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FOLLOW UP NOTE ON TAXATION OF FEES FOR TECHNICAL SERVICES AND COMMENTS ON THAT NOTE

Summary

The note contained in Annex 1 to this note has been prepared by Professor Brian J. Arnold at the request of the Secretariat, acting on behalf of the Subcommittee on Services. The Subcommittee was mandated by the Committee of Experts on International Cooperation in Tax Matters (the Committee) at its seventh session, in 2011, as follows:

> It was agreed that the Committee would start with work on "fees for technical assistance" with a view to achieving concrete results for the next annual session, but it would also have a longer-term plan of work with a view to a comprehensive review of services issues for the United Nations Model Convention.

The note is a follow up to note E/C.18/2012/4 on fees for technical services and explores option IV.H in that paper[1], the option of adding a new article and commentary dealing expressly with the taxation of income from technical and other services and explores that option in more detail. The short notes at Annexes 2 and 3 are comments by, respectively, Anita Kapur and Claudine Devillet on the Annex 1 note. Both are Members of the Committee as well as the Subcommittee on Services, and their comments are provided to assist the Committee in its deliberations.

[1] Option IV.H was identified as 4.8 in the version circulated within the Subcommittee – references have been updated in the Annexes to this note.

ANNEX 1: FOLLOW-UP NOTE BY PROFESSOR BRIAN J ARNOLD

Follow-up Note on the Taxation of Fees for Technical and other Services under the United Nations Model Convention

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1. INTRODUCTION

1.1 This note is a follow-up to a note ("2012 Supplementary Note")[2] prepared by Brian J. Arnold for the Subcommittee on Services of the United Nations Committee of Experts on International Cooperation in Tax Matters ("the Committee"). That note was a supplement to two 2010 notes[3] dealing with the tax treatment of income from services generally under the UN Model; it identified several options for dealing with income from technical and other similar services in the UN Model.

1.2 The comments received from the members of the Subcommittee indicated most support for option [IV.H], the addition to the UN Model of a new Article and Commentary dealing with the taxation of income from technical and other services.

1.3 The purpose of this note is to explore the issues involved in adding a new Article and Commentary dealing with technical and other similar services to the UN Model. The note discusses the broad outlines of a new Article and the difficult issues it would be necessary to deal with. Although a draft Article and draft Commentary are premature at this point, some draft wording showing the structure of a new Article is provided in the Appendix.

1.4 This note should not be construed as a recommendation that option [IV.H] of the 2012 Supplementary Note is the preferred option. This note is simply intended to provide additional information concerning one of the options that at this stage most members of the Subcommittee considered to be worth exploring further in order to facilitate a comprehensive discussion of the topic of the treatment of income from technical services by the Committee. It is anticipated that some of the other options identified in the 2012 Supplementary Note will also be explored further in future notes.

[2] E/C.18/2012/4, available at http://www.un.org/esa/ffd/tax/eighthsession/index.htm.

[3] E/C.18/2010/CRP.7 and E/C.18/2010/CRP.7/Add.1, both available at http://www.un.org/esa/ffd/tax/sixthsession/index.htm.

1.5 This note does not describe the existing provisions of the UN Model dealing with income from services or the special problems posed by fees for technical and similar services. Those background items are dealt with in the 2012 Supplementary Note.

2. DESIGNING A NEW ARTICLE FOR INCOME FROM TECHNICAL SERVICES

2.1 Any new Article dealing with income from technical services should conform to the format and structure of the existing articles of the UN Model. Thus, it should provide that income from services derived by a resident of a Contracting State "shall be taxable only in that country" unless or except if certain conditions are met. If those conditions are met, the income would also be taxable by the source country.

2.2 The new Article should clearly apply to income from technical and other similar services derived by both individuals and enterprises. Consideration must be given to whether separate wording is necessary to deal with individuals and enterprises in this regard, as is done in the OECD alternative services PE provision.

2.3 The new Article must set out the conditions for source-country taxation of income from technical services as clearly as possible. In general conceptual terms, the possible conditions for source-country taxation relate to the following factors:

- a threshold requirement
- the source of the income
- the type of services rendered
- the amount of income derived
- the payer
- in the case of an enterprise, who provides the services

Each of these conditions is discussed below.

2.4 Threshold requirement

2.4.1 The general threshold requirements for source-country taxation of income from services under the existing provisions of the UN Model are the existence of a PE (Article 7) and the existence of a fixed base (Article 14) in the source country, both of which are supplemented by a 183-day physical presence test (working days in the case of Article 5(3)(b) and days of presence in the case of Article 14(1)(b)). Therefore, the threshold requirement in a new Article dealing with technical services must be a lower threshold; otherwise, a new Article is probably unnecessary.

