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**Issues related to the updating of the United Nations Model Double
Taxation Convention between Developed and Developing Countries**

**REVISED COMMENTARY ON ARTICLE 12A – FEES FOR TECHNICAL
SERVICES**

Summary

At its twelfth session the Committee was presented with the draft Commentary to the new Article 12A on taxation of fees for technical services. The text was discussed and amended before its final approval, notwithstanding necessary editorial changes.

Subsequently, the Subcommittee on Tax treatment of Services reviewed the text for its final form and made changes in the Article text and its Commentary. However, in the course of doing so, the Subcommittee made changes of substance to render the text clearer and easier for its application. The Subcommittee seeks a full discussion by the Committee and approval of the additions. All changes and additions are color-highlighted. The paragraph 6 of the Article is redrafted to eliminate reference to “a third state”. As for the Commentary, most changes concern the following paragraphs:

- 1) An addition of paragraphs 28 to 31 to explain the closely related person concept;
- 2) An addition of a sentence to paragraph 41 explaining the addition of Article 12 A to the switchover provision in Article 23 A(2);
- 3) A revision (rather than deletion) of paragraph 47 (former Paragraph 43) to clarify the point there;
- 4) And the addition of an example concerning reimbursement of expenses in paragraphs 79 and 80.
- 5) Paragraphs 125 to 127 to motivate the elimination of reference to “a third state” in paragraph 6 of the Article.

Note: The Article is referred to as Article 12A (without space) as compared with Articles 23 A and 23 B (with spaces) to differentiate, in the view of the Subcommittee, the difference between a fully optional Article (12A) and two options for one Article to be found in one form or the other in all or nearly all tax treaties (Article 23 A or Article 23 B – without space).

A. General Considerations

1. Article 12A was added to the United Nations Model Convention in 2017 to allow a Contracting State to tax fees for certain technical services paid to a resident of the other Contracting State on a gross basis at a rate to be negotiated by the Contracting States. Under this Article, a Contracting State is entitled to tax fees for technical services if the fees are paid by a resident of that State or by a non-resident with a permanent establishment or fixed base in that State and the fees are borne by the permanent establishment or fixed base; it is not necessary for the technical services to be provided in that State. Fees for technical services are defined to mean payments for services of a managerial, technical or consultancy nature.
2. Until the addition of Article 12A, income from services derived by an enterprise of a Contracting State was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a permanent establishment in the other State (the source State) or provided professional or independent personal services through a fixed base in the source State. With the rapid changes in modern economies, particularly with respect to cross-border services, it is now possible for an enterprise resident in one State to be substantially involved in another State's economy without a permanent establishment or fixed base in that State and without any substantial physical presence in that State. In particular, with the advancements in means of communication and information technology, an enterprise of one Contracting State can provide substantial services to customers in the other Contracting State and therefore maintain a significant economic presence in that State without having any

fixed place of business in that State and without being present in that State for any substantial period. The OECD/G20 Base Erosion and Profit Shifting Project, Action 1: Final Report “Addressing the Tax Challenges of the Digital Economy” (2015) illustrates the difficulties faced by tax policy makers and tax administrations in dealing with the new digital business models made available through the digital economy. The Report did not recommend, for the time being, a withholding tax on digital transactions (which include digital cross border services); nor did it recommend a new nexus for taxation in the form of a significant economic presence test. However, it was recognized that countries were free to include such provisions in their tax treaties, among other additional safeguards against BEPS.

3. Before the introduction of Article 12A, countries were faced with more restrictive rules of application when technical services were provided cross border. In general, the rules under Article 7, together with Article 5, and Article 14 of the United Nations Model Convention give limited scope for taxing income from such services, in particular without a fixed base or permanent establishment in the State of source. As noted in these Commentaries, countries have different interpretations of those rules, which can make their application difficult for all parties.
4. Furthermore, under Article 12 of the United Nations Model Convention, fees for technical services paid by a resident of one Contracting State to a resident of the other Contracting State cannot generally be taxed as royalties by the State in which the payer is resident. However, some countries take the view that the expression “information concerning industrial, commercial or scientific experience” includes certain technical services, as noted in paragraph 5 below. Article 12 permits a Contracting State in which royalties arise to tax the gross amount of the royalty payments at a rate to be negotiated

between the Contracting States. Royalties are defined in Article 12, paragraph 3 to mean payments for the use of, or the right to use, any copyright, patent, trademark, design, plan, secret formula or process, any industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience. In other words, royalties are payments for the use of, or the right to use, intellectual property, equipment or know-how (information concerning industrial, commercial or scientific experience). Thus, royalties involve the transfer of the use of, or the right to use, property or know-how. In contrast, when an enterprise provides services to a customer, it does not typically transfer its property or know-how or experience to the customer; instead, the enterprise simply performs work for the customer. Under a so-called “mixed contract,” an enterprise may provide both services and the right to use property or know-how to a customer. In such situations, in accordance with paragraph 12 of the Commentary on Article 12 (quoting paragraph 11.6 of the Commentary on Article 12 of the OECD Model Convention), the payments under the contract must be disaggregated into separate elements of payments for services and royalties unless one element is only ancillary and largely unimportant. The negotiation of a rate of tax for fees for technical services under Article 12A that is the same as the rate for royalties in Article 12 may help to alleviate difficulties with mixed contracts, may be useful for developing countries with scarce administrative resources and may also reduce potential conflicts in applying the article.

5. In addition, countries have different interpretations of the meaning of the expression “information concerning industrial, commercial or scientific experience” in Article 12, paragraph 3 of the United Nations Model Convention (the same wording is contained in Article 12, paragraph 2 of the OECD Model Convention). Some countries take the position that the provision of brain-work and technical services is covered by this

phrase, and therefore payments for such services are in general taxable under Article 12. (See paragraphs 14 and 16 of the Commentary on Article 12.)

6. The uncertainty concerning the treatment of fees for technical and other similar services under the provisions of the United Nations Model Convention as it read before 2017 was undesirable for both taxpayers and tax authorities. It may also have resulted in difficult disputes, both for taxpayers and administrations, consuming scarce resources, as well as causing unrelieved double taxation or double non-taxation.
7. Fees for technical services may also result in the erosion of the tax base of countries that are prevented from taxing such fees by the provisions of the United Nations Model Convention. Fees for technical services are usually deductible against a country's tax base if the payer is a resident of the country or a non-resident with a permanent establishment or fixed base in the country. The reduction or erosion of a country's tax base by deductible fees for technical services is not generally objectionable. If the payer is an enterprise, the payments are legitimate expenses incurred by the payer for the purpose of earning income and should be deductible (assuming, of course, that the amount of the payments is reasonable). If the country is entitled to tax the non-resident service provider on the fees earned for the technical services, the reduction of the country's tax base by the deductible payments is offset by the country's tax on those fees.
8. Where technical services are provided by an enterprise of one Contracting State to an associated enterprise in the other Contracting State, there is the possibility that the payments may be more or less than the arm's length price of the services. Within a multinational group, fees for technical services may sometimes be used to shift profits from a profitable group company resident and operating in one country to another group

company resident in a low-tax country. Assume, for example, that Company B, an enterprise resident in Country B, a low-tax country, provides managerial, technical or consultancy services to Company A, an associated enterprise resident in Country A, a high-tax country. Assuming that the tax treaty between Country A and Country B contains provisions following those of the United Nations Model Convention, Company B can avoid having a permanent establishment in Country A by not establishing a fixed place of business in Country A and by not furnishing services in Country A for more than 183 days in any 12-month period. Thus, before the adoption of Article 12A, even if Company B was subject to tax on its income from services provided to Company A under the domestic tax law of Country A, the income would not have been taxable by Country A as a result of the tax treaty between Country A and Country B. If, for whatever reason, Company B is not taxable by Country B on that income, or is subject to a low rate of tax on such income, the multinational enterprise will have effectively shifted profits from a relatively high-tax country (Country A) to a relatively low-tax country (Country B).

9. In addition, ordinarily the fees paid by Company A to Company B for the services would be deductible by Company A in computing its income subject to tax by Country A. This deduction reduces the tax base of Country A and, before the adoption of Article 12A, Country A would not have been able to impose tax on the payments by Company A to Company B, as discussed in paragraph 8, to offset the effect of the deduction. However, under Article 12A, if the fees for technical services were paid by a resident of Country A or a non-resident of Country A with a permanent establishment or fixed base in Country A, Country A would be entitled to tax those fees.

