent establishments set up solely for that purpose in countries that do not tax, or offer preferential tax treatment, to the income from***

[9] See for example, paragraph 5 of Article 30 of the France-United States treaty.

such assets. 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 proposed paragraph, which applies where a Contracting State exempts the income of enterprises of that State that are 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 is derived in connection with, 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.***

[2. In any case where benefits are denied under this paragraph, the resident of a Contracting State who derives the relevant income may request the competent authority of the other Contracting State to 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.]

3. 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 4, 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 applicable to income derived in connection with or incidental to the active conduct of a business applies to the relevant income [or unless these benefits are granted, under the discretionary relief provision, by the competent authority of the State in which the interest arises].

4. The reference to the word "income" in subparagraph a) 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 carries on business in a third State through a permanent establishment situated therein and the first-mentioned State treats the right or property in respect of which

the income is paid as effectively connected with such permanent establishment (including under a provision such as paragraph 2 of Article 21 in a treaty between that State and the third State).

5. Where the conditions of subparagraphs a) and b) are met, the paragraph 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 effective rate of tax levied on these profits in that third jurisdiction is less than the lower of the following two rates: a) the minimum rate that the Contracting States have determined bilaterally for the purposes of the paragraph, and b) 60 per cent of the effective rate of tax that would be imposed on the profits of the permanent establishment in the State of the enterprise if that permanent establishment were situated in that State.

64. Instead of adopting the wording of paragraph 4, 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 derived in connection with or 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<u>s</u> 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 Contracting 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 Contracting 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 percent of the general statutory rate of company tax applicable in the first-mentioned Contracting 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 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.

Article 24

2. The Committee considers that the following extracts from the Commentary on paragraphs 1 to 4 of Article 24 of the OECD Model Convention are applicable to corresponding paragraphs of Article 24 (the additional comments that appear in square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to reflect the differences between the provisions of the OECD Model Convention and those of this Model and also to specify the applicable paragraph/subparagraph of this Model):

[…]

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 or royalties 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 4 of Article 1 denies the benefits of the Convention with respect to that income.*** ~~If the Contracting State of which the enterprise is a resident exempts from tax the profits of the permanent establishment located in the other Contracting State, there is a danger that the enterprise will transfer assets such as shares, bonds or patents to permanent establishments in States that offer very favourable tax treatment, and in certain circumstances the resulting income may not be taxed in any of the three States. To prevent such practices, which may be regarded as abusive, a provision can be included in the convention between the State of which the enterprise is a resident and the third State (the State of source) stating that an enterprise can claim the benefits of the convention only if the income obtained by the permanent establishment situated in the other State is taxed normally in the State of the permanent establishment.~~

Article 4, paragraph 3: tie-breaker for non-individuals

Comment

It is proposed that the non-individual tiebreaker in paragraph 3 of Article 4 be amended to replace the place of effective management test with a requirement that the competent authorities should endeavour to resolve the question of residence by mutual agreement. A similar provision already exists as an option in the UN commentary. If there is a mandatory arbitration provision, this provision would not be applicable because the consequences of not reaching mutual agreement are already set out in the provision.

It is proposed that the UN Commentary be updated to include the current paragraph 3 of Article 4 (place of effective management test or " POEM test") as an optional alternative.

Proposed change to Article 4, paragraph 3 of the United Nations Model Convention

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.~~ ***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.***

Proposed change to the United Nations Model Convention Commentary

Article 1

45. 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"~~ 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.

45.1 Recognizing the various uncertainties and opportunities for abuse arising from determining the residence of non-individuals solely with regard to the place of effective management, the Committee~~Also, some countries have~~ replaced paragraph 3 of Article 4, ~~which deals with cases of dual residence of legal persons on the basis of their place of effective management, by~~***with*** a rule that leaves such cases of dual residence to be decided

under the mutual agreement procedure **– *having regard to place of effective management, place of incorporation and other relevant factors***. ~~An example of such a provision is found in paragraph 3 of Article 4 of the treaty signed in 2004 by Mexico and Russia, which reads as follows:~~

> ~~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 by mutual agreement endeavour to settle the question and to determine the mode of application of the Agreement to such person. In the absence of such agreement, such person shall be considered to be outside the scope of this Agreement, except for the Article "Exchange of information".~~

Article 4

8. Paragraph 3, which reproduces Article 4, paragraph 3, of the OECD Model Convention, deals with companies and other bodies of persons, irrespective of whether they are legal persons. The OECD Commentary indicates in paragraph 21 that "~~[i]t 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,~~ ***Cases where a company, etc. is subject to tax as a resident in more than one State may occur if,*** for instance, one State attaches importance to the registration and the other State to the place of effective management. So, in the case of companies, etc. also, special rules as to the preference must be established". According to paragraph 22 of the OECD Commentary, "~~[i]t would not be an adequate solution to attach importance to a purely formal criterion like registration. Therefore paragraph 3 attaches importance to the place where the company, etc. is actually managed~~ ***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.***". ~~It may be mentioned that, as in the case of the OECD Model Convention, the word "only" was added in 1999 to the tie-breaker test for determining the residence of dual residents, other than individuals.~~

9. ***However, the OECD/G20 recommendation in the Final Report on Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) resulted in changes to sole reliance on place of effective management to resolve cases of dual residence. The Committee considers that the changes to the OECD Commentary should also be adopted as follows:*** ~~The OECD Commentary goes on to state:~~

> 23. ~~The formulation of the preference criterion in the case of persons other than individuals was considered in particular in connection with the taxation of income from shipping, inland waterways transport and air transport. A number of conventions for the avoidance of double taxation on such income accord the taxing power to the State in which the "place of management" of the enterprise is situated; other conventions attach importance to its "place of effective management", others again to the "fiscal domicile of the operator".~~ ***In [2014], however, the 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 "place of effective management" has been adopted as the preference criterion for persons other than individuals […].~~ ***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.***

~~10. It is understood that when establishing the "place of effective management", circumstances which may, inter alia, be taken into account are the place where a company is actually managed and controlled, the place where the decision-making at the highest level on the important policies essential for the management of the company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the place where the most important accounting books are kept. In this respect the OECD Commentary refers to some relevant country practices:~~

~~24.1 Some countries, however, consider that cases of dual residence of persons who are not individuals are relatively rare and should be dealt with on a case-by-case basis. Some countries also consider that such a case-by-case approach is the best way to deal with the difficulties in determining the place of effective management of a legal person that may arise from the use of new communication technologies. These countries are free to leave the question of the residence of these persons to be settled by the competent authorities, which can be done by replacing the paragraph by the following provision:~~

~~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.~~

Competent authorities having to apply ***paragraph 3*** ~~such a provision to determine the residence of a legal person for purposes of the Convention~~ would be expected to take account of various factors, such as where the meetings of ***the person's*** ~~its~~ 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. ~~Also, since the application of the provision would normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25, the request should be made within three years from the first notification to that person that its taxation is not in accordance with the Convention since it is considered to be a resident of both Contracting States. 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.~~ [*the next sentence has been moved to new paragraph 24.2; the last sentence of the paragraph has been moved to new paragraph 24.3*]

24.2 ~~Also, since the~~ ***A determination under paragraph 3*** ~~application of the provision would~~ ***will*** normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25~~, the~~***. 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.

