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Update of the UN Model Double Taxation Convention between Developed and Developing Countries – Technical changes proposed for the 2021 Update of the UN Model

Note by the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries

Summary

At its 17th session (Geneva, 16-19 October 2018), the Committee discussed its future work on the UN Model Tax Convention between Developed and Developing Countries (the UN Model) on the basis of note E/C.18/2018/CRP.8, which identified possible topics to be addressed as part of the next update of the UN Model.

These topics were discussed by the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries at its meetings held on 27-28 April 2019 and 14-16 February 2020.

This note, which is presented ***for discussion only***, has been prepared as a result of these discussions. Section 1 includes proposed changes to the UN Model and its Commentary that the Subcommittee recommends to include in the next update of the UN Model, together with brief explanations. Section 2 refers to other topics that the Subcommittee recommends to be addressed by the next membership of the Committee.

At its twentieth session, the Committee is invited to have a first discussion of the proposals and recommendations included in sections 1 and 2 of this note. The proposals will be revised on the basis of that discussion and presented for final discussion and approval at the twenty-first session of the Committee.

Introduction

1. At its 15th Session (Geneva, 17-20 October 2017), the Committee set up the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries (the Subcommittee) and gave it the following mandate:

> The Subcommittee is mandated to consider, make recommendations and provide proposed drafting for the next update of the UN Model Double Taxation Tax Convention (the Update) focusing on issues of the most relevance to developing countries.
>
> The Subcommittee will report to the Committee at its sixteenth session in 2018, and at each session thereafter, with a view to finalizing its work no later than the twenty-first session in 2020.

2. At its 17th session (Geneva, 16-19 October 2018), the Committee discussed its future work on the UN Model Tax Convention between Developed and Developing Countries (the UN Model) on the basis of note E/C.18/2018/CRP.8, which identified possible topics to be addressed as part of the next update of the UN Model.

3. The note proposed that a generalized review of the UN Model be carried out, noting that the last two updates had focussed on specific topics and suggesting that it would be possible, as part of the next update, to do a wide review of the Model in order to "identify and amend inconsistences, improve the clarity, and update or remove historic passages that no longer hold relevance." It added, however, that "the priority of the Subcommittee's work will be in line with the issues already identified." The note then listed a number of topics that the Committee had already agreed to consider as part of the next update. It also included a list of changes previously made to the OECD Model that the Committee could consider, suggesting that the concept of beneficial ownership could be a key issue. It finally observed that other changes to the UN Model could result from the work of other subcommittees.

4. These lists were discussed by the Subcommittee at its meetings held on 27-28 April 2019 and 14-16 February 2020.

5. This note has been prepared as a result of the discussions during these meetings. Section 1 includes proposed changes to the UN Model and its Commentary that the Subcommittee recommends to include in the next update of the UN Model, together with brief explanations. Section 2 includes other topics that were mentioned in note E/C.18/2018/CRP.8 or that were otherwise considered by the Subcommittee but which the Subcommittee, due to time constraints and the amount of work that would be required by the Subcommittee to approve changes related to these topics, recommends to be addressed by the next membership of the Committee.

6. At its twentieth session, the Committee is invited to have a first discussion of the proposals and recommendations included in sections 1 and 2 of this note. The proposals will be revised on the basis of that discussion and presented for final discussion and approval at the twenty-first session of the Committee scheduled for October 2020.

Possible Contents of the 2021 Update of the UN Model

Table of Contents

1. Topics that the Subcommittee recommends to address through the 2021 update

1. A number of notes presented by the Subcommittee for discussion at the twentieth session of the Committee include proposed changes to the UN Model that could be included in the 2021 update in relation to various topics.

2. The following are additional changes to the UN Model and its Commentary that the Subcommittee recommends to include in the next update of the UN Model in order to address various technical issues.

A. Clarification of the meaning of "may be taxed"

3. In 2014, the following new paragraph 25.1 was added to the Introduction of the OECD Model in order to clarify that the phrase "may be taxed" used throughout the Convention in relation to either Contracting State was purely permissive and did not imply any restriction on the taxing rights of the other Contracting State:

> 25.1 It follows from the preceding explanations that, throughout the Convention, the words "may be taxed in" a Contracting State mean that that State is granted the right to tax the income to which the relevant provision applies and that these words do not affect the right to tax of the other Contracting State, except through the application of Article 23 A or 23 B when that other State is the State of residence.

