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REVISED DRAFT ARTICLE XX AND COMMENTARY
UNITED NATIONS MODEL TAX CONVENTION

Article XX – Fees for Technical and Other Services

1. Fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, notwithstanding Article 14 and subject to the provisions of Articles 8, [17 and 20], fees for technical services arising in a Contracting State 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 fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ percent of the gross amount of the fees (the percentage to be established through bilateral negotiations).

3. The term "fees for technical services" as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:

(a) to an employee of the person making the payment;
(b) to a director or top-level managerial official of a company that is a resident of the Contracting State in which the fees arise;
(c) for teaching in or by educational institutions [as part of a degree granting program];
(d) by an individual for services for the personal use of the individual; or
[(e) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property].

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for technical services arise through a permanent establishment situated in that other State, or performs in the other Contracting State independent personal services from a fixed base situated in that other State, and the fees for technical services are effectively connected with

a) such permanent establishment or fixed base, or
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. For the purposes of this Article, subject to paragraph 6, fees for technical services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person 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 obligation to pay the fees was incurred, and such fees are borne by the permanent establishment or fixed base.

6. For the purposes of this Article, fees for technical services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State or a third State through a permanent establishment situated in that other State or the third State, or performs independent personal services through a fixed base situated in that other State or the third State and such fees are borne by that permanent establishment or fixed base.

7. Where, by reason of a special relationship between the payer and the beneficial owner of the fees for technical services or between both of them and some other person, the amount of the fees, having regard to the services 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 [the amount that would have been agreed upon in the absence of such relationship]. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

REVISED DRAFT COMMENTARY ON ARTICLE XX – FEES FOR TECHNICAL SERVICES

A. General Considerations

1. Article XX was added to the United Nations Model Convention in 2016 to allow a Contracting State to tax fees for certain technical and other services made to a resident of the other Contracting State on a gross basis at a rate to be negotiated by the Contracting States. In general, a Contracting State is entitled to tax fees for technical services if the fees are paid by a resident of that State or by a nonresident with a permanent establishment or fixed base in that State if the payments are borne by the permanent establishment or fixed base; it is not necessary for the technical services to be performed in that State.

2. Until the addition of Article XX, income from services, including income from technical services, derived by an enterprise of a Contracting State was taxable exclusively by the State in which the enterprise was resident. However, if the enterprise carried on business through a permanent establishment in the other State (the source State) or provided professional or independent personal services through a fixed base in the source State, the source State was entitled to tax the income attributable to the permanent establishment or fixed base under Article 7 or 14 respectively. In the absence of a permanent establishment or fixed base in the source State, it was thought that an enterprise resident in a Contracting State was not sufficiently involved in the economy of the source State to justify that State taxing the income. However, with the rapid changes in modern economies, particularly with respect to cross-border services, it is now possible for an enterprise resident in one State to be substantially involved in another State's economy without a permanent establishment or fixed base in that State and without any substantial physical presence in that State.

3. The United Nations Model Convention recognizes certain exceptions to the general rule of exclusive residence-State taxation of income from services in the absence of a permanent establishment or fixed base in the other Contracting State. These exceptions are limited to certain types of services. For example, under Article 8 (alternative A), income from international transport is taxable exclusively by the State in which the place of effective management of the enterprise is located; under Article 8 (alternative B), the source country is entitled to tax income from the operations of ships in international traffic if the operations in that country are more than casual.

4. Exceptions are also found in Articles 16 and 17. Under Article 16, a Contracting State is entitled to tax directors' fees and the remuneration of top-level managerial officials derived by residents of the other State if the fees or remuneration are derived by those residents in their capacity as directors or officials of companies resident in the first State. In this case, the State in which the company paying the fees or remuneration is resident is entitled to tax irrespective of whether the services are performed inside or outside that State. Under Article 17, a Contracting State is permitted to tax income

from the activities of an artiste or sportsperson if the activities take place in that State. No permanent establishment or fixed base is necessary. Nor is it necessary for the artiste or sportsperson to be present in the source State for a certain minimum amount of time.

5. Where an enterprise of one Contracting State provides technical, consulting or management services to a resident of the other Contracting State or to nonresidents carrying on business through a permanent establishment in that State or providing independent services through a fixed base in that State, the other State will not generally be able to impose tax on the income from services derived by the enterprise unless the enterprise has a permanent establishment or fixed base in that State through which the services are performed. Under Article 7 of the United Nations Model Convention, a Contracting State is not entitled to tax business profits derived by an enterprise of the other Contracting State unless the enterprise has a permanent establishment in the first State and the profits are attributable to the permanent establishment. Under Article 5, a permanent establishment is defined to be a fixed place of business that, in accordance with international practice, must generally be maintained by the enterprise for a minimum period of 6 months. Under Article 5(3)(b), a permanent establishment is deemed to exist if an enterprise furnishes services in the other State for the same or a connected project for a period or periods aggregating more than 183 days in any 12-month period. With modern means of communication and information technology, it is relatively easy for an enterprise of one Contracting State to provide substantial services in the other Contracting State without having any fixed place of business in that State and without being present in that State for any substantial period. As a result, the State in which the payments arise is often precluded from taxing income from technical and other similar services under Article 7.

6. A similar analysis applies with respect to the possible application of Article 14 in the case of professional and other independent personal services for those countries that choose to retain Article 14 in their bilateral treaties. Under Article 14, a Contracting State is entitled to tax income from such services provided by a resident of the other Contracting State only if the resident has a fixed base in the first State regularly available to him and the income is attributable to that fixed base or if the resident is present in the first State for 183 days or more in any 12-month period beginning or ending in the relevant fiscal period. Thus, a resident of one Contracting State can often provide independent personal services to persons in the other Contracting State without having a fixed base in that State and without being present there for any substantial period. If the resident does not have a fixed base in the other State or is not present in the other State for at least 183 days, that State is not allowed to tax fees for technical or other similar services of an independent nature derived by the resident despite the fact that the fees arise in that State.

7. It is also worth noting that fees for technical services paid by a resident of one Contracting State to a resident of the other Contracting State cannot generally be taxed by the State in which the payer is resident as royalties under Article 12 of the United Nations Model Convention. Article 12 permits a Contracting State in which royalties arise to tax the gross amount of the royalty payments at a rate to be negotiated between the Contracting States. Royalties are defined in Article 12(2) to

mean payments for the use of, or the right to use, any copyright, patent, trademark, design, plan, secret formula or process, any industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience. In general, royalties mean payments for the use of, or the right to use, intellectual property, equipment or know-how (information concerning industrial, commercial or scientific experience). Thus, royalties involve the transfer of the use of or the right to use property or know-how. In contrast, typically when an enterprise provides services to a customer, the enterprise does not transfer its property or know-how or experience; instead, the enterprise simply performs work for the customer. Under a so-called "mixed contract," an enterprise may provide both services and the right to use property or know-how to a customer. In such situations, in accordance with paragraph 12 of the Commentary on Article 12 (quoting paragraph 11.6 of the Commentary on Article 12 of the OECD Model Convention), the payments under the contract must be disaggregated into separate elements of payments for services and royalties unless one element is only ancillary and largely unimportant. The negotiation of a rate of tax for fees for technical services that is the same as the rate for royalties in Article 12 may help to alleviate the difficulties with mixed contracts and, in particular, may be useful for developing countries with scarce administrative resources.