2.4.2 The range of possibilities for a lower threshold include:

- services performed in the source country – Thus, the source of the income from services would be the threshold in the same way as it is under Article 17 dealing with income derived by artistes and sportspersons.

- services performed in the source country for a certain number of days (less than 183 days) – In effect, this option would adopt the threshold in existing Article 5(3)(b) but lower it from 183 days to, say, 90 days for technical and other similar services.

- physical presence in the source country for a certain number of days (less than 183 days) – In effect, this option would adopt the threshold in existing Article 14(1)(b) but lower it from 183 days to, say, 90 days for technical and other similar services.

2.5 Source of income

2.5.1 Under the existing provisions of the UN Model, income from services is generally considered to have its source, arise, or be derived from the country in which the services are performed. Thus, the source country is entitled to tax:

- under Article 5(1)(b) only if "the activities … continue … within a Contracting State";

- under Article 14(1), "only so much of the income as is derived from his activities performed" in the source country;

- under Article 17, income "from his personal activities as such [artiste or sportsperson] exercised in the source country";

- under Article 15, income from employment only if "the employment is exercised" in the source country.

2.5.2 There are some narrow exceptions to the rule that income from services is sourced in the country in which the services are performed. For example, under Article 16 directors' fees and remuneration of top-level managerial officials is sourced in the country in which the company paying the fees or remuneration is resident. Similarly, under Article 19(1) remuneration paid by a country to an individual for services rendered to the country are taxable only by that country irrespective of where the services are performed.

2.5.3 Based on paragraph 2 of the Commentary on Article 14, it would appear that the members of the Committee accept that, with respect to income from services generally, the income must be sourced in or derived from activities taking place in the source country. Thus, under the existing UN Model, the source country is generally not entitled to tax income from services where the services are performed outside the source country but are paid for by a resident of the source country. However, some countries have agreed to articles on technical services in their treaties that give the country in which the payer is resident the right to tax the payments irrespective of where the technical services are rendered. This aspect of the source of income from services is a critical issue with respect to the treatment of income from technical and other similar services. If agreement cannot be reached on this issue, it is difficult to see how agreement could possibly be reached on a new Article dealing with technical services.

2.6 The definition of technical and other similar services

2.6.1 The biggest single difficulty with adding a new Article and Commentary dealing with source country taxation of income from technical and other similar services is defining the types of services to be covered by the article. There are various possibilities in this regard:

1) refer to "technical, managerial and consulting services" (or some similar wording) but leave the terms undefined in the Article. Some elaboration of the meaning of "technical, managerial and consulting services" could be provided in the Commentary in order to give some guidance for taxpayers and tax authorities. This type of approach is occasionally used in both the UN Model and the OECD Model (e.g., the concept of employment for purposes of Article 15).

   The problem with this approach is that it will likely be difficult to agree, even in general terms and with the use of examples, on Commentary that provides useful guidance to taxpayers and tax officials. If such guidance is not provided in the Commentary, the meaning of the phrase "technical, managerial and consulting services" would be determined initially by the tax authorities of the source country and then by the courts of the source country. Because of the uncertainty, conflicts between taxpayers and the tax authorities seem inevitable. In addition, conflicts between the tax authorities of the two contracting states on this issue are likely to lead to unrelieved double taxation contrary to one of the fundamental purposes of the UN Model.

   In the absence of any guidance in the Commentary, the terms "technical, managerial and consulting" might be given their meaning under domestic law, subject to the context of the treaty requiring otherwise, in accordance with Article 3(2). It is questionable whether the use of domestic law meaning is appropriate for purposes of the treaty in these circumstances. Many countries treat all income from services in the same way so they have no meaning for technical, managerial and consultancy services in their domestic law.[4] Other countries have broad definitions of technical services in their domestic law. For example, under the domestic law of Brazil, technical services are defined as "work, endeavor, or undertaking of which the execution depends on specialized technical knowledge by its provider."[5] However, since administrative services provided by nonresidents are subject to Brazilian withholding tax in the same way as technical services "most of the services provided by nonresidents qualify as either technical or administrative assistance services" according to the Brazilian tax authorities.[6] Under its tax treaties, Brazil takes the position that technical and administrative services that do not involve the transfer of technology are taxable in accordance with Article 21 as other income. This position is the subject of ongoing litigation in Brazil.

Alternatively, the terms might be given their ordinary meaning in accordance with Article 31(1) of the Vienna Convention on the Law of Treaties. The difficulty is that the ordinary meaning of "technical" is very broad and could encompass all services. For example, the relevant meaning of "technical" in the *Shorter Oxford English Dictionary* is "pertaining to, involving, or characteristic of a particular art, science, profession, or occupation or the applied arts and sciences generally."