10. While the place of effective management test was removed in the 2017 update, some States may consider it to be preferable to deal with cases of dual residence of entities using such a test. These States may consider that this rule can be interpreted in such a way to prevent it from being abused and may wish to include the following version of

paragraph 3, which appeared in the United Nations Model Convention 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.***

~~11. A particular issue, as regards a bilateral treaty between State A and State B, can arise in relation to a company which is under paragraph 1 of Article 4, a resident of State A, and which is in receipt of, say, interest income, not directly, but instead, through a permanent establishment which it has in a third country, State C. Applying the Model Convention has the effect that such a company can claim the benefit of the terms on, say, withholding tax on interest in the treaty between State A and State B, in respect of interest that is paid to its permanent establishment in State C. This is one example of what is known as a "triangular case". Some concern has been expressed that treaties can be open to abuse where, in the example given, State C is a tax haven and State A exempts the profits of permanent establishments of its resident enterprises. The situation is discussed in depth in the OECD study on the subject.[10] States which wish to protect themselves against potential abuse can take advantage of the possible solutions suggested there, by adopting additional treaty provisions.~~ *[this should be removed as triangular cases are now dealt with in Article 1]*

Article 10, paragraph 2

Comment

It is proposed that the threshold for the reduced dividend withholding rate be increased to 25 per cent, but the rates themselves remain to be set through bilateral negotiations. It is also proposed that a 365-day holding period be inserted into paragraph 2(a).

Proposed change to Article 10, paragraph 2 of the United Nations Model Convention

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident 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 (other than a partnership) which holds directly at least ~~10~~***25*** per cent of the capital of the company paying the dividends ***throughout a 365 day period that includes the day of the***

[10] Reproduced in Volume II of the full-length version of the OECD Model Convention at page R(11)-1.

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.

Proposed change to the United Nations Model Convention

Article 1

Transactions that seek to circumvent thresholds found in treaty provisions

94. 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 subparagraph (*a*) of paragraph 2 of Article 10, which only applies if the beneficial owner of the dividends is a company which holds directly at least ~~10~~***25*** per cent of the capital of the company paying the dividends.

95. Taxpayers may enter into arrangements in order to obtain the benefits of such provisions in unintended circumstances. For instance, a non-resident shareholder who owns less than ~~10~~***25*** per cent of the capital of a resident company could, in contemplation of the payment of a dividend, arrange for his 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 the 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. As noted in the Commentary on Article 10, which reproduces paragraph 17 of the OECD Commentary on that Article:

> 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.

The following are other examples of arrangements intended to circumvent various thresholds found in the Convention.

Article 10

4. This paragraph reproduces Article 10, paragraph 2, of the OECD Model Convention with certain changes which will be explained hereunder.

5. The OECD Model Convention restricts the tax in the source country to 5 per cent in subparagraph *a)* for direct investment dividends and 15 per cent in subparagraph *b)* for portfolio investment dividends, but the United Nations Model Convention leaves these percentages to be established through bilateral negotiations.

6. ***Until the 2017 update, the previous*** ~~Also, the~~ minimum ownership necessary for direct investment dividends ***was***~~is~~ reduced in subparagraph (*a*) from 25 per cent to 10 per cent. However, the 10 per cent threshold which determines the level of shareholding qualifying as a direct investment ~~is~~ ***was intended to be*** illustrative only. ~~When it last considered this issue,~~ ***T***~~t~~he former Group of Experts decided to replace "25 per cent" by "10 per cent" in subparagraph (*a*) as the minimum capital required for direct investment dividend status because in some developing countries non-residents are limited to a 50 per cent share ownership, and 10 per cent is a significant portion of such permitted ownership. ***However, as part of the 2017 update, the current Committee of Experts considered that 25 per cent is a more appropriate threshold for direct investment, in line with the OECD Model Convention.***

6.1 In line with the OECD Model Convention, the Committee considered 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 payment of the dividend or after the time the dividend is paid.

7. 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 Convention 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 in withholding taxes 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.

8. 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 withholding 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 withholding

rates on the grounds that (*a*) the exemption itself stresses the concept of not taxing inter-corporate dividends, and a limitation of the withholding rate 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 withholding rate at source, which would also benefit the investor, would be in keeping with this aspect of the exemption.

9. 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.

10. In 1999, it was noted that recent developed/developing country treaty practice indicates a range of direct investment and portfolio investment withholding tax rates. Traditionally, dividend withholding rates 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 withholding rates is justified by the increased foreign investment in the medium and long terms. Thus, several modern developed/developing country treaties contain the OECD Model rates for direct investment, and a few treaties provide for even lower rates.

11. 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. 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.

12. 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 rate:

(*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.

13. The Commentary on the OECD Model Convention contains the following passages:

[The United Nations Model Convention Commentary then quotes OECD commentary paras 11-22 - it will need to be checked if these are changing. The Commentary omits part of 12.2 , and 12.3-12.7]

Article 13, paragraphs 4 and 5

Comment

It is proposed that the actual text of paragraph 4 of the current United Nations Model Convention be replaced by the OECD proposal. The current United Nations Model Convention already has similar wording, so it is not considered to be a significant change.

The concept of a comparable interest is also proposed to be added into paragraph 5 as the current United Nations Model Convention only deals with shares in a company, even though paragraph 4 was amended to account for other interests. Paragraph 8 of the Commentary will need to be revised.

Paragraph 99 of the United Nations Model Convention Commentary on Article 1 may need to be reconsidered. This is highlighted.

Proposed change to Article 13, paragraphs 4 and 5 of the United Nations Model Convention

~~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.~~

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 ~~12-month period~~ ***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.

Proposed change to United Nations Model Convention Commentary

Article 1

Thresholds for the source taxation of capital gains on shares

97. Paragraph 4 of Article 13 allows a State to tax capital gains on shares of a company (~~and on interests in certain other entities~~ ***or comparable interests, such as interests in a partnership or trust***) ***where the shares or comparable interests derive 50 per cent or more of their value directly or indirectly from*** ~~the property of which consists principally of~~ immovable property situated in that State. ~~For the purposes of that provision, the property of such an entity is considered to consist principally of immovable property situated in a State if the value of such immovable property exceeds 50 per cent of the value of all assets of the entity.~~

98. One could attempt to circumvent that provision by diluting the percentage of the value of an entity that derives from immovable property situated in a given State in contemplation of the alienation of shares or interests in that entity. 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.

99. Where 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, 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:

> 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.