8. The meaning of the expression "information concerning industrial, commercial or scientific experience" in Article 12 of the United Nations Model Convention is unclear. Some countries take the position that the provision of brain-work and technical services are covered by this phrase and that therefore payments for such services are taxable under Article 12. (See paragraphs 14 and 16 of the Commentary on Article 12.)

9. The uncertainty concerning the treatment of fees for technical and other similar services under the provisions of the United Nations Model Convention, as it read before 2016, was undesirable for both taxpayers and tax authorities. It may have discouraged cross-border trade in services, contrary to the fundamental purpose of the United Nations Model Convention and bilateral tax treaties generally. It may also have resulted in unrelieved double taxation or double non-taxation.

10. Fees for technical and other similar services may also result in the erosion of the tax base of source countries if these countries are prevented from taxing such fees by the provisions of the United Nations Model Convention. Fees for technical and other similar services are usually deductible against a country's tax base if the payer is a resident of the country or a nonresident with a permanent establishment or fixed base in the country. The reduction or erosion of a country's tax base by deductible fees for technical services is not generally objectionable. If the payer is an enterprise, the payments are legitimate expenses incurred by the payer for the purpose of earning income and should be deductible (assuming, of course, that the amount of the payments is reasonable). If the country is entitled to tax the nonresident service provider on the fees earned for the technical services, the reduction of the country's tax base by the deductible payments will be offset by the country's tax on the fees for technical services.

11. Where technical and other similar services are provided by an enterprise of one Contracting State to an associated enterprise in the other Contracting State, there is the possibility that the payments may be more or less than the arm's length price of the services. Within a multinational group, technical services may sometimes be used to shift profits from a profitable group company resident and operating in one country to another group company resident in a low-tax country. Assume, for example, that Company B, an enterprise resident in Country B, a low-tax country, provides technical or other similar services to Company A, an associated enterprise resident in Country A, a high-tax country. Company B arranges its affairs so that it does not have a permanent establishment in Country A within the meaning of the tax treaty between Country A and Country B. Assuming that the tax treaty between Country A and Country B is similar to the United Nations Model Convention, Company B can avoid having a permanent establishment in Country A by not establishing a fixed place of business in Country A and by not furnishing services in Country A for more than 183 days in any 12-month period. Thus, even if Company B is subject to tax on its income from services provided to Company A under the domestic tax law of Country A, the income is not taxable by Country A if there is a tax treaty between Country A and Country B similar to the United Nations Model Convention. In addition, Company B may not be taxable by Country B on its income from services provided to Company A or may be subject to a low rate of tax on such income. Thus, the multinational enterprise has effectively shifted profits from a relatively high-tax country (Country A) to a relatively low-tax country (Country B).

12. In addition, ordinarily the fees paid by Company A to Company B for the services will be deductible by Company A in computing its income subject to tax by Country A. This deduction erodes the tax base of Country A and Country A cannot impose tax on the payments by Company A to Company B as discussed in paragraph 11 to offset the effect of the deduction. However, if the fees for technical services were paid to a resident of Country A or a nonresident of Country A with a permanent establishment or fixed base in Country A, Country A would be entitled to tax those fees.

13. The base erosion and profit shifting illustrated in this example raise serious concerns for both developed and developing countries. The G-20 and the OECD have identified base erosion and profit shifting ("BEPS") as a serious problem and launched an ambitious project with 15 actions to control and limit base erosion and profit shifting (www.oecd.org). The OECD BEPS project does not identify the performance of services as a base-erosion or profit-shifting issue to be dealt with. However, as illustrated by the preceding example, services can be used by multinationals with relative ease to shift profits out of a country and erode that country's tax base. This problem is especially serious from the perspective of developing countries because they are disproportionately importers of such services and may not have the administrative capacity to control or limit such base erosion and profit shifting through anti-avoidance rules in their domestic law and their tax treaties.

14. The inability of source countries to tax fees for technical services provided by nonresident service providers under the provisions of the United Nations Model Convention gives nonresident service providers an inappropriate competitive advantage over domestic service providers. Fees for technical services provided by domestic service providers will be subject to domestic tax at the ordinary rate

applicable to business profits. In contrast, as indicated above, nonresident service providers will not be subject to any source country tax if they do not have a permanent establishment or a fixed base in the source country and they may only be subject to low taxes (or no tax at all) on the fees earned in their country of residence.

15. As a result of these considerations, the United Nations Committee of Experts identified as a priority the provision of technical and similar services as part of its larger project on the taxation of services under the United Nations Model Convention. After considerable study and debate, the Committee decided to add a new article to the United Nations Model Convention to allow a Contracting State to tax fees for technical services paid to a resident of the other Contracting State by a resident of the first State or a nonresident with a permanent establishment or fixed base in the first State.

16. The OECD Model Convention has no similar provision dealing with fees for technical services. The OECD considers that there is a fundamental principle underlying the OECD Model Convention that a Contracting State is entitled to tax income from services derived by a resident of the other Contracting State only if the services are performed in the first State. The United Nations Committee of Experts rejects this position as a fundamental principle underlying the United Nations Model Convention. Base erosion is a sufficient nexus to justify source country taxation of income from employment under Article 15 and directors' fees and remuneration of top-level managerial officials under Article 16. Although taxation of employment income under Article 15 is limited to employment exercised in a country, Article 16 allows a Contracting State to tax an individual resident in the other Contracting State on fees derived by the individual as a director or remuneration derived as a top-level managerial official of a company resident in the first State irrespective of whether the services are rendered inside or outside the first State. Moreover, even under Articles 7 and 14, a country is entitled to tax income derived outside the country as long as the income is attributable to a permanent establishment or fixed base.

17. "Minority view" draft …

[…]

[21.] Article XX allows fees from technical services to be taxed by a Contracting State on a gross basis. In contrast, income from services is generally considered to be taxable on a net basis under Article 7 or Article 14. The OECD takes the view that income from services should invariably be taxed on a net basis (paragraph 42.18 of the Commentary on Article 5 of the OECD Model Convention). However, many developing countries have limited administrative capacity and need a simple, reliable and efficient method to enforce tax imposed on income derived by nonresidents from services. A withholding tax imposed on the gross amount of payments made by residents of the country, or nonresidents with a permanent establishment or fixed base in the country, is well established as an effective method of collecting tax imposed on nonresidents. Such a method of taxation also simplifies compliance for enterprises providing services in another State since they are not required to compute their net

profits or file tax returns. Moreover, if necessary, enterprises of one Contracting State that are substantially involved in the economy of another Contracting State can take steps to establish a permanent establishment or fixed base in that State to ensure that the profits derived from the services performed through that permanent establishment or fixed base are taxable by that State on a net basis.