10. The base erosion and profit shifting illustrated in the example above raise serious concerns for both developed and developing countries. However, the problem is especially serious from the perspective of developing countries, because they are disproportionately importers of technical services and often lack the administrative capacity to control or limit such base erosion and profit shifting through anti-avoidance rules in their domestic law and tax treaties.
11. The inability of countries to tax fees for technical services provided by non-resident service providers under the provisions of the United Nations Model Convention before the addition of Article 12A may have given non-resident service providers, in certain circumstances, a tax advantage over domestic service providers. Fees for technical services provided by domestic service providers are subject to domestic tax at the ordinary rate applicable to business profits. In contrast, as indicated above, non-resident service providers would not have been subject to any domestic tax if they did not have a permanent establishment or fixed base in that country, and they might have been subject only to low taxes (or no tax at all) on the fees earned in their country of residence.
12. As a result of these considerations, the United Nations Committee of Experts identified fees for technical services as a matter of priority to be dealt with as part of its larger project on the taxation of income from services under the United Nations Model Convention. After considerable study and debate, having due regard to all the arguments for and against the expansion of taxing rights with regards to services, the Committee decided to add a new article to the United Nations Model Convention expanding the taxing rights for States from which fees for technical services are paid.
13. The majority of the Committee of Experts rejected the position that a State should be entitled to tax income from services derived by a resident of the other Contracting State

only if the services are provided in the first State. In particular, the majority rejected the argument that the residence of a payer of fees for technical services in a Contracting State and the deduction of those fees against that State's tax base do not provide sufficient nexus to that State to justify that State taxing those fees. In the view of those members of the Committee, base erosion is a sufficient justification for the taxation of income from employment under Article 15 and directors' fees and remuneration of top-level managerial officials under Article 16. Although taxation of employment income under Article 15 is limited to employment exercised in a country, Article 16 allows a Contracting State to tax an individual resident in the other Contracting State on fees derived by the individual as a director or remuneration derived as a top-level managerial official of a company resident in the first State, irrespective of whether the services are rendered inside or outside the first State. Moreover, under Articles 7 and 14, a country is entitled to tax income derived outside the country as long as the income is attributable to a permanent establishment or fixed base in that country.

14. Article 12A may result in some non-resident service providers grossing up the cost of technical services provided to residents of a Contracting State. Countries should be aware of this possibility in the same way that they should be aware of the possibility of similar grossing up with respect to interest and royalties under Articles 11 and 12 respectively. The possibility that fees for technical services may be grossed up is a factor to be taken into account in this regard, along with many other factors. It is also a factor to be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for technical services under Article 12A, paragraph 2.
15. The taxation of fees for technical services on a gross basis under Article 12A may result in excessive or double taxation. However, the possibility that fees for technical services

may be subject to excessive or double taxation is reduced or eliminated under Article 23 (Methods for the Elimination of Double Taxation)]. In addition, the possibility of excessive or double taxation can be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for technical services under Article 12A, paragraph 2, and depending on the negotiated rate, the risk of an excessive tax may be completely eliminated.

16. Despite the inclusion of Article 12A in the United Nations Model Convention, a significant minority of the members of the Committee did not agree with the policy justifications set forth above for the Article. Fundamentally, these members did not agree with the justification set forth in paragraph 2 above that rapid changes in modern economies, particularly with respect to cross-border services, enable non-resident service providers to be substantially involved in another State's economy without a physical presence. Rather, these members were of the view that in cases of payments for technical services that are not provided in the payer's State, there is no nexus to that State that warrants taxation by that State on the payment.
17. In the view of these members of the Committee, as a policy matter, taxation of fees for technical services is warranted only when the service provider has a sufficient nexus to the payer's State, which typically is in the form of a permanent establishment or fixed base. In other words, to justify taxation of technical services in a State, the services should be provided in that State with the degree of nexus required by Articles 5 (Permanent Establishment), 7 (Business Profits) and 14 (Independent Personal Services).
18. The other argument advanced for the inclusion of Article 12A is that payments for services are deductible and hence erode the tax base of the payer's State. However, in

the view of the members opposed to Article 12A, mere deductibility of a commercially justified payment cannot be equated to harmful base erosion, and is therefore not a sufficient reason for taxing that payment in the same State.

19. Those members of the Committee that did not agree with the inclusion of Article 12A in bilateral tax treaties were also concerned that the term “technical services” as used in the Article is not adequately defined. These members were therefore concerned that the application of the Article would result in increased uncertainty, inconsistent treatment, and lengthy disputes between taxpayers and tax authorities.

20. In the view of those members of the Committee that did not agree with the inclusion of Article 12A, a further problem with taxation of fees for technical services on a gross basis is that it can lead to double taxation. The imposition of a tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection with the provision of the services, which would be deductible if tax were imposed on a net basis. Thus, it is possible that the residence State’s remedies for relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State.

21. As a matter of broader economic policy, those members that opposed the inclusion of Article 12A were concerned that, as a result of the Article, consumers of technical services in the source State may encounter higher prices for those services, because foreign service providers could pass added tax costs on to the consumer through means such as so-called “gross-up” clauses in contracts. Typically, a gross-up clause will specify a net amount that the provider will receive, effectively passing the burden of any withholding tax on to the consumer of the services. The use of gross-up clauses could result in the tax being shifted to the consumer and make it more expensive to

purchase the services. This can put a foreign service provider at a competitive disadvantage, effectively foreclosing access to a market that imposes such a withholding tax and restricting the consumer's legitimate choice of suppliers,

22. These members were also concerned that the inclusion of Article 12A would lead to trade distortions as the taxation of goods and services would operate on a different basis. The reason for this is that the profits of an exporter of goods are taxable only in its State of residence, whereas, under Article 12A, what is in effect an import tariff would be applied to technical services.
23. In summary, these members did not accept the analysis in paragraphs 2 to 15 above, and regarded any expanded taxing jurisdiction on fees for technical services as an unjustified shift of the balance of taxation from the place where services are provided to the place where services are consumed. Countries sharing these concerns may wish not to include Article 12A in their bilateral tax treaties.
24. Alternatively, countries, which wish to obtain additional taxing rights on fees for technical services, but are concerned with the broad scope of Article 12A, may consider agreeing to amend Article 12 (Royalties) to permit taxation of certain "fees for included services," an approach that is found in a number of bilateral tax treaties between developing and developed countries. The underlying policy rationale for this narrower approach is that, in order to justify taxation by the State from which the payment is made even in cases where the services are not performed in that State, fees for services must be directly related to the enjoyment of property for which a royalty as otherwise defined in Article 12 is paid. Wording for this narrower alternative approach is set forth in paragraphs 25 and 26 of the Commentary on Article 12.

25 However, a majority of the members of the Committee of Experts was of the view that the alternative referred to in paragraph 24 is not an acceptable alternative to Article 12A for developing countries because, in essence, those members considered that there is no principled justification for restricting the taxation of fees for technical services to services directly related to property producing royalties. Moreover, those members took the view that the alternative supported by a minority of the members of the Committee contains many vague terms of uncertain meaning, which may lead to frequent disputes about the interpretation of that provision.

26. Instead, countries concerned about the scope of Article 12A and the uncertainty associated with the definition of “fees for technical services” in Article 12A, paragraph 3 might consider an alternative version of Article 12A under which Article 12A would potentially apply to all fees for services (technical and other services) provided in a Contracting State, and also to fees for services provided outside that State by closely related persons, other than payments expressly excluded under paragraphs 3(a), (b), and (c). Under this alternative provision, paragraphs 1, 2, 4, and 7 of Article 12A would remain unchanged except that the term “fees for technical services” in those paragraphs would be replaced by the term “fees for services.” However, paragraphs 3, 5 and 6 would be replaced by the following paragraphs:

3. The term “fees for services” as used in this Article means any payment in consideration for any service, unless the payment is made:

(a) to an employee of the person making the payment;

(b) for teaching in an educational institution or for teaching by an educational institution; or

(c) by an individual for services for the personal use of an individual.

5. For the purposes of this Article, fees for services shall be deemed to arise in a Contracting State if:
 - (a) the services are performed in that State; or
 - (b) the payer is a resident of that State and the fees are paid to a closely related enterprise or person unless the payer carries on business in the other Contracting State or a third State through a permanent establishment situated in that State, or performs independent personal services through a fixed base situated in the other Contracting State or a third State and such fees are borne by that permanent establishment or fixed base; or
 - (c) the payer has in that State a permanent establishment or a fixed base in connection with which the obligation to pay the fees for services was incurred, and such fees are borne by such permanent establishment or fixed base, and are paid to a closely related enterprise or person.

