

**United Nations Manual for the Negotiation of Bilateral Tax
Treaties between Developed and Developing Countries**

**Appendix for Special Consideration Articles:
A Proposed Protocol for Appendix Inclusion**

Revised for Comments Received up to October 1, 2009

PREAMBLE

At the Fourth meeting of the UN Committee of Experts on International Cooperation in Tax Matters in October of 2008, the Secretariat indicated that the development of this section of the Manual “...with a practical and solutions oriented focus...”¹ was very important and would be very valuable. It was also stated that “...the Manual needed, for full impact, to be an interactive web-based product.”² At the conclusion of the discussion regarding the new structure of the Manual, the suggested general format of the Manual, including this section was approved.

Further, it was requested at the closing meeting of the meeting that a first step towards implementation of this section of the newly formatted Manual would be the suggestion of a protocol whereby articles will be selected for inclusion. The following discussion is a preliminary proposal, mostly in general terms, to begin the discussion and evolution of such a protocol.

INTRODUCTION

The Appendix for Special Consideration Articles serves as a separate section of the revised Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (hereinafter “Model”). The purpose of the appendix is to provide a repository for articles that articulate discussion items that have been raised in discussion or review of the Model. While they are topics or issues that arise in the context of such a discussion or review, and appear to have a high level of interest to member countries, technically, they do not meet established conventions for inclusion in either the provisions of the Model or the “Commentary.” While they are viewed as having relatively high priority in the process of the timely and accurate dissemination of helpful information for the treaty negotiation process they are orphans of the process and, outside such a repository as this, are not centrally located for review by the Model’s stakeholders. Such a situation may result from a number of factors, e.g. the issue is unsettled at the time, the issue might focus on elements that are experience based and so specific that they are deemed inappropriate for inclusion the general provisions of the Model, or the issue might arise in between revisions of the Manual. In any case, with their practical and solutions oriented focus, they can be extremely helpful to stakeholders who may be looking for guidance in a particular area or who may benefit from another party’s experience and expertise in the negotiations process.

Typically, the articles included in this section would arise from discussions at meetings of the Committee of Experts on International Cooperation in Tax Matters, but it is proposed that such articles could be proposed outside that specific venue, according to protocols agreed to by the Committee members.

Regardless of the reason for non inclusion, the usefulness of the manual would be enhanced with, and in some cases compromised without the availability of articles such as these. The manual should be both timely and accurate. If significant issues such as these are not available for guidance, the usefulness of the manual, their integrity or accuracy, may be sacrificed. The same result obtains if such information cannot be added on a timely basis. It would appear appropriate to have a designated repository for this type of article, a Special Appendix to which stakeholders can refer for guidance on issues that the Committee deems affect the scope, accuracy, or timeliness of the Model and its interpretation and application.

It is important to establish a process whereby articles selected for inclusion in the Special Appendix further those stated purposes. In that context, the integrity and accuracy of the Special Appendix must be preserved in the process of developing a protocol for the submission for consideration materials for inclusion in the Appendix.

DISCUSSION OF PRINCIPLES FOR BASIC GUIDELINES FOR INCLUSION

In looking for a place to start the discussion it appeared that there are a number of similarities between this selection issue and the same basic selection issue for academic and professional journals. For example, the materials present the results of primary investigation, that is, it is not comprised strictly of the compilation of existing materials or opinions, but must consist of analysis of issues that are current and relevant to stakeholders which is supported by facts and reasoned analysis. Discussion and conclusions should be presented in an intelligible fashion, with any instance of hypothesis or speculation clearly identified. The structure and content should, above all else, be consistent with the purpose of the Appendix, and promote the intentions for which it was established and adhere to the highest of ethical standards. Finally, the most efficient way to achieve compliance with these standards or goals is to subject the submissions to a rigorous Peer Review process that concentrates on technical and qualitative concerns to determine whether the materials are accurate, timely, and useful to the stakeholders of the Model.

GUIDELINES: A PROPOSAL

The following are very preliminary, but could serve as a starting point for the discussion:

- a. The articles included in the Appendix should have a practical and solutions oriented focus.
- b. The articles should preserve and strengthen the integrity and accuracy of the Manual and the Commentaries.
- c. The content included in the Appendix should be considered for its contribution to facilitating effective communication among the stakeholders.
- d. The discussion should facilitate the dissemination of knowledge and experience among Manual users that is relevant to the negotiation process.
 - i. The topics or articles that appear have a high level of interest to stakeholders, but, technically, they do not meet established conventions for consideration as an inclusion in either the provisions of the Model or the Commentaries, e.g.
 - (1) the issue is unsettled at the time of the discussion, but it is important and relevant, and should be available for general discussion,
 - (2) the issue focuses on elements that are experience based and are too specific to be considered for language to be interjected into provisions, or are too preliminary to receive the formal approval required for inclusion in the Commentaries, but are critical in nature to the negotiation process.
 - ii. The topics are viewed as having relatively high priority in the process of the timely and accurate dissemination of helpful information for the treaty negotiation process.
 - iii. The issue takes on the nature of a discussion item that needs development before it is presented in a manner that could be considered for inclusion in another section of the Manual.