[22.] Article XX does not require any threshold, such as a permanent establishment, fixed base or minimum period of presence in a Contracting State as a condition for the taxation of fees for technical and other similar services. In this regard, Article XX is significantly different from Article 7 and Article 14, which require a relatively high threshold for source-country tax. However, in the case of technical and other services, modern methods for the delivery of services allow nonresidents to furnish substantial services in or to a country with no or limited presence there. This ability to derive income from a country with little or no presence there, combined with concerns about the base-erosion and profit-shifting aspects of technical services, is considered by a majority of the members of the Committee of Experts to justify the absence of any threshold requirement as a condition for source-country taxation.

[23.] Where fees for technical services are dealt with in both Article XX and Article 7, paragraph 7 of Article 7 provides that the provisions of Article XX prevail. However, this priority for Article XX does not apply if the beneficial owner of the fees for technical services carries on business through a permanent establishment in the Contracting State in which the fees arise and the technical services are effectively connected with the permanent establishment or business activities referred to in (c) of paragraph 1 of Article 7. In this situation, paragraph 4 of Article XX provides that the provisions of Article 7 apply instead of Article XX.

[24.] Similarly, where fees for technical services are dealt with in both Article XX and Article 14, paragraph 2 of Article XX indicates expressly that Article XX applies notwithstanding the application of Article 14. However, the priority for Article XX over Article 14 does not apply if the beneficial owner of the fees performs independent personal services in the Contracting State in which the fees for technical services arise through a fixed base situated in that State and the technical services are effectively connected with the fixed base. In this situation, paragraph 4 of Article XX provides that the provisions of Article 14 apply instead of Article XX.

[25.] There is no overlap between Article XX and Articles 15, 16, 18 and 19 dealing with income from employment, directors' fees and remuneration of top-level managerial officials of a company resident in a Contracting State, pensions and government services respectively because the definition of fees for technical services in paragraph 3 of Article XX expressly excludes these amounts. Similarly, since paragraph 2 of Article XX is subject to the provisions of Articles 8, 17 and 20, Article XX does not apply to the fees for technical services covered by those provisions. Although it is unlikely that payments for activities covered by Article 17 or Article 20 would be within the definition of fees for technical services, it was considered important to eliminate any uncertainty in this regard. Therefore, for example, if payments are made by residents of one Contracting State to an entertainer or sportsperson resident in the other Contracting State for technical services, such

payments are not subject to tax by the first Contracting State in which the payers are resident if the technical services are performed outside the Contracting State.

[26.] Fees for technical services could possibly include profits from international shipping, inland waterways transport and international air transport dealt with in Article 8, especially profits from activities auxiliary to the direct operation of ships and aircraft as discussed in paragraph 11 of the Commentary on Article 8. Therefore, to eliminate any uncertainty, paragraph 2 of Article XX provides expressly that it is subject to Article 8. Thus, any fees for technical services that result from the operation of ships or aircraft in international traffic or the operation of boats in inland waterways or auxiliary activities are taxable exclusively in accordance with Article 8 of the United Nations Model Convention.

[27.] There is the potential for the application of both Article XX and Article 12 dealing with royalties in particular cases. The distinction between technical services under Article XX and royalties under Article 12 is clear in principle although difficult issues may arise in practice with respect to the distinction between payments for services and payments for information concerning industrial, commercial or scientific experience or know-how. Guidance for making the distinction on a practical basis in particular situations is provided in paragraph 12 of the Commentary on Article 12.

B. Commentary on the Paragraphs of Article XX

Paragraph 1

[28.] This paragraph establishes that fees for technical services arising in one Contracting State and paid to a resident of the other Contracting State may be taxed in the other Contracting State. It does not, however, provide that such fees are taxable exclusively by the State of residence.

[29.] In most cases, the person who performs the technical services will be the recipient of the fees for those services. If the person who receives the fees for technical services is not the person who performs those services, it is a matter of domestic law as to who is the proper taxpayer. If fees for technical services are made to a person other than the person who performs the services, Article XX applies to the fees as long as the recipient is a resident of the other Contracting State.

[30.] The expression “fees for technical services” is defined in paragraph 3 of Article XX to mean any “payment” for managerial, technical or consulting services. The term “payment” has a broad meaning consistent with the meaning of the related term “paid” in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the OECD Model Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the OECD Model Convention), the concept of payment means the fulfillment of the obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

[31.] Article XX deals only with fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State who performs those services. It does not, therefore, apply to fees for technical services arising in a third State. Paragraphs 5 and 6 specify when fees for technical services are deemed to arise in a Contracting State and deemed not to arise in a Contracting State. However, unlike Articles 10 and 11, which do not apply to dividends paid by a company resident in a third State or interest arising in a third State, Article XX applies to fees for technical services paid by a resident of a Contracting State or a third State that are borne by a permanent establishment or fixed base that the resident has in the other Contracting State.

Paragraph 2

[32.] This paragraph lays down the principle that the Contracting State in which fees for technical services arise may also tax those payments. However, if the beneficial owner of the fees is a resident of the other Contracting State, the amount of tax imposed by the State in which the fees for technical services arise may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the payments

[33.] When considered in conjunction with Article 23, paragraph 2 establishes the primary right of the country in which fees for technical services arise to tax those payments in accordance with its domestic law. Accordingly, the country in which the recipient of the fees is resident is obligated to prevent double taxation of those fees. Under Article 23, the residence country is required to provide relief from double taxation through the exemption of the fees for technical services or the granting of a credit for any source-country tax imposed on those fees in accordance with Article XX.

[34.] The decision not to recommend a maximum rate of tax on fees for technical services is consistent with Articles 10, 11 and 12 of the United Nations Model Convention dealing with dividends, interest and royalties, respectively. The decision can be justified under current treaty practice. The withholding rates for payments for technical services adopted in bilateral tax treaties between developed and developing countries vary widely.

[35.] A precise level of withholding tax on fees for technical services should take into account several factors, including the following:

- the possibility that a high rate of withholding tax might cause nonresident service providers to pass on the cost of the tax to customers in the source country, which would mean that the source country would increase its revenue at the expense of its own residents rather than the nonresident service providers;
- the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment;
- the possibility that some nonresident service providers may incur high costs in providing technical services so that a high rate of withholding tax

on the gross fees may result in an excessive effective tax rate on the net income derived from the services;

- The potential benefit of applying the same rate of withholding tax to both royalties under Article 12 and fees for technical services under Article XX (see Example 5, paragraphs 82 and 83).
- the fact that a reduction of the withholding rate has revenue and foreign-exchange consequences for the source country; and
- the relative flows of payments for technical services (e.g., from developing to developed countries).

