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## TAXATION OF FEES FOR TECHNICAL SERVICES

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# Taxation of Fees for Technical Services

- work on the issue was approved at 7<sup>th</sup> Annual Session of the Committee of Experts
- note prepared for the Subcommittee on Services (E/C.18/2012/4) earlier this year to start the work

# Taxation of Fees for Technical Services

- the purpose of the note was to set out the available options for consideration by the Committee members for dealing with fees for technical services in the UN Model Convention
- a majority of the members of the Subcommittee expressed a strong preference to pursue the development of a new Article and Commentary dealing with fees for technical services
- a follow-up note was prepared for the Subcommittee identifying the major issues in the design of a new Article (E/C18/2012/CRP.4)

## Existing Provisions of the UN Model Dealing with Services

- under the existing provisions of the UN Model, there are no provisions dealing specifically with technical services
- therefore, income from technical services (other than construction, insurance, international transport, and entertainment) is taxable in accordance with Articles 7 and 14

# Existing Provisions of the UN Model Dealing with Services

- under Article 7 income from technical services is taxable by the source country only if:
  - the taxpayer has a fixed place of business in the source country and the income is attributable to the PE, or
  - furnishes services in the source country for more than 183 days in respect of the same or connected projects

# Existing Provisions of the UN Model Dealing with Services

- under Article 14 income from technical services is taxable by the source country only if:
  - the taxpayer has a fixed base regularly available to him and the professional or independent services are attributable to the fixed base, or
  - the taxpayer stays in the source country for 183 days or more

# The Issue

- it is relatively easy for enterprises resident in one contracting state to earn substantial income from services in the other state without becoming subject to tax in the other state
- moreover, the fees paid to the nonresident service providers are usually deductible against the source country's tax base
- thus, intragroup managerial, technical, and consultancy services can be used to strip profits out of the source country

# Options for Dealing with Fees for Technical Services

1. Revise the Commentary to add a neutral discussion of the issue – an objective discussion of the arguments for and against any special provisions for technical services
  - no recommendations
2. Revise the Commentary to add a neutral discussion of the issue and provide a selection of provisions dealing with technical services that have been included in actual bilateral treaties
  - no recommendations



# Options for Dealing with Fees for Technical Services

3. Revise the Commentary to add a neutral discussion of the issue and provide an alternative provision or provisions that countries would be encouraged to adopt if they decide to adopt a special provision dealing with technical services
  - would include recommendation

# Options for Dealing with Fees for Technical Services

4. Revise the time thresholds in Articles 5(3)(b) and 14(1)(b)
  - current thresholds are 183 working days and days of presence in source country
  - could be reduced to a lower threshold (e.g., 120 or 90 days)
  - would apply to all services, not just technical services
  - could have reduced threshold just for technical services

# Options for Dealing with Fees for Technical Services

5. Revise Article 12 (Royalties) to include technical and other similar services
  - would apply to payments for technical services related to or connected with transfers of intellectual property
  - could be included in Commentary on Article 12 as an alternative provision

# Options for Dealing with Fees for Technical Services

6. Revise Article 14 to include the base erosion conditions of Article 15(2)
  - the source country would be entitled to tax payments for professional or independent services if the payments were made by a resident of the source country or borne by a PE of a nonresident in the source country (i.e., deductible)
  - could be limited to technical and other similar services

# Options for Dealing with Fees for Technical Services

## 7. Revise Article 21(3)

- currently, Article 21(3) allows the source country to tax other income that arises in the source country
- income from technical services could be defined to be other income for purposes of Article 21
- currently, there is no limit on source country under Article 21(3) but a limitation could be added

# Options for Dealing with Fees for Technical Services

8. Add a new Article and Commentary dealing with Income from technical services
  - 134 of almost 2,000 treaties concluded in 14 years from 1997 to December 2010 contain such an article
  - what conditions for source country tax?
  - what method of source country tax?
  - requires definition of technical services
  - could be included in the Commentary as an alternative provision

# Options for Dealing with Fees for Technical Services

9. Deem a subsidiary to be a PE of its nonresident parent
  - any income derived by parent from services rendered to subsidiary would be attributable to PE and subject to source country tax
  - would deal with intragroup services
  - not limited to technical services, but could be
  - would not apply to arm's-length services

# Subcommittee Views

- majority of members of the Subcommittee on Services expressed support for a new Article and Commentary
- minority view set out in a note by Claudine Devillet suggests that a new Article is unnecessary, or at least premature, and more targeted solutions should be explored first



# Major Issues in the Design of a New Article Dealing with Technical Services

1. What services should the new Article apply to?
  - most existing technical services provisions refer to “managerial, technical and consultancy services”
  - is it necessary to define managerial, technical, and consultancy services? if so, how?

# Major Issues in the Design of a New Article Dealing with Technical Services

- possible methods of defining technical services:
  - refer to “managerial, technical and consultancy services in the new Article and
  - 1) leave the expression undefined but provide guidance in the Commentary
  - 2) leave the terms to be given their meaning under domestic law
  - 3) provide an inclusive definition in the treaty
  - 4) provide an exclusive definition in the treaty

# Major Issues in the Design of a New Article Dealing with Technical Services

## 2. Threshold requirement – options:

- no threshold
- services performed in the source country
- services performed in the source country for a minimum time
- physical presence in the source country for a minimum time

# Major Issues in the Design of a New Article Dealing with Technical Services

## 3. Source of Income

- under existing provisions, source country tax is generally limited to services performed in the source country
- in some actual treaties, fees for technical services are treated like royalties and subject to source country tax if paid by a resident or borne by a PE
- should new Article be limited to services performed in the source country or apply to payments for services irrespective of where they are performed?

# Major Issues in the Design of a New Article Dealing with Technical Services

## 4. Method of taxation

- net-basis taxation – source country allows deduction of expenses
- gross-basis taxation – withholding on fees for technical services at limited flat rate
- gross-basis taxation with no limit on rate
- allow taxpayer to elect net- or gross-basis taxation