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[4] See Ariane Pickering, General Report, in International Fiscal Association, *Enterprise Services,* Cahiers de droit fiscal international, Enterprise Services, vol. 97a, (Sdu, 2012) 17-60.

[5] See Sergio Andre Rocha, "Brazil," in IFA, *Enterprise Services,* Cahiers de droit fiscal international vol. 97a, (Sdu, 2012) 155-167 at 158.

[6] Ibid., at 160.

2) refer to "technical, managerial and consulting services" (or some similar wording) and provide an inclusive definition of technical, managerial, and consulting services. This approach would be similar to that used in Article 14. "Professional services" are defined in Article 14(2) to include certain types of activities but the meaning of the term is not limited to those activities. Again, some additional elaboration on the meaning could be provided in the Commentary, although the Commentary on Article 14 provides little elaboration on the meaning of professional or other independent services.

   The difficulties with this approach are twofold. First, it is not readily apparent what services would be included in the definition of technical, managerial and consulting services (as discussed below in connection with the third possibility). Second, the same problems described with respect to the first approach (leaving "technical, managerial and consulting services" undefined) but providing clarification in the Commentary apply equally to an inclusive definition.

3) refer to "technical, managerial and consulting services" and provide an exclusive definition of such services ("'technical, managerial and consulting services' means …"). Under this approach, only services within the definition would be covered by the new article. Other services would be dealt with under other Articles of the UN Model. The obvious problem with this approach is how to draft the definition in a manner that is not over- or under-inclusive. This is a formidable challenge because, in substance, there are no obvious distinguishing characteristics of technical, managerial and consulting services and other services. For example, advice provided by professionals can be considered to be professional services or consulting services. The articles dealing with technical services in actual bilateral tax treaties do not provide much assistance with respect to a definition of technical services, as noted in section 3 below.

   As noted, each of these options presents serious difficulties.

2.6.2 There are several issues that must be addressed in formulating a definition of the services (referred to here as "technical services") that are to be covered by the new Article. For example, how should the definition deal with services connected with or ancillary to the transfer of technology? If a treaty definition is limited to such services, it might be preferable to extend Article 12 (Royalties) to payments for such services rather than introduce a new Article. Should the definition be limited to services that involve activities of individuals as the major element, as it is under the domestic law of India? Thus, standardized services, such as utility services, primarily involving the use of equipment or technology would be excluded. Should administrative services be included in the definition of technical and other similar services for purposes of the new Article? In several UK treaties containing a separate Article dealing with fees for technical services, those fees are typically defined as "payments of any kind to any person, other than an employee of the person making the payment, in consideration for any services of an administrative, technical, managerial or consultancy nature."[7] In some of India's tax treaties, technical services are defined as services that "make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or design."

[7] Article 13 of the Botswana-United Kingdom treaty.

2.7 Method of taxation

2.7.1 Once the conditions for the source-country taxation of income from technical and other similar services have been determined, it is necessary to establish how the source country should tax such income. There are 3 basic options in this regard:

- taxation of the net income derived. Under this method, the source country would be required to allow the deduction of expenses incurred in earning the income, as under Articles 7 and 14 of the UN Model.

- taxation of the gross revenue derived, but at a maximum rate to be specified in the new Article or left to be established by the negotiations of the parties. Under this method, the source country is not obligated to allow deductions for expenses incurred in earning the income. However, the rate of source-country tax would be limited so that the tax on the gross revenue would roughly approximate the tax on the net income. In effect, this option would be similar to the source-country taxation of royalties under Article 12.

- unlimited source-country taxation. This option would be similar to the source-country taxation of income derived by artistes and sportspersons under Article 17.

2.7.2 Where the source country is entitled to tax fees for technical services on a gross basis, it would be possible to provide in the new Article for the taxpayers to elect to be taxed on a net basis. Several UK treaties with developing countries provide such an election.[8]

2.8 Other design features

2.8.1 Consideration should be given to whether it is necessary to include in a new Article dealing with technical services the concept of beneficial ownership and a provision dealing with technical services where there is a special relationship between the payer and the service provider. Both of these are features of Articles 10, 11, and 12 of the UN Model. However, they are not found in other Articles such as Articles 7, 14, and 15.

2.8.2 If payments for technical services are considered to be similar to royalties, presumably it would be appropriate to use the beneficial-ownership and special-relationship provisions in any new Article dealing with technical services. However, if fees for technical services are considered to be similar to royalties, they should be dealt with by expanding Article 12 (option [IV.E] in the 2012 Supplementary Note). The members of the Subcommittee expressed little support for that option. Therefore, assuming that income from technical services is considered to be different in kind from royalties, it would be unnecessary to include beneficial-ownership and special-relationship provisions in the new technical services Article.

