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United Nations Model Tax Convention Update

**SECRETARIAT NOTE ON PROPOSED UPDATE OF
UNITED NATIONS MODEL TAX CONVENTION**

Summary

This note has been prepared by the Secretariat as a possible updated Introduction of the United Nations Model double Tax Convention. It should not necessarily be taken as reflecting the final views of the Secretariat, but is intended merely to facilitate discussion at the 2011 annual session.

INTRODUCTION

A. ORIGIN OF THE UNITED NATIONS MODEL CONVENTION

1. The United Nations Model Double Taxation Convention between Developed and Developing Countries (the United Nations Model Convention) forms part of the continuing international efforts aimed at eliminating double taxation. These efforts were begun by the League of Nations and pursued in the Organisation for European Economic Cooperation (OEEC) (now known as the Organisation for Economic Co-operation and Development (OECD)) and in regional forums, as well as in the United Nations, and have in general found concrete expression in a series of model or draft model bilateral tax conventions.
2. These Models, particularly the United Nations and OECD Models, have had a profound influence on international treaty practice, and have significant common provisions. The similarities between these two leading Models reflect the importance of achieving consistency where possible while the important areas of divergence exemplify, and allow a close focus upon, some key differences in approach or emphasis as exemplified in state practice. Such differences relate, in particular, to the issue of how far one country or the other should forego, under a bilateral tax treaty, taxing rights which would be available to it under domestic law, with a view to avoiding double taxation and encouraging investment.
3. The United Nations Model Convention generally favours retention of so called “source State” taxing rights under a tax treaty – the taxation rights of the host state of investment - as compared to those of the residence State of the investor. This has long been regarded as an issue of special significance to developing countries, although it is something that some developed countries seek in their bilateral treaties also.
4. The desirability of promoting greater inflows of foreign investment to developing countries on conditions which are politically acceptable as well as economically and socially beneficial has been frequently affirmed in resolutions of the General Assembly and the Economic and Social Council of the United Nations and the United Nations Conference on Trade and Development. The 2002 Monterrey Consensus on Financing for Development¹ and the follow up Doha Declaration on Financing for Development of 2008² together recognize the special importance of international tax cooperation in encouraging investment for development and maximizing domestic resource mobilization, including by combating tax evasion. They also recognize the importance of supporting national efforts in these areas by strengthening technical assistance (in which this Model will play a vital part) and enhancing international cooperation and participation in addressing international tax matters (of which this Model is one of the fruits).
5. The growth of investment flows between countries depends to a large extent on the prevailing investment climate. The prevention or elimination of international double taxation in respect of the same income—the effects of which are harmful to the exchange of goods and services and to the

¹ United Nations 2002, A/CONF.198/11

² United Nations 2008, A/CONF.212/L.1/Rev.1

movement of capital and persons, constitutes a significant component of such a climate.

6. Broadly, the general objectives of bilateral tax treaties therefore include the protection of taxpayers against double taxation with a view to improving the flow of international trade and investment and the transfer of technology. They also aim to prevent certain types of discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can confidently be carried on. With this background, tax treaties should contribute to the furtherance of the development aims of developing countries. In addition, the treaties seek to improve cooperation between taxing authorities in carrying out their functions, including in relation to exchange of information such as with a view to combating tax evasion.

7. The desirability of encouraging the conclusion of bilateral tax treaties between developed and developing countries was recognized by the Economic and Social Council of the United Nations, in its resolution 1273 (XLIII) adopted on 4 August 1967. This led to the Secretary-General setting up in 1968 the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries. The Group was composed of tax officials and experts from both developing and developed countries, appointed in their personal capacity.

8. In 1980, the United Nations published, as a result of the Ad Hoc Group of Experts' deliberations, the United Nations Model Double Taxation Convention between Developed and Developing Countries, which was preceded in 1979 by the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries. By its resolution 1980/13 of 28 April 1980, the Economic and Social Council renamed the Group of Experts as the "Ad Hoc Group of Experts on International Cooperation in Tax Matters", recognizing the importance of non tax treaty related international tax cooperation issues.

9. In the 1990s, the Ad Hoc Group of Experts recognized that significant changes had taken place in the international economic, financial and fiscal environment. In addition, there was increasing focus on tax impacts of new financial instruments, transfer pricing, the growth of tax havens and the globalization affecting international economic relations. The subsequent increasingly frequent OECD Model Convention updates contributed to this process of greater reflection on international tax cooperation issues. Consequently, the Group of Experts proceeded with the revision and update of the UN Model and the Manual. This led to a new version of the UN Model published in 2001³ and the new version of the Manual published electronically in 2003⁴.

10. In 2005 the Group of Experts was upgraded by conversion into a Committee structure, which remains its current form. The 25 Members of the Committee of Experts on International Cooperation in Tax Matters are nominated by countries and chosen by the Secretary-General of the United Nations to act in their personal capacities for a period of 4 years. The Committee now directly reports to the UN Economic and Social Council (ECOSOC) and it now meets every year rather than every second year.

