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United Nations Model Double Taxation Convention between Developed and Developing Countries: brief summary of articles**

Note by the Secretariat

Introduction

1. The short summary of the articles of the *United Nations Model Double Taxation Convention between Developed and Developing Countries* (hereinafter referred to as the United Nations Model Convention),[1] as contained in the present note, does not reflect formal positions taken by the United Nations or the Committee of Experts on International Cooperation in Tax Matters (hereinafter referred to as the Committee) with regard to the interpretation and application of the provisions of the United Nations Model Convention. The aim, instead, is to provide informal summaries of each article by briefly highlighting its scope, noting key areas where the text of an article or the commentary upon it has been updated in the latest (2011) version of the United Nations Model Convention and pointing out relevant differences from the corresponding article of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention on Income and Capital[2] (hereinafter referred to as the OECD Model Convention), the other main model tax convention.

* E/C.18/2012/1.
** Including the main changes made by the 2011 update.
[1] United Nations publication (New York, 2011). Also available from http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf.
[2] Paris, OECD, 1 September 2010.

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2. The various model double tax treaties try to resolve the problem stemming from the fact that under international economic law, both the place of an investment or provision of goods or services (“the source country”) and also the “residence country” of the investor/provider can legitimately tax profits from such investment or provision. This can be a problem because most States tax, in domestic law, on *both* a source and a residence basis and the resulting double taxation may have adverse implications, such as dampening of cross-border investment.

3. Domestic law can address some of these double taxation-related issues, but not as thoroughly as, and not with the certainty and solemnity of, an international agreement. All double tax treaties therefore seek to avoid double taxation owing to such overlapping taxing rights: they provide in particular that residence States must generally give relief for source-State taxes allowed by the treaty, and may only retain residual taxing rights, so that a central issue for any tax treaty is how much of those source-State taxing rights are preserved.

4. The introduction to the United Nations Model was completely revised for the 2011 update. While the introduction does not go into the same historical depth on the origins of the United Nations Model Convention as the previous version of the Convention[3] (effectively completed in 1999 and published in 2001) it clearly places the Convention, and the role of the Committee in the context of the financing for development process.

5. The introduction to the Convention (para. 4) notes in particular that both the 2002 Monterrey Consensus of the International Conference on Financing for Development[4] and the 2008 Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus[5] recognize the special importance of international tax cooperation in encouraging investment for development and maximizing domestic resource mobilization, including by combating tax evasion. This “balance” between encouraging investment as a route to development, on the one hand, and ensuring, on the other, that revenue benefits from that investment are available to fund development, is at the heart of the financing for development process and the purpose of the Model.

Article 1: Persons covered

6. Article 1 determines the persons to whom the treaty applies and, by its wording, covers persons who are resident in one or both of the treaty States (“the Contracting States”). The term “person” is very broadly defined under article 3 (1) (a) to include an individual, a company and any other body of persons.

7. In recent years, article 1 of the United Nations Model Convention has been discussed thoroughly by the Committee in the context of addressing treaty abuse. As a result of this work, the commentary was amended in 2011 to give further guidance

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[3] United Nations publication, Sales No. E.01.XVI.2. Available from http://www.un.org/ga/search/view_doc.asp?symbol=ST/ESA/PAD/SER.E/21&Lang=E.

[4] *Report of the United Nations Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex.

[5] General Assembly resolution 63/239, annex.

in relation to this issue, similar to that contained in the discussion in the OECD Model Convention commentary.

8. The United Nations Model Convention commentary on article 1 notes, for example, that "the Committee recognizes that for tax treaties to achieve their role, it is important to maintain a balance between the need for tax administrations to protect their tax revenues from the misuse of tax treaty provisions and the need to provide legal certainty and to protect the legitimate expectations of taxpayers".[6]

9. The commentary also expresses agreement with the OECD commentary that States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the tax treaty have been entered into.[7]

10. The commentary continues on this point:

> 25. Under the guiding principle presented above, two elements must therefore be present for certain transactions or arrangements to be found to constitute an abuse of the provisions of a tax treaty:
>
> – a main purpose for entering into these transactions or arrangements was to secure a more favourable tax position; and
>
> – obtaining that more favourable treatment would be contrary to the object and purpose of the relevant provisions.
>
> 26. These two elements will also often be found, explicitly or implicitly, in general anti-avoidance rules and doctrines developed in various countries.
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> 27. In order to minimize the uncertainty that may result from the application of that approach, it is important that this guiding principle be applied on the basis of objective findings of facts, not solely on the alleged intention of the parties. Thus, the determination of whether a main purpose for entering into transactions or arrangements is to obtain tax advantages should be based on an objective determination, based on all the relevant facts and circumstances, of whether, without these tax advantages, a reasonable taxpayer would have entered into the same transactions or arrangements.