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

interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise. For the purposes of this Article, an individual shall be a closely related person with respect to another individual if the individual is related to that other individual by blood relationship, marriage or adoption.

27. Under this alternative, a country would be entitled to impose tax under Article 12A, paragraph 2 up to the maximum agreed rate on fees for services paid by a resident of that country or by a non-resident with a permanent establishment or fixed base in that country to a resident of the other Contracting State if the fees for services arise in the first country. Fees for services would be deemed to arise in a country in accordance with paragraph 5 if:

1. the services are provided in that country, or
2. the services are provided outside that country by a person who is closely related to the payer of the fees.

Thus, this alternative provision would eliminate any disputes about whether the relevant services are within the definition of "fees for technical services" in Article 12A, paragraph 3 because it applies to all fees for services except those payments excluded by paragraphs 3 (a) to (c). Under this alternative provision, a Contracting State would not be entitled to tax fees for services paid to service providers resident in the other Contracting State that are not closely related to the payer for services performed outside the first State. In contrast, under Article 12A, fees for technical services paid to non-closely related service providers resident in the other Contracting State for services provided outside the first State would be taxable by the first State. However, under the alternative provision, a Contracting State would be entitled to tax fees for services

provided outside that State if the services are provided by persons closely related to the payer. In many cases, such closely-related party services present the most serious risk of eroding a country's tax base.

28. For purposes of the alternative provision, paragraph 6 provides rules for determining whether a person is closely related to an enterprise and whether an individual is closely related to another individual. The concept of a closely related person is to be distinguished from the concept of "associated enterprises" which is used for the purposes of Article 9; although the two concepts overlap to a certain extent, they are not intended to be equivalent.
29. A person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. This general rule would cover, for example, situations where a person or enterprise controls an enterprise by virtue of a special arrangement that allows that person to exercise rights that are similar to those that it would hold if it possessed directly or indirectly more than 50 per cent of the beneficial interests in the enterprise. As in most cases where the plural form is used, the reference to the "same persons or enterprises" at the end of the first sentence of paragraph 6 covers cases where there is only one such person or enterprise.
30. The second sentence of paragraph 6 provides that the definition of "person closely related to an enterprise" is automatically satisfied in certain circumstances. A person is considered to be closely related to an enterprise if either one possesses directly or indirectly more than 50 per cent of the beneficial interests in the other or if a third person possesses directly or indirectly more than 50 per cent of the beneficial interests in both the person and the enterprise. In the case of a company, this condition is satisfied where a person holds directly or indirectly more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company.
31. The final sentence of paragraph 6 provides that individuals are closely related if they are related by blood relationship, marriage or adoption. This rule is necessary for

situations where an individual pays for services (other than services for the personal use of an individual) provided by another individual who is not carrying on an enterprise. For this purpose, the terms “blood relationship,” “marriage” and “adoption” take their meaning from the domestic law of the country applying the treaty in accordance with paragraph 2 of Article 3.

32. Article 12A allows fees for technical services to be taxed by a Contracting State on a gross basis. Many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents. A withholding tax imposed on the gross amount of payments made by residents of a country, or non-residents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on non-residents. Such a method of taxation may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns.
33. Article 12A does not require any threshold, such as a permanent establishment, fixed base or minimum period of presence in a Contracting State as a condition for the taxation of fees for technical services. In this regard, Article 12A is significantly different from Article 7 and Article 14. However, in the case of technical services, modern methods for the delivery of services allow non-residents to perform substantial services for customers in the other country with little or no presence in that country. This ability to derive income from a country with little or no presence there, combined with concerns about the base-erosion and profit-shifting aspects of technical services, is considered by a majority of the members of the Committee to justify the absence of any threshold requirement as a condition for a country to tax fees for technical services.

34. Where fees for technical services are dealt with in both Article 12A and Article 7, paragraph 6 of Article 7 provides that the provisions of Article 12A prevail. However, this priority for Article 12A does not apply if the beneficial owner of the fees for technical services carries on business through a permanent establishment in the Contracting State in which the fees for technical services arise, and those services are effectively connected with the permanent establishment or business activities referred to in (c) of paragraph 1 of Article 7. In this situation, paragraph 4 of Article 12A provides that the provisions of Article 7 apply instead of Article 12A.
35. Similarly, where fees for technical services are dealt with in both Article 12A and Article 14, Article 12A, paragraph 2 indicates expressly that Article 12A applies notwithstanding the application of Article 14. However, this priority for Article 12A over Article 14 does not apply if the beneficial owner of the fees performs independent personal services in the Contracting State in which the fees for technical services arise through a fixed base situated in that State and the technical services are effectively connected with the fixed base. In this situation, Article 12A, paragraph 4 provides that the provisions of Article 14 apply instead of Article 12A.
36. There is no overlap between Article 12A and Articles 15, 18 and 19 dealing with income from employment, pensions and government services respectively because the definition of “fees for technical services” in Article 12A, paragraph 3 expressly excludes payments, including pension payments, to employees. Thus, for example, payments received by an employee from an employer resident in a country for employment services exercised outside that country would not be taxable by that country under Article 12A, paragraph 2 even if the payments are fees for technical services.
37. Since paragraph 2 of Article 12A is subject to the provisions of Articles 8

(Shipping, Inland Waterways Transport and Air Transport), 16 (Directors' Fees and Remuneration of Top-Level Managerial Officials) and 17 (Artistes and Sportspersons), Article 12A does not apply to fees for technical services to which the provisions of those Articles apply. In general, the taxing rights of a country under Article 8, 17 or 18 are unlimited, whereas the taxing rights under Article 12A, paragraph 2 are limited to the maximum percentage of the gross fees for technical services agreed to in that provision. The relationship between Article 12A, paragraph 2 and Articles 8, 17 and 18 is discussed further in the Commentary on paragraph 2.

B. Commentary on the Paragraphs of Article 12A

Paragraph 1

38. This paragraph establishes that fees for technical services arising in one Contracting State and paid to a resident of the other Contracting State may be taxed in the other Contracting State. It does not, however, provide that such fees are taxable exclusively by the State of residence.

39. In most cases, the person who provides technical services will receive fees for those services. If the person who receives the fees for technical services is not the person who provides those services, it is a matter of domestic law as to who is the proper taxpayer with respect to those fees. If fees for technical services are paid to a person, other than the person who provides the services, Article 12A applies to the fees as long as the recipient is a resident of the other Contracting State.

40. The expression "fees for technical services" is defined in paragraph 3 to mean any "payment" for managerial, technical or consulting services. The term "payment" has a

broad meaning consistent with the meaning of the related term “paid” in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the OECD Model Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the OECD Model Convention), the concept of payment means the fulfillment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

41. Article 12A deals only with fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to fees for technical services arising in a third State. Paragraph 5 and paragraph 6 specify when fees for technical services are deemed to arise in a Contracting State and deemed not to arise in a Contracting State, respectively. However, unlike Articles 10 and 11, which do not apply to dividends paid by a company resident in a third State or interest arising in a third State, Article 12A applies to fees for technical services paid by a resident of a Contracting State or a third State that are borne by a permanent establishment or fixed base that the resident has in the other Contracting State.

Paragraph 2

42. This paragraph lays down the principle that the Contracting State in which fees for technical services arise may tax those payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the fees is a resident of the other Contracting State, the amount of tax imposed by the State in which the fees for technical services arise may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the payments.

43. When considered in conjunction with Article 23 (Methods for the Elimination of Double Taxation), paragraph 2 establishes the primary right of the country in which fees for technical services arise to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the fees is a resident of the other Contracting State). Accordingly, the country in which the recipient of the fees is resident is obligated to prevent double taxation of those fees. Under Article 23 A or 23 B, the residence country is required to provide relief from double taxation through the exemption from tax of the fees for technical services or the granting of a credit against tax payable to the residence country on the fees for technical services for any tax imposed on those fees by the other Contracting State in accordance with Article 12A. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under Article 23 A, paragraph (2) with respect to items of income taxable under Article 10, 11, 12 or 12A.

44. The decision not to recommend a maximum rate of tax on fees for technical services is consistent with Articles 10, 11 and 12 of the United Nations Model Convention dealing with dividends, interest and royalties, respectively. This decision can be justified under current treaty practice. The withholding rates on fees for technical services adopted in bilateral tax treaties between developed and developing countries vary widely. Thus, the maximum rate of tax on fees for technical services is to be established through the bilateral negotiations of the Contracting States.