4. The Subcommittee recommends that the same clarification be made with respect to the UN Model and therefore recommends that paragraph 14 of the Introduction of the UN Model be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 14. In drawing upon the United Nations Model Convention for guidance, a country should bear in mind the important relationship between treaties and domestic law, the nature of which may vary from country to country. In general, the provisions of tax treaties prevail over the provisions of domestic law in the event of a conflict between those provisions. More specifically, tax treaties establish which Contracting State shall have jurisdiction to tax a given item of income or capital and under what conditions and subject to which limitations it may do so. ***For that purpose, both the UN and the OECD models identify various categories of income and indicate in which of the Contracting States such income "shall be taxable only" or "may be taxed". In this respect, it is important to note, as is done in paragraph 25.1 of the Introduction of the OECD Model, that "…throughout the Convention, the words 'may be taxed in' a Contracting State mean that that State is granted the right to tax the income to which the relevant provision applies and that these words do not affect the right to tax of the other Contracting State, except through the application of Article 23 A or 23 B when that other State is the State of residence."***
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> ***14.1*** C~~onsequently, c~~ountries wishing to enter into bilateral tax treaty negotiations should analyse carefully the applicable provisions of their domestic tax laws in order to assess the implications of applying the treaty. They should also discuss the relevant domestic laws of potential treaty partners, as part of the preparation for and negotiation of a treaty.

B. Procedural aspects of withholding tax restrictions

5. In 2003, a new heading and paragraph were added to the Commentary on Article 1 of the OECD Model in order to clarify that tax treaties do not address procedural questions and each State is therefore free to use the procedure provided in its domestic law in order to apply the limits to source taxation provided in Articles such as 10 and 11. The Subcommittee considers that the relevant paragraph provides a useful clarification and therefore recommends that the following heading and new paragraph 123 be added to the Commentary on Article 1 of the UN Model:

> **Practical application of the restrictions to source taxation provided by the Convention**
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> 123. As indicated in paragraph 119 above, it is important that developing countries develop their own procedures regarding the application of tax treaties. One issue that should be addressed through such procedures is whether the restrictions to source taxation provided by various provisions of the Convention (e.g. Articles 10, 11, 12 and 12A) should be granted automatically or through a refund mechanism. This issue is not addressed in the Convention and is therefore governed by the procedure provided in the domestic law of each State. The Committee considers that the following part of the Commentary on Article 1 of the OECD Model Tax Convention is applicable in that respect:
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> > 109. A number of Articles of the Convention limit the right of a State to tax income derived from its territory. As noted in paragraph 19 of the Commentary on Article 10 as concerns the taxation of dividends, the Convention does not settle procedural questions and each State is free to use the procedure provided in its domestic law in order to apply the limits provided by the Convention. A State can therefore automatically limit the tax that it levies in accordance with the relevant provisions of the Convention, subject to possible prior verification of treaty entitlement, or it can impose the tax provided for under its domestic law and subsequently refund the part of that tax that exceeds the amount that it can levy under the provisions of the Convention. As a general rule, in order to ensure expeditious implementation of taxpayers' benefits under a treaty, the first approach is the highly preferable method. If a refund system is needed, it should be based on observable difficulties in identifying entitlement to treaty benefits. Also, where the second approach is adopted, it is extremely important that the refund be made expeditiously, especially if no interest is paid on the amount of the refund, as any undue delay in making that refund is a direct cost to the taxpayer.

C. Clarification of the application of the Art. 4(2) tie-breaker rules for the treaty residence of individuals

6. In 2017, various changes were made to paragraphs 13 to 20 of the Commentary on Article 4 of the OECD Model in order to clarify the concepts of "permanent house available" and "habitual abode" that are found in the tie-breaker rules of Art. 4(2) which are used to determine the treaty residence of individuals who would otherwise be residents of the two Contracting States.