3United Nations 2001, E.01. XVI.2. Available at: <http://www.un.org/esa/ffd/tax/index.htm>

4 <http://www.un.org/esa/ffd/tax/manual.htm>

B. SPECIAL CHARACTERISTICS OF THE UNITED NATIONS MODEL

11. The United Nations Model Convention represents a compromise between the source principle and the residence principle, although as noted above, it gives more weight to the source principle than does the OECD Model Convention. It aims not to be prescriptive, but to equip decision-makers in countries with the information they need to understand the consequences of these differing approaches for that country's specific situation. As noted in the previous version of the Model, the provisions of the Model Convention are not themselves enforceable. Its provisions are not binding and should not be construed as formal recommendations of the United Nations. It aims to facilitate the negotiation, interpretation and practical application of bilateral tax treaties based upon it.

12. The Model seeks to be balanced in its approach. As a corollary to the principle of taxation at source the articles of the Model Convention are based on a recognition by the source country that (a) taxation of income from foreign capital would take into account expenses allocable to the earnings of the income so that such income would be taxed on a net basis, that (b) taxation would not be so high as to discourage investment and that (c) it would take into account the appropriateness of the sharing of revenue with the country providing the capital. In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption as in the OECD Model Convention.

13. In using the United Nations Model Convention, a country should bear in mind the fact that the relationship between treaties and domestic law may vary from country to country and that it is important to take into account the relationship between tax treaties and domestic law. Tax treaties affect the tax rules prevailing under the domestic tax laws of the Contracting States by establishing which Contracting State shall have jurisdiction to subject a given income item to its national tax laws and under what conditions and with what limitations it may do so. Consequently, countries wishing to enter into bilateral tax treaty negotiations should analyse carefully the applicable provisions of their domestic tax laws in order to assess the modifications that might be required if the treaty were applied. They should also discuss the relevant domestic laws of potential treaty partners, as part of the preparation and negotiation of a treaty.

14. It may also be noted that domestic tax laws in their turn exert a substantial influence on the content of bilateral tax treaties. They are an important reason for many of the differences between treaties, and form the basis for the policy positions found in the various Models. Conversely, if countries do not exert certain taxing rights in domestic law, and see no likelihood of that changing, they generally do not seek to retain the ability to exert that taxing right under their treaties.

15. The current revision of the United Nations Model is the beginning of an ongoing process of review, which the Committee hopes will result in more frequent updates to keep up with developments and to operate as a process of continuous improvement. This means that some articles have not yet been substantively reviewed by the Committee.

16. The main objectives of this revision of the United Nations Model Convention were to take account of developments in the area of international tax policies relevant for developing and developed countries. The Committee also identified treaty policy issues that require further work and it mandated one Subcommittee to address the issue of the taxation treatment of services in general and in a broad way including all related aspects and issues. Furthermore, the issue of taxation of fees for technical services should also be addressed. Many source states, particularly certain developing countries, have found that the lost revenue opportunity, which can be considerable when dealing with the service industry, can be reduced by including a right to tax technical services in the tax treaty either in a separate article or including technical services in the definition of royalties. It was recognized that this was the initiation of some extensive work and it was agreed that there would not be any results ready for incorporation into this version of the Model Convention. In the future, if the Committee so decides, any potential conclusions that could be useful may therefore be presented as a Committee Report which may shape the next revision of the United Nations Model Convention.

C. MAIN FEATURES OF THE CURRENT VERSION OF THE MODEL

[This is subject, especially for the Commentaries, to decisions taken at the 2011 Annual Session]

17. The main differences between this version of the Model and the previous version published in 2001 are as follows:

- A modified version of Article 13(5) to address possible tax evasion;
- A modification of the note to Article 22 to reflect that the Group of Experts referred to in that note no longer exists;
- An optional version of Article 25 that provides for mandatory binding arbitration when a dispute cannot be solved under the usual Mutual Agreement Procedure;
- A new version of Article 26 that confirms and clarifies the importance of exchange of information under the Model, along the lines of the current OECD provision; and
- A new Article 27 on Assistance in the Collection of Taxes, along the lines of the current OECD provision.

18. There have been some changes to the Commentaries on the Articles to reflect the changes referred to above, as well as:

- Additions to the Commentary on Article 1 addressing the improper use of tax treaties (paragraphs 8-103);
- A generally updated Commentary on Article 5;
- Alternative text in the Commentary on Article 5 for cases where countries delete Article 14 and rely on Articles 5 and 7 to address cases previously covered by that Article (paragraphs 15.1-15.25);
- An addition to the text of the Commentary on Article 7, noting that the OECD approach to Article 7 evidenced in the 2010 OECD Commentary (and deriving from the 2008 OECD

Report on the Attribution of Profits to Permanent Establishments) is not adopted in relation to the differing United Nations Model Convention Article (paragraph 1) ;

- Incorporation of newer text on beneficial ownership drawn from the OECD Model Tax Convention in the Commentaries on Article 10 (paragraph 13) Article 11(paragraph 18); and
- New text in the Commentary on Article 11 on the treatment of certain instruments which, while technically not interest bearing loans, are treated in the same fashion for treaty purposes. This is especially relevant for the treatment of certain Islamic financial instruments (paragraph 19.1-19.4).

D. TERMS USED IN THE COMMENTARIES

19. The Commentaries on the Articles are regarded as part of the United Nations Model Convention, along with the Articles themselves. The OECD Model Tax Convention on Income and on Capital is referred to in the Commentaries on the Articles as “the OECD Model Convention,” and references are to the 2010 version of that Model unless otherwise indicated. The United Nations Model Double Taxation Convention between Developed and Developing Countries is referred to in the Commentaries on the Articles as “the United Nations Model Convention”.