[36.] Article XX applies notwithstanding Article 14. Under Article 14, income from the performance of professional or other independent personal services by a person who is a resident of a Contracting State is taxable by the other Contracting State only if the services are performed through a fixed base in the other Contracting State that is regularly available to the person or if the person stays in that State for 183 days or more in any twelve-month period commencing or ending in the relevant fiscal period.

[37.] Since Article XX applies notwithstanding Article 14, the conditions for the taxation of income from professional or other independent personal services under Article 14 do not apply to the taxation of fees for technical services under paragraph 2 of Article XX. Thus, fees for technical services are taxable by a Contracting State in accordance with the provisions of paragraph 2 of Article XX if the fees arise in that State, irrespective of whether the person who performs the services has a fixed base in that State, stays in that State for any particular length of time, or performs the technical services in that State. However, by virtue of paragraph 4 of Article XX, if a resident of one Contracting State performs independent personal services (that are technical services) in the other Contracting State through a fixed base that is regularly available to the resident, or stays in the other Contracting State for 183 days or more and receives fees for technical services within the meaning of paragraph 3 of Article XX, Article 14 will apply to those payments in priority to Article XX.

[38.] Article XX takes priority over Article 7 as a result of paragraph 7 of Article 7. Thus, the conditions for the taxation of the business profits of an enterprise under Article 7 do not apply to fees for technical services covered by Article XX. Fees for technical services are taxable by a Contracting State under paragraph 2 of Article XX if the fees arise in that State irrespective of whether the enterprise performing the services has a permanent establishment in that State, performs services that are similar to those effected through the permanent establishment or performs the technical services in that State. However, by virtue of paragraph 4 of Article XX, if an enterprise of one Contracting State performs technical services through a permanent establishment in the other Contracting State and receives fees for technical services within the meaning of paragraph 3 of Article XX, Article 7 will apply to those payments in priority to Article XX.

[39.] The application of paragraph 2 of Article XX is expressly subject to the provisions of Articles 8, [17 and 20]. Certain payments for international shipping, air transportation or inland waterways transport under Article 8 could be within the definition of fees for technical services in paragraph 3 of Article XX. This might be

the case with respect to auxiliary activities that are closely connected to the direct operation of ships and aircraft, as discussed in paragraph 11 of the Commentary on Article 8. To eliminate any uncertainty in this regard, paragraph 2 of Article XX explicitly provides that in any situation in which both Article XX and Article 8 apply to the same services, Article 8 takes precedence over Article XX.

[40.] Paragraph 2 of Article XX is not expressly subject to Article 17 and 20 dealing with entertainment or sports activities or services provided by students, apprentices or business trainees, respectively. It is unlikely that such activities or services would be within the definition of fees for technical services in paragraph 3 of Article XX. However, if an overlap between the provision of Article XX and either Article 17 or Article 20 does occur, Article 17 or Article 20, as the case might be, takes precedence over Article XX. [This position appears to be inconsistent with relationship between Article XX and Article 8 discussed in paragraph 39?])

[The following paragraphs dealing with beneficial owner are modeled on the similar paragraphs in the OECD 2014 Commentary on Article 11 with appropriate modifications. Deletions are shown as strike through.]

[41.] The requirement of beneficial owner is included in paragraph 2 of Article XX to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over fees for technical services merely because those fees were paid direct to a resident of a State with which the State of source had concluded a convention.

[42.] Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country ~~(in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries)~~. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

1. For example, where the trustees of a discretionary trust do not distribute fees for technical services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such fees for the purposes of Article XX even if they are not the beneficial owners under the relevant trust law.

[43.] Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or

exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

[44.] It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies"[1] concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

1. Reproduced at page R(6)-1 of Volume II of the full-length version of the OECD Model Tax Convention.

[45.] In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the fees for technical services is not the "beneficial owner" because that recipient's right to use and enjoy the fees is constrained by a contractual or legal obligation to pass on the fees received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the fees by the direct recipient such as an obligation that is not dependent on the receipt of the fees and which the direct recipient has as a debtor or as a party to financial transactions~~, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1~~. Where the recipient of fees for technical services does have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the fees received to another person, the recipient is the "beneficial owner" of those fees. ~~It should also be noted that Article XX refers to the beneficial owner of fees as opposed to the service provider with respect to which the fees are paid, which may be different in some cases.~~

[46.] The fact that the recipient of fees for technical services is considered to be the beneficial owner of those fees does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as

substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the interest to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

[47.] The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12 and XX the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends, interest, royalties and fees for technical services rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]

1. See, for example, Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

   In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2. See the Financial Action Task Force's definition quoted in the previous note.

[48.] Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State. The text of the United Nations Model Convention was amended in 2001 (following amendments to the OECD Model Convention in 1995 and 2014 to clarify this point.

[49.] The paragraph lays down nothing about the mode of taxation in the State in which fees for technical services arise. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by

individual assessment. As with other provisions of the United Nations Model Convention, procedural questions are not dealt with in the Article. Each State is able to apply the procedure provided in its own law.

Paragraph 3

[50.] This paragraph specifies the meaning of the phrase "fees for technical services" for purposes of Article XX. The definition in paragraph 3 is exhaustive. "Fees for technical services" are limited to the payments described in paragraph 3; other payments for services are not included in the definition and are not dealt with in Article XX.

[51.] Article XX applies only to fees for technical services, and not to all payments for services. Paragraph 3 defines fees for technical services as payments for managerial, technical or consultancy services. Given the ordinary meanings of the terms "managerial," "technical" and "consultancy," the fundamental concepts underlying the definition of fees for technical services are that the services must involve the application by the service provider of specialized knowledge, skill or expertise on behalf of a client or the transfer of knowledge, skill or expertise to the client, other than a transfer of information covered by the definition of "royalties" in paragraph 3 of Article 12. Services that do not involve the application of such specialized knowledge, skill or expertise are not within the scope of Article XX.

[52.] The ordinary meaning of the term "management" involves the application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Thus, if the management of all or a significant part of an enterprise is contracted out to persons other than the directors, officers or employees of the enterprise, payments made by the enterprise for those management services would be payments for technical services within the meaning of paragraph 3 of Article XX. Similarly, payments made to a consultant for advice related to the management of an enterprise (or of the business of an enterprise) would be payments for technical services.

[53.] The ordinary meaning of the term "technical" involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Therefore, fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering and dentistry would be fees for technical services within the meaning of paragraph 3 of Article XX. Thus, if an individual receives payments for professional services referred to in paragraph 2 of Article 14 from a resident of a Contracting State, those payments would be fees for technical services. If the payments arise in that Contracting State because they are made by a resident of that State or borne by a permanent establishment or fixed base in that State, the payments would be subject to tax by that State in accordance with paragraph 2 of Article XX irrespective of the fact that the services are not performed in that State through a fixed base in that State.