7. The UN Model quotes the 2014 version of the relevant paragraphs of the Commentary on Article 4 OECD Model, which do not include these clarifications. The Subcommittee therefore recommends that paragraph 7 of the Commentary on Article 13 UN Model be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 4. This paragraph, which reproduces Article 4, paragraph 2, of the OECD Model Convention, lists in decreasing order of relevance a number of subsidiary criteria to be applied when an individual is a resident of both Contracting States and the preceding criteria do not provide a clear-cut determination of his status as regards residence. ***The Committee considers that the following part of the Commentary on Article 4 of the 2017 OECD Model Tax Convention is applicable to paragraph 2:*** ~~It may be noted that in 1999, the word "only" was inserted in subparagraphs (a), (b) and (c) of paragraph 2, following the changes previously made to the OECD Model Convention. The OECD Commentary states~~:
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>> 9. This paragraph relates to the case where, under the provisions of paragraph 1, an individual is a resident of both Contracting States.
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>> 10. To solve this conflict special rules must be established which give the attachment to one State a preference over the attachment to the other State. As far as possible, the preference criterion must be of such a nature that there can be no question but that the person concerned will satisfy it in one State only, and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State. The facts to which the special rules will apply are those existing during the period when the residence of the taxpayer affects tax liability, which may be less than an entire taxable period. For example, in one calendar year an individual is a resident of State A under that State's tax laws from 1 January to 31 March, then moves to State B. Because the individual resides in State B for more than 183 days, the individual is treated by the tax laws of State B as a State B resident for the entire year. Applying the special rules to the period 1 January to 31 March, the individual was a resident of State A. Therefore, both State A and State B should treat the individual as a State A resident for that period, and as a State B resident from 1 April to 31 December.
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>> 11. The Article gives preference to the Contracting State in which the individual has a permanent home available to him. This criterion will frequently be sufficient to solve the conflict, e.g. where the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State.
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>> 12. Subparagraph *a*) means, therefore, that in the application of the Convention (that is, where there is a conflict between the laws of the two States) it is considered that the residence is that place where the individual owns or possesses a home; this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration.
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>> 13. As regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room). But the permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily

of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc.). ***For instance, a house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an unrelated party so that the individual no longer has the possession of the house and the possibility to stay there.***

14. If the individual has a permanent home in both Contracting States, paragraph 2 gives preference to the State 139 Article 4 Commentary with which the personal and economic relations of the individual are closer, this being understood as the centre of vital interests. In the cases where the residence cannot be determined by reference to this rule, paragraph 2 provides as subsidiary criteria, first, habitual abode, and then nationality. If the individual is a national of both States or of neither of them, the question shall be solved by mutual agreement between the States concerned according to the procedure laid down in Article 25.

15. If the individual has a permanent home in both Contracting States, it is necessary to look at the facts in order to ascertain with which of the two States his personal and economic relations are closer. Thus, regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc. The circumstances must be examined as a whole, but it is nevertheless obvious that considerations based on the personal acts of the individual must receive special attention. If a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first State.

16. Subparagraph *b*) establishes a secondary criterion for two quite distinct and different situations: a) the case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests; b) the case where the individual has a permanent home available to him in neither Contracting State. Preference is given to the Contracting State where the individual has an habitual abode.

17. In the first situation, the case where the individual has a permanent home available to him in both States, the fact of 140 Article 4 Commentary having an habitual abode in one State ~~rather than~~***but not*** in the other appears therefore as the circumstance which, in case of doubt as to where the individual has his centre of vital interests, tips the balance towards the State where he stays more frequently. For this purpose regard must be had to stays made by the individual not only at the permanent home in the State in question but also at any other place in the same State.

18. The second situation is the case of an individual who has a permanent home available to him in neither Contracting State, as for example, a person going from one hotel to another. In this case also all stays made in a State must be considered without it being necessary to ascertain the reasons for them.

