



Secretariat

Distr.
LIMITEDST/SG/AC.8/1995/L.7
28 July 1995

ORIGINAL: ENGLISH

AD HOC GROUP OF EXPERTS ON INTERNATIONAL
COOPERATION IN TAX MATTERS
Seventh meeting
Geneva, 11-15 December 1995

REPORT OF THE STEERING COMMITTEE OF THE AD HOC GROUP OF EXPERTS
ON INTERNATIONAL COOPERATION IN TAX MATTERS

NEW YORK, 5-7 JUNE 1995

A. Origin and purpose of the Steering Committee

1. The work of the Steering Committee of the Ad Hoc Group of Experts on International Cooperation in Tax Matters forms part of the continuing international effort aimed at eliminating double taxation, preventing international tax evasion and avoidance and improving national tax collection performance, so as to generate increased financial resources for fostering sustainable economic and social development and reducing public sector borrowing requirements and debt-servicing obligations. In 1968, pursuant to Economic and Social Council resolution 1273 (XLIII) of 4 August 1967, the Secretary-General set up the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, consisting of 20 experts and tax administrators nominated by Governments but acting in their personal capacity, from both developed and developing countries and adequately representing different regions and tax systems. The purpose of the Group was to explore "ways and means for facilitating the conclusion of treaties between developed and developing countries". The Ad Hoc Group, having completed that mandate with the publication in 1979 of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries 1/ and in 1980 the United Nations Model Double Taxation Convention between Developed and Developing Countries, 2/ the Economic and Social Council decided in resolution 1980/13 of 28 April 1980 that the Group should continue and extend the scope of its work. To that end, the Group was expanded from 20 to 25 members and renamed the Ad Hoc Group of Experts on International Cooperation in Tax Matters. At its second meeting held in December 1983, the Group finalized the "Guidelines for international

cooperation against the evasion and avoidance of taxes (with special reference to taxes on income, profits, capital and capital gains)" (document ST/ESA/142).

2. At its sixth meeting, held in December 1991, the Ad Hoc Group requested its preparatory Subgroup to prepare on the basis of materials to be submitted by members of the Group, working papers on the topics to be discussed at the seventh meeting of the Group, namely: transfer pricing, in particular as it related to pricing of primary products between related entities, cost-sharing arrangements and the provision of services; tax treatment of new financial instruments (hybrid instruments); tax treatment of students and teachers; draft revision of the United Nations Model Double Taxation Convention; and draft revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.

3. Draft documents on the five aforementioned topics were prepared for preliminary consideration by the Steering Committee, whose purpose is to facilitate the work of the Ad Hoc Group, inter alia by reviewing in advance the drafts of the working and conference papers to be submitted to the Group with a view to strengthening and streamlining them as necessary during its Meeting at United Nations Headquarters from 5 to 7 June 1995.

B. Attendance

4. The Steering Committee consists of nine experts from industrialized and developing countries who are members of the Ad Hoc Group of Experts. The members of the Steering Committee are the following: William W. Alder (Jamaica), Ernst Bunders (Netherlands), Mordecai Feinberg (United States of America), Antonio Hugo Figueroa (Argentina), Nemi Chand Jain (India), Daniel Luthi (Switzerland), Reksoprajitno Mansury (Indonesia), John Evans Atta Mills (Ghana) and Alain Ruellan (France).

5. The meeting was attended by the following observers: Mark V. Follmi (Union Bank of Switzerland), Francisco Garcia Arjona (Harvard International Tax Program) and Alfredo Garcia Prats (University of Valencia, Spain). The meeting was also attended by the following consultants: Peter D. Byrne (Harvard International Tax Program), Harold Ullman, Esq. (Curtis, Mallet-Prevost, Colt & Mosle) and J. Pierre Benoit (former Chief of the Fiscal and Financial Branch in the United Nations Secretariat).

C. Documentation

6. The Steering Committee had before it the following documents:

Working papers

Provisional agenda (ST/SG/AC.8/1995/WP.1) (English only)

Annotated agenda of the Seventh Meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters, Geneva, 11-15 December 1995 (ST/SG/AC.8/1995/WP.2) (English only)

/...