[54.] Technical services are not limited to the professional services referred to in paragraph 2 of Article 14. Services performed by other professionals, such as

pharmacists, and other occupations, such as scientists, academics, etc., may also constitute technical services if those services involve the provision of specialized knowledge, skill and expertise.

[55.] The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature. Professionals usually provide advice or services that fit within the general meaning of consultancy services although, as noted in paragraphs 52 and 53, they may also constitute management or technical services.

[56.] The terms “management,” “technical” and “consultancy” do not have precise meanings. Thus, for example, services of a technical nature may also be services of a consultancy nature and management services may also be considered to be services of a consultancy nature.

[57.] The definition of “fees for technical services” does not include a reference to the domestic law of a Contracting State. The lack of any reference to domestic law is justified because:

a) the definition generally covers most types of services that are regarded as technical services under the domestic law of the countries that tax such services;
b) such a reference would introduce a large element of uncertainty;
c) future changes in a country’s domestic law with respect to the taxation of payments for technical services could otherwise have an effect on the Convention; and
e) in the United Nations Model Convention reference to domestic laws should be avoided as far as possible.

It would be inconsistent with this definition of fees for technical services for the meaning of terms used in the definition, especially the terms “management,” “technical” and “consultancy,” to be determined in accordance with the domestic law of the country applying the treaty under paragraph 2 of Article 3.

[58.] As expressly provided in paragraph 3, fees for technical services for purposes of Article XX do not include payments of salary, wages or other remuneration to an employee of the payer. Where such payments are made by an employer resident in one Contracting State to an employee resident in the other Contracting State, they are covered by Article 15 or Article 19 of the Convention. Similarly, fees for technical services do not include fees paid to the directors of a company resident in a Contracting State or salary, wages and other remuneration paid to top-level managerial officials of a company resident in a Contracting State. Such items of income are covered by the provisions of Article 16. In addition, since pensions arise in respect of prior employment, they are excluded from Article XX and are dealt with by Article 18 even if the employment involved the provision of technical services to the employer.

[59.] As expressly provided in paragraph 3, the definition of fees for technical services does not include payments for teaching in or by educational institutions. Thus, if an educational institution established in one Contracting State receives

payments from an enterprise resident in the other Contracting State for technical training provided by that institution to some of the enterprise's employees, the payments received by the educational institution would not be fees for technical services subject to Article XX because of the specific exclusion in paragraph 3(c) of Article XX. Some countries may wish to limit the exclusion for teaching in or by educational institutions in paragraph 3(c) of Article XX to teaching services provided as part of a degree program offered by an educational institution. These countries are free to do so by adding the words "as part of a degree granting program" or similar words to paragraph 3(c). In this case, payments received by an educational institution for teaching services of a managerial, technical or consultancy nature that are not part of a degree program would be fees for technical services within the meaning of paragraph 3 of Article XX.

[60.] As expressly provided in paragraph 3(d), the definition of fees for technical services does not include payments by individuals for services for their personal use. Such payments would not normally be deductible by those individuals and, therefore, the payments would cause any erosion of the tax base of the State in which the fees for technical services arise. Moreover, the imposition of withholding tax obligations on such payments by individuals under domestic law would be difficult to enforce and might cause serious compliance problems for individuals utilizing technical services supplied by nonresidents.

[61. Payments for technical services that are intimately connected to the sale of property are expressly excluded from the definition of fees for technical services by paragraph 3(e) of Article XX.]

[62.] The treatment of reimbursements of expenses for purposes of the definition of fees for technical services in paragraph 3 of Article XX poses special difficulties. As an initial matter, it is important to distinguish between an allowance for expenses and the reimbursement of expenses. An allowance is an amount usually established in advance for which the recipient of the allowance is not obligated to account. A per diem allowance for meals and accommodation is an example of a typical allowance. Since the recipient of an allowance does not have to account for the actual expenses incurred, any allowance received by a person for technical services is included within the meaning of fees for technical services under paragraph 3 of Article XX.

[63.] The reimbursement of expenses is different from an allowance because the person must account for the actual expenses incurred and only those actual expenses qualify for reimbursement. The issue is whether payments in reimbursement of actual expenses incurred in connection with the provision of technical services should be included in the definition of fees for technical services.

[64.] First, a person may be reimbursed for expenses incurred in connection with performing technical services, but may not receive any fee. For example, an individual resident in one Contracting State might be invited to speak at a conference or participate in a meeting in the other Contracting State and might be reimburse for his or her travel expenses, but not receive any fee. In these circumstances, it seems difficult to justify the application of withholding tax to the reimbursement. However,

unless reimbursements are explicitly excluded from the definition of fees for technical services, Article XX would permit the State in which the fees arise to impose withholding tax on the reimbursement at the rate specified in the treaty.

[65.] Second, a nonresident service provider may be paid a fee and separately reimbursed for all of the expenses incurred in performing the services. In these circumstances, if reimbursements are excluded from the definition of fees for technical services, the tax imposed by the State in which the fees arise would be limited to the amount of the fee. On these facts, the fee represents the nonresident's entire net profit from the performance of the technical services. However, the tax imposed in accordance with Article XX will ordinarily be imposed on the gross amount of the payments and the rate of withholding tax specified in Article XX may have been established on the assumption that the fees represent the nonresident's gross revenue. As a result, if reimbursements are excluded from the definition of fees for technical services, the rate of withholding agreed to by the Contracting States may be too low. Moreover, the exclusion of reimbursements from the definition of fees for technical services might lead to abuses. For example, nonresident service providers might receive payments labeled as reimbursements that are actually fees or might be reimbursed for expenses for which they would not ordinarily be reimbursed in order to reduce the source country's withholding tax. Preventing these types of abuses would impose a significant administrative burden on the tax authorities.

[66.] Third, a nonresident service provider might not be reimbursed for any of the expenses incurred in performing the services. The rate of withholding tax in Article XX may have been agreed to on the assumption that some of a nonresident's expenses would be reimbursed. Therefore, if reimbursements are excluded from the definition of fees for technical services, the rate established in the treaty may be too low for a nonresident service provider that receives no reimbursement for expenses.

[67.] It appears to be extremely difficult to predict to what extent, on average, nonresident service providers are reimbursed for their expenses. As a result, any single rule for the treatment of reimbursements will operate improperly in some situations. On the one hand, if reimbursements are excluded from the definition of fees for technical services, the rate agreed to in the treaty may be too low where most or all of a nonresident's expenses are reimbursed, but too high where none of the expenses are reimbursed. Also, taxpayers might try to disguise part of their fees as reimbursements of expenses and it might be difficult for the tax authorities of developing countries to detect such abuses. On the other hand, if reimbursements are not excluded, the rate agreed to in the treaty may be too high where a nonresident's expenses are reimbursed but too low where they are not reimbursed.

[68.] As a result of the difficulties described in the foregoing paragraphs, the solution that has been adopted is to omit any reference to the reimbursement of expenses in Article XX. However, countries are encouraged to deal with the problem in their domestic laws and to take the issue into account in establishing the rate of withholding under paragraph 2 of Article XX.