19. ~~In stipulating that in the two situations which it contemplates preference is given to the Contracting State where the individual has a habitual abode, subparagraph b) does not specify over what length of time the comparison must be made. The comparison must~~

~~cover a sufficient length of time for it to be possible to determine whether the residence in each of the two States is habitual and to determine also the intervals at which the stays take place~~. ***The application of the criterion provided for in subparagraph b) requires a determination of whether the individual lived habitually, in the sense of being customarily or usually present, in one of the two States but not in the other during a given period; the test will not be satisfied by simply determining in which of the two Contracting States the individual has spent more days during that period. The phrase "séjourne de façon habituelle", which is used in the French version of subparagraph b), provides a useful insight as to the meaning of "habitual abode", a notion that refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual's life and are therefore more than transient. As recognised in subparagraph c), it is possible for an individual to have an habitual abode in the two States, which would be the case if the individual was customarily or usually present in each State during the relevant period, regardless of the fact that he spent more days in one State than in the other. Assume, for instance, that over a period of five years, an individual owns a house in both States A and B but the facts do not allow the determination of the State in which the individual's centre of vital interests is situated. The individual works in State A where he habitually lives but returns to State B two days a month and once a year for a three-week holiday. In that case, the individual will have an habitual abode in State A but not in State B. Assume, however, that over the same period of five years, the individual works short periods of time in State A, where he returns 15 times a year for stays of two weeks each time, but is present in State B the rest of the time (assume also that the facts of the case do not allow the determination of the State in which the individual's centre of vital interests is situated). In that case, the individual will have an habitual abode in both State A and State B.***

19.1 Subparagraph b) does not specify over what length of time the determination of whether an individual has an habitual abode in one or both States must be made. The determination must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual's life. Care should be taken, however, to consider a period of time during which there were no major changes of personal circumstances that would clearly affect the determination (such as a separation or divorce). The relevant period for purposes of the determination of whether an individual has an habitual abode in one or both States will not always correspond to the period of dual-residence, especially where the period of dual-residence is very short. This is illustrated by the following example. Assume that an individual resident of State C moves to State D to work at different locations for a period of 190 days. During that 190-day period, he is considered a resident of both States C and D under their respective domestic tax laws. The individual lived in State C for many years before moving to State D, remains in State D for the entire period of his employment there and returns to State C to live there permanently at the end of the 190-day period. During the period of his employment in State D, the individual does not have a permanent home available to him in either State C or State D. In this example, the determination of whether the individual has an habitual abode in one or both States would appropriately consider a period of time longer than the 190-day period of dual-residence in order to ascertain the frequency, duration and regularity of stays that were part of the settled routine of the individual's life.

> 20. Where, in the two situations referred to in subparagraph b) the individual has a***n*** habitual abode in both Contracting States or in neither, preference is given to the State of which he is a national. If, in these cases still, the individual is a national of both Contracting States or of neither of them, subparagraph d) assigns to the competent authorities the duty of resolving the difficulty by mutual agreement according to the procedure established in Article 25.

D. Clarification that registration for VAT/GST purposes is not relevant for determining a PE under a tax treaty

8. In 2017, a new paragraph 5 was added to the Commentary on Article 5 of the OECD Model in order to clarify that the mere fact that a foreign enterprise registers for the purposes of a value-added tax (VAT) or goods and services tax (GST) is not sufficient to conclude that the foreign enterprise has a permanent establishment under Article 5 of a tax treaty.

9. The UN Model does not include that clarification. The Subcommittee recommends that the new paragraph 5 of the OECD Model be quoted in the UN Model because the clarification is relevant for the large number of countries that have a VAT or GST and that require or allow foreign enterprises to register for the purposes of such taxes. The Subcommittee therefore recommends that the following paragraph 5 of the OECD Commentary and its footnote be added to the paragraphs of the OECD Commentary that are quoted in paragraph 3 of the Commentary on Article 5 UN Model:

> 5. In many States, a foreign enterprise may be allowed or required to register for the purposes of a value added tax or goods and services tax (VAT/GST) regardless of whether it has in that State a fixed place of business through which its business is wholly or partly carried on or whether it is deemed to have a permanent establishment in that State under paragraph 5 of Article 5. By itself, however, treatment under VAT/GST is irrelevant for the purposes of the interpretation and application of the definition of permanent establishment in the Convention; when applying that definition, one should not, therefore, draw any inference from the treatment of a foreign enterprise for VAT/GST purposes, including from the fact that a foreign enterprise has registered for VAT/GST purposes.[1]
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> *[Footnote 1]* See paragraph 337 of the Report on Action 1 of the BEPS Project ("… it is important to underline that registration for VAT purposes is independent from the determination of whether there is a permanent establishment (PE) for income tax purposes."), OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, http://dx.doi.org/10.1787/ 9789264241046-en. Cf. footnote 24 of the International VAT/GST Guidelines ("For the purpose of these Guidelines, it is assumed that an establishment comprises a fixed place of business with a sufficient level of infrastructure in terms of people, systems and assets to be able to receive and/or make supplies. Registration for VAT purposes by itself does not constitute an establishment for the purposes of these Guidelines. Countries are encouraged to publicise what constitutes an "establishment" under their domestic VAT legislation."), OECD (2017), *International VAT/GST Guidelines*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264271401-en.