2.8.3 The new Article may apply to all payments for technical services made by residents of the source country to residents of the other contracting state. If so, consideration should be given to whether the Article should also apply where a payment for technical services is made by a nonresident with a PE in the source country to another nonresident. It may be appropriate

[8] The treaties with Gambia, Ghana, Ivory Coast, Kenya, Lesotho, Pakistan and, Uganda. See Angharad Miller, United Kingdom, in IFA, *Enterprise Services,* Cahiers de droit fiscal international, vol. 97a, (Sdu, 2012) 699-720 at 716-18.

for the new Article to allow the source country to tax payments for technical services that are deductible in computing the income of a PE in the source country of a nonresident. Such a provision would be similar to Article 15(2)(c) with respect to employment income borne by a PE.

2.8.4 Consideration should also be given to whether the new Article should contain an anti-avoidance rule similar to the rule in the OECD alternative services PE provision where the technical services are provided by an individual. Consideration should also be given to whether it is appropriate for the new Article to contain separate provisions for technical services provided by individuals and enterprises, as is the case with the OECD alternative services PE provision. Moreover, it may be appropriate to exclude from the new Article any technical services provided by an enterprise through independent personnel that are not controlled by the enterprise like employees.

2.9 Relationship with other Articles

2.9.1 It would be necessary and desirable to spell out the relationship between a new Article dealing with technical services and the other Articles of the UN Model.

2.9.2 Relationship with Article 7

As a result of Article 7(6), the new Article would take precedence over Article 7 in any case where both Articles apply. It must be considered whether this result is appropriate or whether it is appropriate to have a throwback rule in the new Article similar to those in Articles 10(4), 11(4), 12(4), and 21(2). If the new Article allows source-country taxation on a gross basis, it would appear to be appropriate to allow taxpayers who carry on business in the source country through a PE to be subject to net-basis taxation under Article 7. This would appear to be the case even if the new Article limits source-country taxation to technical services performed in the source country.

2.9.3 Relationship with Article 14

Although Article 14 does not contain a provision similar to Article 7(6), it would seem that the same principles should govern the relationship between Article 14 and a new technical services Article. Thus, the new Article could contain a rule similar to Articles 10(4), 11(4), 12(4), and 21(2) giving priority to Article 14 if a taxpayer carries on business through a fixed base in a source country and derives income from technical or other similar services that are effectively connected with that fixed base. However, such a rule would not deal with the situation where Article 14(1)(b) applies (no fixed base but the taxpayer stays in the source country for more than 183 days). Therefore, it may be more appropriate to make the new Article "subject to Article 14" or add a provision to the new Article indicating that it does not apply in any case where Article 14 applies.

From a fundamental tax policy perspective, the treatment of income from independent personal services covered by Article 14 (or by Article 7 for treaties that have deleted Article 14) and the treatment of income derived from technical services under a new Article should be reasonably consistent. Assuming there is little, if any, difference in kind between independent personal services, such as professional services, and technical services, it is questionable whether it is reasonable to allow source country tax of the former under Article 14 only if the nonresident has a fixed base in the source country or stays in the source country for more than

183 days but to allow source country tax of the latter if any services are performed in the source country or if a resident of the source country pays for the services.

2.9.4 Relationship with Article 12

The relationship between Article 12 and new Article dealing with technical services should be clearly spelled out so that there is no overlap between them. The problem with respect to technical services is that in some situations it is difficult to distinguish between payments for information or experience (royalties) and payments for services. Under Article 12, royalties are taxable by a source country if the payer is a resident of the source country and the payment is consideration for the use of or the right to use the intellectual property. This qualification difficulty is especially pronounced with respect to embedded services and mixed contracts.

Any possible conflict between the two Articles could be avoided by giving priority to one of them. Obviously, it is necessary to decide which Article should have priority. The consequences of this decision depend on the method of source-country taxation, including the rate of tax, allowed under the two Articles.

2.9.5 Relationship with Article 23

Article 23 would appear to operate appropriately with respect to a new Article dealing with technical services. In any case, where income from technical services is taxable by the source country in accordance with the new Article, the residence country would be obligated by Article 23 either to provide an exemption for the income or a credit for the source-country tax on the income.

If the source rule adopted for purposes of the new Article is that income from technical services arises where the payer for the services is resident, Article 23 will require the residence country to provide relief for any source-country tax imposed on income from technical services performed in the residence country. Under the domestic law of most countries, relief from international double taxation is limited to foreign taxes imposed on foreign-source income. It is unclear whether countries would be reluctant to agree to give up domestic tax on domestic-source income (derived by their own residents from providing technical services to nonresidents) in their tax treaties in this way.