Article 13

Paragraph 4

8. This paragraph ***corresponds with paragraph 4 of the OECD Model Convention. Until the 2017 update, paragraph 4 of the United Nations Model Convention 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 formulations are ~~, which broadly corresponds to paragraph 4 of the OECD Model Convention, allows a Contracting State to tax a gain on an alienation of shares of a company or on an alienation of interests in other entities the property of which consists principally of immovable property situated in that State. It is~~ 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 incorporation of a company to hold 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 would have to apply 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. 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. ~~It also decided to exclude from its scope such entities whose property consists directly or indirectly principally of immovable property used by them in their business activities. However, this exclusion will not apply to an immovable property management company, partnership, trust or estate. In order to fulfil its purpose, paragraph 4 must apply whether the company, partnership, trust or estate owns the immovable property directly or indirectly, such as, through one or more interposed entities. Contracting States may agree in bilateral negotiations that paragraph 4 also applies to gains from the alienation of other corporate interests or rights forming part of a substantial participation in a company. For the purpose of this paragraph, the term "principally" in relation to the ownership of an immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by such company, partnership, trust or estate.~~ ***In 2017,***

the Committee decided to adopt the updated provision from the OECD Model Convention as it considered that the difference in wording was no longer necessary.

Paragraph 5

9. 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 in 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 ~~12-month period~~ ***365 days*** preceding the alienation, held, directly or indirectly, a substantial participation. ~~In this context, "12-month period" means the period beginning with the date which is one calendar year earlier than the date of the alienation and ending at the time of the alienation.~~ The determination of what is a substantial participation is left to bilateral negotiations, in the course of which an agreed percentage can be determined.

9.1 In 2017, the Committee decided that paragraph 5 should apply to interests comparable to shares in a company, as paragraph 4 already did. This means that interests in a trust or partnership, for example, are also subject to the rule in this paragraph.

10. This paragraph provides for taxation of a gain on the alienation of shares ***and comparable interests*** as contemplated in the paragraph above but excludes gains from the alienation of shares to which paragraph 4 of Article 13 of the Convention 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 12-month period preceding the alienation. A substantial shareholding is determined according to the percentage shareholding decided in 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 12-month period.

11. 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 level of holdings of the alienator, in particular, how to determine an interest held indirectly. 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 level of the alienator's direct or indirect holdings. The treaty text itself or associated documents could alternatively expand on the meaning of these concepts.

12. The question of laying down a concessionary rate of tax (compared with the normal domestic rate) on gains arising on alienation of shares, other than the shares referred to in paragraph 4, that is, not being shares of companies principally owning 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.

13. It is costly to tax gains from the alienation of quoted shares. In addition, developing countries may find it economically rewarding to 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 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 12-month period 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".

14. 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.

15. 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.

16. If countries choose not to tax the gains derived in the course of corporate reorganizations, they are of course also free to do so.

Attachment 2:

Proposed changes to Article 5 of the United Nations Model Double Taxation Convention between Developed and Developing Countries

Subcommittee on Base Erosion and Profit Shifting

Contents

Article 5, paragraph 4: preparatory and auxiliary activities

Comment

It is proposed that Article 5,paragraph 4 be amended to ensure that the specific activity exemptions cannot be used to artificially avoid PE status. The proposal is based on the recommendations of the G20 and OECD in the 2015 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status).

The amended Article 5, paragraph 4 will still omit the words "or delivery".

There are differences in views among countries as to whether all items under the existing paragraph 4 are excluded from constituting a PE regardless of whether they have a preparatory and auxiliary character or not. However, the proposed changes to paragraph 4 of Article 5 will make it explicit that all the activities are subject to the condition of having a preparatory and auxiliary character regardless of particular country views on the interpretation of the previous provision.

It is also proposed that the Commentary on Article 5, paragraph 4 be updated to reflect the change to the United Nations Model Convention and to acknowledge that there are some compliance and administrative difficulties in relation to the threshold of "preparatory and auxiliary".

Proposed change to Article 5, paragraph 4 of the United Nations Model Convention

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.~~**;**

(*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.~~**,**

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

Proposed change to United Nations Model Convention Commentary

16. ***In 2017, the Committee agreed to include in the update to the United Nations Model Convention, an amended paragraph 4 of Article 5. The changes made were in line with the recommendations of the OECD/G20 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status)***

to clarify in the OECD Model Convention that all of the activities listed in paragraph 4 are subject to the preparatory and auxiliary requirement. Following the approval of the Action 7 Report, the OECD Commentary on paragraph 4 was also substantially modified to take account of changes to Article 5, paragraph 4.

16.1[Placeholder for new paragraph on the prospective effect of these 2017 changes and the implications for texts used in earlier bilateral treaties]

17. ~~This paragraph reproduces Article 5, paragraph 4 of the OECD Model Convention with one substantive amendment~~: ***The new paragraph 4 of Article 5 in the United Nations Model Tax Convention still omits the reference to*** ~~the deletion of~~ "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.***

17.1 In view of the similarities to ***that recommended text***~~the OECD Model Convention provision~~ and the general relevance of its Commentary, the general principles of Article 5, paragraph 4 under both Models are first noted below and then the practical relevance of the deletion of references to "delivery" in the United Nations Model Convention is considered.

~~17. 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.~~

18. The OECD Commentary on paragraph 4 of the OECD Article reads as follows:

> 21. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which ~~are not~~ ***, when carried on through fixed places of business, are not sufficient for these places to constitute*** permanent establishments~~, even if the activity is carried on through a fixed~~

~~place of business~~. ***The final part of the paragraph provides that these exceptions only apply if the listed activities have a preparatory or auxiliary character.*** ~~The common feature of these activities is that they are, in general, preparatory or auxiliary activities. This is laid down explicitly in the case of the exception mentioned in~~***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*** ~~which~~ actually amount~~s~~ 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*** ~~it~~ limit~~s~~ th***e***~~at~~ definition ***in paragraph 1*** and exclude~~s~~ from its rather wide scope a number of ~~forms of business organisations which, although they are carried on through a fixed place of business~~ ***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. *[the last two sentences and the last part of the preceding one have been moved from paragraph 23 to this paragraph]* 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,*** ~~provided~~ 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 ~~in that other State,~~ 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.***

21.1~~24.~~ 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.

21.2 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.

21.3 Subparagraphs a) to e) refer to activities that are carried on for the enterprise itself. A permanent establishment~~, however,~~ ***would therefore*** exists~~s~~ if ***such activities were performed on behalf of other enterprises at the same fixed place of business*** ~~the fixed place of business exercising any of the functions listed in paragraph 4 were to exercise them not only on behalf of the enterprise to which it belongs but also on behalf of other enterprises~~. If, for instance, an ~~advertising agency~~ ***enterprise that maintained an office for the advertising of its own products or services*** were also to engage in advertising ~~for~~ ***on behalf of*** other enterprises ***at that location***, ~~it~~***that office*** would be regarded as a permanent establishment of the enterprise by which it is maintained.