45. A precise level of withholding tax on fees for technical services should take into account several factors, including the following:

- the possibility that a high rate of withholding tax imposed by a country might cause non-resident service providers to pass on the cost of the tax to customers in the

country, which would mean that the country would increase its revenue at the expense of its own residents rather than the non-resident service providers;

- the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment;
- the possibility that some non-resident service providers may incur high costs in providing technical services, so that a high rate of withholding tax on the gross fees may result in an excessive effective tax rate on the net income derived from the services;
- the potential benefit of applying the same rate of withholding tax to both royalties under Article 12 and fees for technical services under Article 12A (see Example 6, paragraphs [99] and [100]).
- the fact that a reduction of the withholding rate has revenue and foreign-exchange consequences for the country imposing withholding tax; and
- the relative flows of fees for technical services (e.g., from developing to developed countries).

46. Paragraph 2 applies notwithstanding the provisions of Article 14. Under Article 14, income from the performance of professional or other independent personal services by a person who is a resident of a Contracting State is taxable by the other Contracting State only if the services are performed through a fixed base in the other Contracting State that is regularly available to the person or if the person stays in that State for 183 days or more in any twelve-month period commencing or ending in the relevant fiscal period.

47. Under paragraph 4, if a resident of one Contracting State performs independent personal services (that are technical services) in the other Contracting State through a fixed base that is regularly available to the resident and receives fees for technical services within the meaning of Article 12A, paragraph 3, Article 14 will apply to those payments in priority to Article 12A. However, if a resident of one Contracting State provides independent personal services (that are technical services) that arise in the other Contracting State, but those services are not provided through a fixed base in that other State, the fees for those services are taxable by that other State under Article 12A paragraph (2).

48. Paragraph 2 applies in priority to Article 7 as a result of Article 7, paragraph 6. Thus, the conditions for the taxation of the business profits of an enterprise under Article 7 do not apply to fees for technical services covered by paragraph 2. Fees for technical services are taxable by a Contracting State under paragraph 2 if the fees arise in that State irrespective of whether the enterprise providing the services has a permanent establishment in that State, provides services that are similar to those effected through the permanent establishment or provides the technical services in that State. However, by virtue of paragraph 4, if an enterprise of one Contracting State provides technical services through a permanent establishment in the other Contracting State and receives fees for those technical services within the meaning of paragraph 3, Article 7 will apply to those payments in priority to Article 12A, paragraph 2.

49. The application of paragraph 2 is expressly subject to the provisions of Article 8. Certain payments for international shipping, air transportation or inland waterways transport under Article 8 could be within the definition of “fees for technical services” in paragraph 3. This might be the case with respect to auxiliary activities that are

closely connected to the direct operation of ships and aircraft, as discussed in paragraph 11 of the Commentary on Article 8. To eliminate any uncertainty in this regard, paragraph 2 explicitly provides that in any situation in which both Article 12A and Article 8 apply to the same services, the provisions of Article 8 prevail. Thus, any fees for technical services that result from the operation of ships or aircraft in international traffic, or the operation of boats in inland waterways, in accordance with the terms of Article 8 are taxable exclusively in accordance with that Article.

50. Similarly, paragraph 2 is subject to the provisions of Article 16 dealing with directors' fees and the remuneration of top-level managerial officials. Therefore, under Article 16 where directors' fees or remuneration of top-level managerial officials are taxable by the Contracting State in which the company paying the fees or remuneration is resident, Article 12A cannot apply to the fees or remuneration because paragraph 2 is expressly subject to the provisions of Article 16. The taxing rights of a Contracting State under Article 16 are unlimited, whereas the taxing rights under Article 12A are limited to the maximum rate of tax agreed to in paragraph 2. If, however, the payments are outside the scope of Article 16 (because, for example, the payments are made with respect to services provided by the individual in a capacity, other than that of a director or top-level managerial official of the company, such as an independent contractor), the other State is entitled to tax the payments in accordance with paragraph 2.

51. Similarly, paragraph 2 is expressly subject to the provisions of Article 17 dealing with entertainment or sports activities. Although it may be unlikely that such activities would be within the definition of "fees for technical services" in paragraph 3, it is important to provide certainty in this regard. Therefore, if an overlap between the provisions of paragraph 2 and Article 17 does occur, Article 17 takes precedence over Article 12A.

If, however, an artiste or sportsperson resident in one Contracting State receives fees for technical services from a person resident in the other Contracting State and those fees are outside the scope of Article 17 (because, for example, although the fees are in consideration for personal activities as an artiste or sportsperson, those activities take place outside the country in which the payer is resident), the first Contracting State is entitled to tax the fees under paragraph 2.

52. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words “paid to a resident” as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over fees for technical services merely because those fees were paid directly to a resident of another State with which the first State had concluded a convention.
53. Since the term “beneficial owner” is included in paragraph 2 to address potential difficulties arising from the use of the words “paid to a resident” in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term “beneficial owner” is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries¹), rather, it should be understood in its context, in particular in relation to the words “paid to a resident”, and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

¹ For example, where the trustees of a discretionary trust do not distribute fees for technical services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such fees for the purposes of Article 12A even if they are not the beneficial owners under the relevant trust law.

54. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.
55. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"² concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.
56. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the fees for technical services is not the "beneficial owner" because that recipient's right to use and enjoy the fees is constrained by a contractual or legal obligation to pass on the fees received to another person. Such

² Reproduced at page R(6)-1 of Volume II of the full-length version of the OECD Model Tax Convention.

an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the fees by the direct recipient such as an obligation that is not dependent on the receipt of the fees and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of fees for technical services does have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person, the recipient is the “beneficial owner” of those fees.

57. The fact that the recipient of fees for technical services is considered to be the beneficial owner of those fees does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision. As explained in the section on “Improper use of the Convention” in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on fees for technical services to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

58. The above explanations concerning the meaning of “beneficial owner” make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments³ that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of “beneficial owner” cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e., individuals), cannot be reconciled with the express wording of Article 10, subparagraph 2(a), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12 and 12A, the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends, interest, royalties and fees for technical services rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement”.⁴

³ See, for example, Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, “*Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*” (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14): In this Report, “beneficial ownership” refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

⁴ See the Financial Action Task Force’s definition quoted in the previous note.

59. Subject to other conditions imposed by the Article, the limitation of tax in a State remains applicable when an intermediary, such as an agent or nominee located in the other Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State. The text of the United Nations Model Convention was amended in 2001 and 2017 (following amendments to the OECD Model Convention in 1995 and 2014) to clarify this point.

60. The paragraph lays down nothing about the mode of taxation in the State in which fees for technical services arise. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or individual assessment. As with other provisions of the United Nations Model Convention, procedural questions are not dealt with in the Article. Each State is able to apply the procedure provided in domestic law.

Paragraph 361. This paragraph specifies the meaning of the phrase “fees for technical services” for purposes of Article 12A. The definition of “fees for technical services” in paragraph 3 is exhaustive. “Fees for technical services” are limited to the payments described in paragraph 3; other payments for services are not included in the definition and are not dealt with in Article 12A. See the examples in paragraphs [87] to [103] below.

62. Article 12A applies only to fees for technical services, and not to all payments for services. Paragraph 3 defines “fees for technical services” as payments for managerial, technical or consultancy services. Given the ordinary meanings of the terms “managerial,” “technical” and “consultancy,” the fundamental concept underlying the definition of fees for technical services is that the services must involve the application by the service provider of specialized knowledge, skill or expertise on behalf of a client

or the transfer of knowledge, skill or expertise to the client, other than a transfer of information covered by the definition of “royalties” in Article 12, paragraph 3. Services of a routine nature that do not involve the application of such specialized knowledge, skill or expertise are not within the scope of Article 12A.

63. The ordinary meaning of the term “management” involves the application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Thus, if the management of all or a significant part of an enterprise is contracted out to persons other than the directors, officers or employees of the enterprise, payments made by the enterprise for those management services would be fees for technical services within the meaning of paragraph 3. Similarly, payments made to a consultant for advice related to the management of an enterprise (or of the business of an enterprise) would be fees for technical services.

64. The ordinary meaning of the term “technical” involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Therefore, fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering and dentistry would be fees for technical services within the meaning of paragraph 3. Thus, if an individual receives payments for professional services referred to in Article 14, paragraph 2 from a resident of a Contracting State, those payments would be fees for technical services. If the payments arise in that Contracting State because they are made by a resident of that State or borne by a permanent establishment or fixed base in that State, the payments would be subject to tax by that State in accordance with paragraph 2 irrespective of the fact that the services are not performed in that State through a fixed base in that State.