2.9.6 Relationship with Article 24

If a new Article dealing with technical services is added to the UN Model, the implications for Article 24 (Nondiscrimination) should be considered. Currently, Article 24 of the UN Model provides protection against discrimination for business profits derived by a resident of one country through a PE in the other country (Article 24(3)). This protection does not extend to income from services covered by other Articles of the UN Model, not even Article 14 dealing with income from independent services derived through a fixed base in the source country. It would be possible to add a provision to Article 24 requiring source countries not to discriminate against nonresidents providing technical services. However, such a provision would be inconsistent with the lack of protection for nonresidents providing services, including technical services, through a fixed base. Moreover, if the new Article allows source countries to tax income from technical services on a gross basis, nondiscrimination protection would be inappropriate because most countries would not tax their residents on income from technical services on a gross basis. On the other hand, if the new Article requires taxation of

income from technical services on a net basis, nondiscrimination protection could be appropriately added to Article 24.

3. TECHNICAL SERVICES ARTICLES IN ACTUAL TAX TREATIES

3.1 The 2011 survey by the IBFD identified 134 of the almost 1,600 tax treaties concluded between 1997 and 2011 as containing a separate article dealing with fees for technical services.[9] These Articles do not include Articles dealing with royalties that are extended to include technical services.

3.2 In the 2012 IFA General Report on Enterprise Services, Ariane Pickering indicates that the articles in existing tax treaties dealing separately with technical services treat such services in the same way as royalties.[10] Source country tax is allowed on a gross basis and the rate of tax varies; surprisingly, the rate is sometimes lower than or higher than the rate of tax on royalties. Typically, these Articles provide that fees for technical services arise or are sourced in the country in which the payer is resident.

3.3 The IBFD study gives Article 13 of the 2001 India-Malaysia treaty as a representative example of this type of provision:

> 1. Fees for technical services arising in a Contracting State which are derived by a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, fees for technical services may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the recipient is the beneficial owner of the fees for technical services, the tax so charged shall not exceed 10 per cent of the gross amount of the fees for technical services.
>
> 3. The term "fees for technical services" means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Article 14 and Article 15 of this Agreement.

3.4 As can be seen, this provision allows source-country taxation of fees for technical services on a gross basis at the maximum rate of 10 percent. Whether such a rate is reasonable depends on the expenses typically incurred to provide technical services. If an enterprise earns a net profit of 20 percent from providing technical services, a 10 percent gross-based withholding tax represents a tax rate of 50 percent on the net profits.

3.5 The definition of fees for technical services in the India-Malaysia treaty does not provide any meaning for the crucial expression "managerial, technical or consultancy services." The definition excludes payments for services under Articles 14 and 15, but not

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[9] Wim Wijnen, Jan de Goede, and Andrea Alessi, "The Treatment of Services in Tax Treaties," vol. 66, no. 1 *Bulletin for International Taxation* (January 2012) 27-38, at 33.

[10] Supra note 2, at 50.

Article 7. The definition includes the provision of services by technical and other personnel. In effect, technical services include services provided by technical personnel and other personnel. In other words, whether the personnel providing the technical services are technical or not is irrelevant. If the services provided qualify as technical, managerial, or consultancy services, the Article applies irrespective of who provides those services. Conversely, if the services provided are not technical, managerial, or consultancy services, the Article does not apply even if the services are provided by technical personnel.

4. ALTERNATIVES

4.1 The difficulties presented by the adoption of a new Article and Commentary dealing with income from technical and other similar services should not be underestimated. Any attempt to distinguish between technical and other services seems likely to prove troublesome and a source of ongoing conflict. Therefore, it seems appropriate for the Committee to consider alternatives that do not require a definition of technical and other similar services.

4.2 The objective of introducing a new Article on technical services into the UN Model is to expand source-country taxing rights with respect to such amounts. Fees for technical services may be substantial and usually the source country will be required to allow the resident payer to deduct such amounts in computing its income, resulting in a significant erosion of the source country's tax base.

4.3 It is important to recognize that this objective of increasing source-country taxing rights can be accomplished in a variety of ways. All payments by residents of a source country to nonresidents in consideration for services rendered will be deductible and erode the source country's tax base. Fees for technical, managerial, and consulting services are not special in this regard. Accordingly, it should be carefully considered whether a solution that focuses only on certain technical services is appropriate. It may be more appropriate to adopt a solution that deals with all income from services. This might be accomplished by reducing the threshold requirements for source-country taxation of income from services under Article 5(3)(b) and Article 14(1)(b) of the UN Model.

4.4 Further, given that the fundamental purpose of tax treaties is to facilitate cross-border trade and investment, any revisions to the UN Model must balance an increase in source-country taxing rights against the impact on trade and investment flows. Consequently, a targeted approach that focuses on the payments for services that are most likely to erode a source country's tax base but not adversely impact on trade in services may be preferable to a new Article dealing with technical services. Such a targeted approach might focus exclusively on payments for services rendered between related or associated enterprises, as described in option [IV.I] of the 2012 Supplementary Note.