22. Subparagraph *a)* relates ~~only to the case in which an enterprise acquires the use of~~ ***to a fixed place of business constituted by*** facilities ***used by an enterprise*** for storing, displaying or delivering 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 and delivering 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 and delivery 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.*** ~~Subparagraph b) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. Subparagraph c) covers the case in which 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. The reference to the collection of information in subparagraph d) is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "mere purchase".~~

22.1 ***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 custom clearance process in that other State. It would also cover a fixed place of business***

that an enterprise maintained solely for the delivery of spare parts to customers for machinery sold to those customers. Paragraph 4 would not apply, however, where ~~A permanent establishment could also be constituted if~~ an enterprise maintain***ed***~~s~~ a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers ***and, in addition,*** ~~where, in addition, it~~ ***for the*** maint~~ain~~***enance***~~s~~ or repair~~s~~ ***of*** ~~such~~ machinery, as this ***would*** go~~es~~ beyond the pure delivery mentioned in subparagraph *a)* ~~of paragraph 4~~ ***and would not constitute preparatory or auxiliary activities S~~s~~ince*** these after-sale ***activities constitute*** ~~organisations perform~~ an essential and significant part of the services of an enterprise vis-à-vis its customers.~~, their activities are not merely auxiliary ones~~ [*the preceding two sentences have been moved from paragraph 25 to this paragraph*].

22.2~~26.1~~***Issues may arise concerning the application of the definition of permanent establishment to*** ~~Another example is that of~~ 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 ~~they~~***these*** facilities constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether ***subparagraph a)*** ~~paragraph 4~~ applies to them. Where these facilities are used to transport property belonging to other enterprises, subparagraph *a)*, which is restricted to delivery of goods or merchandise belonging to the enterprise that uses the facility, will not be applicable as concerns the owner or operator of these facilities. Subparagraph *e)* also 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. The situation is different, however, where an enterprise owns and operates a cable or pipeline that crosses the territory of a country solely for purposes of transporting its own property and such transport is merely incidental to the business of that enterprise, as in the case of an enterprise that is in the business of refining oil and that owns and operates a pipeline that crosses the territory of a country solely to transport its own oil to its refinery located in another country. In such case, subparagraph *a)* would be applicable. ~~An additional~~***A separate*** question is whether the cable or pipeline could ~~also~~ constitute a permanent establishment for the customer of the operator of the cable or pipeline, *i.e.* 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.

22.3 Subparagraph *b)* relates to the ***maintenance of a stock of goods or merchandise belonging to the enterprise*** ~~stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery~~. ***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, an ~~independent~~ 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.

22.4 Subparagraph *c)* covers the situation ~~case in which~~ ***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 the preceding paragraph, 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.***

22.5 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.***

22.6 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.

23. Subparagraph *e)* ***applies to*** ~~provides that~~ 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*** ~~through which the enterprise exercises solely an activity which~~ has ~~for the enterprise~~ 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 ~~exceptions~~ ***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***. ~~Furthermore, this subparagraph provides a generalised exception to the general definition in paragraph 1~~ *[(the following part of the paragraph has been moved to paragraph 21):* ~~*and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of business activities which, although they are carried on through a fixed place*~~

~~*of business, 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.]* Examples are fixed places of business 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.~~ *[that last sentence has been moved to paragraph 23]*

24. ~~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~~ *[the preceding three sentences have been moved to paragraph 21.1]*. 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 *[this sentence currently appears at the end of paragraph 23]*. ***Paragraph 4 would not apply, however,*** ~~This would not be the case, where, for example,~~ ***if a*** fixed place of business ***used for the supply of information would*** ~~does~~ not only give information but ***would*** also furnish~~es~~ plans etc. specially developed for the purposes of the individual customer. Nor would it ~~be the case~~ ***apply*** if a research establishment were to concern itself with manufacture *[these two sentences currently appear at the end of paragraph 25]*. ***Similarly,*** ~~W~~***w***here~~, for example,~~ 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*** ~~subparagraph *e)*~~. 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~~s~~ with international ramifications establish***es*** a so-called "management office" in ***a*** State~~s~~ in which ~~they~~***it*** maintain***s*** 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*** ~~a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a "place of management" within the meaning of subparagraph *a)* of paragraph 2. T~~***t***he 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 ~~subparagraph *e)* of~~ paragraph 4.

~~25. A permanent establishment could also be constituted if an enterprise maintains a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers where, in addition, it maintains or repairs such machinery, as this goes beyond the pure delivery mentioned in subparagraph *a*) of paragraph 4. Since these after-sale organisations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones. Subparagraph *e*) applies only if the activity of the fixed place of business is limited to a preparatory or auxiliary one. This would not be the case where, for example, the fixed place of business does not only give information but also furnishes plans etc. specially developed for the purposes of the individual customer. Nor would it be the case if a research establishment were to concern itself with manufacture.~~

~~26. Moreover, subparagraph *e*) makes it clear that the activities of the fixed place of business must be carried on for the enterprise. A fixed place of business which renders services not only to its enterprise but also directly to other enterprises, for example to other companies of a group to which the company owning the fixed place belongs, would not fall within the scope of subparagraph *e*).~~

~~26.1 Another example is that of 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 they constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether paragraph 4 applies to them. Where these facilities are used to transport property belonging to other enterprises, subparagraph *a*), which is restricted to delivery of goods or merchandise belonging to the enterprise that uses the facility, will not be applicable as concerns the owner or operator of these facilities. Subparagraph *e*) also 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. The situation is different, however, where an enterprise owns and operates a cable or pipeline that crosses the territory of a country solely for purposes of transporting its own property and such transport is merely incidental to the business of that enterprise, as in the case of an enterprise that is in the business of refining oil and that owns and operates a pipeline that crosses the territory of a country solely to transport its own oil to its refinery located in another country. In such case, subparagraph *a*) would be applicable [...].~~

27. As already mentioned in paragraph 21 above, paragraph 4 is designed to provide ~~for~~ 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)* ~~of paragraph 4~~, the fact that one fixed place of business combines any of the activities mentioned in subparagraphs *a)* to *e)* ~~of paragraph 4~~ 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. ~~The criterion "preparatory or auxiliary character" is to be interpreted in the same way as is set out for the same criterion of subparagraph *e)* (see paragraphs 24 and 25 above). States which want to allow any combination of the items mentioned in subparagraphs *a)* to *e)*, disregarding whether or not the criterion of the preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words "provided" to "character" in subparagraph *f)*.~~

27.1 ***Unless the anti-fragmentation provisions of paragraph 4.1 are applicable (see below),*** ~~S~~***s***ubparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) ~~provided that they are separated from each other locally and organisationally,~~ as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. ~~Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.~~

