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General issues in the review of Commentaries

**Comments on the Proposal for Amendments of the United Nations
Model Double Taxation Convention between Developed and
Developing Countries: Further Issues Relating to Permanent
Establishment**

Conference Note*

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Comments on the Proposal for Amendments of the United Nations Model Double Taxation Convention between Developed and Developing Countries: Further Issues Relating to Permanent Establishment

This note expresses some views and ideas in relation to the work done by the Subcommittee on Article 5 of the UN Model dealt with in the paper “*Proposal for Amendments of the United Nations Model Double Taxation Convention between Developed and Developing Countries: Further Issues Relating to Permanent Establishment*” issued by the Subcommittee on Definition of Permanent Establishment (“the Subcommittee”). The idea is to facilitate the discussion of this work.

The problem and what this paper will try to amend is that many countries will prefer to maintain Article 14 instead of eliminating it as that Article is perceived as more generous for source taxation. The paper will therefore try and present alternatives that solves these conflicts. It is recognized that retaining Articles 5, 7 and 14 in their present wording is causing interpretative difficulties.

1. Elimination of “*especially*” in Article 5 (2)

This elimination will be a strange change as this word is identical in the OECD and the UN Model. Therefore the position of those members in the Subcommittee that wanted to retain this word “on the basis that its removal was not likely appreciable improve clarity or certainty” is justified.

2. Rewording and renumbering Article 5 (3)(a) as article 5 (3)

The discussion on the issue of what constitutes a deeming provision in Article 5 is important. If paragraph (3) is not a deeming provision, in order to meet the requirement to be a permanent establishment the conditions under paragraph (1) will have to be met. The wording of the UN Model however is expressly establishing a deeming provision by using the words “*also encompasses*”. In this context the word “*also*” is the key word which means that paragraph 3 (a) and (b) are deeming provisions which differentiates this paragraph from paragraph 2. There seem also to be an inconsistency in arguing that paragraph 3 (a) is not a deeming provision but accepting that paragraph 3 (b) is when both subparagraphs have the same heading. If the drafters of the UN Model intended to make this paragraph subject to paragraph 1 conditions they could have used the OECD wording but as we have seen they clearly did not.

Furthermore, in the technical explanation by the United States with regards to the US - Venezuela tax treaty which uses the UN Model language it is clearly expressed that paragraph 3 is a deeming provision.

Therefore it is suggested to maintain the wording of paragraph 3 and if it is felt necessary to clarify the scope of the paragraph it is suggested to do that in the commentaries. Some wording to that effect could be as follows:

“xx. This paragraph expressly provides that a construction site in subparagraph (a) and service activities in subparagraph (b) can always be regarded as constituting *per se* a permanent establishment if the conditions in the subparagraphs are met. An alternative wording which may be used by countries to make the same determination is:

“3. A permanent establishment shall be deemed to exist where:

- (a) ...
- (b) ...”

For clarity purposes there is therefore no need to separate the construction permanent establishment and the services permanent establishment, indeed there is no policy reason to do so either as this is the policy many UN

countries would like to follow. Those who do not want to follow the UN Model can always follow the OECD Model.

3. Adaptation of the references in Article 5(5) and consequent renumbering of current paragraph 5 to 8.

The Subcommittee proposes to change the references in Article 5(5), eliminating the reference to paragraph 2 and including services covered by the “*new*” paragraph 4. As a result of this change activities covered by Article 5 (3) (a) which, as proposed, would be included in a new paragraph 3 would be excluded from this provision.

As said, it is clear that the activities dealt with by Article 5 (3) (a) are deemed permanent establishments. Therefore, if the Committee considers necessary to change the references made by Article 5(5) it would be appropriate to include expressly such activities in its wording.

In any case, the reference in Article 5 (5) of the UN Model to paragraphs 1 and 2 of Article 5 follows the wording of the OECD Model and it does not seem that the change proposed provides for any further clarity, in fact it gets more confusing, in the interpretation of the clause which justify deviating from it.

4. Proposed Article 5(4) (b) and definitions of “business” and “enterprise”

See comments on proposed deletion of Article 14.