- e. The information presented must focus on the discussion of the topic of the particular inquiry.
- f. The information must be timely and accurate.
- g. The submission process should be transparent to and accessible by interested parties.
- h. The determination to include a submission in the Appendix should be the product of a Peer Review process with a panel to be comprised of Committee members and observers.

GUIDELINES FOR INCLUSION

In the context of the preceding, the actual guidelines can be developed with reference to the principles set out therein.

The articles included in the Appendix should preserve and strengthen the integrity and accuracy of the Manual. This is a fundamental principle. There can be nothing included in the Appendix that compromises any of those characteristics of the Manual Provisions or Commentary. It is for such reasons that all submissions must be reviewed in the light of the basic purpose of the Manual (*insert such verbiage here*) and such review needs to be conducted, as a preliminary filter, by identified parties that are Committee members or observers and who are privy to and experienced in the negotiation process. Keep in mind, acceptance for inclusion in the Appendix is acceptance of an item to promote discussion, communication, and development, not adoption as part of the Manual Provisions or Commentary, on any level.

As discussed in the preceding paragraph, one characteristic of submissions that are to be considered for inclusion should be an assessment of its contribution to facilitating effective communication among the stakeholders. Does the discussion and presentation identify, at the very least, a fundamental level of the depth and breadth of the implications of the topic for the range of stakeholders. Does the submission communicate, in itself, the perceived nature of the problem such that the potential stakeholders can see the significance of its consideration. Why is this a topic that is of interest to and should be communicated to the stakeholders?

As stated in the principles for guidelines discussion, the article that is included should address issues that are relevant to the negotiation process, and the issues will have a high level of interest to stakeholders. They may consist of issues that are in discussion by the Committee and observers or novel issues that stem from the experiences or expertise of stakeholders. The issues may be such that discussion needs to be disseminated with a high priority or emphasis on timeliness and accuracy. A dramatic shift in business or economic structures may warrant communication to the stakeholders on a more timely basis than would be provided if the only resolution was to propose changes to the Model provisions or Commentary. It may be that the experiences of a small group of stakeholders needs to be put forth in order that the general population of stakeholders is apprised of the issue and can evolve the discussion.

In keeping with a proposed mission statement for the revision of the manual. "The manual has three main objectives to take in consideration "- the manual is an important tool to support countries in the implementation and negotiation of treaties to avoid double taxation. At the same time, the manual is a unique document to train tax officials in these matters."³

The Appendix should not be a forum for general discussions on a wide range of topics or on disparate levels of discussion of the same issue. Keep in mind that this is an Appendix to the Manual and usefulness should be prioritized in the process of selecting and editing that which is included. There needs to be sufficient focus and specificity to be useful to stakeholders, not a general discussion of many related topics.

Whatever process is implemented, there needs to be a priority placed on a timely dissemination of useful information that is accurate for the views and facts presented at that level of the discussion.

The review or selection process should be transparent to and accessible by interested parties. The submitting parties must be aware of the criteria and how the criteria is applied. The selection process needs to be above criticism and without any appearance of bias or predisposition at any stage. Also, the parties need to be apprised of the criteria for and process of selection so that they may evolve their submissions in a manner that addresses all the criteria and facilitates compliance with procedural requirements.

The individual items that will be included in the Appendix are individual articles. It may be that implications of one discussion will affect other issues, but each article will be judged

on its own as a separate and independent piece of work (unless a special section of contributions is called for by the Committee, as might be the case with a special topic). What has been set forth all addresses relevance, interpretation, and application. To be adequately addressed in the selection process it will require a review body that has both experience and expertise that has the breadth and depth to address the various issues, and can subsume the diversity of perspectives. It is imperative that an integral part of this process be placed in the hands of a Peer Review Group that is comprised in such a way as make the Group as robust a source of experience and expertise as possible. This may mean that the Group is selected for specific articles from a pool of potential members, an Ad Hoc Group if you will.

CONCLUDING REMARKS

There is no question that flesh needs to be added to the bones of the skeletal structure as presented above. As stated earlier, this process has many similarities to the general process that is adopted by academic journals in selecting articles to publish, from the submissions they receive. One very critical element of the academic process which must be adopted as a necessary element of the process here is the Peer Review element.

In general, the articles must be relevant, timely, accurate, and useful to the stakeholders. The selection group must make sure that the information provided does not detract from the integrity or validity of the Model or Commentary.