APPENDIX TO ANNEX 1

ARTICLE ___ (INCOME FROM TECHNICAL SERVICES)

1. Income derived [payments received] by a resident of a Contracting State in respect of technical services or other similar activities shall be taxable only in that State unless the income arises in the other Contracting State, in which case such income may also be taxed in the other Contracting State; [however, the tax so charged shall not exceed __ percent of the gross amount of such payments.]

2. Threshold if necessary

3. Deduction for expenses if necessary

4. Income in respect of technical services or other similar activities shall be deemed to arise in a Contracting State [when the services or activities are performed in that State] [when the payer is a resident of that State.]

5. The provisions of paragraphs 1 and 2 shall not apply if the resident carries on business in the other Contracting State in which the income arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the income is effectively connected with such permanent establishment or with business activities referred to in (c) of paragraph 1 of Article 7. In such cases, the provisions of Article 7 shall apply.

6. The provisions of this Article shall not apply in any case where the provisions of Article 14[11] [or Article 12] apply.

7. The term “technical services” [“technical services or other similar activities”] [means …] [includes …] [but does not include …]

[11] This is necessary to cover both Articles 14(1)(a) – fixed base and 14(1)(b) – length of stay.

ANNEX 2: COMMENTS BY ANITA KAPUR ON THE NOTE AT ANNEX 1

Thanks are due to Professor Arnold whose follow up Note is exhaustive and instructive and does focus on the relevant issues for designing an Article in terms of option [IV.H]. I have the following comments regarding the format and structure of a new Article for "fees for technical services":

Para 2 to 2.5.3 of the Note

- The design of the new Article as suggested in the Note is conceptually on the format where the primary right of taxation is with the State of residence of the recipient of income and on satisfaction of certain conditions, the income could also be taxable by the source State. In my view, the Article should be modelled on the Article on Royalties in the UN Model wherein both the Resident State and the State in which the income arises have the right to tax. However, tax charged by the State in which the income arises is limited to a percentage (to be established through bilateral negotiations) of gross revenue . The research paper of Professor Wim Wijnen, Prof. Jan de Goede and Andrea Alessi referred in the earlier Note of Prof. Arnold, indicates that 134 tax treaties have an autonomous Article for technical services in general. The example cited in the said research paper ,reflecting the basic structure and content of such an Article in these treaties, permits State of source to impose withholding tax limited to a bilaterally negotiated percentage of gross amount of fees for technical services.
- The source country taxation right should apply to income from technical services derived by any person whether individual or juridical person and no separate wording are necessary in regard to different forms of taxable entities.
- There should be no threshold requirement for source State taxation. There is no such requirement in the case of dividend, interest, royalty etc.
- There should also be no prerequisite that to assert source country taxation right, the services must be performed in the source State. The source State should get a right if the payer is a resident of that state or has a PE/fixed base and the fee for technical services is borne by such PE or fixed base or if the services are utilised in that State.

Para 2.6 of the Note

The Note highlights the difficulties in giving a definition of the technical services. Under the Indian Tax Code "fees for technical services” has been defined to mean “any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project

undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries". This definition could be considered and meaning could be elaborated in the Commentary or left to be governed by the domestic law.

Para 2.7 & 2.8 of the Note

- Taxation of gross revenue would be preferable as that is the simplest to administer and may possibly be worded on the lines of Article 10, 11 or 12. The rate could be bilaterally settled in the treaty. Giving an option to be taxed on net basis would increase the complexity and may entail disputes
- The beneficial ownership and special relationship provision as featured in Article 10, 11, & 12 should be included in the new Article

Para 2.9 of the Note

- The issues like relationship with other Articles can be addressed once an agreement is reached on the basic design and definition.

Para 3 of the Note

- The committee should not be deterred by the difficulties well captured in the Note but should look for solutions that allow expansion of source State rights with a simple structure of an independent Article vesting easily enforceable taxation rights with the source State.

ANNEX 3: COMMENTS BY CLAUDINE DEVILLET ON THE NOTE AT ANNEX 1

At the 7th Annual Session, the UN Committee of Experts on International Cooperation in Tax Matters agreed that the Subcommittee on Services should prepare proposals for the taxation of income from technical assistance for consideration during the 8th Annual Session in October 2012:

> "It was agreed that the Committee would start with work on *"fees for technical assistance"* with a view to achieving concrete results for the next annual session, but it would also have a longer-term plan of work with a view to a comprehensive review of services issues for the United Nations Model Convention." (paragraph 97 of the report of the 7th Annual Session)

In order to start this work, a note ("2012 Supplementary Note" available at http://www.un.org/esa/ffd/tax/eighthsession/index.htm) was prepared by Brian J. Arnold for the Subcommittee on Services. That note identified several options for dealing with income from technical and other similar services in the UN Model.