Provisional list of participants (ST/SG/AC.8/1995/WP.3) (English only)

Tax treatment of students and teachers: working paper prepared by the Subgroup of the Ad Hoc Group of Experts on International Cooperation in Tax Matters (ST/SG/AC.8/1995/WP.4) (English only)

Transfer pricing: working paper elaborated by the Subgroup of the Ad Hoc Group of Experts on International Cooperation in Tax Matters (ST/SG/AC.8/1995/WP.5) (English only)

La mondialisation des marchés de capitaux (ST/SG/AC.8/1995/WP.6) (French only)

Derivative markets: economic implication for taxation (ST/SG/AC.8/1995/WP.7) (English only)

Taxation of derivatives and new financial instruments (ST/SG/AC.8./1995/WP.8) (English only)

United Nations Model Double Taxation Convention Between Developed and Developing Countries (ST/SG/AC.8/1995/WP.9) (English only)

List of documents (ST/SG/AC.8/1995/WP.10) (English only)

Conference papers

Taxation of students, teachers and other categories (ST/SG/AC.8/1995/CP.1) (English only)

Taxation of students and teachers (ST/SG/AC.8/1995/CP.2) (English only)

Article 20 of the UN Model Double Taxation Convention: Payments Received by Students (ST/SG/AC.8/1995/CP.3) (English and French only)

Transfer pricing guidelines for multinational enterprises and tax administrations (ST/SG/AC.8/1995/CP.4) (English only)

The arm's length principle in Swiss fiscal law (an extract) (ST/SG/AC.8/1995/CP.5) (English only)

Tax treatment of new financial instruments (hybrid instruments) in Indonesia (ST/SG/AC.8/1995/CP.6) (English only)

Taxation of new financial instruments (ST/SG/AC.8/1995/CP.7) (English and French only)

The New OECD Model Tax Convention: working document prepared by a member of the Subgroup of the Ad Hoc Group of Experts on International Cooperation in Tax Matters (ST/SG/AC.8/1995/CP.8) (English only)

Revision de la Convencion Modelo sobre la Doble Tribuacion entre Paises Desarrollados y Paises en Desarrollo (ST/SG/AC.8/1995/CP.9) (English and Spanish only)

The New OECD Model Tax Convention (ST/SG/AC.8/1995/CP.10) (English and French only)

Tax treatment of financial instruments and derivatives (ST/SG/AC.8/1995/CP.11) (English only)

Taxation of the new financial instruments, relevance of tax conventions (ST/SG/AC.8/1995/CP.12) (English and French only)

Taxation of teachers and researchers' remuneration (ST/SG/AC.8/1995/CP.13) (English and French only)

D. Opening of the Meeting

7. The meeting was opened by Ji Chaozhu, Under-Secretary-General, Department for Development Support and Management Services. After welcoming the participants, the Under-Secretary-General emphasized the importance of the issues to be discussed and in particular that of the revision of the United Nations Model Double Taxation Convention. He also stressed the importance of taxation in view of the globalization of the world economy brought about by the end of the cold war and observed that even though the world was no longer polarized into different economic systems, any discussion of international tax issues must take account of the varying levels of economic development of countries around the world. After summarizing the history of the Group of Experts, Mr. Ji said that there was an urgent need for international cooperation aimed at reducing incompatibilities between tax systems in order to promote international trade and investment and the transfer of technology. Such cooperation was likewise necessary with regard to the exchange of information, so as to facilitate the implementation of double taxation treaties and enhance tax payment compliance. In his concluding remarks, he noted that, as suggested by the Ad Hoc Group of Experts at its sixth meeting, the United Nations Secretariat could play an increasingly useful role as a clearing-house for information concerning taxation issues and the availability of technical assistance.

E. Chairman and Meeting servicing officials

8. Nemi Chand Jain (India) was elected Chairman by acclamation. The United Nations Secretariat was represented by Guido Bertucci, Director of the Division of Public Administration and Development Management, and Abdel Hamid Bouab, Officer-in-Charge of the Public Finance and Enterprise Management Branch, who served as Secretary of the Ad Hoc Group of Experts. Peter E. Heijkoop and Cynthia J. Conti provided the necessary support to the Committee.