It will be like any selection process. There are submissions that will be clearly at or above the standards that are ultimately articulated and are appropriate for inclusion, and some that will be clearly inappropriate for inclusion, for any number of reasons. The difficulty, as usual, lies with those submissions that fall somewhere in between. In some cases the Peer Review Committee (PRC) will suggest revision and resubmission, in some cases not. As standards for inclusion in this type of forum cannot be strictly objective, it becomes critical that the PRC be comprised in such a manner that captures the various levels of experience and expertise, and represents the diverse nature and interests of the stakeholders. Hence, design of and selection for the PRC is something that must be taken very seriously.

1. Draft report of the Fourth Meeting of the UN Committee of Experts on International Cooperation in Tax Matters, paragraph 65, E/C18/2007/19

2. Draft report of the Fourth Meeting of the UN Committee of Experts on International Cooperation in Tax Matters, paragraph 67, E/C18/2007/19

³ Ms. Ayala, statement made by Ms. Ayala during Manual Revision Subcommittee discussions, regarding proposal for a Mission Statement.

United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

Appendix for Special Consideration Articles:

A Proposed Timeline for Submission and Consideration of Articles for the Appendix for Special Consideration Articles

Revised for Comments Received up to October 1, 2009

As has generally been an issue, timeliness of submission of articles for inclusion in the proceedings of the Committee of Experts on International Cooperation in Tax Matters is of critical importance, given the nature of the process and the multitude of actions that is required for each paper that is finally placed on the agenda. Most of the papers that have been placed on the agenda in the past, for the Committee of Experts on International Cooperation in Tax Matters, deal with topics that have been settled on far in advance of the meeting for which they are proposed. In the case of the Special Consideration Articles, there would be an additional step. As these would typically be proposals submitted by the individuals without call from the Committee, they would be submitted to a panel of reviewers for approval for consideration, then would be placed on the agenda of the next upcoming meeting of the Committee for discussion and approval, denial, or revision. That review process will put additional time pressure on the process. Therefore, it is suggested that dates certain be established for submission, distribution to the review panel, and status resolution. The exact dates or time frames would be established by the Committee, in discussion with representatives present at the Committee meeting where such timeline is approved.

In general, the review panel should be made up of a pool of Committee members and other representatives from the government and non-government sectors. It would not be foreseen that there would be such a volume of proposals submitted that the task would be onerous, however, there could be times when the burden on the reviewers is greater than others. Therefore, it is suggested that each review be conducted by a panel of three, that at least one be a Committee member, and the other two be drawn from the pool. It would be appropriate that the pool could be expanded if it was felt that a member or representative that was not in the pool had a recognized level of expertise in a particular topic and would have valuable input into the decision making process. It would also be appropriate that the review be a blind review, that is the reviewers are anonymous. That is another reason to have a pool of eligible reviewers.

Keep in mind, this panel is only determining whether the proposal should be placed on the agenda for a Committee annual meeting, not for inclusion in the appendix. If the item was placed on the agenda and

discussion went forward at the meeting, there could be a vote for acceptance for inclusion in the Special Appendix.

This begs the question as to who would be eligible to vote. One response is that the Committee members would hold a secret ballot. This could lead to some discussion of the structure or composition of the Committee if it were felt that the appropriate interests were not represented. An extension of that would be to have a secret ballot of all the Committee members, the government representatives who are attending the meeting, and the representatives in attendance who are there in their capacity representing coalitions of member countries who do not send individual representatives. I think that since it is the Manual for the UN Model Convention, that voting should be limited to representatives of the UN membership. Neither process is without room for critique, but it would seem the latter is the most representative and leaves the least amount of room for scrutiny.

As to the timeline itself, if the logistical requirements indicate the staff must have the document two months prior to the Committee meeting, it would seem appropriate that submission to the panel must be no later than 5 months before the Committee meeting date. This would give the reviewers time to read and evaluate the proposal. If it was felt that the proposal needed modification, that would give time for a return of the proposal for revision and resubmission. The call for submissions should be made at each meeting to put the constituents on notice of the timeline and the process, even though the parties submitting the proposal need not necessarily be present at the meeting where the call is issued.

All of these suggestions can serve as a basis for initiating the discussion. The terms or requirements may also change if it is felt there would be a large number of submissions. Unfortunately, the level of interest cannot be predicted with any accuracy, and it may very well vary from year to year. So, there needs to be elements of rigor, consistency, and flexibility in the timeline consideration.

Please comment.