28. The fixed places of business ~~mentioned in~~***to which*** paragraph 4 ***applies do not*** ~~cannot be deemed to~~ constitute permanent establishments so long as ~~their~~***the business*** activities ***performed through those fixed places of business*** are restricted to the ***activities referred to in that paragraph*** ~~functions which are the prerequisite for assuming that the fixed place of business is not a permanent establishment~~. This will be the case even if the contracts necessary for establishing and carrying on the***se*** 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*** ~~The employees of places of business within the meaning of paragraph 4 who are authorised to conclude such contracts should not be regarded as agents within the meaning of~~ paragraph 5 ***as long as the conclusion of these contracts satisfies the conditions of paragraph 4 (see paragraph 33 below)***. ~~A case in point would be a research institution~~ ***An example would be where*** the manager of ~~which~~ ***a place of business where preparatory or auxiliary research activities are conducted*** ~~of which is authorised to~~ conclude***s*** the contracts necessary for ***establishing and*** maintaining ***that place of business*** ~~the institution and who exercises this authority within the framework~~ ***as part of the activities carried on at that location*** ~~functions of the institution. A permanent establishment, however, exists if the fixed place of business exercising any of the functions listed in paragraph 4 were to exercise them not only on behalf of the enterprise to which it belongs but also on behalf of other enterprises. If, for instance, an advertising agency maintained by an enterprise were also to engage in advertising for other enterprises, it would be regarded as a permanent establishment of the enterprise by which it is maintained.~~

29. If, ***under paragraph 4,*** a fixed place of business ~~under paragraph 4~~ 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*** ~~in such installation~~ (see paragraph 11 above and paragraph 2 of Article 13). ~~Since~~***Where***, for example, the display of merchandise during a trade fair ***or convention*** is excepted under subparagraphs *a)* and *b),* the sale of th***at***~~e~~ merchandise at the termination of ***the***~~a~~ trade fair or convention is covered by ***subparagraph e) as such sale is merely an auxiliary activity***~~this exception~~. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.

30. ***Where paragraph 4 does not apply because a***~~A~~ fixed place of business used ***by an enterprise*** ~~both~~ for activities ***that are listed in that*** ~~which rank as exceptions~~ ***of*** ~~(~~paragraph ~~4)~~ ***is also used*** ~~and~~ 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*** ~~as regards~~ both types of activities ***may be taxed in the State where that permanent establishment is situated***. ~~This would be the case, for instance, where a store maintained for the delivery of goods also engaged in sales.~~

19. ~~Subparagraph (*f*) was added to Article 5, paragraph 4 in 1999. It follows the OECD Model Convention and provides that "the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (*a*) to (*e*)" is not a permanent establishment if "the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character".~~ ***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 may agree to include the previous paragraph 4, which reads as follows:***

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.

(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.

20. As noted above, the United Nations Model Convention, in contrast to the OECD Model Convention, 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 United Nations Model Convention as an important point of departure from the OECD Model Convention, believing that a stock of goods for prompt delivery facilitates sales of the product and thereby the earning of profit in the host country.

21. In reviewing the United Nations Model Convention, the Committee retains the existing distinction between the two Models, but it notes 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 the United Nations Model Convention, 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.

Article 5, paragraph 4.1: new anti-fragmentation rule

Comment

It is proposed that an anti-fragmentation rule be added immediately following Article 5, paragraph 4 as new paragraph 4.1. This uses the concept of a "closely related enterprise" which is defined in a proposed amendment to paragraph 7 under the proposal relating to dependent agent permanent establishments in Article 5, paragraphs 5 and 7.

The main idea in paragraph 4.1 is to prevent fragmentation of activities by an enterprise or a closely related enterprise to come within the specific activity exemptions and thereby avoid the existence of a permanent establishment of the enterprise.

Proposed addition of Article 5, paragraph 4.1 to the United Nations Model Convention

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.

Proposed change to United Nations Model Convention Commentary

Paragraph 4.1

21.1 In 2017 the Committee decided to adopt a new paragraph 4.1 in Article 5. The new paragraph 4.1 is an anti-fragmentation rule that is recommended for the OECD Model Tax Convention in the OECD/G20 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). 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 also includes new Commentary to provide guidance on the application of paragraph 4.1 to situations where an enterprise or a group of closely related enterprises attempt to circumvent the preparatory or auxiliary activity rule in paragraph 4 by fragmenting a cohesive business operation into several small operations. The new OECD Commentary states:

> ***30.2 […*** ***]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.***
>
> ***30.3 The concept of "closely related enterprises" that is used in paragraph 4.1 is defined in subparagraph b) of paragraph 6 of the Article (see paragraphs 38.8 to 38.10 below).***
>
> ***30.4 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 4 a), 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).

Article 5, paragraphs 5 and 7: dependent agents

Comment

Article 5, paragraph 5

Amendments are proposed to Article 5, paragraphs 5 and 7 to broaden the scope of the dependent agent PE rule to counter structures aimed at the avoidance of a PE (including commissionaire arrangements).

Two options are proposed for an amended paragraph 5 for **discussion** at the 12th meeting. Option 1 is based on the OECD/G20 proposal in the Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status) . Option 2 is also based on the OECD/G20 recommendations but removes certain wording which might either be confusing or be interpreted (rightly or wrongly) as limiting the provision beyond its intended scope. In particular, option 2 proposes to remove the reference to "that are routinely concluded without material modification by the enterprise" from the recommendation in the Action 7 Final Report.

Note however, that regardless of which option goes into the United Nations Model Convention, The related new Commentary for the United Nations Model Convention would be fundamentally the same in either case except for minor consequential drafting changes relating only to the additional wording in option 1. Any necessary changes along these lines will be made after the discussion by the Committee.

Article 5, paragraph 7

Amendments are also proposed for Article 5, paragraph 7. One change of substance to the United Nations Model Convention is in relation to the situation when the activities an agent are devoted wholly or almost wholly on behalf of an enterprise and is therefore not an agent of independent status. Currently paragraph 7 the United Nations Model Convention provides that even in this situation an agent is still independent if it deals with the enterprise on an arm's length basis. This exception has never appeared in the OECD Model Convention with the result that, the OECD Model Convention has a more limited concept of independent agent than the United Nations Model Convention. The Subcommittee considers that in proposing amendments to paragraph 7 it should remove this feature of its rule.

Article 5, paragraph 5

OPTION 1

Proposed change to Article 5, paragraph 5 of the United Nations Model Convention

5. Notwithstanding the provisions of paragraphs 1 and 2 ***but subject to the provisions of paragraph 7***, where a person~~ — other than an agent of an independent status to whom paragraph 7 applies —~~is acting in a Contracting State on behalf of an enterprise ~~of the other Contracting State~~, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) ~~Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise,~~ ***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, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) ~~Has no such authority, but~~ ***the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but*** habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

OPTION 2

Proposed change to Article 5, paragraph 5 of the United Nations Model Convention

5. Notwithstanding the provisions of paragraphs 1 and 2 ***but subject to the provisions of paragraph 7***, where a person~~ — other than an agent of an independent status to whom paragraph 7 applies —~~is acting in a Contracting State on behalf of an enterprise ~~of the other Contracting State~~, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) ~~Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise,~~ ***habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that 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, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) ~~Has no such authority, but~~ ***the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but*** habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

Proposed change to United Nations Model Convention Commentary

Depending on which option is chosen, square brackets may need to be used when quoting the Commentary to the OECD Model Convention to omit the reference to material modification - the relevant lines below are square bracketed and highlighted

Paragraph 5

22. ***In 2017 the Committee decided to modify paragraphs 5 and 7 of Article 5. The new paragraphs address the artificial avoidance of PE status through commissionaire arrangements and similar strategies. These changes to the United Nations Model Convention and relevant Commentary are in line with recommendations for the OECD Model Convention in the OECD/G20 Final Report on Action 7, (Preventing the Artificial Avoidance of Permanent Establishment Status).***

22.1 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*).