F. Agenda

9. The Steering Committee adopted the following substantive agenda:
 1. Taxation of special categories: teachers and students: Articles 14-15 and 20 of the United Nations Model Double Taxation Convention Between Developed and Developing Countries.
 2. Taxation of financial instruments and derivatives (hybrid instruments).
 3. Transfer pricing, in particular as it relates to pricing of primary products between related entities, cost sharing arrangements and the provision of services.
 4. Discussion of the draft revision of the United Nations Model Double Taxation Convention Between Developed and Developing Countries.
 5. Discussion of the draft revision of the Manual for the Negotiation of Bilateral Tax Treaties Between Developed and Developing Countries.
 6. Other matters.

I. TAX TREATMENT OF STUDENTS AND TEACHERS

10. The Steering Committee's discussion was based on document ST/SG/AC.8/1995/WP.4, prepared by the Subgroup (that is, the Steering Committee's predecessor), at its 1993 meeting. It was observed that the goal of the United Nations Model Convention was the elimination of double taxation, not the elimination of all taxation in both the source country and the country of residence. With regard to the tax treatment of students, covered by article 20 of the United Nations Model Convention, the Steering Committee considered the proposal in paragraph 2 of the aforementioned document that in article 20, paragraph 1, the word "solely" should be replaced by "principally," and decided that the text should remain unchanged.

11. One participant questioned the need for article 20, paragraph 2: he noted that there was no corresponding provision in the OECD Model Convention and although he found the paragraph acceptable he wondered whether it was necessary. It was decided to refer the proposal to the Ad Hoc Group of Experts. In the ensuing general discussion, it was pointed out that developed countries often accorded students from developing countries favourable treatment under their domestic law. The question was raised as to whether the issue deserved more comprehensive treatment, because such students often remained in the host countries after completing their studies, causing a "brain drain" which was detrimental to developing countries. It was also suggested that other factors to be considered in connection with the tax treatment of students might include the age of the student and the duration of the studies abroad.

12. With regard to the tax treatment of teachers, who are subject to the normal personal services provisions of articles 14 and 15 of the United Nations Model,

/...

one participant proposed that article 14, paragraph 1 (c), concerning taxation of independent personal services where remuneration exceeded a certain fixed amount, should be deleted, among other reasons because inflation could cause that provision to have unintended results.

13. The Steering Committee then discussed the distinction between the tax treatment of students and the tax treatment of teachers. One participant suggested that the United Nations Model Convention should include a separate provision covering teachers, along the lines of those included in some recent bilateral tax treaties. After some discussion, it was decided that such a separate provision was not necessary. One participant observed that if teachers were in the service of a Government, they could potentially be covered by article 19 of the United Nations Model. He suggested that the treatment of such persons might be clarified and noted that as long as there was no possibility of double taxation or double exemption, there would be no need to amend the United Nations Model.

14. The Steering Committee agreed by consensus to recommend that the Ad Hoc Group of Experts should, at its seventh meeting, consider the possible deletion of article 14, paragraph 1 (c), and article 20, paragraph 2, of the United Nations Model.

II. TRANSFER PRICING

15. The Chairman drew attention to the working paper on the item prepared by the Subgroup in 1993 (ST/SG/AC.8/1995/WP.5) and opened the discussion by observing that developing countries could benefit greatly from the experience acquired by economically advanced countries with regard to transfer pricing, which was an important facet of international taxation. He noted that while some developing countries had adopted rules concerning the tax treatment of transfer pricing, they did not have sufficient administrative capacity to enforce them to the full.

16. One participant cautioned that in considering the aforementioned working paper as well as the other working papers on the topic, it should be remembered that the Organisation for Economic Cooperation and Development (OECD) had conducted a comprehensive analysis of the transfer pricing issue and was expected to issue its final report on the subject in the course of the next 12 months. Another participant suggested that waiting for that report might imply that the United Nations was displaying undue deference to the anticipated OECD conclusions on the issue. Several participants questioned whether those conclusions would address transfer pricing concerns which were unique to developing countries. In response, it was suggested that the Ad Hoc Group of Experts should analyse the OECD findings in the light of the developing countries' transfer pricing concerns, so that the United Nations efforts would supplement those of OECD, thus contributing to attainment of the overall goal of international consensus on the treatment of transfer pricing.