ISLAMIC FINANCIAL INSTRUMENTS

TREATMENT OF ISLAMIC FINANCIAL INSTRUMENTS UNDER THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES^v

At the Third session of the Committee one of the items discussed was the taxation of income from Islamic financial instruments. The working group document stated, in its Summary that the "... current drafting of the United Nations Model Double Taxation Convention between Developed and Developing Countries seems to be capable to deal with Islamic financial instruments, but some language could be included in commentary to provide that the definition of interest would include income from some types of Islamic financial arrangements..." At different points after the Working Group presented its document, it was suggested that such definitional statements, while perhaps not appropriate for inclusion in the Commentaries, would be the type of guidance oriented information that would be appropriate for the Special Appendix. Accordingly, the following items that emanate from the working group document have been included.

The working group emphasized in their presentation that the taxation of income from these financial arrangements is primarily a function of the characterization of the proceeds transferred from the various instruments. The significant distinction in the characterization process is the distinction between the use of a legal, or form-based approach, and an economic based approach to characterize the income. The latter approach looks to the substance or the economic realities of the arrangement. It is also the latter approach that can be interpreted to provide for the recharacterization of most of the Islamic financial arrangements described below into loans and to, therefore, treat the payments made according to the contractual terms of those arrangements as interest.^{vi}

The following descriptions are based upon the language and limited to the specific examples provided in the E/c.18/2007/9 document. Therefore, it may be deemed that other arrangements would be added to enhance the guidance provided by this item in the Special Appendix.

In the way of background^{vii}, over the past 1400 years, Islamic law has formulated details on how business is to be conducted, how accounting is to be performed, and how banking and finance is to be executed. Islamic finance methods that were sanctioned by the Quran^{viii} and Sunnah^{ix}, the two main sources of Islamic law, have provided merchants with a framework to engage in commerce and trade. Islam has defined a set of rules for trade and commerce. That which defies Islamic law, also known as *Shariah*, is considered *haram*, not permitted; practices that are permissible are *halal*. Islam has defined a set of rules for trade and commerce. That which defies Islamic law, also known as *Shariah*, is considered *haram*, not permitted; practices that are permissible are *halal*. Among these rules is the strict prohibition of the payment or collection of interest, also known as usury or *riba*.^x

The Working Group document addressed the following types of instruments or contracts: *musharaka*, *mudaraba*, *murabaha*, *ijara*, *salam*, *istisna'a*, and *sukuk*. Accordingly, they are included in the Special Appendix. The language used in the description is based upon that as presented in the Working Group document^{xi}, and various other sources of commentary.

Musharaka

Musharaka means partnership. The essence of the arrangement is an "equity participation contract" where the partners or owners contribute jointly to finance a project. The partners include a bank or banks as well as other forms of participants.

Profits and losses are split according to a pre-agreed formula.

A variation of this arrangement is the “diminishing musharaka” that is a partnership type arrangement that provides for a gradual buyout of one or more of the partners.

In the context of such an arrangement, the profit/loss sharing ratio does not have to reflect the same ratio as the investment ratio. Similar to the partnership rules in the United States tax law, the agreement of the partners is deciding, and as long as there is agreement, generally, the discrepancy between the two ratios is valid.

Mudaraba

This arrangement is characterized as an “investment partnership”^{xii} where the investor agrees to provide money to another party, an entrepreneur, in order to invest the funds or to undertake a business venture. Profits are distributed on the basis of a pre-agreed formula, while losses are born solely by the investor partner.

The profit sharing scheme is described as perfectly *sharia* compliant.^{xiii} The scheme is described as: a depositor deposits money with a financial institution (an Islamic bank), which would be used by the institution with the intent to produce a profit. The depositor has no role in deciding how the funds are to be invested. At various times, the institution would credit the depositor with a distribution of profits that have been generated by the institution’s use of the funds.

Murabaha

The literal translation of the term is “a sale on a mutually agreed profit.” The technical structure is an asset-based financing whereby the party that provides the capital (a bank) purchases an asset, as directed by the client (the capital user), from a third party in an open market, and resells it at a predetermined higher price to the client (client user) in a deferred payment arrangement, without interest, thereby obtaining a credit against the purchase obligation, without paying interest.

This arrangement is subject to strict conditions in the effort to achieve validity, i.e. be *sharia* compliant. While strict the conditions are not onerous. There must be full disclosure of all costs, including the purchase price, and the profit margin, at the time of the agreement, by the capital provider. Also, there can be no sale of the asset before all ownership issues are settled and the item(s) is reduced to possession and the risks of ownership are assumed by the capital provider.^{xiv}

A variation on that theme which raises concerns regarding *sharia* compliance has the capital provider selling the asset or commodity to the client on a deferred payment contract, who then immediately sells the commodity for cash. This level of immediacy associated with the client’s conversion of the commodity to cash gives the appearance of a loan from the capital provider, not a purchase and deferred payment arrangement.^{xv}