[69.] Although paragraph 3 of Article XX defines the phrase "fees for technical services," it does not provide a definition for the term "services." Similarly, other

articles of the United Nations Model Convention dealing with various types of services do not contain any definition of the term “services.” Neither Article 14, which deals with professional and other independent personal services, nor Article 19, which deals with services rendered to the government of a Contracting State, provides a definition of the term “services.” Similarly, the General Agreement on Trade in Services does not contain any definition of the term “services.”

[70.] Although the term “services” in the phrase “fees for technical services” is undefined in the context of Article XX, it should be understood to have a broad meaning in accordance with ordinary usage to generally include activities performed by one person for the benefit of another person in consideration for a fee.

[71.] It is often necessary to distinguish between fees for services, including fees for technical services, and royalties to determine whether Article 12 or another Article of the Convention (Article XX in the case of technical services) is applicable. The distinction between services and royalties is clear in principle. Under paragraph 3 of Article 12, royalties are payments for the use, or the right to use, certain types of property or information concerning industrial, commercial or scientific experience (so-called know-how). In contrast, the performance of services does not involve any transfer of the use of or the right to use property. However, in practice it is often difficult to distinguish between royalties and payments for services, including technical services, especially with respect to so-called mixed contracts. Guidance with respect to the distinction between services and royalties is provided in paragraph 12 of the Commentary on Article 12 of the United Nations Model Convention, which reproduces paragraphs 11.2 – 11.6 of the Commentary on Article 12 of the OECD Model Convention.

[72.] Example 1: X is a resident of State R and a skilled heart surgeon. X’s practice is carried on primarily in State R, although X occasionally travels to other countries to perform complicated heart surgery. X performs surgery in State R on an individual resident in State S. The tax treaty between State R and State S contains a provision identical to Article XX of the United Nations Model Convention. Under paragraph 3 of Article XX, although the payments made by the patient, a resident of State S, to X would be considered to be fees for technical services that arise in State S, they are explicitly excluded from the definition by subparagraph (d). As a result, the payments would not be taxable by State S in accordance with paragraph 2 of Article XX.

[73.] The result in Example 1 would be the same if X travelled to State S and performed the surgery in State S unless X performed the services through a fixed base regularly available in State S in which case Article 14 would apply.

[74.] Example: 2 X is a resident of State R and a skilled heart surgeon. X’s practice is carried on primarily in State R, although X occasionally travels to other countries to perform complicated heart surgery. X enters into a contract with a health services corporation resident in State S under which X agrees to perform heart surgery on patients referred to him by the health services corporation. The surgeries are performed both in State S and in State R. The tax treaty between State R and State S

contains a provision identical to Article XX of the United Nations Model Convention. Under paragraph 3 of Article XX, the payments made by health services corporation, a resident of State S, to X would be considered to be fees for technical services that arise in State S, irrespective of whether the surgery is performed in State S or State R. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article XX.

[75.] Example 3: R Company is a resident of State R. R Company's business is the collection, organization and maintenance of various databases. R Company sells access to these databases to its clients. One of R Company's clients is Company S, a resident of State S. State R and State S have a tax treaty that contains a provision identical to Article XX of the United Nations Model Convention. The payments that R Company receives from S Company for access to its databases would not be fees for technical services within the meaning of paragraph 3 of Article XX. Although R Company used its knowledge, skill and expertise in creating the database, the services that R Company provides to S Company – access to the database – do not involve the application of R Company's knowledge, skill and expertise for the benefit of S Company. Accordingly, Article XX would not apply to the payments.

[76.] If, however, S Company entered into a contract with R Company under which R Company created a specialized database tailored for S Company's use from information supplied by S Company, the payments by S Company to R Company would be fees for technical services under paragraph 3 of Article XX. In this situation, R Company would be applying its knowledge, skill and expertise for S Company's benefit. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article XX. It would not matter whether R Company performed all or any part of the services of creating the database in State S.

[77.] Example 3: R Company, a resident of State R, is engaged in the insurance business in both State R and State S. R Company provides insurance against a wide variety of risks. State R and State S have a tax treaty that is the same as the United Nations Model Convention, including Articles 5, 7 and XX. R Company would be deemed to have a permanent establishment in State S under paragraph 6 of Article 5 to the extent that it collects premiums or insures risks in State S other than through an agent of independent status. Therefore, by virtue of paragraph 4 of Article XX, R Company's insurance activities in State S would be taxable by State S in accordance with Article 7, and Article XX would not apply.

[78.] Even if R Company is not deemed to have a permanent establishment in State S under Article 5, Article XX would not apply because the insurance premiums received by R Company cannot be considered to be fees for technical services within the meaning of paragraph 3 of Article XX. Although R Company uses its knowledge, skill and expertise to develop its various insurance products that are sold to its clients, R Company is not applying its knowledge, skill and expertise directly for the benefit of each particular client.

[79.] Example 4: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, credit and debit cards, payment and

transmission services, bankers drafts, guarantees, foreign exchange, negotiable instruments, derivative products, investment research and advisory services. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty that is identical to the United Nations Model Convention including Article XX.

[80.] Whether the payments received for services provided by a financial institution constitute fees for technical services within the meaning of paragraph 3 of Article XX depends on the nature of the particular services. Many services provided by financial institutions do not involve the application of knowledge, skill and expertise on behalf of a particular client. Instead, the financial institution uses its knowledge, skill and expertise to develop general products, services or practices that are made available to its clients in consideration for fees. This would be the case, for example, with respect to payment and transmission services, bankers drafts, foreign exchange, debt and credit card services and negotiable instruments.

[81.] However, where a financial institution uses its knowledge, skill and expertise to provide research, analysis or advice to a specific client related to that clients' particular circumstances, the payments received by the financial institution for those services could be fees for technical services within the meaning of paragraph 3 of Article XX. This would be the case, for example, if R Company provides advice to S Company, resident in State S, with respect to a potential merger or acquisition involving S Company. As a result, the payments for such advice would be taxable by State S in accordance with paragraph 2 of Article XX. If, however, R Company provides the services through a permanent establishment located in State S, the fees received for those services will be taxable by State S in accordance with Article 7 rather than Article XX by virtue of paragraph 4 of Article XX (see paragraph 84).

[82.] Example 5: S Company, an enterprise resident in State S enters into a contractual arrangement with R Company, an enterprise resident in State R, for the right to use a patented chemical formula owned by R Company for the production of an industrial substance. The contract also requires R Company to use its specialized knowledge and expertise to assist S Company to produce the industrial substance in accordance with specifications set out in the contract. In particular, R Company will perform the following services for S Company:

Provide the production procedures and assist S Company in carrying out those procedures; and
Provide specifications concerning the necessary materials, tools, containers used in the production process.