17. It was emphasized that the complex issue of transfer pricing would probably continue to develop over the next decade and that therefore no definitive United Nations approach could realistically be expected to emerge at the seventh

/...

meeting of the Ad Hoc Group of Experts. An extended discussion ensued on various technical aspects of transfer pricing, particularly those relating to transfer of technology and the developing countries' lack of adequate administrative capability to deal with transfer pricing. It was agreed that economically advanced countries should assist developing countries in their efforts to improve their enforcement capabilities. It was noted that the work to be done on transfer pricing might lead to changes in the United Nations Manual and in the commentary to the United Nations Model Convention but not in the text of the United Nations Model itself.

18. One participant noted that the OECD transfer pricing rules might focus on issues relating to the pricing of finished goods, whereas developing countries would be more concerned about primary goods. In response, it was pointed out that the arm's length principle was a general principle that should cover all transactions and all countries. Another participant observed that many economically advanced countries were very concerned about transfer prices for primary goods such as oil and natural gas. Other participants mentioned advanced pricing agreements as a potential future solution to the transfer pricing problem. One participant emphasized the need for an adequate exchange of information and an effective mechanism to ensure correlative adjustments.

19. Two participants pointed out that many of the transfer pricing issues which were of concern to developing countries were also of concern to economically advanced countries. The view was expressed that the OECD Model should not be viewed as "an anti-United Nations Model". The concerns of all countries, developing and economically advanced countries alike were similar. In that connection, it was noted that OECD, placed great emphasis on relations between its current membership - which included countries at various stages of economic development - and developing countries; furthermore, Mexico was already a member of OECD, and other developing countries could be expected to become members in the near future.

20. At the conclusion of the discussion on transfer pricing, the Secretary suggested that the Ad Hoc Group of Experts should become involved in the proceedings being conducted by OECD and other international fiscal organizations. It was agreed by consensus that such an approach would constitute an appropriate and effective way of ensuring that the views of developing countries, as well as those of economically advanced countries, would be considered in any emerging consensus on transfer pricing issues. The participants agreed that the matter should be actively pursued and that the United Nations Secretariat should take steps to ensure United Nations participation in meetings convened by OECD and other international fiscal organizations so as to foster a consensus-building approach.

III. TAX TREATMENT OF FINANCIAL INSTRUMENTS AND DERIVATIVES

21. The Chairman opened the discussion of the topic by noting that the taxation of financial instruments and derivatives was a new area, especially for developing countries. A major problem in that connection was whether the income from such instruments should be treated as interest, capital gains, business profits or income from other sources. There were several possible ways of

/...

solving that problem: for example, the definition of "debt claims" in article 11 of the United Nations Model Convention could be expanded to encompass new financial instruments, or the income could be treated as business profits under article 7 or as "other income" under article 21.

22. He emphasized that cross-border financial cooperation was necessary, given the need for funds for capital projects, but that the lack of uniform views on the treatment of financial instruments could seriously impede the free flow of funds and might also lead to tax evasion or double taxation.

23. One participant proposed that article 21, paragraph 3, should be amended to provide that income from financial instruments should be taxed solely in the country of residence. Another participant noted that the United Nations Model Convention differed from the OECD Model Convention in that the former permitted such other income to be taxed by the source country as well. Concern was expressed that the proposal could lead to the erosion of the source country's tax base. Another participant noted that income from financial instruments raised questions not only about the characterization of such income but also about its source.

24. With regard to the domestic treatment of such income in developing countries, it was noted that some of those countries did not have a separate capital gains tax and would treat such income as "ordinary income" for domestic tax purposes. Developing countries would have to weigh the economic benefits derived from such instruments against the tax losses associated with the acceptance of proposals to tax such income solely in the country of residence.

25. Another participant, noting that OECD had held lengthy discussions on new financial instruments, summarized its preliminary conclusions. OECD had considered, but rejected, the idea of including in the OECD Model a separate article on the taxation of new financial instruments. Concern had been expressed in OECD that abuses might exist in the case of financial instruments involving entities with special relationships and it had been recommended that the OECD Model Convention commentary should be broadened to provide that article 21, paragraph 3, could be amended in bilateral negotiations to deal with the issue of tax abuse in the context of special relationships. Thus far, however, few countries had experienced difficulties in that area. He further noted that OECD had organized a special study group to analyse issues relating to financial instruments.