E. Deletion of the note at the end of Article 7 UN Model

10. The following note currently appears at the end of Article 7 of the UN Model:

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

11. This note refers to the unresolved issue of the possible inclusion in a bilateral treaty of the following provision which used to appear in Article 7 of the OECD Model: "No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise". That provision, however, was deleted from the OECD Model in 2010. The Subcommittee therefore recommends that the note be deleted and that paragraph 5 of the Commentary on Article 7 UN Model and its footnotes be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 5. ***Until 2017,*** ~~T~~***t***he ***United Nations Model Convention included a note at the end of Article 7 according to which "[t]he question of whether profits should be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods and merchandise for the enterprise was not resolved. It should therefore be settled in bilateral negotiations." That note was deleted in 2017 is recognition of the fact that*** ~~does not contain paragraph 5 of Article 7 of the 2008[29] OECD Model Convention, which states, "No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise". When drafting the 1980 United Nations Model Convention the former Group of Experts could not reach a consensus on whether profits should be attributed to a permanent establishment by reason of the mere purchase of goods and therefore decided to include in Article 7 a note stating that this question should be settled in bilateral negotiations. When this issue was considered by the former Group of Experts, several members from developing countries believed that this provision could be included if it were amended to include a statement that in the case of a permanent establishment engaged in purchasing and other activities, profits derived from purchasing activities should be attributed to the permanent establishment. Other members from developing countries felt that the provision should be omitted because, even where purchasing is the sole activity of an enterprise in the source country, a permanent establishment could exist in that country,~~ the purchasing activity may contribute to the overall profit of the enterprise, and some portion of that profit thus may appropriately be taxed by that country. ~~The members from developed countries generally favoured inclusion of paragraph 5 of Article 7 of the OECD Model Convention, without amendment.~~[30] ***This conforms with the view expressed in the following paragraph of the Commentary on Article 7 of the 2017 OECD Model Convention which explains why a provision according to which "[n]o profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise" was deleted from that Model in 2010:***
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>> ***43. A final provision that was deleted from the Article at the same time provided that "[n]o profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise." Subparagraph 4 d) of Article 5, as it read at that time, recognised that where an***

enterprise of a Contracting State maintained in the other State a fixed place of business exclusively for the purpose of purchasing goods for itself, its activity at that location should not be considered to have reached a level that justified taxation in that other State (changes made to Article 5 in 2017 have restricted the scope of that exception). Where, however, subparagraph 4 d) was not applicable because other activities were carried on by the enterprise through that place of business, which therefore constituted a permanent establishment, it was appropriate to attribute profits to all the functions performed at that location. Indeed, if the purchasing activities had been performed by an independent enterprise, the purchaser would have been remunerated on an arm's length basis for its services. Also, since a tax exemption restricted to purchasing activities undertaken for the enterprise required that expenses incurred for the purposes of performing these activities be excluded in determining the profits of the permanent establishment, such an exemption could raise administrative problems. The Committee therefore considered that a provision according to which no profits should be attributed to a permanent establishment by reason of the mere purchase of goods or merchandise for the enterprise was not consistent with the arm's length principle and should not be included in the Article.