65. Technical services are not limited to the professional services referred to in Article 14, paragraph 2. Services performed by other professionals, such as pharmacists, and other occupations, such as scientists, academics, etc., may also constitute technical services if those services involve the provision of specialized knowledge, skill and expertise.
66. The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature. Professionals usually provide advice or services that fit within the general meaning of consultancy services although, as noted in paragraphs [63] and [64], they may also constitute management or technical services.
67. The terms "management," "technical" and "consultancy" do not have precise meanings and may overlap. Thus, for example, services of a technical nature may also be services of a consultancy nature and management services may also be considered to be services of a consultancy nature.
68. The definition of "fees for technical services" does not include a reference to the domestic law of a Contracting State. The lack of any reference to domestic law is justified because:
- a) the definition generally covers most types of services that are regarded as technical services under the domestic law of the countries that tax such services;
 - b) such a reference would introduce a large element of uncertainty;
 - c) future changes in a country's domestic law with respect to the taxation of fees for technical services could otherwise have an effect on the Convention; and
 - e) in the United Nations Model Convention, reference to domestic laws should be avoided as far as possible.

It would be inconsistent with the definition of “fees for technical services” for the meaning of terms used in the definition, especially the terms “management,” “technical” and “consultancy,” to be determined in accordance with the domestic law of the country applying the treaty under Article 3, paragraph 2.

69. As expressly provided in subparagraph 3(a), fees for technical services for purposes of Article 12A do not include payments of salary, wages or other remuneration to an employee of the payer. Where such payments are made by an employer resident in one Contracting State to an employee resident in the other Contracting State, they are covered by Article 15 or Article 19 (Government Service) of the Convention. In addition, since pensions arise in respect of prior employment, they are excluded from Article 12A and are dealt with by Article 18 (Pensions and Social Security Payments) even if the employment involved the provision of technical services to the employer.

70. As expressly provided in paragraph 3, the definition of fees for technical services does not include payments for teaching in an educational institution or teaching by an educational institution. Thus, if an educational institution established in one Contracting State pays for teaching services provided by an individual or an enterprise resident in the other Contracting State that are otherwise considered to be fees for technical services, the payments made by the educational institution for those teaching services are excluded from the definition of “fees for technical services” by subparagraph 3(b). Further, if an educational institution established in one Contracting State receives payments from an enterprise resident in the other Contracting State for teaching services provided by that institution to some of the enterprise’s employees, the payments received by the educational institution for those teaching services (to the extent that they would otherwise be considered to be fees for technical services) would

not be fees for technical services subject to Article 16 because of the specific exclusion in subparagraph 3(b). There is no definition of the term “educational institution” for purposes of subparagraph 3(b). Consequently, in accordance with Article 3, paragraph 2 of the Convention, the term would have its meaning under the law of the State applying the Convention. The meaning of the term would generally include universities, colleges and other post-secondary educational institutions. Countries in which the term “educational institution” has a very broad or unusual meaning may wish to clarify the meaning of the term in their treaties.

71. Some countries may be concerned that the exclusion in subparagraph 3(b) is excessively broad and uncertain and may be subject to abuse. These countries may wish to omit the exclusion in subparagraph 3(b) entirely or limit that exclusion to teaching services that are provided as part of a degree program offered by an educational institution. These countries are free to do so by adding the words “as part of a degree granting program” or similar words to subparagraph 3(b). In this case, payments received by an educational institution for teaching services of a managerial, technical or consultancy nature that are not part of a degree program would be fees for technical services within the meaning of paragraph 3.

72. As expressly provided in subparagraph 3(c), the definition of “fees for technical services” does not include payments by individuals for services for personal use. Such payments would not normally be deductible by those individuals for tax purposes, and therefore the payments would not cause any erosion of the tax base of the State in which the fees for technical services arise. Moreover, the imposition of withholding tax obligations on such payments by individuals under domestic law would be difficult to

enforce and might cause serious compliance problems for individuals utilizing technical services supplied remotely by non-residents.

73. The definition of “fees for technical services” in paragraph 3 does not exclude profits from international shipping, inland waterways transport and international air transport, income from entertainment and sports activities, and pensions and social security payments. However, such income (even if it is within the definition of “fees for technical services”) is not subject to tax by a country under paragraph 2 if it is taxable under Article 8 , 17 (Artistes and Sportspersons), or 18 (Pensions and Social Security Payments) as the case might be, because paragraph 2 is expressly subject to the provisions of Article 8, 17 and 18.

74. The treatment of reimbursements of expenses for purposes of the definition of “fees for technical services” in paragraph 3 poses special difficulties. As an initial matter, it is important to distinguish between an allowance for expenses and the reimbursement of expenses. An allowance is an amount usually established in advance for which the recipient of the allowance is not obligated to account; a *per diem* allowance for meals and accommodation is an example of a typical allowance. Since the recipient of an allowance does not have to account for the actual expenses incurred, any allowance received by a person for technical services is included within the meaning of “fees for technical services” under paragraph 3.

75. The reimbursement of expenses is different from an allowance because the person must account for the actual expenses incurred, and only those actual expenses qualify for reimbursement. The issue is whether payments received in reimbursement of actual expenses incurred in connection with the provision of technical services should be included in the definition of “fees for technical services”.

76. First, a person may be reimbursed for expenses incurred in connection with providing technical services, but may not receive any fee for those services. For example, an individual resident in one Contracting State might be invited to speak at a conference or participate in a meeting in the other Contracting State and might be reimbursed for his or her travel expenses, but not receive any fee. In these circumstances, it seems difficult to justify the application of withholding tax to the reimbursement. However, unless reimbursements are explicitly excluded from the definition of “fees for technical services”, paragraph 2 would permit the State in which the fees arise to impose withholding tax on the reimbursement at the rate specified in the treaty.
77. Second, a non-resident service provider may be paid a fee and separately reimbursed for all the expenses incurred in providing the services. In these circumstances, if reimbursements are excluded from the definition of fees for technical services, the tax imposed by the State in which the fees arise would be limited to the amount of the fee. On these facts, the fee represents the non-resident’s entire net profit from the performance of the technical services. However, the maximum limit on the tax imposed under paragraph 2 is based on the gross amount of the payments, and the rate of withholding tax specified in Article 12A may have been established on the assumption that the fees represent the non-resident’s gross revenue. As a result, if reimbursements are excluded from the definition of fees for technical services, the rate of withholding agreed to by the Contracting States may be too low. Moreover, the exclusion of reimbursements from the definition of fees for technical services might lead to abuses. For example, in order to reduce the source country’s withholding tax, non-resident service providers might receive payments labeled as reimbursements that are actually fees, or might be reimbursed for expenses for which they would not ordinarily be

reimbursed. Preventing these types of abuses would impose a significant administrative burden on the tax authorities.

78. Third, a non-resident service provider might not be reimbursed for any of the expenses incurred in providing the services. In this case, the amount of the payment received by the non-resident service provider will be greater than the amount of the service provider's net profit. The maximum rate of withholding tax in paragraph 2 may have been agreed to on the assumption that some of a non-resident's expenses would be reimbursed. On this assumption, the maximum rate of withholding tax may be established at a higher rate than it otherwise would be in order to approximate tax on the net profit. Therefore, if reimbursements are excluded from the definition of "fees for technical services", the rate established in the treaty might be too high for a non-resident service provider that receives no reimbursement for expenses.

79. The issues discussed in paragraphs 77 and 78 are illustrated in the example in paragraph 80, which shows that the effect of a gross-based withholding tax on fees for technical services depends, in part, on whether payments in reimbursement of expenses are subject to the withholding tax and the extent to which service providers are reimbursed for their expenses.

80. Example: X, a resident of Country A, is a management consultant, who provides advice to companies concerning best practices for corporate governance. X enters into a contract to provide services to B Co, a public company resident in Country B, for a period of 60 days for fees of 5,000 per day plus the reimbursement of reasonable expenses incurred in providing the services. X receives fees of 300,000 from B Co and a payment of 250,000 in reimbursement for expenses. Thus, in this situation, X's net profit from the services provided to B Co is 300,000. Assume that Country A and

Country B have entered into a tax treaty with a provision identical to Article 12A of the United Nations Model Convention which allows the imposition of withholding tax on fees for technical services at a maximum rate of 5 percent. On these facts, assuming that the payment in reimbursement for X's expenses is not considered to be fees for technical services, Country B would be entitled to impose tax of 15,000 of the fees received by X, which represents a relatively low tax rate of 5 percent on X's net profit. Alternatively, assuming that the payment in reimbursement of X's expenses is subject to withholding tax under Article 12A, Country B would be entitled to impose tax of 27,500, which represents a tax rate of over 9 percent on X's net profit. If X did not receive any reimbursement for his expenses, Country B's tax would be 15,000 representing a tax rate of 30 percent on X's net profit irrespective of whether payments in reimbursement of expenses are subject to withholding tax under Article 12A as fees for technical services.