Article 2: Taxes covered

11. Article 2 concerns the taxes to be covered by the treaty and is similar to the corresponding article of the OECD Model Convention. Article 2 (1) sets out in general terms the taxes to be covered by the treaty; "taxes on income and on capital", as further defined in paragraph 2. According to article 2 (1), the treaty applies to the taxes covered irrespective of the official authority[8] that imposes the tax or the method by which the taxes are levied. The commentary on article 2 (2) makes it clear that the definition does not comprise social security charges. Article 2 (3) then allows for a specific but not exhaustive list of taxes to be explicitly covered by the treaty.

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[6] Commentary to article 1, at para. 9.

[7] At para. 22.

[8] That is, the State itself, political subdivisions or local authorities.

12. Article 2 (4) provides for treaty dynamism by stating that the article also covers substantially similar taxes imposed by a contracting State after the signing of the treaty. The provision finally includes an obligation of the competent authorities of the treaty partners to notify each other of significant changes to their tax laws.

Article 3: General definitions

13. Article 3 (1) contains several *general* definitions necessary for understanding and applying the Convention. Article 3 (2) provides that an undefined term shall have the meaning it has under the laws of the State (that is, the State granting the treaty benefits) for the purposes of the taxes to which the Convention applies, unless the context otherwise requires — if, for example, there is clearly meant to be a single international meaning with which the domestic law is inconsistent.

14. Article 3 (2) reflects the realities that not all definitional issues could be dealt with adequately over the long span of a treaty's life without some reference to the potentially more fluid and responsive laws of the parties to that treaty, and that treaties defining all terms would be potentially more complicated and harder to negotiate.

Article 4: Resident

15. Article 4 (1) defines the expression "resident of a Contracting State" as any person liable to tax under the laws of that State by reason of domicile, residence, place of incorporation, place of management or any other criterion of a similar nature. The aim of the provision is to address various forms of attachment to a State that constitute the basis of tax residence under domestic law, with the right to tax therefore not being limited to persons who are "domiciled" in a country. The article provides tie-breaker rules for resolving cases of dual residence for individuals referred to in paragraph 2, and for companies and the like covered in paragraph 3.

16. There may be dual residence when two States apply different criteria (within the framework of paragraph 1) or interpret a criterion differently in determining a taxpayer's residence. In order to resolve a conflict of dual residence for an *individual*, paragraph 2 lists several criteria relevant in a decreasing order (permanent home, centre of vital interests, habitual abode and, finally, nationality). The "mutual agreement procedure" set out in article 25 is relied on in cases where the factor of nationality still cannot resolve the issue of dual residence.

17. In a situation of dual residence for a person that is not an individual (such as a *company*), it shall be deemed to be a resident of the State where its place of effective management is situated.

18. The "place of effective management" is not defined in the United Nations Convention Model, although the commentary does point to circumstances that may be taken into account in that regard (for example, where the company is actually managed and controlled).

Article 5: Permanent establishment

19. Article 5 defines the term "permanent establishment" as "a fixed place of business through which the business activity of an enterprise is wholly or partly carried on". The concept of a permanent establishment is used in tax treaties basically for the purpose of determining the right of a State to tax business profits earned by an enterprise of a treaty partner. The article generally requires a certain level of economic activity in the source State before a permanent establishment is said to exist: this allows potential investors to "test the waters" before full-scale investment, which is regarded as a means of creating a conducive investment climate.

20. If the source State *does* apply taxation to the profits of the investment, the State of the foreign investor must, to meet the treaty goals of avoiding double taxation, give a credit for the tax paid in the source State or else exempt the income altogether.

21. The profits of the enterprise are generally taxable in the source State to the extent that they are attributable to the permanent establishment (an exception to this principle occurs under the "limited force of attraction" rule in article 7, discussed below). The degree of economic activity required to form a permanent establishment in a country is in many respects lower under the United Nations Model Convention than under the OECD Model Convention, and the threshold differences between the two Model Conventions noted below mean that the United Nations Model Convention preserves more taxing rights to source States as compared with the OECD Model Convention.

22. The update to the United Nations Model Convention does not change this key difference between the two Model Conventions. While supporting foreign direct investment (FDI) as a route to development, the United Nations Model Convention operates on the basis that for many States, productive investment can be achieved in a way that best fulfils the developmental role of taxation treaties (and taxation more generally) with a balance of more source-State taxation rights being preserved under the treaty.

23. Based on this perspective, the United Nations Model Convention takes on board some of the updated OECD Model Convention commentaries where they are seen as relevant to interpreting and applying the United Nations Model Convention. This is because the 2001 United Nations Model Convention had been essentially completed in 1999 and the latest OECD Model Convention commentaries quoted were those included in the 1997 version of the OECD Model Convention. There have been developments since then which have been incorporated so that the United Nations Model Convention can better meet its objectives of assisting developing countries in the policy, negotiation and application of tax treaties. They also provide greater clarity for other stakeholders in tax systems, including taxpayers and tax advisers.

24. Perhaps most significantly, there remains a distinct difference in the treatment of taxation of services under the two Model Conventions. The United Nations Model Convention retains a "services permanent establishment" provision at article 5 (3) (b), while the OECD Model Convention article has no similar rule.[9] Under the

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[9] Although the OECD commentary on article 5 does provide an alternative for States wanting a specific services provision, at paragraph 42.23.