~~*[Footnote 29]* Paragraph 5 of Article 7 of the OECD Model Convention was deleted as part of the 2010 update of the OECD Model Convention.~~

~~*[Footnote 30]* The wording favoured by those members was identical to that found in paragraph 5 of the 2008 OECD Model Convention.~~

F. Application of Art. 10(2)(a) where shares are held through transparent entities

12. In 2017, changes were made to Art. 10(2)*a*) of the OECD Model and its Commentary in order to address the situation where shares are held through a transparent entity (such as partnership that is not liable to tax). In such a situation, the transparent partnership itself cannot qualify for the lower rate of withholding tax provided in Art. 10(2)*a*) because it is not a "resident of the other Contracting State". If, however, the partnership is treated as a body corporate for tax purposes, it should be given the benefit of the lower rate provided by Art. 10(2)*a*), as recognized in paragraph 13 of the Commentary on Article 10 UN Model which quotes paragraph 11 of the 2010 OECD Commentary. This means that there is no reason for the phrase "(other than a partnership)" found in Art. 10(2)(*a*) of the UN Model but deleted from the OECD Model in 2017.

13. In addition, the changes made to the Commentary on Article 10 of the OECD Model explain how Art. 10(2)*a*) should apply where a company hold shares through a transparent entity and provides alternative wording for States that wish to clarify that issue in the Article itself.

14. The Subcommittee considers that these changes made to Art. 10(2)*a*) of the OECD Model and its Commentary are equally relevant for Art. 10(2)(*a*) UN Model. It therefore recommends that Art. 10(2)(*a*) of the UN Model and paragraph 13 of the Commentary on

Article 10 UN Model be replaced by the following (changes to the existing version of the Article and Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

Art. 10(2)a)

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

(*a*) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company ~~(other than a partnership)~~ which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

Paragraph 13 of the Commentary on Article 10

13. ~~The Commentary on the 2010 OECD Model Convention contains the following passages:~~ ***The Committee considers that the following parts of the Commentary on the 2017 OECD Model Convention, with the minor changes shown below between brackets, are applicable to paragraph 2:***

11. ~~If a partnership is treated as a body corporate under the domestic laws applying to it, the two Contracting States may agree to modify subparagraph a) of paragraph 2 in a way to give the benefits of the reduced rate provided for parent companies also to such partnership.~~ ***Before 2017, subparagraph a) of paragraph 2 referred to a company "other than a partnership". That exception was deleted in recognition of the fact that if a partnership is treated as a company for tax purposes by the Contracting State in which it is established, it is appropriate for the other State to grant the benefits of subparagraph a) to that partnership. Indeed, an entity or arrangement (e.g. a partnership) that is treated as a company for tax purposes qualifies as a company under the definition in subparagraph b) of paragraph 1 of Article 3 and, to the extent that it is a resident of a Contracting State, is therefore entitled to the benefits of subparagraph a) of paragraph 2 with respect to dividends paid by a company resident of the other State, as long as it holds directly at least 25 per cent of the capital of that company. This conclusion holds true regardless of the fact that the State of source of the dividends may regard that entity or arrangement as fiscally transparent. That conclusion is confirmed by the provision on fiscally transparent entities in paragraph 2 of Article 1.***

11.1 That provision also ensures that the part of the dividend received by a fiscally transparent entity or arrangement that is treated as the income of a member of that entity or arrangement for purposes of taxation by the State of residence of that member will be considered as a dividend paid to that member for the purposes of Article 10 (see paragraph 12 of the Commentary on Article 1). Where, for example, a company resident of State A pays a dividend to a partnership that State B treats as a transparent entity, the part of that dividend that State B treats as the income of a partner resident of State B,

will, for the purposes of paragraph 2 of the convention between States A and B, be treated as a dividend paid to a resident of State B. Also, for the purposes of the application of subparagraph a) of paragraph 2 in such a case, a member that is a company should be considered to hold directly, in proportion to its interest in the fiscally transparent entity or arrangement, the part of the capital of the company paying the dividend that is held through that entity or arrangement and, in order to determine whether the member holds directly at least 25 per cent of the capital of the company paying the dividends, that part of the capital will be added to other parts of that capital that the member may otherwise hold directly. In that case, for the purposes of the application of the requirement that at least 25 per cent of the capital of the company paying the dividends be held throughout a 365 day period, it will be necessary to take account of both the period during which the member held the relevant interest in the fiscally transparent entity or arrangement and the period during which the part of the capital of the company paying the dividend was held through that entity or arrangement: if either period does not satisfy the 365 day requirement, subparagraph a) will not apply and subparagraph b) will therefore apply to the relevant part of the dividend. States are free to clarify the application of subparagraph a) in these circumstances by adding a provision drafted along the following lines:

> ***To the extent that a dividend paid by a company which is a resident of a Contracting State is, under paragraph 2 of Article 1, considered to be income of another company resident of the other Contracting State because that other company is a member of a fiscally transparent entity or arrangement referred to in that paragraph, that other company shall be deemed, for the purposes of the application of subparagraph (a) of paragraph 2 of Article 10, to hold directly that part of the capital of the company paying the dividend that is held by the transparent entity or arrangement which corresponds to the proportion of the capital of that fiscally transparent entity or arrangement that is held by that other company.***

[Currently quoted paragraphs 12 to 12.2, which are not reproduced here, would be replaced as provided in the note on the Clarification of the concept of beneficial owner]

13. ~~The tax rates fixed by the Article for the tax in the State of source are maximum rates. The States may agree, in bilateral negotiations, on lower rates or even on taxation exclusively in the State of the beneficiary's residence .~~ **...** The reduction of rates provided for in paragraph 2 refers solely to the taxation of dividends and not to the taxation of the profits of the company paying the dividends.

13.1 Under the domestic laws of many States, pension funds and similar entities are generally exempt from tax on their investment income. In order to achieve neutrality of treatment as regards domestic and foreign investments by these entities, some States provide bilaterally that income, including dividends, derived by such an entity resident of the other State shall be exempt from source taxation. States wishing to do so may agree bilaterally on a provision drafted along the lines of the provision found in paragraph 69 of the Commentary on Article 18.

13.2 Similarly, some States refrain from levying tax on dividends paid to other States and some of their wholly-owned entities, at least to the extent that such dividends are derived from activities of a governmental nature. Some States are able to grant such an exemption under their interpretation of the sovereign immunity principle (see paragraphs 52 and 53 of the Commentary on Article 1); others may do it pursuant to provisions of their domestic law. States wishing to do so may confirm or clarify, in their bilateral conventions, the scope of these exemptions or grant such an exemption in cases where it would not otherwise be available. This may be done by adding to the Article an additional paragraph drafted along the following lines:

> Notwithstanding the provisions of paragraph 2, dividends referred to in paragraph 1 shall be taxable only in the Contracting State of which the recipient is a resident if the beneficial owner of the dividends is that State or a political subdivision or local authority thereof.

14. The two Contracting States may also, during bilateral negotiations, agree to [lower the holding percentage required for direct investment dividends]. A lower percentage is, for instance, justified in cases where the state of residence of the parent company, in accordance with its domestic law, grants exemption to such a company for dividends derived from a holding of less than 25 per cent in a non-resident subsidiary.

15. In subparagraph *a*) of paragraph 2, the term "capital" is used in […] [defining the minimum ownership required for direct investment dividends]. The use of this term in this context implies that, for the purposes of subparagraph *a*), it should be used in the sense in which it is used for the purposes of distribution to the shareholder (in the particular case, the parent company).

a) As a general rule, therefore, the term "capital" in subparagraph *a*) should be understood as it is understood in company law. Other elements, in particular the reserves, are not to be taken into account.

b) Capital, as understood in company law, should be indicated in terms of par value of all shares which in the majority of cases will be shown as capital in the company's balance sheet.

c) No account need be taken of differences due to the different classes of shares issued (ordinary shares, preference shares, plural voting shares, non-voting shares, bearer shares, registered shares etc.), as such differences relate more to the nature of the shareholder's right than to the extent of his ownership of the capital.

d) When a loan or other contribution to the company does not, strictly speaking, come as capital under company law but when on the basis of internal law or practice ("thin capitalisation", or assimilation of a loan to share capital), the income derived in respect thereof is treated as dividend under Article 10, the value of such loan or contribution is also to be taken as "capital" within the meaning of subparagraph *a*).

e) In the case of bodies which do not have capital within the meaning of company law, capital for the purpose of subparagraph *a*) is to be taken as meaning the total of all contributions to the body which are taken into account for the purpose of distributing profits.

In bilateral negotiations, Contracting States may depart from the criterion of "capital" used in subparagraph *a*) of paragraph 2 and use instead the criterion of "voting power".

