

Taxation of Services under Tax Treaties

International Tax Cooperation for Financing of Sustainable Development and the Role of the United Nations Model Double Taxation Convention between Developed and Developing Countries

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Services

- Cross-border trade in services now exceeds trade in goods
- Wide variety of domestic law tax treatments of income from services
 - No consistent approach to classification, source, nexus or method of taxation
- Different treaty approaches to source taxation of income from services

Treaty issues

Model conventions deal with services in various articles:

- **Article 7:** Business profits (read in conjunction with Article 5)
- **Article 8:** Shipping, inland waterways transport and air transport
- **Article 12:** Royalties (sometimes dealing also with fees for technical services)
- **Article 14:** Independent personal services (now deleted from the OECD Model)
- **Article 17:** Artistes and sportsmen

Services – classification issues

- ‘Services’ not defined in treaties
- OECD Commentary on Article 12 distinguishes between services and royalties
 - Some countries have broader interpretation of royalties, especially supply of know-how

Services – classification issues

- **Technical Services**
 - Some treaties include a provision for fees for *technical services* under the Royalties Article or similar stand-alone article
 - There have been a number of disputes regarding what exactly constitutes technical services for the purposes of this type of provision
 - Can be a fine line between fees for technical services, technical assistance, royalties, and the general provision of services falling under Article 7

Services – classification issues

- Many treaties include separate articles dealing with *independent personal services* (based on former Article 14 of the OECD Model or current Article 14 of the UN Model)
 - Article 14 was removed from the OECD Model because no *relevant* distinction between carrying on a profession and a business

Services – Treaty nexus

3 main approaches:

1. No special rules - Article 7 applies (OECD Model approach)
 - treated as business profits, fixed place of business threshold
 - net taxation of attributable profits

Services – Treaty nexus

3 main approaches:

2. Additional time threshold - Article 7 or Article 14 applies (UN Model approach)
 - deemed Service PE, net taxation of attributable profit
 - Art 14 - fixed base or >183 days

Services – Treaty nexus

3 main approaches:

3. Withholding tax - Article 12 or separate article applies (royalty approach)
 - usually only applies to income from technical services or technical assistance
 - interpretation 'supply of know-how', or extensions to royalties definition, or separate article
 - source rule based on residence of payer or place where PE is situated

Services – UN Model – Art. 5(3)(b)

- UN Model services PE clause creates a deemed PE if services are rendered beyond a certain time limit

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

- The territorial requirement depends on the interpretation of the term “activities ... within”
- Same or connected project requirement

Services - OECD-Alternative Services PE

- The OECD Commentary now provides for a services PE alternative (para 42.11 to 42.47 of the commentary to Article 5). There are two main conditions:
 - Services must be performed in the source state
 - Minimum time period in the source state
- Services must be rendered to a third party, not to the enterprise itself
- Would apply irrespective of application of Art. 5(1), (2) or (3)

Services - OECD-Alternative Services PE

“... an enterprise that performs services in the other Contracting State, for a period or periods exceeding in the aggregate 183 days in any twelve month period,

and these services are performed through one or more individuals who are present and performing such services in that other State.”

Services – UN work

- The Committee of Experts on International Cooperation in Tax Matters
- Work on the 2011 UN Model update
- The Subcommittee on Article 5 - Permanent Establishments
- Deletion of Article 14?

Services – UN work

- The discussion on scope of Article 14
- Paragraph 9 of the Commentaries to article 14:
 - *“Payments to an enterprise in respect of the furnishing by that enterprise of the activities of employees or other personnel are subject to Articles 5 and 7.”*
- New paragraph 11 of the Commentaries to article 14

Services – UN work

- US Tax Treaty Model (1996):

Article 14

1. *Income derived by an individual who is a resident of a Contracting State in respect of the performance of personal services of an independent character shall be taxable only in that State.*

Services – UN work

- UN Model interpretation (paragraph 23 of the Introduction)

“... Additionally, in some cases, the views reflected in the Commentaries relate to discussions held by the former Group of Experts ...”

Services – UN work

- Further work by the UN Committee (paragraph 17 of the Introduction)
- *“... The Committee also identified treaty policy issues that require further work and it mandated one Subcommittee to address the issues of the taxation treatment of services in general and in a broad way including all related aspects and issues. Furthermore, the issue of taxation of fees for technical services should also be addressed. The work programme of the Committee, including that on services, will be made available as it develops on the Committee’s website.”*

Services – UN work

- Study of the treatment of services approved by committee of experts in 2009
- Preparation of proposals for treatment of fees for technical services approved in 2011
- Work carried out by subcommittee on services

Services – UN work

**Note prepared for October 2012 meeting notes 9
options for dealing with technical services**

Selected: Addition of a new Provision/Article dealing
with technical services

THANK YOU
MUCHAS GRACIAS

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