The comments received from the members of the Subcommittee on Services have indicated that a majority supports option [IV.H]) (Addition to the UN Model of a new Article on technical fees) and a minority supports option [IV.D] (Revision of the UN Commentary to provide a discussion of the issue of taxation of services and alternative provisions that countries might adopt). As a consequence of the preference expressed by a majority of the participants to the Subcommittee, Brian J. Arnold has prepared a note for the Committee exploring the issues involved in a new Article dealing with technical and other similar services (Annex 1 of this Note)

This note presents the minority view expressed within the Subcommittee on Services and proposes another approach in order to deal with business and professional services under the UN Model.

A. Focusing on an additional Article on technical and other similar services without having considered further the reasons why such an additional Article would be required is premature.

Whilst the issue may be important to some countries, only a small number of bilateral treaties contain specific provisions dealing with technical services. According to the research undertaken by the IBFD:

> Treaty provisions dealing with technical assistance related to the use of rights, property or information mentioned in the definition of "royalties":
> Group A (treaties between two non-OECD countries): 34 of 691 tax treaties (**4.92%**);
> Group B (treaties between a non-OECD and an OECD country): 33 of 694 tax treaties (**4.75%**); and
> Group C (treaties between two OECD countries): 16 of 201 tax treaties (**8.00%**).
>
> Autonomous treaty provisions for technical services and other similar services:
> Group A: 91 of 691 tax treaties (**13.17%**);
> Group B: 43 of 694 tax treaties (**6.20%**); and
> Group C: 0 of 201 tax treaties (**0.00%**).

Consequently, only few countries seem to consider that it is necessary to deal specifically with technical services in tax treaties.

Moreover, before trying to set out the possible conditions for source-country taxation of income from technical services, the Committee should first determine what distinguishes technical services from other business activities and from other services in such a way that these services would require a specific tax treatment. It should identify the problems that would make it necessary to depart from the existing rules for income for technical services before envisaging any specific solution.

B. Examples of possible problems that countries might wish to solve with respect to the taxation of income from technical services.

1. *One problem may relate to the fact that fees for technical services paid to non-residents are ordinarily deductible in computing the income of the person to whom the services are furnished but are not always taxable by the source country under the provisions of the UN Model.*

Such situation may, however, exist with respect to any service furnished to an enterprise or an independent person where the furnishing of services does not give rise to a permanent establishment under Articles 5(1), 5(3)(b) or 5(5) or to a fixed base or a presence of 183 days under Article 14 and is not covered by the limited force of attraction of Article 7(1)(c). Moreover, such situation may also exist with respect to any sale of goods where the goods are not sold through a permanent establishment in accordance with Articles 5(1) or 5(5) and the sales are not covered by the limited force of attraction of Article 7(1)(b).

The fact that the payments for technical services erode the source country's tax base cannot justify the taxation at source of income from the furnishing of technical services when similar base erosion also results from the furnishing of services in general as well as from the sale of goods and merchandise from abroad.

Some countries may consider that source taxation of payments for the furnishing of technical services is desirable because their import of services exceeds their export while their trade in goods is rather balanced. This economic situation can, however, certainly not justify the inclusion in the UN Model of a provision extending the taxing rights of those countries with respect to income from technical services in order to compensate their deficit in the trade of services.

2. *Another problem may relate to the fact that taxation at source of fees for technical services paid to non-residents under Article 7 would be rather difficult to apply and that withholding tax on a gross basis would be easier to apply and would reduce the administrative costs for the source country as well as the compliance costs for the taxpayers.*

As a final withholding tax on the gross amount of payments to non-residents does not take into account the expenses incurred in earning the income, the tax may often be arbitrary and too high. This would especially be the case with respect to fees for technical services, which generally require the intervention of skilled personnel temporarily present in the source country. This is illustrated by the following example.

Where, for instance, an enterprise from country X receives a fee of 20.000 for providing technical services to an enterprise of country Y, this fee may include 15.000 of expenses specifically relating to the presence of personnel during 20 days in order to perform the services (salaries, flights, hotel, etc.) as well as 2.000 of general expenses attributable to the provision of these services.

If a withholding tax of 10% applied on the gross amount of the fee, the tax in the country of source would amount to 2.000.

If the tax rate in the country of residence of the enterprise was 33%, the tax on the profits attributable to the provision of the services (20.000 – (15.000 + 2.000) = 3.000) would amount to 990. The country of residence would however eliminate the juridical double taxation by exempting the profits of 3.000 or by crediting the source tax on its own tax of 990.