R Company also agrees to use its best efforts to ensure that S Company is able to produce the industrial substance in the quantities and with the characteristics that S Company expects.

[83.] The payments by S Company to R Company for the right to use the patented formula would be a royalty within the meaning of paragraph 3 of Article 12. However, the payments for the services provided by R Company to S Company

would not be royalties because R Company is not transferring its specialized knowledge, skill or experience to S Company. On the facts of example 5, R Company is using its specialized knowledge, skill and experience on behalf of S Company and guaranteeing the result of S Company's use of the patented chemical formula. Consequently, the payments made by S Company to R Company for the services are fees for technical services within the meaning of paragraph 3 of Article XX and State S would be entitled to impose tax on those fees under paragraph 2 of Article XX.

Paragraph 4

[84.] This paragraph provides that paragraphs 1 and 2 of Article XX do not apply to fees for technical services if the person who performs the services has a permanent establishment or fixed base in the State in which the fees arise and the fees are effectively connected with that permanent establishment or fixed base. In this regard, paragraph 4 is similar to paragraph 4 of Article 10, paragraph 4 of Article 11 and paragraph 4 of Article 12. Thus, if a resident of one Contracting State provides technical services through a permanent establishment located in the other Contracting State, the fees received for those services will be taxable by the State in which the permanent establishment is located in accordance with Article 7, rather than in accordance with Article XX, by virtue of paragraph 4 of Article XX.

[85.] Since Article 7 of the United Nations Model Convention adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 4 of Article XX also makes paragraphs 1 and 2 inapplicable if the fees for technical services are effectively connected with business activities in the State in which the fees arise of the same or similar kind as those effected through the permanent establishment.

[86.] The paragraph does not define the meaning of the expression "effectively connected." As a result, whether fees for technical services are effectively connected with a permanent establishment, fixed base or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, fees for technical services would be considered to be effectively connected with a permanent establishment or fixed base if the technical services are closely related or connected to the permanent establishment, fixed base or business activities similar to those carried out through the permanent establishment. This will be the case where the remuneration paid to the person performing the services is borne by the permanent establishment or fixed base in the State in which the fees arise.

[87.] Where paragraph 4 applies, the fees for technical services are taxable in the State in which the fees arise as part of the profits attributable to the permanent establishment in accordance with Article 7 or the income attributable to the fixed base in accordance with Article 14. Thus, paragraph 4 relieves the State in which the fees for technical services arise from the limitations on its taxing rights imposed by Article XX. Where Article 7 applies as a result of the application of paragraph 4 of Article XX, most countries consider that the State in which the permanent establishment is located is allowed to tax only the net profits from the technical services attributable to the permanent establishment. Similarly, where Article 14 applies, most countries consider that the State in which the fixed base is located is allowed to tax only the net

income derived from the technical services. However, it may be useful for countries to clarify these issues during the negotiation of the treaty (see paragraphs 9 and 10 of the Commentary on Article 14).

Paragraphs 5 and 6

[88.] Paragraph 5 lays down the principle that the State in which fees for technical services arise for purposes of Article XX is the State of which the payer of the fees is resident or the State in which the payer has a permanent establishment or fixed base if the fees for technical services are borne by the permanent establishment or fixed base. It is not necessary for the services to be performed in the Contracting State in which the payer is resident or has a permanent establishment or fixed base. Whether a person is a resident of a Contracting State for purposes of Article XX is determined in accordance with the provisions of Article 4 of the Convention.

[89.] Where there is an obvious economic link between the technical services and the permanent establishment or fixed base of the payer for the services, the fees for technical services are considered to arise in the State in which the permanent establishment or fixed base is situated. This result applies irrespective of the residence of the owner of the permanent establishment or fixed base, even where the owner resides in a third State.

[90.] Where there is no economic link between the technical services and the permanent establishment or fixed base, the payments for technical services are considered to arise in the Contracting State in which the payer is resident. If the payer of fees for technical services is not a resident of a Contracting State, Article XX does not apply to the fees for technical services unless the payer has a permanent establishment or fixed base in a Contracting State and there is a clear economic link between the technical services and the permanent establishment or fixed base. Otherwise there would be, in effect, a force-of-attraction principle for fees for technical services, which would be inconsistent with other provisions of the United Nations Model Convention.

[91.] Paragraph 5 is subject to paragraph 6, which provides a source rule for payments for technical services to supplement the source rule in paragraph 5. Paragraph 6 deems fees for technical services made by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State or in a third State, or performs independent personal services through a fixed base in the other Contracting State or in a third State and the fees for technical services are borne by that permanent establishment or fixed base. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for technical services under paragraph 2 of Article XX.

[92.] The phrase “borne by” must be interpreted in the light of the underlying purpose of paragraphs 5 and 6 of the Article, which is to provide source rules for fees for technical services. A Contracting State is entitled to tax fees for technical services under paragraph 2 of Article XX only if the fees arise in that State. The basic source

rule in paragraph 5 is that fees for technical services arise in a Contracting State if the payer is a resident of that State or the payer has a permanent establishment or fixed base in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In addition, the basic rule is limited by the rule in paragraph 6 where the payer is a resident of a Contracting State but the fees for technical services are borne by a permanent establishment or fixed base that the payer has in the other Contracting State or a third State.

[93.] Where fees for technical services are incurred for the purpose of a business carried on through a permanent establishment or for the purpose of independent personal services performed through a fixed base, those fees will usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7 or the income attributable to the fixed base under Article 14. The deductibility of the fees for technical services provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment or fixed base is situated.

[94.] The fact that the payer has, or has not, actually claimed a deduction for the fees for technical services in computing the profits of the permanent establishment or the income of the fixed base is not necessarily conclusive, since the proper test is whether any deduction available for those fees should be taken into account in determining the profits attributable to the permanent establishment or the income attributable to the fixed base. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment or fixed base being exempt from tax in the source country or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the fees for technical services are not deductible for some reason other than the fact that the fees for technical services should not be allocated to the permanent establishment or fixed base.

[95.] The application of paragraphs 5 and 6 of Article XX can be illustrated by the following examples.

[96.] Example 6: R Enterprise is carried on by a resident of State R. R Enterprise provides technical services to S Company, a resident of State S. The tax treaty between State R and State S is identical to the United Nations Model Convention including Article XX. S Company carries on business State S and in State R (or a third State) through a permanent establishment situated there. However, the technical services provided by R Enterprise to S Company are related to S Company's business carried on in State S, not to the business carried on in State R (or a third State).

[97.] In this case, since the payments are made by S Company, a resident of State S, and are not borne by a permanent establishment of S Company outside State S, the fees for technical services would be considered to arise in State S in accordance with paragraph 5. Therefore, State S would be entitled to tax the fees for technical services under paragraph 2 of Article XX.

[98.] Example 7: The facts are the same as in Example 6, except that the fees for technical services are borne by S Company's permanent establishment in State R or in a third State.