Ijara

The term means, literally, to rent. In the context of Islamic jurisprudence, the term includes the “...usufruct of assets and property (rental) and the hire of services of a person for a wage.”^{xvi}

The Ijara is a mode of financing to the lessee and a mode of investment for the lessor. The essential rules for a basic Ijara transaction include^{xvii}:

1. The term of the lease and consideration must be specified.
2. Liabilities given rise through the use of the asset/property will be the responsibility of the lessee. Liabilities surfacing from the ownership of the property are the responsibility of the lessor. If the lessee damages the property, they must compensate the lessor for it.
3. The day the asset is delivered or available for use is the day the lease is affective.
4. The object of rent cannot be something that can be consumed, like money, gas, or food. This gives rise to a loan and any rent charges constitutes *riba*. The item must stay in the owner's possession for the validity of the contract.

A variation is the Ijara Waktina which involves an arrangement whereby an asset is leases with a sale to the lessee at the end of the period.^{xviii}

Salam

Referred to as a *bai essalam* (or salam) contract, the arrangement is a contract of sale whereby the price (also referred to as capital) is immediately payable and the delivery of the commodity is deferred. The outcome of this structure: the seller is provided with immediate cash to finance his activity and to provide the buyer with the commodity at a relatively low price^{xix}

In Islam, there are three mandatory elements to a sale in order for it to be legitimate. At the time of sale, the product 1: must exist, 2: the seller must own it, and 3: it must be in the seller's possession. The only two exceptions to this general rule are the contracts of *salam* and *istisna'*. Historically, the *salam* arrangement was used in situations where the seller of the commodity needed the cash to finance the production of the commodity. One example of such a situation is the case of the farmer who needs the funds to finance the growing and harvesting of a crop.^{xx} The benefit to the buyer was generally realized in the form of a discount embedded in the purchase price.

The most important conditions to the validity of the *salam* are: the capital should be paid immediately (there can be no debt from the buyer to the seller), and the buyer cannot sell the commodity before the *salam* contract has been settled.

Istisna'a

The other document mentioned in the above discussion of the *salam* is the *istisna'a* which is a particular form of sale whereby a party (the purchaser) places an order to another party (the manufacturer) to manufacture a specific commodity for a determined price.^{xxi} It is generally agreed that the *istisna'a* is binding on both parties.^{xxii}

Of the four main schools of Islamic jurisprudence, three (Maliki, Chafii, and Hanbali schools) take the view of the *istisna'a* as a form of the *salam*. The distinction is the type of commodity to which the contract applies. The *istisna'a*

generally applies to manufactured commodities.^{xxiii} The requisite elements and conditions of validity for the *istisna'a* are the same as those for the *salam*.

The fourth school, the Hanafi school, offers forth the currently prevailing opinion that the *istisna'a* and *salam* are separate and distinct forms of contract. The differences between the two are, primarily: advance payment is not a condition of the *istisna'a*, the time of delivery is not necessarily fixed in the terms of the *istisna'a* while such element is essential in the *salam* contract, and once signed, the *salam* cannot be cancelled unilaterally, while the *istisna'a* can be cancelled before the manufacturer starts the work.^{xxiv}

In general, the *istisna'a* is similar in nature to the contract of *salam*, except *istisna'* pertains to specific goods ordered to be produced by a manufacturer. The goods must be manufactured with materials supplied by the manufacturer. Also, the price and specifications of the goods must be agreed upon for the validity of *istisna'*.

It is also pointed out, that, to distinguish from the *ijara*, the contract is for the manufactured commodity, not the services of the manufacturer. This permits the use of the *istisna'a* for project financing.

Sukuk

This is usually presented as the Islamic equivalent of the conventional corporate bond. It is better described as an investment certificate that represents a proportionate ownership in an asset. The significant characteristic is that the owner of the *sukuk* holds a beneficial interest in the asset(s) that is proportional

to the amount of the asset investment in the same proportion that is represented by the holders subscription to the total asset investment.^{xxv} A primary purpose of this arrangement is to spread the risk of the investment. Ownership shares in a project or investment that may require significant capital are offered to subscribers as a way to generate the capital and spread the risk. The subscribers then share in the profits. The arrangement, in its pure form, is likened to a western joint stock company.^{xxvi}

The sukuk may take different forms. The most popular or familiar forms are the salam sukuk, the istisna'a sukuk and the ijara sukuk. There are also the mudaraba and musharaka sukuk (or notes).^{xxvii} The following descriptions are taken from information presented in paragraphs 28 through 38 of E/c.18/2007/9.