22.2 Subparagraph (*a*) follows the substance of the OECD Model Convention and proceeds on the basis that if a person ~~with the authority to~~ ***habitually*** conclude***ing*** 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*** creates for that enterprise a sufficiently close association with a State ***(or if they are habitually playing the principal role leading to the conclusion of such contracts)***, then it is appropriate to deem that such an enterprise has a permanent establishment there. The condition in subparagraph (*b*), relating to the maintenance of a stock of goods, is discussed below.

23. In relation to subparagraph (*a*), a dependent agent causes a "permanent establishment" to be deemed to exist only if ~~his authority is used~~ ***he*** repeatedly ***concludes contracts or plays the principal role leading to the conclusion of contracts*** and not merely in isolated cases. The OECD Commentary states further:

> ~~32.1 Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.~~
>
> ***32.1 For paragraph 5 to apply, all the following conditions must be met:***
>
> – ***a person acts in a Contracting State on behalf of an enterprise;***
>
> – ***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.***
>
> ***32.2 Even if these conditions are met, however, 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 22.5 above).***
>
> ***32.3 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 32, 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.

32.4 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.

32.5 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, i.e. 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.]

32.6 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.

32.7 The following is another example that illustrates the application 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.

32.8 The wording of subparagraphs a), b) and c) ensures that 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.

32.9 A typical case covered by these subparagraphs 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 subparagraphs 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.

32.10 The reference to contracts "in the name of" in subparagraph a) does not restrict the application of the subparagraph 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.

32.11 The crucial condition for the application of subparagraphs b) and c) 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.

32.12 For the purposes of subparagraph b), 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.

32.13 The cases to which 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.

33. The ~~authority to conclude~~ contracts ***referred to in paragraph 5*** ~~must~~ cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person ~~had authority to~~ ***concluded employment contracts*** ~~engage employees~~ for the enterprise to assist that person's activity for the enterprise or if the person ~~were authorised to~~ conclude***d***, in the name of the enterprise, similar contracts relating to internal operations only. Moreover***, whether or not a*** ~~the authority has to be~~ ***person*** habitually ~~exercised~~ ***concludes contracts or habitually plays the principal role leading to the conclusion of contracts [that are routinely concluded without material modification by the enterprise]*** ~~in the other State;~~should be determined on the basis of the commercial realities of the situation. ~~A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation.~~ The mere fact~~, however,~~ 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 ~~exercised in that State an authority to~~ conclude***d*** contracts ***or played the principal role leading to the conclusion of contracts [that are routinely concluded without material modification by the enterprise]*** ~~in the name of 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. ~~Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.~~

33.1 The requirement that an agent must "habitually" ~~exercise an authority to~~ 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 ~~exercising~~" ***concluding contracts or playing the principal role leading to the conclusion of contracts [that are routinely concluded without material modification by the enterprise]"*** ~~contracting authority~~ 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 paragraph 6 would be relevant in making that determination

~~24. The Committee's view is that where paragraph 33 of the OECD Commentary above refers to "[a] person who is authorised to negotiate all elements and details of a contract", this should be taken to include a person who has negotiated all the essential elements of the contract, whether or not that person's involvement in the negotiation also extends to other non-essential aspects.~~ *[the OECD is removing the sentence to which this paragraph corresponds]*

25. With the addition of paragraph 5, subparagraph (*b*), relating to the maintenance of a stock of goods, this paragraph is broader in scope than paragraph 5 of the OECD Model Convention. Some countries believe that a narrow formula might encourage an agent who was in fact dependent to represent himself as acting on his own behalf.

26. The former Group of Experts understood that paragraph 5, subparagraph (*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.[11] 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.[12]

Article 5, paragraph 7

Both options for Article 5, paragraph 5 would require the same change to paragraph 7

Proposed change to Article 5, paragraph 7 of the United Nations Model Convention

7. ~~An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.~~

(a) 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. ~~However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will~~

[11] See paragraph 25 of the Commentary on Article 5 of the 1999 version of the United Nations Model Convention.

[12] Ibid.

~~not be considered an agent of an independent status within the meaning of this paragraph.~~ ***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.***

(b) 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.

Proposed change to United Nations Model Convention Commentary

Paragraph 7

30. The first sentence of this paragraph reproduces Article 5, paragraph 6 of the OECD Model Convention, with a few minor drafting changes. The relevant portions of the Commentary on the OECD text are as follows:

> 36. Where an enterprise of a Contracting State carries on business dealings through ~~a broker, general commission agent or any other agent of~~ an independent ~~status~~ ***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 ~~his~~ ***that*** business (see paragraph 32 above). ~~Although it stands to reason that s~~***The activities of s***uch an agent, ***who*** represent~~sing~~ a separate ***and independent*** enterprise, ~~cannot constitute a~~ ***should not result in the finding of a*** permanent establishment of the foreign enterprise~~,~~ ~~paragraph 6 has been inserted in the Article for the sake of clarity and emphasis~~.
>
> ~~37. A person will come within the scope of paragraph 6, i.e. he will not constitute a permanent establishment of the enterprise on whose behalf he acts only if:~~
>
> ~~– he is independent of the enterprise both legally and economically, and~~
>
> ~~– he acts in the ordinary course of his business when acting on behalf of the enterprise.~~
>
> ***37. 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, 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 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 38.7 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.

38. 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 subparagraph a) of paragraph 6 provides that in certain circumstances a person shall not be considered to be an independent agent (see paragraphs 38.6 to 38.11 below).*** ~~38.2~~ 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.

38.1 ***I***t should be noted that***, where the last sentence of subparagraph a) 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 38.11 below)***. ~~But, as paragraph 41 of the Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies.~~

38.***2***~~3~~ 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.

38.***3***~~4~~ 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.

38.***4***~~5~~ 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.

38.5 Another factor to be considered in determining independent status is the number of principals represented by the agent. As indicated in paragraph 38.7, 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.