[99.] In this case, since the fees for technical services are borne by a permanent establishment of S Company situated outside State S, paragraph 6 applies to deem the fees for technical services not to arise in State S. Consequently, the fees for technical services are not taxable by State S under paragraph 2 of Article XX but are taxable exclusively by State R under paragraph 1 of Article XX.

[100.] In this situation, the Convention denies State S the right to tax the fees for technical services despite the fact that the fees are paid by a resident of State S. This result is justified because the fees relate to a business carried on by a resident of State S outside State S, either in the other Contracting State – State R – or in a third State. In such a situation, where the fees for technical services are deductible in computing the profits of a business attributable to a permanent establishment situated in another country or in computing the income from independent personal services furnished through a fixed base situated in another country, those payments have a closer economic connection to the activities carried on in that other country than to State S.

[101.] If there is a bilateral tax treaty between State R and the third State in which S Company has a permanent establishment, and that treaty contains a provision comparable to Article XX of the United Nations Model Convention, the fees for technical services would be considered to arise in that third State for purposes of that treaty. As a result, that treaty would allow the third State in which the permanent establishment is located to tax the fees for technical services in accordance with paragraph 2 of Article XX.

[102.] Example 8: T Enterprise is carried on by a resident of State T. T Enterprise carries on business through a permanent establishment situated in State S or provides independent personal services through a fixed base situated in State S. T Enterprise pays R Company, a resident of State R, for technical services performed by R Company for T Enterprise in connection with its income-earning activities carried on in State S. The payments made by T Enterprise to R Company for the technical services are deductible in computing the profits attributable to the permanent establishment of T Enterprise in State S or the income attributable to the fixed base of T Enterprise in State S.

[103.] In this case, although the fees for technical services are not paid by a resident of State S, the fees are borne by the permanent establishment or fixed base that T Enterprise has in State S. In these circumstances, the fees for technical services have a close economic connection to the income-earning activities carried on in State S. Thus, the fees are deemed to arise in State S under paragraph 5 of Article XX and State S is entitled to tax the payments in accordance with paragraph 2 of Article XX.

[104.] In the case of interest and royalties, paragraph 21 of the Commentary on Article 11 and paragraph 19 of the Commentary on Article 12 indicate that countries might substitute a rule that would identify the source of interest or royalties as the

State in which the loan giving rise to the interest or the property or right giving rise to the royalties was used. A similar source rule might be substituted for purposes of Article XX. Similarly as suggested in the Commentary on Articles 11 and 12, where, in bilateral negotiations, the parties differ on the appropriate rule, a possible solution would be a rule that, in general, would accept the payer's place of residence as the source of fees for technical services, but where the technical services are used or consumed in a State having a place-of-use rule, the payment would be deemed to arise in that State.

[105.] Various other alternative source rules for fees for technical services are possible. Such alternatives include the following:

- The Contracting States might decide not to include paragraph 6 in Article XX. In this case, fees for technical services would be considered to arise in the State in which the payer is resident, even where those fees are incurred for purposes of a permanent establishment or fixed base of the payer situated outside the payer's State of residence.

- The Contracting States might decide not to include paragraph 6 in Article XX and to revise paragraph 5 so that fees for technical services could be considered to arise in a Contracting State only if the payer is a resident of that State and the technical services are used or consumed by the payer in that State, or, if the payer is not a resident of a Contracting State, the payer has a permanent establishment or fixed base situated in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In this case, technical services used or consumed by a resident of a Contracting State outside that State would not be considered to arise in that State and that State would not be entitled to tax fees for such services under Article XX. Paragraph 6 would be unnecessary because technical services used or consumed outside a Contracting State would include any technical services incurred for the purposes of a resident's permanent establishment or fixed base situated outside that State.

- Fees for technical services could be considered to arise in a Contracting State only if the payer is a resident of that State and the technical services are performed in that State or if the payer, not being a resident of a Contracting State, has a permanent establishment or fixed base situated in a Contracting State and the fees for technical services are borne by that permanent establishment or fixed base. In this case, a Contracting State would be entitled to tax fees for technical services paid by its residents to residents of the other Contracting State if the technical services are performed in the State. In this event, paragraph 6 would be unnecessary.

Paragraph 7

[106.] The purpose of paragraph 7 of Article XX is to restrict the operation of the provisions concerning the taxation of fees for technical services in cases 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 fees paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length. It provides that in such a case the provisions of the Article apply only to that last-mentioned amount and that the excess part of the fees for technical services shall remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

[107.] It is clear from the text that for this clause to apply the fees for technical services held to be excessive must be due to a special relationship between the payer and the beneficial owner or between both of them and some other person. There may be cited as examples of such a special relationship cases where fees for technical services paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the individual or is subordinate to a group having common interest with the individual. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

[108.] Where their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of fees for technical services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

[109.] With regard to the taxation treatment to be applied to the excess part of the fees for technical services, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike paragraph 6 of Article 11, which, because of the limiting phrase "having regard to the debt-claim for which it is paid", permits only the adjustment of the rate at which interest is charged, paragraph 7 of Article XX permits the reclassification of the fees for technical services in such a way as to give them a different character. This paragraph can affect not only the recipient of the fees but also the payer of excessive fees for technical services and if the law of the State of source permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States should have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the fees for technical services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 7, as long as they do not alter its general purport.

[110.] Should the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of fees for technical services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

[Paragraphs 111-113 below are inserted to deal with some of the issues that seem to arise in connection with paragraph 7 and its relationship to Article 9. These issues are not dealt with in connection with the comparable provisions in Articles 10-12. Consequently, it may be preferable to omit these paragraphs or consider whether similar

paragraphs should be added to the Commentary on Articles 10-12.]

[111.] Where fees for technical services provided by a resident of one Contracting State to an associated enterprise of the other Contracting State, the provisions of Article 9 apply for the purpose of determining whether the fees are in accordance with the arm's length standard. In this case the relationship between paragraph 7 of Article XX and Article 9 is clear. The arm's length standard in Article 9 will be applied as elaborated in the *United Nations Practical Manual on Transfer Pricing for Developing Countries* (2013) and the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* to determine if the amount paid for technical services is excessive. If the amount paid is excessive, Article XX will apply only to the arm's length amount of the fees. Any corresponding adjustments will be dealt with in accordance with paragraph 2 of Article 9.

[112.] Where the amount of fees for technical services is less than the amount that arm's length parties would have agreed on, paragraph 7 does not apply. However, Article 9 might apply in these circumstances to allow the Contracting State in which the service provider is resident to increase the amount of the fees.

[113.] Paragraph 7 of Article XX may apply to a service provider and a client where they have a special relationship but are not associated enterprises for purposes of Article 9. In this case the determination of whether the fees for technical services are excessive must be made by applying the arm's length principle and the transfer pricing guidelines by analogy. If difficulties arise in the application of paragraph 7 of Article XX, the competent authorities can resolve those difficulties through the mutual agreement procedure.

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