81. It appears to be extremely difficult to predict to what extent, on average, non-resident service providers are reimbursed for their expenses. As a result, any single rule for the treatment of reimbursements will operate improperly in some situations. On the one hand, if reimbursements are excluded from the definition of "fees for technical services", the rate agreed to in the treaty might be too low where most or all of a non-resident's expenses are reimbursed, but too high where none of the expenses are reimbursed. Also, taxpayers might try to disguise part of their fees as reimbursements of expenses and it might be difficult for the tax authorities to detect such abuses. On the other hand, if reimbursements are not excluded, the rate agreed to in the treaty might be too high where a non-resident's expenses are reimbursed, but too low where they are not reimbursed.

82. As a result of the difficulties described in the foregoing paragraphs, the solution that has been adopted is to omit any reference to the reimbursement of expenses in the definition of “fees for technical services” in Article 12A, paragraph 3. However, countries are encouraged to deal with the problem in their domestic laws and to take the issue into account in establishing the maximum rate of tax under Article 12A, paragraph 2.
83. Although paragraph 3 defines the phrase “fees for technical services,” it does not provide a definition of the term “services.” Similarly, other articles of the United Nations Model Convention dealing with various types of services do not contain any definition of the term “services.” Neither Article 14, which deals with professional and other independent personal services, nor Article 19, which deals with services rendered to the government of a Contracting State, provides a definition of the term “services.” Similarly, the General Agreement on Trade in Services does not contain any definition of the term “services.”
84. Although the term “services” in the phrase “fees for technical services” is undefined in the context of Article 12A, the term “services” should be understood to have a broad meaning in accordance with ordinary usage to generally include activities carried on by one person for the benefit of another person in consideration for a fee. Such activities can be carried out in a wide variety of ways and the manner in which such services are provided does not alter their character for the purpose of Article 12A, to the extent that such services fall within the definition of “fees for technical services” in paragraph 3.
85. It is often necessary to distinguish between fees for services, including fees for technical services, and royalties in order to determine whether Article 12 or another Article of the Convention (Article 12A in the case of “fees for technical services”) is applicable. The distinction between fees for services and royalties is clear in principle.

Under Article 12, paragraph 3, royalties are payments for the use, or the right to use, certain types of property or information concerning industrial, commercial or scientific experience (so-called know-how). In contrast, the performance of services does not involve any transfer of the use of, or the right to use, property. However, in practice it is often difficult to distinguish between royalties and fees for services, including technical services, especially with respect to so-called mixed contracts. Guidance with respect to the distinction between fees for services and royalties is provided in paragraph 12 of the Commentary on Article 12 of the United Nations Model Convention, which reproduces paragraphs 11.2 – 11.6 of the Commentary on Article 12 of the OECD Model Convention. See also paragraphs [100] to [103] below.

86. The following examples illustrate the application of the definition of “fees for technical services” in paragraph 3.

87. Example 1: X is a resident of State R and a heart surgeon. X’s practice is carried on primarily in State R, although X occasionally travels to other countries to provide heart surgery. X provide surgery in State R on an individual resident in State S. The tax treaty between State R and State S contains a provision identical to Article 12A of the United Nations Model Convention. Although the payments made by the patient, a resident of State S, to X would be considered to be fees for technical services that arise in State S, they are explicitly excluded from the definition by subparagraph (c) of paragraph 3. As a result, the payments would not be taxable by State S in accordance with Article 12A, paragraph 2.

88. The result in Example 1 would be the same if X travelled to State S and provided the surgery in State S unless X provided the services through a fixed base regularly available to X in State S, in which case Article 14 would apply.

89. Example 2: X is a resident of State R and a heart surgeon. X's practice is carried on primarily in State R, although X occasionally travels to other countries to provide heart surgery. X enters into a contract with a health services corporation resident in State S under which X agrees to provide heart surgery on patients referred to him by the health services corporation. X is not an employee of the health services corporation. The surgeries are provided both in State S and in State R. The tax treaty between State R and State S contains a provision identical to Article 12A of the United Nations Model Convention. Under Article 12A, paragraph 3, the payments made by the health services corporation, a resident of State S, to X would be considered to be fees for technical services that arise in State S, irrespective of whether the surgery is provided in State S, State R or a third State. As a result, the payments would be taxable by State S in accordance with paragraph 2. If X were an employee of the health services corporation, the payments to X would be excluded from the definition of "fees for technical services" by subparagraph 3(a).

90. Example 3: R Company is a resident of State R. R Company's business is the collection, organization and maintenance of various databases. R Company sells access to these databases to its clients. One of R Company's clients is Company S, a resident of State S. State R and State S have entered into a tax treaty that contains a provision identical to Article 12A of the United Nations Model Convention. The payments that R Company receives from S Company for access to its databases would not be fees for technical services within the meaning of paragraph 3. Although R Company used its knowledge, skill and expertise in creating the database, the services that R Company provides to S Company – access to the database – are routine services that do not involve the application of R Company's knowledge, skill and expertise for the benefit of S Company. Accordingly, Article 12A would not apply to the payments.

91. If, however, S Company entered into a contract with R Company under which R Company created a specialized database customized for S Company's use from information supplied by S Company or collected by R Company, the payments by S Company to R Company would be "fees for technical services" under paragraph 3. In this situation, R Company would be applying its knowledge, skill and expertise for the benefit of S Company. As a result, the payments would be taxable by State S in accordance with paragraph 2. It would not matter whether R Company performed all or any part of the services of creating the database in State S.
92. Example 4: R Company, a resident of State R, is engaged in the insurance business in both State R and State S. R Company provides insurance against a wide variety of risks through standard form insurance contracts. State R and State S have a tax treaty that is the same as the United Nations Model Convention, including Articles 5, 7 and 12A. Article 12A would not apply because the insurance premiums received by R Company cannot be considered to be fees for technical services within the meaning of paragraph 3. Although R Company uses its knowledge, skill and expertise to develop its various insurance products that are sold to its clients, R Company is not applying its knowledge, skill and expertise directly for the benefit of each particular client.
93. In Example 4, if R Company writes customized insurance contracts dealing with special risks for some clients in State S, the insurance premiums derived by R Company may be considered to be fees for technical services within the meaning of paragraph 3. However, R Company would be deemed to have a permanent establishment in State S under Article 5, paragraph 6 to the extent that it collects premiums or insures risks in State S other than through an agent of independent status. Therefore, by virtue of paragraph 4, the income derived from R Company's insurance activities in State S

would be taxable by State S in accordance with Article 7, and Article 12A would not apply.

94. Example 5: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, credit and debit cards, payment and transmission services, bankers drafts, guarantees, foreign exchange, negotiable instruments, derivative products, investment research and advisory services. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty that is identical to the United Nations Model Convention, including Article 12A.

95. Whether the payments received for services provided by a financial institution constitute fees for technical services within the meaning of paragraph 3 depends on the nature of the particular services. Many services provided by financial institutions do not involve the application of any specialized knowledge, skill and expertise on behalf of a particular client. Instead, the financial institution uses its knowledge, skill and expertise to develop general products, services or practices that are made available to its clients routinely in consideration for fees. This would be the case, for example, with respect to payment and transmission services, banker's drafts, foreign exchange, debt and credit card services and negotiable instruments.

96. However, where a financial institution uses its knowledge, skill and expertise to provide research, analysis or advice to a specific client related to that client's particular circumstances, the payments received by the financial institution for those services could be fees for technical services within the meaning of paragraph 3. This would be the case, for example, if, in Example 5, R Company provides advice to S Company,

resident in State S, with respect to a potential merger or acquisition involving S Company. As a result, the payments for such advice would be fees for technical services taxable by State S in accordance with paragraph 2. If, however, R Company provides the services through a permanent establishment located in State S, the fees received for those services would be taxable by State S in accordance with Article 7 rather than Article 12A by virtue of paragraph 4 (see paragraph 93).