United Nations Model Convention provision, a permanent establishment exists if a non-resident enterprise "furnishes" services in the source State for more than 183 days in any 12-month period in respect of "the same or a connected project".

25. A major project of examining services taxation in a thoroughgoing way is under way in the Committee and the justifications or otherwise for particular treatments of services will no doubt be further considered as part of that work.

26. Turning to the other specific differences between article 5 in the two Model Conventions, the 2011 update retains the following differences from the OECD Model Convention:

- A 6-month (rather than a 12-month) duration test for building and construction permanent establishments (article 5 (3) (a)) is used
- Delivery operations can constitute permanent establishments of themselves (because they are not listed in the exclusions at para. 4 of the United Nations Model Convention, unlike under the OECD Model Convention)
- A dependent agent situation (with a permanent establishment deemed to exist) can occur if the agent maintains stock and regularly makes delivery, even when contracts are not concluded for the principal (article 5 (5) (b))
- A special deemed permanent establishment provision is provided in relation to insurance (article 5 (6)) where premiums are collected in a State or the risks insured are situated there

27. The commentary on article 5 has been substantially updated in many ways, including by addressing issues where negotiating parties wish to delete article 14 (Independent personal services) and rely on articles 5 and 7 instead, an issue noted below. However, there is also a minor change to article 5 itself. Article 5 (3) (b) has been amended to refer to a 183-day period, rather than "six months", thus avoiding any argument about whether part of a month is regarded as constituting a month, and the period for testing whether this threshold is met will now be one "commencing or ending in the fiscal year concerned".

Article 6: Income from immovable property

28. This article provides that income "derived" by a resident of one State from immovable property situated in the other State may be taxed by the State where the immovable property is situated. The basis for this rule is given as the very close economic connection between the source of income and the State where the property is situated. Article 6 is the same as article 6 of the OECD Model Convention, except for one consequential change in the OECD Model Convention when article 14 was deleted.

29. Under article 6 (2), the term "immovable property" has the meaning that it has under the law of the State where the property is situated. However, the term in any case includes the specific assets and rights listed in paragraph 2 (including income from agriculture or forestry, for example). Article 6 (2) makes it clear, on the other hand, that ships, boats and aircraft are *not* to be considered immovable property.

30. In the commentary on the article, it is emphasized that the object should be to tax the profits (rather than gross income). Expenses incurred in earning the income should therefore be taken into account.[10]

Article 7: Business profits

31. Once it is established that a permanent establishment exists, there is a need to attribute the correct amount of profit to it, in order to determine the amount of profit over which the source State retains taxing rights. Article 7 (Business profits) addresses this issue.

32. Article 7 applies to "business profits" in general, but in effect includes only business profits that are not dealt with in any of the other specific articles of the Convention, since these are given precedence by paragraph 6.

33. The article provides that the profits of an enterprise shall be taxed only in the State where the enterprise is resident, unless it carries on business in the other contracting State (the source State) through a permanent establishment. If a permanent establishment is found to exist under the provisions of article 5, the source State may tax profits that are attributable to the permanent establishment — and it is generally understood that expenses should be taken into account when calculating such taxable business profits.[11]

34. Article 7 of the United Nations Model Convention further contains a "limited force-of-attraction rule" which extends the source-State's taxing rights to also include profits from certain similar transactions carried out by the enterprise in the same State but not through the permanent establishment. Article 7 of the OECD Model Convention has a more restricted scope for source-State taxation and allows only profits attributable to the permanent establishment to be taxed there.

35. This difference should not be overstated, however, because many States using the United Nations Model Convention do not include the limited force-of-attraction provision; usually, this is because they do not have such a provision in domestic law, and therefore do not need to preserve its operation under the treaty.

36. With regard to allocation of profits to the permanent establishment, the 2011 United Nations Model Convention does not adopt the approach taken in the 2008 OECD report on attribution of profits to permanent establishments (the "authorized OECD approach", now reflected in the 2010 update of the OECD Model Convention). This report was, in particular, considered by the Committee to be in direct conflict with paragraph 3 of the United Nations article, which generally rejects deductions for amounts "paid" by a permanent establishment to its head office (other than reimbursements of actual expenses).[12]

37. The United Nations Model Convention does not include a special provision on technical, management and consulting services and it considers that income from such services is governed by article 7 (or by article 14 in the case of the rendering of

[10] At para. 2. This does not, however, preclude a withholding tax based on gross income; in that case, however, the rate should recognize the expenses involved by being lower.

[11] At para. 3 of the commentary.

[12] Para. 1 of the commentary.

independent personal services). The issue of taxation of such services is under consideration as part of the current work on services.

Article 8: Shipping, inland waterways transport and air transport

38. This article provides two alternative versions. Article 8, alternative A, which is similar to article 8 of the OECD Model Convention, allocates exclusive taxing rights of profits from shipping, inland waterways and air transport to the State where the enterprise has its "place of effective management". In a situation where the place of effective management is aboard a ship or a boat, the article determines that the place of effective management is deemed to be situated in the contracting State where the home harbour of the ship or boat is situated. If there is no such home harbour, the determining factor is where the operator of the ship or boat is a resident.