Salam sukuk

This arrangement represents a fractional ownership in the capital investment of a salam transaction in which the purchaser will issue certificates representing ownership of the commodity to buyers. The benefit to the buyers is that the purchase price of the commodity, the basis for the ownership certificates, is lower than the value. At the time the certificates mature, the buyer is entitled to their respective share of the commodity which can then be sold at the higher, value oriented, price.^{xxviii}

The certificates represent a right to receive a share of the commodity when the underlying salam contract is settled. This point is important to

the discussion of whether or not the certificates themselves can be sold. While the debate continues, it appears that most scholars of Islamic financial arrangements take the position that the certificates cannot be transferred as they represent future interests in a commodity that has not been reduced to possession by the purchaser in the salam contract.^{xxix}

Istisna'a sukuk^{xxx}

The istisna'a involves financing a project consisting of manufacturing or constructing an asset at a price to be paid in future installments. The total amount of these installments includes a profit margin. The istisna'a sukuk is a fractional share in the istisna'a project financing.

The project customer provides the Islamic bank (the capital source) with the details of the project and the bank then engages contractors to submit bids which include specifications as to the timing of delivery of their product and the payment schedule which covers their costs and a profit margin. The bank issues the sukuk certificates based on the expected future income streams from the project.

Ijara sukuk^{xxxi}

Under the ijara contract the asset or property is leased by the owner to another person for a rental payment. The arrangement is structured to represent a lease for financial statement purposes, and will generate a

fixed income stream. The ijara sukuk represents a fractional ownership in this income stream.

Since the ijara sukuk represent an ownership in an existing tangible asset it may be traded in a secondary market.

Musharaka and mudaraba sukuk ^{xxxii}

The musharaka and mudaraba represent equity instruments. The musharaka and mudaraba sukuk represent fractional ownership interests in those equity instruments. The equity instruments represent ownership interests in private commercial enterprises or projects.

Holders of the sukuk certificates in a mudaraba sukuk share the profits with the entrepreneur who issues the certificates, but bear, in the totality, any losses arising from the mudaraba operations. While the owners are equity interest holders, they are not registered owners so hold no voting or representation rights. There is no guarantee that the certificate holders will be returned their capital investment, but most Islamic scholars recommend that such a guarantee by voluntary on the part of the entrepreneur.

There remain many questions regarding the issue of Islamic financial instruments but the purpose of this presentation in the Special Appendix is to provide a basic point of reference for representative types of Islamic financial instruments.

Reviewers should consider whether the discussion should include a discussion of the economic or legal theory which facilitates interpretation of the financial realities of these instruments.

Reviewers should also consider whether there are representative examples, such as the ones contained in E/c.18/2007/9, paragraphs 69 through 71, that should be included here.

PROPOSED TOPICS

It was proposed during the 3rd Session of the Committee that examples addressing issues surrounding the schemes for percentage sales and time period for sales of shares in real estate corporations should be included.

It was proposed during the 3rd Session of the Committee that examples reflecting scenarios in which states have refused to furnish requested information be included in order to give states guidance as to how to handle such refusals and factors that affect the alternative strategies for dealing with such situations.

There was also some discussion at the 3rd Session of the Committee that the Special Appendix would be an appropriate place for a "Best Practices" section for such specific topics as dispute resolution.

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- i E/C.18/2007/CRP2, page 3.
- ii E/C.18/2007/CRP2, page 4.
- iii E/C.18/2007/CRP2
- iv Double Taxation Convention and the Use of Conduit Companies”, in volume II of the loose-leaf version of the *OECD Model Tax Convention*, OECD, R(6)-1, at page R(6)-4, paragraph 4.
- v E/C.18/2007/9
- vi E/c.18/2007/9, “Summary.”
- vii “Islamic Banking and Accounting,” a research paper submitted by Ms. Sarah Tantawy in partial fulfillment of a course for matriculation of her program at California State University, Sacramento, April 2008.
- viii The Quran is the Holy Book that Muslims believe was revealed to the Prophet Muhammad as the last revelation sent to mankind and is the primary source used to deduce legislation.
- ix Along with the Quran, the Sunnah is another primary source used by Jurists and refers to the binding rules derived from the Prophet Muhamad’s sayings.
- x The Holy Qur’an in verse 278 of the second chapter (Al-Baqarah) states:
 “O ye who believe! Fear Allah and give up what remains of your demand for riba, if ye are indeed believers.” Verse 279 says,
 “If you do it not, take notice of war from Allah and His Messenger. But if ye turn back, ye shall have your capital sums. Deal not unjustly and you shall not be dealt with unjustly.
- xi E/c.18/2007/9, paragraphs 4 through 38.
- xii E/c.18/2007/9, paragraph 7.
- xiii E/c.18/2007/9, paragraph 6.
- xiv E/c.18/2007/9, paragraphs 9 and 10.
- xv E/c.18/2007/9, paragraph 11.
- xvi E/c.18/2007/9, paragraph 12.
- xvii “Islamic Banking and Accounting,” supra.
- xviii E/c.18/2007/9, paragraph 13.
- xix E/c.18/2007/9, paragraph 15.
- xx “Islamic Banking and Accounting,” supra.
- xxi E/c.18/2007/9, paragraph 18.
- xxii E/c.18/2007/9, paragraph 19.
- xxiii E/c.18/2007/9, paragraph 20.
- xxiv E/c.18/2007/9, paragraph 22.
- xxv E/c.18/2007/9, paragraphs 24 and 25.
- xxvi E/c.18/2007/9, paragraph 25.
- xxvii E/c.18/2007/9, paragraph 26.
- xxviii E/c.18/2007/9, paragraph 28.
- xxix E/c.18/2007/9, paragraph 29.
- xxx E/c.18/2007/9, paragraphs 30 and 31.
- xxxi E/c.18/2007/9, paragraphs 32 through 35.
- xxxii E/c.18/2007/9, paragraphs 36 through 38.