38.~~6~~7 ***An independent agent*** ~~Persons~~ cannot be said to act in the ordinary course of ~~their own~~ ***its*** business ***as agent when it performs activities that are unrelated to that agency business*** ~~if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations~~. Where, for example, a ~~commission agent not only sells the goods or merchandise of the enterprise in his own name but also habitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment, since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent), unless his activities are limited to those mentioned at the end of paragraph 5~~ ***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 subparagraph [6] a)***. ***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.***

~~38.8 In deciding whether or not particular activities fall within or outside the ordinary course of business of an agent, one would examine the business activities customarily carried out within the agent's trade as a broker, commission agent or other independent agent rather than the other business activities carried out by that agent. Whilst the~~

~~comparison normally should be made with the activities customary to the agent's trade, other complementary tests may in certain circumstances be used concurrently or alternatively, for example where the agent's activities do not relate to a common trade.~~

38.7 The last sentence of subparagraph a) 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 38.5, 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.

38.8 The last sentence of subparagraph a) applies only where the person acts "exclusively or almost exclusively" on behalf of closely related enterprises. 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.

38.9 Subparagraph b) explains the meaning of the concept of a "person closely related to an enterprise" for the purpose of the Article. 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.

38.10 The first part of subparagraph b) includes the general definition of "a person closely related to an enterprise". It provides that 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 subparagraph b) covers cases where there is only one such person or enterprise.

38.11 The second part of subparagraph b) provides that the definition of "person closely related to an enterprise" is automatically satisfied in certain circumstances. Under that second part, 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.

38.12 The rule in the last sentence of subparagraph a) and the fact that subparagraph b) covers situations where one company controls or is controlled by another company does not restrict in any way the scope of paragraph 7 of Article 5. As explained in paragraph 41.1 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.

~~31. In the 1980 edition of the United Nations Model Convention,[13] the second sentence of paragraph 7 read: "However, when the activities of such an agent are devoted wholly or almost wholly on behalf of the enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph."~~

32. ~~It was subsequently recognized that this sentence had given rise to anomalous situations. The concern was that if the number of enterprises for which an independent agent was working fell to one, the agent would, without further examination, be treated as dependent.~~ In the 1999 revision of the Model, the wording was ~~therefore~~ amended ~~as follows:~~ ***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.***

> ~~However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered as an agent of an independent status within the meaning of this paragraph.~~

33. ~~The revised version makes clear that the essential criterion for *automatically* treating an agent as not being of "an independent status" is the absence of the arm's-length relationship. The mere fact that the number of enterprises for which the independent agent acts has fallen to one does not of itself change his status from independent to dependent,~~

[13] United Nations Publication: ST/ESA/102: Sales No. E.80.XVI.3.

~~though it might serve as an indicator of the absence of the independence of that agent~~. ***In the 2017 update, 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 noted that 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 United Nations Model Convention than under the OECD Model Convention.***

Article 5, paragraph 3

Anti-contract splitting rule

Comment

The Subcommittee on Base Erosion and Profit Shifting discussed two distinct but related problems with the splitting up of contracts which it wishes to bring to the attention of the Committee. They are related because they both address concerns that enterprises can artificially split up contracts, or projects or activities to circumvent the permanent establishment threshold.

The first issue is there is a problem with the splitting up of contracts, which was also an issue addressed in the work on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). This is already a concern identified in the UN Model Convention. The particular matter it deals with is avoidance of time thresholds in the construction site rule in paragraph 3 or any other similar time thresholds for service permanent establishments and similar rules.. To resolve this problem, it is proposed that the Commentary be amended to include an anti-contract splitting rule. There are two options for this rule - one will be based on the OECD proposal, and the other on a formulation used in double tax agreements.

The second issue relates to the use of the phrase "same or connected project" in Article 5, paragraph 3. This is covered in the next section.

Proposed change to United Nations Model Commentary

Paragraph 3

11. In this connection, the OECD Commentary observes, with changes in parentheses to take account of the different time periods in the two Models:

> 18. 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). *[rest of the paragraph is moved to paragraph 18.1]*
>
> ***18.1*** 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 of less than twelve 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, ~~countries concerned with this issue can adopt solutions in the framework of bilateral negotiations.~~ ***these abuses could also be addressed through the application of the anti-abuse rule of paragraph 7 of Article [X], as shown by example J in paragraph [14] of the Commentary on Article [X]. Some States may nevertheless wish to deal expressly with such abuses. Moreover, States that do not include paragraph 7 of Article [X] 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 twelve 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 or installation project and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding periods of time that do not last more than twelve months, and***
>
> ***b) connected activities are carried on at the same building site or construction or installation project 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 aggregate period of time during which the first-mentioned enterprise has carried on activities at that building site or construction or installation project.***

The concept of "closely related enterprises" that is used in the above provision is defined in subparagraph b) of paragraph 6 of the Article (see paragraphs 38.8 to 38.10 below).

18.2 For the purposes of the alternative provision found in paragraph 18.1, 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

The Committee points out that measures to counteract abuses would apply equally in cases under Article 5, paragraph 3, subparagraph (*b*). ***The anti-contract splitting rule provided in paragraph 18.1 of the OECD Commentary can be amended to also counteract abuses under subparagraph (b). One 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 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 ~~associated enterprises~~ closely related enterprises, provided that the activities of such ~~an associated enterprise~~ a closely related enterprise in that Contracting State are connected with the activities carried on in that Contracting State by its ~~associated enterprises~~ closely related enterprises. The period during which two or more ~~associated enterprises~~ closely related enterprise are carrying on concurrent activities shall be counted only once for the purpose of determining the duration of activities. ~~An enterprise shall be deemed to be associated with another enterprise if one participates directly or indirectly in the management, control or capital of the other, or the same person or persons participate directly or indirectly in the management, control or capital of both enterprises.~~

The Commentary of the OECD Model Convention continues as follows:

> 19. 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, *e.g.* if he installs a planning office for the construction. In general, it continues to exist until the work is completed or permanently abandoned. 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 1st May, stopped on 1st [August] because of bad weather conditions or a lack of materials but resumed work on 1st [October], completing the road on 1st [January the following year], his construction project should be regarded as a permanent establishment because [eight] months elapsed between the date he first commenced work (1st May) and the date he finally finished (1st [January] of the following year). If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts 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. The subcontractor himself has a permanent establishment at the site if his activities there last more than [six] months.

The Committee considers that the reference in the penultimate sentence of this paragraph of the OECD Commentary to "parts" of such a project should not be taken to imply that an

enterprise subcontracting *all* parts of the project could never have a permanent establishment in the host State.

The Commentary of the OECD Model Convention continues as follows:

> 19.1 In the case of fiscally transparent partnerships, the [six] month 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 by 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.
>
> 20. 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.

12. [new paragraph 12 commentary as below]

13. If States wish to treat fishing vessels in their territorial waters as constituting a permanent establishment (see paragraph 6 above), they could add a suitable provision to paragraph 3, which, for example, might apply only to catches over a specified level, or by reference to some other criterion.

14. If a permanent establishment is considered to exist under paragraph 3, only profits attributable to the activities carried on through that permanent establishment are taxable in the source country.