97. Example 6: S Company, an enterprise resident in State S, enters into a contractual arrangement with R Company, an enterprise resident in State R, for the right to use a patented chemical formula owned by R Company for the production of an industrial substance. The contract also requires R Company to use its specialized knowledge and expertise to assist S Company to produce the industrial substance in accordance with specifications set out in the contract. In particular, R Company will provide the following services for S Company:

- provide the production procedures and assist S Company in carrying out those procedures; and
- provide specifications concerning the necessary materials, tools, and containers used in the production process.

R Company also agrees to use its best efforts to ensure that S Company is able to produce the industrial substance in the quantities and with the characteristics that S Company expects. State S and State R have entered into a tax treaty with provisions identical to those of the United Nations Model Convention, including Article 12A.

98. In Example 6, the payments by S Company to R Company for the right to use the patented formula would be royalties within the meaning of Article 12, paragraph 3. However, the payments for the services provided by R Company to S Company would

not be royalties because R Company is not transferring its specialized knowledge, skill or experience to S Company. On the facts of Example 6, R Company is using its specialized knowledge, skill and experience on behalf of S Company and guaranteeing the result of S Company's use of the patented chemical formula. Consequently, the payments made by S Company to R Company for the services are fees for technical services within the meaning of paragraph 3 and State S would be entitled to impose tax on those fees under paragraph 2.

99. As noted in paragraphs 4 and 5 above, under the United Nations Model Convention as it read before 2017, it was difficult, but important, to determine if certain payments were royalties or fees for services. If the payments were royalties, they would have been taxable by the Contracting State in which they arose in accordance with Article 12 subject to the limitation on the rate of tax in paragraph 2 of Article 12. On the other hand, if the payments were fees for services, they would have been taxable by a Contracting State only if the service provider had a permanent establishment or fixed base in that State and the payments were attributable to that permanent establishment or fixed base in accordance with Article 7 or Article 14. Thus, the tax consequences varied significantly depending on whether payments were characterised as royalties or fees for services. The determination of the nature of payments as royalties or fees for services was especially difficult with respect to mixed contracts involving the transfer of the use of or the right to use information concerning industrial, commercial or scientific experience and the performance of services.

100. The addition of Article 12A to the United Nations Model Convention in 2017 has had the potential effect of reducing the significance of the distinction between royalties and fees for technical services if the limits on the rate of tax in paragraph 2 of Article 12 and

paragraph 2 of Article 12A are the same. If these rates of tax are the same, it will not matter whether payments under mixed contracts are considered to be royalties for the transfer of know-how or fees for technical services. However, if the maximum rates of tax in the two articles are different, it will be important to determine if a particular payment is a royalty taxable in accordance with Article 12, fees for technical services under Article 12A, or some other type of payment.

101. The following example illustrates the distinction between payments for the transfer of know-how and fees for technical services. The considerations to be taken into account in making this distinction are discussed in paragraph 12 of the Commentary on Article 12.

102. Example 7: S Company, an enterprise resident in Country S, enters into a contractual arrangement with R Company, an enterprise resident in Country R, to acquire the use of a secret formula or process developed by R Company. The contract requires R Company to provide the information to S Company subject to strict confidentiality conditions and to use its specialized knowledge and expertise to train employees of S Company with respect to the use of the secret formula or process. State R and State S have entered into a tax treaty with provisions identical to those of the United Nations Model Convention, including Articles 12 and 12A.

103. In Example 7 the payments made by S Company to R Company for the right to use the secret formula or process would be payments for “information concerning industrial, commercial or scientific experience” within the meaning of the definition of “royalty” in paragraph 3 of Article 12. This would be the case even if the information represents know-how that is not patented or otherwise protected by intellectual property laws. Similarly, the payments made by S Company to R Company for the training of S Company’s employees would also be payments for “information concerning industrial,

commercial or scientific experience” within the meaning of the definition of “royalty” in paragraph 3 of Article 12 since the training is necessary to transfer R Company’s know-how to S Company. Therefore, irrespective of whether the payments for the training are provided for separately from the payments for the secret formula or process or whether the contract provides for a single payment for both, the payments for the training would be considered royalties under Article 12 rather than fees for technical services under Article 12A. However, if the training provided by R Company was not necessary to transfer the secret formula or process to S Company and S Company could obtain such training from other sources, the training would not be considered to be a transfer of know-how and the payments for the services would be considered fees for technical services assuming that they fit within the definition of “fees for technical services” in paragraph 3 of Article 12A.

Paragraph 4

104. This paragraph provides that paragraphs 1 and 2 do not apply to fees for technical services if the person who provides the services has a permanent establishment or fixed base in the State in which the fees arise and the fees are effectively connected with that permanent establishment or fixed base. In this regard, paragraph 4 is similar to Article 10, paragraph 4, Article 11, paragraph 4 and Article 12, paragraph 4. Thus, if a resident of one Contracting State provides technical services through a permanent establishment or fixed base located in the other Contracting State, the fees received for those services will be taxable by the State in which the permanent establishment or fixed base is located in accordance with Article 7 or Article 14, rather than in accordance with Article 12A.

105. Since Article 7 of the United Nations Model Convention adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 4 also makes paragraphs 1 and 2 inapplicable if the fees for technical services are effectively connected with business activities in the State in which the fees arise that are of the same or similar kind as those effected through the permanent establishment.

106. The paragraph does not define the meaning of the expression “effectively connected.” As a result, whether fees for technical services are effectively connected with a permanent establishment, fixed base or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, fees for technical services would be considered to be effectively connected with a permanent establishment or fixed base if the technical services are closely related to or connected with the permanent establishment or fixed base or if the business activities are similar to those carried out through the permanent establishment. This will be the case where the remuneration paid to the person providing the services is borne by the permanent establishment or fixed base in the State in which the fees arise.

107. Where paragraph 4 applies, fees for technical services are taxable by the State in which the fees arise as part of the profits attributable to the permanent establishment in accordance with Article 7 or the income attributable to the fixed base in accordance with Article 14. Thus, paragraph 4 relieves the State in which the fees for technical services arise from the limitations on its taxing rights imposed by Article 12A. Where Article 7 applies as a result of the application of paragraph 4, most countries consider that the State in which the permanent establishment is located is allowed to tax only the

net profits from the technical services attributable to the permanent establishment. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis, but a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Nondiscrimination). Similarly, where Article 14 applies, most countries consider that the State in which the fixed base is located is allowed to tax only the net income derived from the technical services. However, it may be useful for countries to clarify these issues during the negotiation of the treaty (see paragraphs 9 and 10 of the Commentary on Article 14).

Paragraphs 5 and 6

108. Paragraph 5 lays down the principle that the State in which fees for technical services arise for purposes of Article 12A is the State of which the payer of the fees is a resident or the State in which the payer has a permanent establishment or fixed base if the fees for technical services are borne by the permanent establishment or fixed base. It is not necessary for the services to be provided in the Contracting State in which the payer is resident or has a permanent establishment or fixed base. Whether a person is a resident of a Contracting State for purposes of Article 12A is determined in accordance with the provisions of Article 4 of the Convention.

109. Where there is an obvious economic link between technical services being provided and the permanent establishment or fixed base of the payer to which the services are provided, the fees for technical services are considered to arise in the State in which the permanent establishment or fixed base is situated. This result applies irrespective of the

residence of the owner of the permanent establishment or fixed base, even where the owner resides in a third State.

110. Where there is no economic link between the technical services and the permanent establishment or fixed base, the payments for technical services are considered to arise in the Contracting State in which the payer is resident. If the payer of fees for technical services is not a resident of a Contracting State, Article 12A does not apply to the fees for technical services unless the payer has a permanent establishment or fixed base in the Contracting State and there is a clear economic link between the technical services and the permanent establishment or fixed base. Otherwise there would be, in effect, a force-of-attraction principle for fees for technical services, which would be inconsistent with other provisions of the United Nations Model Convention.

111. Paragraph 5 is subject to paragraph 6, which provides an exception to the source rule in paragraph 5. Paragraph 6 deems fees for technical services made by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State or performs independent personal services through a fixed base in the other Contracting State or in a third State and the fees for technical services are borne by that permanent establishment or fixed base. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for technical services under paragraph 2.

112. The phrase “borne by” must be interpreted in the light of the underlying purpose of paragraphs 5 and 6, which is to provide source rules for fees for technical services. A Contracting State is entitled to tax fees for technical services under paragraph 2 only if the fees arise in that State. The basic source rule in paragraph 5 is that fees for technical

services arise in a Contracting State if the payer is a resident of that State or the payer has a permanent establishment or fixed base in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. However, the basic rule is limited by the deeming rule in paragraph 6 where the payer is a resident of a Contracting State but the fees for technical services are borne by a permanent establishment or fixed base that the payer has in the other Contracting State.