39. Article 8, alternative B, provides a different rule in paragraph 2 (not found in the OECD Model Convention) with respect to profits from international shipping activities. Pursuant to this provision, such profits may also be taxed in the other State on a net basis if the activity therein is "more than casual". This was seen as being potentially helpful for developing countries without their own shipping industries, but where there is regular planned traffic by foreign enterprises. In such cases, paragraph 2 provides special rules for such taxation, to be negotiated between the States in a way that does not deter such activity but allows appropriate source-State taxation.[13]

Article 9: Associated enterprises

40. Article 9 is based on application of the "arm's-length principle" to transactions between related parties, as is the case in the corresponding OECD article. Subject to the conditions of the article, the tax authorities of a contracting State can, for tax purposes, adjust the reported profits from a transaction between associated enterprises (such as intra-group transactions) if the transaction is not made on arm's-length terms.[14] This is known as a "primary adjustment", such as increasing the profits of A in an A-B transaction. In that case, the other contracting State is to make an appropriate adjustment to the tax charged (a "correlative adjustment", such as reducing the profits of B in the same transaction) provided that such State considers the adjustment to be justifiable.

41. Article 9 (3) of the United Nations Model Convention provides that the obligation under paragraph 2 to make a correlative adjustment does not apply in certain extraordinary situations that involve fraud, gross negligence or wilful default.

42. Paragraph 3 of the commentary was amended in 2011 to make it clear that the discussion of the OECD Transfer Pricing Guidelines in that paragraph reflected the views of the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries which preceded the current Committee and that those views had not yet been considered fully by the Committee. A current development in the

[13] Paras. 13 and 14 of the commentary.

[14] That is, essentially on normal open-market commercial terms.

context of article 9 and transfer pricing is that the Committee is producing a practical transfer pricing manual for developing countries.

Article 10: Dividends

43. This article concerns taxation of dividends received by a resident of a contracting State from sources in the other contracting State. Paragraph 1 provides that dividends may be taxed in the State of residence and paragraph 2 sets out that dividends may also be taxed in the source State, that is, the State where the company paying the dividend is a resident.

44. Taxation of dividends in the source State is limited, however, to a specified percentage of the gross amount if the beneficial owner of the shares is a resident of the other contracting State. The United Nations Model Convention leaves the source-country’s specified tax to be established through bilateral negotiations. (In the OECD Model Convention, the source-country’s taxing rights is limited to a maximum 15 per cent on portfolio investments and a maximum 5 per cent on direct investments.)

45. The threshold for a direct investment is a 10 per cent ownership under the United Nations Model Convention, as compared with 25 per cent ownership under the OECD Model Convention, because when the issue was considered for the first (1980) version of the United Nations Model Convention, foreign ownership in many developing countries was limited to 50 per cent, and 10 per cent of the whole was therefore considered a significant proportion of that permitted foreign ownership.[15]

46. The reason why the United Nations Model Convention does not suggest particular withholding tax rates for dividends, interest (article 11) or royalties (article 12) is that it recognizes that there are balances between, on the one hand, having a very high rate of source-State taxation of such flows that is in practice likely to dampen economic activity, and, on the other hand, having a lower rate that encourages economic activity but does not allow a fair taxing of the profits from such activity that can then be used for development purposes.

47. The term “dividends” is defined in article 10 (3) to mean income from shares and the like, as well as “income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident”. The benefits of the treaty are granted to the “beneficial owner” of the dividend, a term which is not explicitly defined in the United Nations Model Convention. The commentary makes clear, however, that the term beneficial ownership “is not used in a narrow technical sense”. There is some new text on the concept of beneficial ownership in the commentaries on articles 10, 11 and 12 so as to give greater guidance on the concept, drawing upon the text of the OECD Model Convention commentaries.

48. Article 10 of the United Nations Model Convention is essentially the same as article 10 of the OECD Model Convention, apart from the differences noted above.

[15] Commentary to article 10 of the 2011 United Nations Model Convention, para. 6.

Article 11: Interest

49. Article 11 deals with taxation of interest arising in a contracting State and paid to a resident of the other contracting State. Paragraph 1 provides that interest may be taxed in the State of residence; and paragraph 2 sets out that interest may also be taxed in the State where it "arises" (that is, the State where it has its source). Taxation of interest in the source State is limited to a specified percentage of the gross amount of interest in the case where the beneficial owner is a resident of the other contracting State. As it does with dividends, the United Nations Model Convention leaves the source-country's tax rate to be established through bilateral negotiations, while the OECD Model Convention sets the maximum source tax rate at 10 per cent.

50. The commentary on article 11 was updated in 2011 to specifically address the issue of Islamic financial instruments. In effect, the commentary recognizes that even though such forms of financing do not have an interest component, they have a component that should be treated in the same way for the purposes of this article. In other words, the source State from which that component is paid to someone in the other State may impose tax on the amount paid, but only to the maximum rate agreed under the treaty.