15. The following passages of the OECD Commentary are relevant to Article 5, paragraph 3, subparagraph (*a*) of the United Nations Model Convention, although the reference to an "assembly project" in the United Nations Model Convention and not in the OECD Model Convention, and the six-month period in the United Nations Model Convention should, in particular, be borne in mind:

> 16. This paragraph provides expressly that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. Any of those items which do not meet this condition does not of itself constitute a permanent establishment, 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 or construction or installation project that lasts more than twelve 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, and it will be important to ensure that only the profits properly attributable to the functions performed and risks assumed through that office or workshop are attributed to the permanent establishment. This could include profits attributable to functions performed and risks assumed in relation to the various construction sites but only to the extent that these functions and risks are properly attributable to the office.

17. The term "building site or construction 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. States wishing to modify the text of the paragraph to provide expressly for that result are free to do so in their bilateral conventions.

United Nations Model Convention Commentary on Article 1

In addition, paragraph 96 in the Commentary on Article 1 of the United Nations Model Convention refers to paragraphs 11 and 12 of the Commentary on Article 1 - further thought may be required as to whether paragraph 96 of the Commentary on Article 1 also requires amendment.

Time limit for certain permanent establishments

96. Article 5, paragraph 3 of the Convention includes a rule according to which, in certain circumstances, the furnishing of services by a foreign enterprise during a certain period under the same or connected projects will constitute a permanent establishment. Taxpayers may be tempted to circumvent the application of that provision by splitting a single project between associated enterprises or by dividing a single contract into different ones so as to argue that these contracts cover different projects. Paragraphs 11 and 12 of the Commentary on Article 5 deal with such arrangements.

"Same or connected project"

Comment
The second issue relates more specifically to Article 5, paragraph 3(b) regarding concerns with the "same or connected project requirement". It has been drawn to the attention of the Subcommittee that it can be difficult to apply (both administratively and interpretatively). There are concerns that it has been abused and is difficult to deal with for developing countries. One option is to eliminate the words "same or connected project" and redraft paragraph 12 of the Commentary. Another option is to redraft paragraph 12 of the Commentary without removing the words "same or connected project". This second option takes account of the views that some countries have of this requirement.

OPTION 1

Proposed change to Article 5, paragraph 3 of the United Nations Model Convention

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, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue ~~(for the same or a connected project)~~ within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

Proposed change to United Nations Model Convention Commentary

Replace paragraph 12 of the Commentary on Article 5 with the following:

12. Until the 2017 update the UN Model contained the words "(for the same or a connected project)" in subparagraph (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 working 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. However, 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, for 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 subparagraph (b).

Further may need to be made other parts of the Commentary to the United Nations Model Convention relating to Article 5, paragraph 3:

9. Article 5, paragraph 3, subparagraph (*b*) deals with the furnishing of services, including consultancy services, the performance of which does not, of itself, create a permanent establishment in the OECD Model Convention. Many developing countries believe that 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 United Nations Model Convention, the Committee agreed to a slight change in the wording of subparagraph (*b*) of paragraph 3, which was amended to read: "but only if activities of that nature continue (for the same or a connected project) 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 (for the same or a connected project) 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 Article 14, paragraph 1, subparagraph (*b*).

OPTION 2

This option retains the reference to "same or connected project" but proposes a change to United Nations Model Convention Commentary to include an option to delete the phrase

Proposed change to United Nations Model Convention Commentary

Replace paragraph 12 of the Commentary on Article 5 with the following:

12. Subparagraph (b) encompasses service activities only if they "continue (for the same or a connected project) 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". According to some members of the Committee, the inclusion of the words "for the same or a connected project" eliminates 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. However, other members thought that the "project" limitation was too easy for taxpayers 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 working 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 also 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. However, 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 developments. For countries concerned with the administrative burden or who find themselves in agreement with the policy arguments can eliminate the words "(for the same or a connected project)" in subparagraph (b).

Article 5, paragraph 6: insurance businesses

Comment
Due to the Committee's concerns that Article 5(6) can be abused and avoided in relation to re-insurance, it is proposed that the re-insurance exception be removed. It is also proposed that Article 5, paragraph 6 be inserted into the model commentary as an option.

Proposed change to Article 5, paragraph 6 of the United Nations Model Convention

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 ~~other than an agent of an independent status to whom paragraph 7 applies~~.

Proposed change to United Nations Model Convention Commentary

27. This paragraph of the United Nations Model Convention does not correspond to any provision in Article 5 of the OECD Model Convention and is included to deal with certain aspects of the insurance business. The OECD Model Convention nevertheless discusses the possibility of such a provision in bilateral tax treaties in the following terms:

> 39. According to the definition of the term "permanent establishment" an insurance company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on business through a person within the meaning of paragraph 5. Since agencies of foreign insurance companies sometimes do not meet either of the above requirements, it is conceivable that these companies do large-scale business in a State without being taxed in that State on their profits arising from such business. In order to obviate this possibility, various conventions concluded by OECD member countries include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there—other than an agent who already constitutes a permanent establishment by virtue of paragraph 5—or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

28. Paragraph 6 of the United Nations Model Convention, which achieves the aim quoted above, is necessary because insurance agents generally have no authority to conclude contracts; thus, the conditions of paragraph 5, subparagraph (*a*) would not be fulfilled. If an insurance agent is independent, however, the profits of the insurance company attributable to

his activities are not taxable in the source State because the provisions of Article 5 paragraph 7 would be fulfilled and the enterprise would not be deemed to have a permanent establishment.

28.1 Paragraph 6 of the United Nations Model Convention previously contained an exception for re-insurance. This was removed in the 2017 update due to concerns about the ease with which the provision could be abused and a permanent establishment thus avoided. Countries that do not share this concern regarding reinsurance can continue to use the wording of Article 5, paragraph 6 as it read prior to the 2017 update.

29. Some countries, however, favour extending the provision to allow taxation even where there is representation by such an independent agent. They take this approach 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 countries see no reason why the insurance business should be treated differently from activities such as the sale of tangible commodities. They also point to the difficulty of ascertaining the total amount of business done when the insurance is handled by several independent agents within the same country. In view of this difference in approach, the question how to treat independent agents is left to bilateral negotiations, which could take account of the methods used to sell insurance and other features of the insurance business in the countries concerned.

30. To address the difficulties faced in administering a provision that deems an insurance business to constitute a permanent establishment, for example in relation to the attribution of profits, some countries may prefer to provide the source country with the right to tax insurance businesses without deeming a permanent establishment to exist. Some countries may prefer to include a maximum rate of taxation permitted in the source country, with the rate to be determined in bilateral negotiations.

> ***6. Notwithstanding the other provisions of this Article, an enterprise of a Contracting State that derives profits from any form of insurance, in the form of collecting premiums or insuring risks in the other Contracting State, may be taxed on such profits in that other Contracting State. However, the tax in the other Contracting State may not exceed ___ percent of the premiums collected.***