113. Where fees for technical services are incurred for the purpose of a business carried on through a permanent establishment or for the purpose of independent personal services performed through a fixed base, those fees will usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7 or the income attributable to the fixed base under Article 14. The deductibility of the fees for technical services provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment or fixed base is situated.

114. The fact that the payer has, or has not, actually claimed a deduction for the fees for technical services in computing the profits of the permanent establishment or the income of the fixed base is not necessarily conclusive, since the proper test is whether any deduction available for those fees should be taken into account in determining the profits attributable to the permanent establishment or the income attributable to the fixed base. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment or fixed base being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the fees for technical services are not

deductible for some reason other than the fact that the fees for technical services should not be allocated to the permanent establishment or fixed base.

115. The application of paragraphs 5 and 6 can be illustrated by the following examples.

116. Example 8: R Enterprise is carried on by a resident of State R. R Enterprise provides technical services to S Company, a resident of State S. The tax treaty between State R and State S is identical to the United Nations Model Convention, including Article 12A. S Company carries on business in State S and in State R (or a third State) through a permanent establishment situated there. However, the technical services provided by R Enterprise to S Company are related to S Company's business carried on in State S, not to the business carried on through the permanent establishment in State R (or a third State).

117. In Example 8, since the payments are made by S Company, a resident of State S, and are not borne by a permanent establishment of S Company in State R, the fees for technical services would be considered to arise in State S in accordance with paragraph 5. Therefore, State S would be entitled to tax the fees for technical services under paragraph 2.

118. Example 9: The facts are the same as in Example 8, except that the fees for technical services are borne by S Company's permanent establishment in State R.

119. In Example 9, since the fees for technical services are borne by a permanent establishment of S Company situated in State R, paragraph 6 applies to deem the fees for technical services not to arise in State S. Consequently, the fees for technical services are not taxable by State S under paragraph 2 but are taxable exclusively by State R under paragraph 1 of Article 12A.

120. In Example 9, Article 12A of the Convention denies State S the right to tax the fees for technical services despite the fact that the fees are paid by a resident of State S. This result is justified because the fees relate to a business carried on by a resident of State S in State R. In such a situation, where fees for technical services are deductible in computing the profits of a business attributable to a permanent establishment situated in the other Contracting State or in computing the income from independent personal services furnished through a fixed base situated in the other Contracting State, those payments have a closer economic connection to the activities carried on in that other State than to State S.

121. Example 10: T Enterprise is carried on by a resident of State T. T Enterprise carries on business through a permanent establishment situated in State S or provides independent personal services through a fixed base situated in State S. T Enterprise pays R Company, a resident of State R, for technical services provided by R Company for T Enterprise in connection with its income-earning activities carried on in State S. The payments made by T Enterprise to R Company for the technical services are deductible in computing the profits attributable to the permanent establishment of T Enterprise in State S or the income attributable to the fixed base of T Enterprise in State S. The tax treaty between State S and State T is identical to the United Nations Model Convention including Article 12A.

122. In Example 10, although the fees for technical services are not paid by a resident of State S, the fees are borne by the permanent establishment or fixed base that T Enterprise has in State S. In these circumstances, the fees for technical services have a close economic connection to the income-earning activities of T Enterprise carried on in

State S. Thus, the fees are deemed to arise in State S in accordance with paragraph 5 and State S is entitled to tax the payments in accordance with paragraph 2.

123. In the case of interest and royalties, paragraph 21 of the Commentary on Article 11 and paragraph 19 of the Commentary on Article 12 of the United Nations Model Convention indicate that countries might substitute a rule that would identify the source of interest or royalties as the State in which the loan giving rise to the interest or the property or right giving rise to the royalties was used. A similar source rule might be substituted for purposes of Article 12A. Similarly, as suggested in the Commentary on Articles 11 and 12, where, in bilateral negotiations, the parties differ on the appropriate rule, a possible solution would be a rule that, in general, would accept the payer's place of residence as the source of fees for technical services, but where the technical services are used or consumed in a State having a place-of-use rule, the payment would be deemed to arise in that State.

124. Various other alternative source rules for fees for technical services are possible. Such alternatives include the following:

- The Contracting States might decide not to include paragraph 6. If paragraph 6 were omitted from Article 12A, fees for technical services would be considered to arise in the State in which the payer is resident, even where those fees are incurred for purposes of a permanent establishment or fixed base of the payer situated outside the payer's State of residence.
- The Contracting States might decide not to include paragraph 6 and to revise paragraph 5 so that fees for technical services could be considered to arise in a Contracting State only if the payer is a resident of that State and the technical

services are used or consumed by the payer in that State; or if the payer is not a resident of a Contracting State, the payer has a permanent establishment or fixed base situated in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In this case, technical services used or consumed by a resident of a Contracting State outside that State would not be considered to arise in that State, and that State would not be entitled to tax fees for such services under Article 12A. Paragraph 6 would be unnecessary because technical services used or consumed outside a Contracting State would include any technical services incurred for the purposes of a resident's permanent establishment or fixed base situated outside that State.

- Fees for technical services could be considered to arise in a Contracting State only if the payer is a resident of that State and the technical services are provided in that State or if the payer, not being a resident of a Contracting State, has a permanent establishment or fixed base situated in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In this case, a Contracting State would be entitled to tax fees for technical services paid by its residents to residents of the other Contracting State if the technical services are provided in the State. In this situation, paragraph 6 would be unnecessary.

125. Paragraph 6 provides no solution for the case where the beneficiary and the payer are residents of the Contracting States, but the fees for technical services were incurred for the benefit of a permanent establishment or fixed base owned by the payer in a third State and the fees for technical services are borne by that permanent establishment or fixed base. In such a case, the fees for technical services are deemed to arise in the Contracting State of which the payer is a resident under paragraph 5 and not in the third State in which the

permanent establishment or fixed base is situated. Thus, the fees for technical services will be taxed both in the Contracting State of which the payer is a resident and in the Contracting State of which the beneficiary is a resident. Although double taxation will be avoided between these two States, it will not be avoided between them and the third State if the third State taxes the fees for technical services because they are borne by the permanent establishment or fixed base in its territory. Paragraph 6 is consistent in this regard with paragraph 5 of Article 11 and paragraph 5 of Article 12.

126. As explained in paragraph 21 of the Commentary on Article 11 (quoting paragraphs 29 and 30 of the Commentary on Article 11 of the OECD Model Convention), if the third State did not subject the fees for technical services to tax, there could be attempts to avoid taxation in the Contracting State of which the payer is a resident through the use of a permanent establishment or fixed base situated in such a third State. States for which this is not a concern and that wish to address the issue described in paragraph __ above may do so by agreeing, in their bilateral convention, to the alternative formulation of paragraph 6 suggested in paragraph 127 below.

127. As mentioned in paragraph 126, the State of which the beneficiary is a resident and the State of which the payer of fees for technical services is a resident may avoid the double taxation described in paragraph 125 above by agreeing to the following wording of paragraph 6:

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

personal services through a fixed base situated in that other State or the third State and such fees are borne by that permanent establishment or fixed base.

This wording would have the effect of ensuring that paragraphs 1 and 2 would not apply to the fees for technical services because they would not arise in a Contracting State. As a result, such fees for technical services would typically fall under Article 7 or 14.

Paragraph 7

128. The purpose of paragraph 7 is to restrict the operation of the provisions concerning the taxation of fees for technical services in cases where, by reason of a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person, the amount of the fees paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length. Paragraph 7 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the fees for technical services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

129. It is clear from the text that in order for this paragraph to apply the fees for technical services held to be excessive must be due to a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person. There may be cited as examples of such a special relationship cases where fees for technical services are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the individual or is subordinate to a group

having common interest with the individual. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

130. On the other hand, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationships giving rise to the fees for technical services.

131. With regard to the taxation treatment to be applied to the excess part of the fees for technical services, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike Article 11, paragraph 6, which, because of the limiting phrase “having regard to the debt-claim for which it is paid,” permits only the adjustment of the rate at which interest is charged, paragraph 7 permits the reclassification of the fees for technical services in such a way as to give them a different character. This paragraph can affect not only the recipient of the fees, but also the payer of excessive fees for technical services; if the law of the State where the payer is resident or has a permanent establishment or a fixed base permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the fees for technical services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 7, as long as they do not alter its general purport.

132. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of

fees for technical services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.