Article 12: Royalties

51. Article 12 concerns taxation of royalties arising in a contracting State and paid to a resident of the other contracting State. Paragraph 1 provides that royalties may be taxed in the State of residence, and paragraph 2 sets out that royalties may also be taxed in the State where they arise. As with dividends and interest, this source-State taxation is allowed only to the maximum of a specified percentage of the gross amount, where the beneficial owner is a resident of the other contracting State. The percentage is left for negotiation, for the same reasons as obtain for dividends or interest.

52. This differs from article 12 of the OECD Model Convention, which provides for exclusive residence-State taxation of royalties, unless the profits are attributable to a permanent establishment as business profits under article 7 (in which case that article applies). The United Nations Model Convention therefore continues to differ from the OECD Model Convention in providing for any source-State taxation of royalty flows, on the basis that this represents the fair taxation of benefits from economic engagement in a country, but with an awareness of the fact that there is potentially some trade-off in terms of the impact of such taxes on the level of technology transfer into the country. Other factors, such as the size of markets and the levels of intellectual property protection, will perhaps be more significant in impacting such flows, but the rate allowed under the treaty (which is only a maximum, in any case: a State may provide a lower rate at domestic law) remains a matter for policy decision at the State level and then for negotiation. In fact, many OECD members themselves depart from the provisions of the OECD article and include in their treaties provisions preserving limited source-State taxing rights for royalties.

53. The United Nations Model Convention and the OECD Model Convention also differ somewhat in how they define royalties; for instance, the United Nations

Model Convention treats equipment rentals as royalties, while the OECD Model Convention has deleted this provision from the definition.

Article 13: Capital gains

54. The scope of article 13 is the taxation of capital gains from the *alienation* of capital (such as by sale). This is different from taxation of the *holding* of capital, which is dealt with in article 22.

55. Paragraphs 1, 2, 4 and 5 address situations where capital gains may be taxed in the State where the alienated property is situated (source-State taxation). One example is provided in article 13 (1) which determines that gains from the alienation of immovable property may be taxed in the State where it is situated. Article 13 (6) then determines that all other gains from the alienation of property (that is, in situations not dealt with in paras. 1-5) are taxable only in the State where the alienator is a resident.

56. The United Nations Model Convention departs from the corresponding article of the OECD Model Convention through the inclusion of a provision that preserves source-State taxation on gains from the alienation of substantial shareholdings in resident companies (article 13 (5)). The provision leaves it to bilateral negotiations to agree on what represents a "substantial shareholding".

57. As a result of work carried out by the Committee in past years on the "improper use of treaties" (as noted above in relationship to article 1), paragraph 5 of article 13 has been amended to read (with the main change highlighted):

> Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least __ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.

58. The change made to the previous version of this paragraph is intended to make clear that multiple sales within the 12-month period can be aggregated to determine if the relevant holding meets the threshold amount agreed in a bilateral agreement. The change addresses the possible argument that a series of sales that did not individually meet the threshold percentage would not be caught by the provision as originally framed, even if collectively they exceeded the threshold.

Article 14: Independent personal services

59. Article 14 concerns taxation of income derived from independent personal services (that is, professional services or other activities of an independent character, as compared with employment, which is treated as a "dependent personal service"). Under article 14 (1), such income is in general taxable in the State where the service provider is resident. Article 14 (1) also allows for source-State taxation of income from independent personal services subject to the condition that *either*:

(a) "he has a fixed base regularly available to him" in that State; or

(b) the service provider is present there for more than 183 days of a fiscal year.

60. Source-State taxation is limited to income attributable to the fixed base (under (a)) or income derived from activities performed in the other State (under (b)).

61. The term "fixed base" is not defined in the Convention, but the commentary gives examples of what it would cover and accepts that article 14 is based on the same principles as article 7, and that guidance can be drawn from that article.[16] The time requirement in subparagraph (b) is connected to days of *presence* in the source State rather than days of *employment*. Article 14 (2) then lists specific activities that are covered by the term "professional services", but as stated in the commentary, the list offers only examples and is not exhaustive. In situations where both articles 7 and 14 could in their own terms apply, article 7 (6) gives priority to article 14.

62. The OECD Committee on Fiscal Affairs had decided to delete article 14 of the OECD Model Convention in 2000, which was done primarily because it did not see any intended differences between the concept of "permanent establishment" (cf. articles 5 and 7) and that of "fixed base". In the 2011 update of the United Nations Model Convention, the commentary on article 5 was amended to give guidance to States considering the removal of article 14 from individual treaties.

Article 15: Dependent personal services

63. Pursuant to article 15 (1), income derived by a resident of one State from employment (dependent personal services) "exercised" in the other State may be taxed in that other State (the source country, where the employment is exercised). However, article 15 (2) determines that income from employment is exempt from source-State taxation if the employment (a) is performed there in a relatively short period of time (not exceeding 183 days) *and also* (b) is not paid for by an employer resident in the source State (or by a permanent establishment therein).