UN MODEL TREATY

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United Nations

2001 U.N. Model Income and Capital Tax Convention

PUBLICATION-DATE: January 11, 2001

2001 WTD 116-41; Doc 2001-16597

2001 U.N. Model Income and Capital Tax Convention

TEXT:
CONVENTION BETWEEN (STATE A) AND (STATE B) WITH RESPECT TO TAXES ON INCOME AND ON
CAPITAL n1

Preamble of the Convention n2

Chapter I
Scope of the Convention

Article 1
Persons Covered

This Convention shall apply to persons who are residents of one or both of the Contracting States.

Article 2
Taxes Covered

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are in particular:

(a) (in State A):

(b) (in State B):

4. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.

Chapter II
Definitions

Article 3
General Definitions

1. For the purposes of this Convention, unless the context otherwise requires:

- (a) The term "person" includes an individual, a company and any other body of persons;
- (b) The term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;
- (c) The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
- (d) The term "international traffic" means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;
- (e) The term "competent authority" means:
 - (i) (In State A):
 - (ii) (In State B):
- (f) The term "national" means:
 - (i) Any individual possessing the nationality of a Contracting State
 - (ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 4
Resident

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.
2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
 - (a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
 - (b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
 - (c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
 - (d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.
3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

Article 5

Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially:
 - (a) A place of management;
 - (b) A branch;
 - (c) An office;
 - (d) A factory;
 - (e) A workshop;
 - (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. The term "permanent establishment" also encompasses:
 - (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
 - (b) 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 a Contracting State for a period or periods aggregating more than six months within any twelve-month period.
4. Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include:
 - (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
 - (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
 - (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
 - (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.
 - (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
5. Notwithstanding the provisions of paragraphs 1 and 2, where a person -- other than an agent of an independent status to whom paragraph 7 applies -- is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

7. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.

8. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Chapter III Taxation of Income

Article 6 Income From Immovable Property

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall also apply to income derived from the direct use, letting or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 7 Business Profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or

similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. In so far as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this article.

5. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where profits include items of income which are dealt with separately in other articles of this Convention, then the provisions of those articles shall not be affected by the provisions of this article.

(NOTE: The question of whether profits should be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods and merchandise for the enterprise was not resolved. It should therefore be settled in bilateral negotiations).

Article 8

Shipping, Inland Waterways Transport and Air Transport

Article 8 (Alternative A)

1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

3. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or a boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.

4. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 8 (Alternative B)

1. Profits from the operation of aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of ships in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated unless the shipping activities arising from such operation in the other Contracting State are more than casual. If such activities are more than casual, such profits may be taxed in that other State. The profits to be taxed in that other State shall be determined on the basis of an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations. The tax computed in accordance with such allocation shall then be reduced by ___ per cent. (The percentage is to be established through bilateral negotiations).

3. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.

5. The provisions of paragraphs 1 and 2 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 9

Associated Enterprises

1. Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State -- and taxes accordingly -- profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of the Convention and the competent authorities of the Contracting States shall, if necessary, consult each other.

3. The provisions of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that by actions giving rise to an adjustment of profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or wilful default.

Article 10

Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;

(b) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except in so far as such dividends are paid to a resident of that other State or in so far as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the companys undistributed profits to a tax on the companys undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11

Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtors profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such

securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this article.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 or article 14, as the case may be, shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12

Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "royalties" as used in this article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 or article 14, as the case may be, shall apply.