5. The Possible deletion of Article 14 and Incorporation in Article 5 and 7

The concern expressed relating to the deleting of Article 14 by some members of the Subcommittee seem to reflect a wider concern by the Committee and many UN countries. It may be appropriate to instead of deleting Article 14 one should try to clarify its understanding and remove ambiguities. As mentioned earlier, it is always possible for countries that want to follow the OECD Model to do so, however what could be important for this Committee is to eliminate uncertainties and provide guidance as to how to interpret the different wordings.

The Subcommittee concludes that “*retaining the combination of article 14 and Articles 5 and 7 would continue to cause difficulties, ambiguities and uncertainties*” [paragraph 63]. These difficulties include: coverage of activities other than professional services; uncertainty over coverage of non-individuals; unnecessarily differentiated treatment of professionals; application to partnerships; and differences in time thresholds.

The following are comments on how to resolve those difficulties.

Coverage of activities other than professional services

The Subcommittee noted that there is uncertainty over the coverage of Article 14, in particular whether it covers activities other than furnishing of professional services. The problem would be a possible overlap between activities covered by Article 7 and 14.

First of all there is no problem if there is an overlap between Article 7 and 14 as the Model text itself resolves the issue by providing that in that case Article 14 prevails (Article 7(6)). It may however be useful if the Commentaries on Article 14 could provide for a clarification of what type of activity is covered by the wording “*other activities of an independent character*”. It may be that the Committee is in agreement with what the OECD commentary established for that Article and the words used by the Ad hoc group was : “... the

commentary on that Article *is relevant*.” The OECD Model tries to set out what is covered by the Article. If there is anything to add to clarify perhaps one could add some words to the actual OECD commentary: “... *The Committee understands* that this excludes industrial and commercial activities, *however in this context commercial activities do not include service activities*, and also professional services performed in employment, ...”.

Bearing in mind that source taxation of fees for technical services is part of the policy of an important number of UN countries, either by application of Article 12 or by including a specific Article on technical fees, it would be desirable that the UN Model could reflect such practices in its Model by providing for the alternative to tax this kind of payments at source with a limited rate and a commentary to explain the interpretative issues.

Uncertainty over coverage of non-individuals

The Subcommittee points out that Article 14 causes uncertainty about coverage of non-individuals.[*paragraph 6*].

The UN Model in Article 14 does not distinguish between companies and individuals as its text makes a reference to “Income derived by a **resident** of a contracting state in respect of professional services or other activities...”. The word resident is defined in the Model text and the only problem seem to be that the UN Commentary is at odds with the express text of the Model. Paragraph 9 of Article 14 indicates that “It was generally agreed that remuneration paid directly to an individual for his performance of activity in an independent capacity was subject to the provisions of 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 article 5 and 7.” There are two difficulties with this commentary, firstly, the commentary starts with the words “It was generally agreed” which indicates that not all members of the group agreed with the interpretation. Furthermore, a country is only bound by the treaty text itself and therefore there cannot be any discussion on what the personal scope of the Article is. However it is clearly not desirable to have commentaries that are at odds with the express language of the Model text.

In order to clarify this issue the UN Commentaries on Article 14 could be modified in order to be in line with the literal text of the Model. A clarification could be worded as follows:

“When Article 14 uses the word “resident”, that word is to be understood in accordance with the definition in Article 4. If the contracting States intend to limit the personal scope of the Article the word “resident” could be exchanged for “individual”.

To use the word “individual” would be a change to the express text of the actual Model. Such a change would make it necessary to consider a new wording of paragraph 3 (b) of Article 5 in order to establish the same scope as intended in Article 14 thereby avoiding inconsistencies and apply the same taxing rules for service providers whether they are individuals or companies. One of the most relevant and important difference between Article 14 and Article 5 seem to relate to the limitation in Article 5 (3) (b) which establishes that the furnishing of services must be “... ***(for the same or connected project)*** ...” which does not exist in Article 14. In order to be consistent with the scope of Article 14, especially if one argues that one can eliminate Article 14 maintaining its scope under Article 5, the text of Article 5 (3) (b) needs to be amended. The following text could be considered either to change the UN Model text (if it is agreed to eliminate Article 14 for instance) or as an alternative provision in the commentaries for countries to use it if that would be their preferred policy.

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

Differences in time thresholds

There is no necessity to eliminate Article 14 in order to harmonize or rationalize the time thresholds included in Article 5 and 14.