64. If the remuneration is paid for by an employer resident in the source State (or a permanent establishment there) the source State may tax the income notwithstanding the fact that the employee stays there only for a very short period of time. The low threshold requirement in this situation is justified by the base-erosion principle, as the employee's remuneration is generally deductible by the employer in the source country.

65. The article reproduces article 15 of the OECD Model Convention, with the exception that the title of the OECD Model Convention article is "Income from employment" and no longer refers to a "fixed base" — both relate to the deletion of article 14 from that Model Convention.

[16] Para. 10.

Article 16: Directors' fees and remuneration of top-level managerial officials

66. This article provides that fees paid to non-resident directors (para. 1) and remuneration paid to top-level managerial officials (para. 2) may be taxed in the State where the company is a resident. Article 16 (1) reproduces article 16 (1) of the OECD Model Convention, while article 16 (2), which extends the taxing rights to include remuneration of non-resident top-level managerial officials, is a special United Nations provision.

Article 17: Artistes and sportspersons

67. Article 17 (1) gives the source State a right to tax income of entertainers and sportspersons derived from activities "exercised" in that State. Article 17 (2), which extends the source-country's taxing rights to situations where income from such activity accrues to another person, such as an agent company, addresses a concern about tax avoidance. The article essentially reproduces article 17 of the OECD Model Convention.

Article 18: Pensions and social security payments

68. This article provides two alternative versions for the taxation of pensions and other social security payments in consideration of past employment. Under both alternatives, the right to tax *public* pensions (social security payments) is granted exclusively to the State making the payment (source country). The conceptual basis for this approach entailing exclusive source-State taxation on public pensions is the fact that these benefits are normally financed from tax revenue.

69. Under article 18, alternative A, taxing rights on *private* pensions are allocated exclusively to the State where the recipient is a resident. Alternative B, however, allows both the paying (source) State and the residence State to tax private pensions. In effect, this would give the primary taxing right to the source State, and only residual taxing rights to the residence State (that is, to the extent that its tax would be higher).

70. Article 18 of the OECD Model Convention differs significantly from the United Nations article and allocates the right to tax pensions and the like, both public and private, exclusively to the residence State of the recipient. However, paragraph 2 of OECD Model Convention, article 19 (3) dealing with Government Service, modifies article 18 by determining that pensions and the like paid by, or out of funds created by, a contracting State in respect of services rendered to that State are normally exclusively taxable by that State. The OECD Model Convention commentary on article 18 also recognizes that social security payments may be regarded by some States as being similar to Government pensions, and therefore further recognizes that States may bilaterally agree on an alternative provision. Many OECD members favour exclusive or limited source-State taxation of pensions

along the lines of the alternative provisions in the OECD Model Convention commentary.[17]

Article 19: Government service

71. This article reproduces article 19 of the OECD Model Convention. It grants the paying State the exclusive right to tax salaries, wages, pensions and other similar remuneration in respect of Government services (employment services) rendered to that State. The general principle of exclusive source-State taxation of such services has developed from international courtesy and the Vienna Convention on Diplomatic Relations of 1961 and the Vienna Convention on Consular Relations of 1963.[18] This principle is modified in subparagraph (b) of paragraphs 1 and 2, whereby the right to tax such income derived by residents who are nationals[19] of the receiving State is granted exclusively to that State if the services are also rendered in that State.

72. For States using the credit method in tax treaties to relieve double taxation, article 19 implies an exception to that general method: they must *exempt* payments made to their residents where the other State has exclusive taxing rights.

73. Article 19 (3) makes it clear that the article does not apply to services rendered in connection with a business carried on by the State.

Article 20: Students

74. This article provides that students or business trainees/apprentices who go abroad solely for the purpose of education or training shall not be subject to tax in that State on certain payments received. The article applies to payments received from sources outside of the State where the student, etc., is staying and must be made for the purpose of his or her maintenance, education or training. There is also a requirement under the article that the student, etc., be or have been immediately before visiting the contracting State, a resident of the other contracting State. Article 20 of the United Nations Model Convention reproduces article 20 of the OECD Model Convention, with the addition of the word "trainee" in the first sentence.

Article 21: Other income

75. Article 21 concerns items of income not dealt with elsewhere in the treaty. Article 21 (1) grants the taxing rights of such income to the State of residence, while paragraph 2 provides an exception to paragraph 1 where the income is connected to a permanent establishment or a fixed base in the other contracting State (in which case, the income is to be dealt with under articles 7 or 14, as appropriate). The

[17] At para. 15.

[18] United Nations, *Treaty Series*, vol. 500, No. 7310; and ibid., vol. 596, No. 8638, respectively.

[19] Taxation by the receiving country pursuant to article 19 (1) (b) does not, however, require the individual to be treated as a national of the receiving State if the individual "did not become a resident of that State solely for the purpose of rendering the services" (article 19 (1) (b) (ii) of the OECD Model Convention), i.e., if he or she became a resident for other reasons also.

United Nations Model Convention, also includes a paragraph 3, which does not appear in the OECD Model Convention. This provision overrides the first two paragraphs with respect to allowing for source-State taxation of "other income", where the income arises in that contracting State.