26. One participant drew attention to the difficulty of taxing income from financial instruments, particularly those that were publicly traded and held by multinational companies; it was often difficult to attribute income from such instruments to the various permanent establishments of those entities. Another participant noted that under the United Nations Model Convention the source of income would be determined under the domestic law of the source country, and if such income arose in a country which was a party to a bilateral tax treaty it could be subject to taxation in that country, under article 21, paragraph 3.

27. The importance of such financial instruments to the world economy was emphasized further by the Secretary who noted that the proper treatment of such instruments was not clear. It was estimated that the capital invested in such

instruments currently exceeded US\$ 5 trillion, and that both capital-importing and capital-exporting countries had competed for that capital. If considerations relating to the generation of revenue too heavily outweighed considerations relating to the free flow of investment, access to such capital could be limited.

28. The Secretary recommended that the Ad Hoc Group should cooperate with other institutions, such as OECD, in developing a common approach to the taxation of such instruments. A participant suggested that a member of the Ad Hoc Group should be requested to report on the progress of OECD with regard to issues relating to financial instruments, and it was recommended that OECD reports on those issues should be made available to the members of the Group. One participant with connections to OECD noted that the latter had declared its readiness to present its conclusions at the seventh meeting of the Ad Hoc Group and to increase its cooperation with the Ad Hoc Group. He noted, however, that even within OECD, much work remained to be done on the issues relating to financial instruments.

29. A general discussion followed on various economic aspects of such instruments. It was noted that while there were many types of financial instruments, such instruments could be divided into three basic categories: swaps, futures and options. One participant noted that those instruments had increased market efficiency and in some instances had become relatively standardized. He recommended that any guidelines adopted by the Ad Hoc Group of Experts should permit the free flow of capital.

30. The Steering Committee reached the following consensus:

(a) The Ad Hoc Group of Experts should be kept informed of the progress made by OECD on the topic and, in particular, a report on that progress should be presented to the Ad Hoc Group at its seventh meeting;

(b) There should be increased cooperation between the Ad Hoc Group of Experts and OECD with a view to harmonizing the tax treatment of such instruments and specific proposals concerning such cooperation should be presented to the Group for consideration at its seventh meeting.

IV. DRAFT REVISION OF THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION

31. The Chairman opened the discussion by asking the secretariat of the Steering Committee to provide some background concerning the revision of the Convention contained in document ST/SG/AC.8/1995/WP.9. The Secretary noted that at its sixth meeting the Ad Hoc Group had recommended that the Model Convention should be revised. He mentioned a number of justifications for the revision, including developments in the world economy and the emergence of international trade as the primary factor in global development. The draft revision which reflected many of the changes made in the OECD Model Convention, had not yet been circulated outside the Steering Committee, but if the Steering Committee approved it could be circulated to other international organizations for their comments prior to the seventh meeting of the Ad Hoc Group.

32. It was noted that the changes proposed in the draft revision included a definition of the term "national" in article 3, a new provision concerning the purchase of goods in article 5, a new provision concerning limited force of attraction in article 7, a new transfer pricing provision in article 9, a new branch profits provision in article 10 and a drafting change in article 17.

33. Concern was expressed by several participants that the revision of the United Nations Model Convention could erode its unique quality as an instrument designed to protect developing countries. Concern was also expressed that other organizations needed to be consulted regarding the revision process. One participant expressed the opinion that the current United Nations Model contained several loopholes that needed to be addressed.

34. The Chairman noted that since the adoption of the United Nations Model in 1980 many developments had occurred that warranted its revision; the Model simply provided guidelines and parties in bilateral negotiations were free to work out their own solutions. A number of participants observed that several of the changes suggested in the draft revision were unique to the United Nations Model Convention, and did not necessarily relate to or follow the OECD Model Convention.