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid,

exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13 Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in article 6 and situated in the other Contracting State may be taxed in that other State.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.
3. Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
4. Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:
 - (1) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.
 - (2) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding fifty percent of the aggregate value of all assets owned by the company, partnership, trust or estate.
5. Gains from the alienation of shares other than those mentioned in paragraph 4 representing a participation of __ per cent (the percentage is to be established through bilateral negotiations) in a company which is a resident of a Contracting State may be taxed in that State.
6. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14 Independent Personal Services

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:
 - (a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or
 - (b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15

Dependent Personal Services

1. Subject to the provisions of articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(c) The remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

Article 16

Directors' Fees and Remuneration of Top-Level Managerial Officials

1. Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the Board of Directors of a company which is a resident of the other Contracting State may be taxed in that other State.

2. Salaries, wages and other similar remuneration derived by a resident of a Contracting State in his capacity as an official in a top-level managerial position of a company which is a resident of the other Contracting State may be taxed in that other State.

Article 17

Artistes and Sportspersons

1. Notwithstanding the provisions of articles 14 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

Article 18

Pensions and Social Security Payments

Article 18 (alternative A)

1. Subject to the provisions of paragraph 2 of article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

2. Notwithstanding the provisions of paragraph 1, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Article 18 (alternative B)

1. Subject to the provisions of paragraph 2 of article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment may be taxed in that State.

2. However, such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by a resident of that other State or a permanent establishment situated therein.

3. Notwithstanding the provisions of paragraphs 1 and 2, pensions paid and other payments made under a public scheme which is part of the social security system of a Contracting State or a political subdivision or a local authority thereof shall be taxable only in that State.

Article 19

Government Service

1. (a) Salaries, wages and other similar remuneration, other than a pension, paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

(b) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the individual is a resident of that State who:

(i) Is a national of that State; or

(ii) Did not become a resident of that State solely for the purpose of rendering the services.

2. (a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

(b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that other State.

3. The provisions of articles 15, 16, 17 and 18 shall apply to salaries, wages and other similar remuneration, and to pensions, in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 20

Students

Payments which a student or business trainee or apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.

Article 21

Other Income

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply.

3. Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing articles of this Convention and arising in the other Contracting State may also be taxed in that other State.

Chapter IV Taxation of Capital

Article 22 Capital

1. Capital represented by immovable property referred to in article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, may be taxed in that other State.

3. Capital represented by ships and aircraft operated in international traffic and by boats engaged in inland waterways transport, and by movable property pertaining to the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

[4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State].

(The Group decided to leave to bilateral negotiations the question of the taxation of the capital represented by immovable property and movable property and of all other elements of capital of a resident of a Contracting State. Should the negotiating parties decide to include in the Convention an article on the taxation of capital, they will have to determine whether to use the wording of paragraph 4 as shown or wording that leaves taxation to the State in which the capital is located).

Chapter V Methods for the Elimination of Double Taxation

Article 23 A Exemption Method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of articles 10, 11 and 12, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

3. Where in accordance with any provision of this Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Article 23 B
Credit Method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State; and as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State. Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.
2. Where, in accordance with any provision of this Convention, income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Chapter VI
Special Provisions

Article 24
Non-Discrimination

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of article 1, also apply to persons who are not residents of one or both of the Contracting States.
2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.
3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.
4. Except where the provisions of paragraph 1 of article 9, paragraph 6 of article 11, or paragraph 6 of article 12 apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.
5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.
6. The provisions of this article shall, notwithstanding the provisions of article 2, apply to taxes of every kind and description.

Article 25
Mutual Agreement Procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, shall develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.

Article 26

Exchange of Information

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention, in so far as the taxation thereunder is not contrary to the Convention, in particular for the prevention of fraud or evasion of such taxes. The exchange of information is not restricted by article 1. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State. However, if the information is originally regarded as secret in the transmitting State it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes which are the subject of the Convention. Such persons or authorities shall use the information only for such purposes but may disclose the information in public court proceedings or in judicial decisions. The competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matters in respect of which such exchanges of information shall be made, including, where appropriate, exchanges of information regarding tax avoidance.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

(a) To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) To supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

Article 27

Members of Diplomatic Missions and Consular Posts

Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.

Chapter VII
Final Provisions

Article 28
Entry Into Force

- 1. This Convention shall be ratified and the instruments of ratification shall be exchanged at _____ as soon as possible.
- 2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

- (a) (In State A):
- (b) (In State B):

Article 29
Termination

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year _____. In such event, the Convention shall cease to have effect:

- (a) (In State A):
- (b) (In State B):

TERMINAL CLAUSE

NOTE: The provisions relating to the entry into force and termination and the terminal clause concerning the signing of the Convention shall be drafted in accordance with the constitutional procedure of both Contracting States.

FOOTNOTES:

n1 States wishing to do so may follow the widespread practice of including in the title a reference to either the avoidance of double taxation or to both the avoidance of double taxation and the prevention of fiscal evasion.

n2 The Preamble of the Convention shall be drafted in accordance with the constitutional procedures of the Contracting States.