Article 22: Capital

76. Article 22 concerns taxes on capital (that is, the *holding/ownership* of capital, not its alienation, which is dealt with by article 13). As noted in the commentary, the article does not cover taxes on estates, inheritances and gifts or transfer duties (para. 3 (1)).

77. The first two paragraphs of this article preserve taxing rights for the State where the capital is located. Paragraph 1 applies to *immovable* property of the type referred to in article 6 owned by a resident of the other contracting State. Paragraph 2 applies to *movable* property connected with a permanent establishment or a fixed base. Capital represented by ships and aircraft in international traffic, etc., is dealt with in paragraph 3, and the taxing rights are exclusively granted to the State in which the place of effective management of the enterprise is located, for purposes of consistency with article 8.

78. Paragraph 4 provides that "[(a)ll other elements of capital of a resident of a Contracting State shall be taxable only in that State]". Paragraph 4 is intentionally set in brackets to point out that the negotiating parties should decide whether to use the wording of that paragraph or a different wording which would preserve taxing rights for the State in which the capital is located. The corresponding provision under the OECD Model Convention is not set in brackets, in accordance with that Model Convention's greater focus on residence-State taxation. Apart from the brackets inserted in paragraph 4, article 22 of the United Nations Model Convention reproduces article 22 of the OECD Model Convention.

Article 23: Methods for the elimination of double taxation

79. Article 23 (alternatives A and B) includes the two principal methods for the elimination of so-called juridical double taxation. Juridical double taxation occurs when the *same* item of income or capital is taxable in the hands of the *same* taxpayer by more than one State.[20] The United Nations Model Convention, like the OECD Model Convention, does not express any preference for either of the two methods. What method is applied depends on a State's policy and practice.

80. Articles 23 A and 23 B apply to the situation where a resident of one contracting State derives income from, or owns capital in, the other contracting State and provides that such income, or capital, in accordance with the treaty, is taxable in that other State (the source country). The article then requires the State of residence *to give relief* for source-State taxation by using one of the alternative methods provided for in article 23.

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[20] As compared with "economic double taxation" where legally distinct taxpayers may both be taxed on essentially the same profits. While this matter is not generally addressed by double tax treaties, article 9 deals with aspects of it.

Article 23 A: Exemption method

81. Article 23 A concerns the exemption method. Under this method, the State of residence exempts from taxation the income or capital, which, pursuant to the treaty, may be taxed in the other State (the source country). There are two subcategories of the exemption method included in the United Nations Model Convention: full exemption, which is dealt with in paragraph 1, and "exemption with progression", which, is dealt with in paragraph 3. Full exemption means that income derived or capital owned in the other contracting State shall not be taken into account by the State of residence for tax purposes (in other words, such income or capital is thus completely exempted from its tax base).

82. Exemption with progression means that the State of residence exempts the income, but can take account of the exempted income or capital when calculating the tax on the remaining income or capital. Through the inclusion of exempted income or capital when the remaining income (or capital) is calculated, the taxpayer may be subject to a higher marginal tax rate on the income (or capital) in the State of residence.

83. Article 23 A of the United Nations Model Convention basically reproduces article 23 A of the OECD Model Convention; however, the OECD Model Convention included a new paragraph 4 in the 2000 update which has not yet been adopted by the Committee.[21] This OECD provision directs itself to situations of so-called double non-taxation wherein a State of residence interprets the treaty to mean that it must exempt the income, while the State of source adopts a different interpretation, to the effect that it cannot exercise a taxing right or can do so only to a limited degree. In such cases, the residence State is no longer required to exempt.

Article 23 B: Credit method

84. The credit method is dealt with in article 23 B. Article 23 B is based upon the ordinary credit method, which means that the State of residence allows as a deduction ("credit") from its own tax on the income or capital of its resident an amount equal to the tax paid in the other State. The deductible amount is limited, however, to the amount that would have been taxable on the same income (or capital) in the State of residence. Article 23 B of the United Nations Model Convention reproduces article 23 B of the OECD Model Convention.

Article 24: Non-discrimination

85. Article 24 (1) sets out the important principle of non-discrimination (for the purposes of taxes) on the basis of nationality. It is substantively the same as article 24 of the OECD Model Convention. The basic rule of paragraph 1 is that a contracting State cannot tax a national from the other contracting State in a way that is "more burdensome" than that provided for its own nationals, provided that they are in the same circumstances (explained by the commentary as meaning in substantially similar circumstances both in law and in fact). The subsequent paragraphs under article 24 extend the scope of the non-discrimination principle to

[21] It was one of the results of recommendations in a 1999 OECD report entitled *The Application of the OECD Model Tax Convention to partnerships* (Paris, 26 August 1999). Such recommendations remain for consideration by the Committee.

stateless persons and permanent establishments, etc. Article 25 (6) makes it clear that the scope of the article is not limited by the provisions of article 2 (Taxes covered).