In the absence in the source country of a permanent establishment bearing the remuneration of the personnel performing the technical services, that remuneration would not be taxed as such in the source country and would be taxable only in the country of residence of the personnel. If that remuneration amounted to 9.000, the tax in the country of residence of the personnel could, for example, amount to (9.000 – 2.000 (social security and other charges) = 7.000) X 40% = 2.800.

The total amount of taxes relating to the furnishing of the technical services would amount to 4.800 (2.000 in the country of source and 2.800 in the country of residence of the personnel).

If, however, Article 7 applied to these technical services:

- only the profits of 3.000 would be submitted to tax in the country of source at the normal rate of tax (e.g. 3.000 X 35% = 1050). The country of residence of the enterprise would eliminate the juridical double taxation by exempting the profits of 3.000 or by crediting the source tax on its tax of 990;
- the remuneration paid to the personnel would be borne by a PE of the employer in the source country and would thus be taxable in that country on a net basis at the normal rate of tax (e.g. 7.000 X 35% = 2450). The country of residence would eliminate the juridical double taxation by exempting the remuneration of 7.000 or by crediting the source tax on its own tax of 2800.

The total amount of taxes relating to the furnishing of the technical services would amount to 3850 (1050 and 2450 in the source country + 350 in the country of residence of the personnel) if the residence country applied the credit method and to 3500 (1050 and 2450 in the source country) if the residence country applied the exemption method.

This example shows that taxation at source on a gross basis of fees for technical services results in the total amount of taxes being higher, even though the amount of tax levied by the source country is less important than if profits from services were taxed in accordance with Article 7. Indeed, when fees for technical services are taxed on a gross basis, the remuneration of the personnel is taxed by the source country as part of the technical fees in the hands of the enterprise providing the services as well as by the country of residence of the personnel as salaries, wages and other similar remuneration.

Such kind of economic double taxation may also result from taxation of technical fees on a gross basis where the service provider subcontracts all or part of the contract. If the service provider would subcontract all or part of the contract to a local subcontractor, the country of source would tax the fees paid to the service provider (including the part of the fees he must retrocede to the subcontractor) at a limited rate of tax and it would also tax in the hands of the local subcontractor the net amount of fees retroceded to him and in the hands of his employees the net amount of remuneration relating to the carrying on of the subcontract.

These examples indicate that taxation on a gross basis is clearly not suitable for technical services fees because in most cases it would significantly increase the global tax burden

imposed on such income with harmful effects on the exchange of technical services and technology and on the development of economic relations between countries.

3. ***The problem may relate to the fact that, while other business activities are generally performed through a fixed place of business (e.g. a place of business maintained for more than six months), technical services are often performed at several places in the territory of a source country and under several unrelated projects, each project requiring activities to be performed during a short period.***

If this is the difference between services and other business activities that the Committee wants to address, it could be addressed through the deletion of the words "(for the same or a connected project)" in the existing Article 5(3)(b). This would allow a source country to tax the income from services performed in its territory as long as activities performed in whatever place and for whatever contract last more than 183 days in any 12-month period.

If it appeared that, due to the nature of services, non-residents would often perform services within a specific country for unrelated projects during periods aggregating less than 183 days in any 12-month period, such issue could be addressed by reducing the period of activities or of presence required under Article 5(3)(b) or Article 14.

However, these difficulties might exist for services generally and might not be specific to technical services. It would therefore not be justified to limit the possible solutions in this area to technical services.

4. ***Another problem may result from the fact that payments for services related to the use or the right to use intangible properties may be used for lowering the amount of royalties paid and avoiding the withholding tax provided by Article 12(2) of the UN Model.***

If this were the case, fees for such "related services" could be dealt with under Article 12. The India-United States treaty provides a model for this type of specific provision. It applies to payments from rendering technical or consultancy services if the services are "ancillary and subsidiary to the application or enjoyment of the right, property or information" covered by Article 12 or if the services "make available technical knowledge, experience, skill, know-how or processes or consist of the development of a technical plan or technical design."

5. ***The problem may relate to the fact that fees for technical, management, and consulting services between associated enterprises established in different countries are used to transfer profits within a group (transfer from an associated enterprise to another associated enterprise which is more favourably taxed).***

If this were the case, the Committee should study this issue thoroughly and favour a solution limited to services provided between associated enterprises. At first sight, this issue does not seem specific to technical services and the possible solution should deal with all income from services provided between associated enterprises.

C. Conclusion

In my view, it is not appropriate that the Committee starts with work on an additional Article on technical services. There seem to be no specific difficulties relating to technical services as such that ought to be solved through such a specific Article.

The Committee should on the contrary analyse specific difficulties relating to services (see for example points 3, 4 and 5 above) and propose possible solutions to solve those difficulties.