35. One participant involved in the drafting of the proposed revision mentioned that it was intended merely as a draft. In preparing the revised text, account had been taken of an analysis of trends in treaties between developing and economically advanced countries, the work of other groups and scholarship in the field. Where doubts had existed, it had been decided to follow the current text of the United Nations Model Convention. It was reiterated that with the consent of the Steering Committee, the revised text would be submitted to other organizations for their comments.

36. Another participant noted that in his experience, the United Nations Model Convention had facilitated the negotiation process and had provided a starting-point for the development of ideas. Developing countries often requested that specific provisions in the United Nations Model Convention be incorporated during bilateral negotiations. With regard to the concern expressed that the revised United Nations Model might follow the OECD Model too closely, he noted that many of the new provisions had been discussed at prior meetings of the Ad Hoc Group of Experts and had often been discussed also in bilateral treaty negotiations.

37. The Chairman expressed the view that the revised text of the United Nations Model should be seen as a working paper. He noted that commentators had identified shortcomings in the United Nations Model Convention and that the discussion on the revision should be pursued. The Ad Hoc Group could amend the proposed draft revision in whole or in part and would not approve any final revision unless it was found to adequately protect the interests of developing countries. Another participant noted that it would be more useful to discuss a draft document than to start with no document at all.

38. It was recommended that the revision of the United Nations Model Convention should be discussed further. One participant observed that it would be useful to have available at the seventh meeting of the Ad Hoc Group the computer base

on tax treaties of the International Bureau of Fiscal Documentation (IBFD) so that the language of specific treaties could be reviewed. Another participant said that it would also be useful to have the analyses of treaties between developing and economically advanced countries used in the preparation of the draft revision. It was noted that IBFD would be represented at the seventh meeting.

39. The Steering Committee agreed by consensus that the draft revision of the United Nations Model Convention (document ST/SG/AC.8/1995/WP.9) should be circulated to the other members of the Ad Hoc Group of Experts and other international organizations for their comments in advance of the seventh meeting, where the draft revision would be discussed.

V. DRAFT REVISION OF THE MANUAL FOR THE NEGOTIATION OF BILATERAL TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

40. One participant noted that the Manual predated the United Nations Model Convention and questioned the need for the Manual in the light of the revision of the Model Convention and the possibility that many items in the Manual could be included in the Model Convention commentary.

41. The Secretary noted that the United Nations Secretariat had not yet begun revising the Manual and that it wanted first to gauge the reaction of the Steering Committee to the revision of the United Nations Model Convention. He pointed out that the United Nations Secretariat had received more requests for the Manual than for the United Nations Model Convention and that in many parts of the world the Manual was better known. One participant noted that the Manual was the only handbook of its kind and recommended that its name should be changed to the "Manual for the Negotiation of Bilateral Tax Treaties" without any reference to developing and developed countries.

42. The Steering Committee agreed by consensus that the United Nations Secretariat should consider the possibility of preparing a revised and updated text of the Manual which could be retitled "Manual for the Negotiation of Bilateral Tax Treaties".

VI. OTHER MATTERS

A. Possible expansion of the role of the Ad Hoc Group of Experts on International Cooperation in Tax Matters

43. The Steering Committee considered whether the role of the Ad Hoc Group of Experts should be expanded to include the provision of technical assistance. The Secretary noted that thus far the Group had been primarily a policy-making body, but had often been requested to provide technical assistance in the areas of tax administration, international taxation, and negotiation of tax treaties. Such assistance could help developing countries generate revenue and facilitate the resolution of treaty disputes. In that connection, reference was made to the work of the United Nations Development Programme (UNDP) and other

international organizations in offering technical assistance, and to seminars convened in Africa with United Nations assistance for the training of tax inspector instructors.

44. The Steering Committee agreed by consensus to recommend that a new item concerning the possible expansion of the role of the Ad Hoc Group to include the provision of technical assistance should be added to the agenda of the seventh meeting of the Group.

B. Additional meeting of the Ad Hoc Group of Experts

45. The Steering Committee agreed by consensus to recommend that at its seventh meeting the Ad Hoc Group should consider the possibility of holding another meeting in 1996 to complete the work begun at the seventh meeting.

Notes

1/ United Nations publication, Sales No. E.79.XVI.3.

2/ United Nations publication, Sales No. E.80.XVI.3.