Article 25: Mutual agreement procedure

86. This article provides that a person covered by the treaty may present a case before the "competent authority" of the contracting State in which the person is a resident. If the taxpayer objects, citing "taxation not in accordance with the provisions" of the treaty, and the objection appears to be justified (and the competent authority itself is not able to arrive at a satisfactory result), then the competent authority shall try to resolve the case by mutual agreement with the competent authority of the other contracting State.

87. Article 25 also provides that competent authorities shall endeavour to resolve issues that arise concerning the interpretation and the application of the treaty. In the 2011 update of the United Nations Model Convention, article 25 was amended to include a new alternative version of the article (alternative B), which in paragraph 5 provides for mandatory arbitration in the case of an inability to resolve the case under the mutual agreement procedure. Alternative A of the article preserves the former position with no mandatory arbitration. Paragraph 5 of the arbitration alternative determines that the competent authorities are obliged to submit unresolved issues to arbitration if one of them requests arbitration.

88. The arbitration provision in the United Nations Model Convention is similar to article 25 (5) of the OECD Model Convention, although there are important differences: first, under the United Nations Model Convention, only the competent authorities may request arbitration, while it is the taxpayer who initiates arbitration under the OECD Model Convention; second, a case can be submitted to arbitration under the United Nations Model Convention only if the competent authorities have not reached an agreement within three years after the case was initiated (the time frame is two years in the OECD Model Convention article); and, finally, under the United Nations Model Convention, the competent authorities can decide to depart from the arbitral decision if they agree on a different solution within six months after the decision was communicated to them.[22]

89. When the issue came up for discussion before the Committee, opinion was divided on the pros and cons of such arbitration. The outcome (in the context of a convention model that offers options, and the information necessary to choose between them, or at least to understand the consequences of the different paths taken or not taken) espoused recognizing the differences of opinion, noting some of the issues raised by proponents and opponents of mandatory binding arbitration, and then providing two alternative articles for use in bilateral tax treaties.

Article 26: Exchange of information

90. Article 26 provides a basis for the effective exchange of information between the contracting States and places an obligation on the competent authorities to

[22] A subsequent agreement which differs from the arbitration decision is also allowed under the relevant provision of the European Union Arbitration Convention.

exchange information "foreseeably relevant" for carrying out the provisions of the treaty and to enable the enforcement of domestic tax laws.

91. The new article on exchange of information essentially reflects changes made to the OECD Model Convention in recent years which were regarded as useful to developing countries in promoting the exchange of information needed to combat tax avoidance and evasion. According to the commentary, the exchange obligation should be interpreted broadly and it is explicitly stated that the obligation to exchange information upon request is not restricted by the scope of articles 1 (Persons covered) or 2 (Taxes covered).

92. Paragraph 4 clarifies that, where information is requested by a State in accordance with a treaty, the other State shall use its information-gathering measures to obtain the requested information, even if that second State may not need such information for its own tax purposes.

93. Paragraph 5 also explicitly notes that the limitations set out in paragraph 3 are not to be construed as allowing a contracting State to decline to supply information solely because the information is held by a bank, another financial institution, or a nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

94. The United Nations Model Convention also includes a sentence in paragraph 1 (not found in the OECD Model Convention article) which reads: "In particular, information shall be exchanged that would be helpful to a Contracting State in preventing avoidance or evasion of such taxes." That change was considered useful in making explicit in the text of article 26 a point that was already clear in the commentary, while still reflecting a common standard on exchange of information under the United Nations and OECD Model Conventions.

Article 27: Assistance in the collection of taxes

95. A new "optional"[23] article 27 on mutual assistance in the collection of taxes was added to the United Nations Model Convention as part of the 2011 revision. The new article 27 allows enforcement of a foreign tax debt as if it were the country's own debt, and is potentially highly beneficial to developing countries that wish to pursue tax debts in an international environment. The commentary on the article includes an alternative provision for States that, for various reasons, may wish to limit the scope of such compulsory assistance. There are also, of course, protections against abuse. The article is based on the corresponding article in the OECD Model Convention. The main difference from the OECD provision is that there is greater recognition in the United Nations Model Convention article that developing countries may require additional financial assistance from the requesting State in carrying out some of the responsibilities provided for under the article, especially in view of their often very limited administrative resources.

[23] For cases where both States consider, bearing in mind the factors discussed in paragraph 1 of the commentary, that they would be able to provide assistance under the article. Ultimately, of course, all United Nations Model Convention provisions are entirely optional.

Article 28: Members of diplomatic missions and consular posts

96. This article provides that the fiscal privileges granted to members of diplomatic missions and consular posts under customary rules of international law and international agreements are not affected by the treaty provisions.

Article 29: Entry into force

97. Article 29 provided for the entry into force of a bilateral treaty following ratification processes in the contracting States and then an exchange of instruments of ratification between the States.

Article 30: Termination

98. This provision provides that the treaty will remain in force until terminated by one of the contracting States, and also sets out the procedural rules for enabling such termination to take effect. Articles 29 and 30 are drawn from general treaty practice, and are commonly modified to reflect treaty practice in the contracting States.