G. Application of Articles 10 and 13 in the case of redemption of shares

15. In 2014, paragraph 28 of the Commentary on Article 10 and paragraph 31 of the Commentary on Article 13 of the OECD Model were modified to clarify that the payment that a shareholder receives upon a redemption of shares by a company may fall under Article 10 as dividends or under Article 13 as capital gains depending on the domestic law of the State in which the company is a resident.

16. The Subcommittee recommends that this clarification be also made in the UN Model. It therefore recommends that paragraph 14 of the Commentary on Article 10 UN Model and paragraph 17 of the Commentary on Article 13 UN Model be replaced by the following (changes to the existing version of the paragraphs appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

Commentary on Article 10

> 14. This paragraph reproduces Article 10, paragraph 3, of the OECD Model Convention. ~~The relevant~~ ***The Committee considers that the following*** part of the Commentary on the ~~2010~~ ***2017*** OECD Model Convention ~~reads as follows~~ ***is applicable to paragraph 3 of the UN Model***:
>
> > 23. In view of the great differences between the laws of OECD member countries, it is impossible to define "dividends" fully and exhaustively. Consequently, the definition merely mentions examples which are to be found in the majority of the member countries' laws and which, in any case, are not treated differently in them. The enumeration is followed up by a general formula. In the course of the revision of the 1963 Draft Convention, a thorough study has been undertaken to find a solution that does not refer to domestic laws. This study has led to the conclusion that, in view of the still remaining dissimilarities between member countries in the field of company law and taxation law, it did not appear to be possible to work out a definition of the concept of dividends that would be independent of domestic laws. It is open to the Contracting States, through bilateral negotiations, to make allowance for peculiarities of their laws and to agree to bring under the definition of "dividends" other payments by companies falling under the Article.
> >
> > 24. The notion of dividends basically concerns distributions by companies within the meaning of subparagraph b) of paragraph 1 of Article 3. Therefore the definition relates, in the first instance, to distributions of profits the title to which is constituted by shares, that is holdings in a company limited by shares (joint stock company). The definition assimilates to shares all securities issued by companies which carry a right to participate in the companies' profits without being debt-claims; such are, for example, "jouissance" shares or "jouissance" rights, founders' shares or other rights participating in profits. In bilateral conventions, of course, this enumeration may be adapted to the legal situation in the Contracting States concerned. This may be necessary in particular, as regards income from "jouissance" shares and founders' shares. On the other hand, debt-claims participating in profits do not come into this category ~~[…]~~***(see paragraph 19 of the Commentary on Article 11);*** likewise interest on convertible debentures is not a dividend.
> >
> > 25. Article 10 deals not only with dividends as such but also with interest on loans insofar as the lender effectively shares the risks run by the company, i.e. when repayment depends largely on the success or otherwise of the enterprise's business. Articles 10 and 11 do not

therefore prevent the treatment of this type of interest as dividends under the national rules on thin capitalisation applied in the borrower's country. The question whether the contributor of the loan shares the risks run by the enterprise must be determined in each individual case in the light of all the circumstances, as for example the following:

- the loan very heavily outweighs any other contribution to the enterprise's capital (or was taken out to replace a substantial proportion of capital which has been lost) and is substantially unmatched by redeemable assets;
- the creditor will share in any profits of the company;
- repayment of the loan is subordinated to claims of other creditors or to the payment of dividends;
- the level or payment of interest would depend on the profits of the company;
- the loan contract contains no fixed provisions for repayment by a definite date.

26. The laws of many of the States put participations in a *société à responsabilité limitée* (limited liability company) on the same footing as shares. Likewise, distributions of profits by co-operative societies are generally regarded as dividends.

27. Distributions of profits by partnerships are not dividends within the meaning of the definition, unless the partnerships are subject, in the State where their place of effective management is situated, to a fiscal treatment substantially similar to that applied to companies limited by shares (for instance, in Belgium, Portugal and Spain, also in France as regards distributions to *commanditaires* in the *sociétés en commandite simple*). On the other hand, clarification in bilateral conventions may be necessary in cases where the taxation law of a Contracting State gives the owner of holdings in a company a right to opt, under certain conditions, for being taxed as a partner of a partnership, or, vice versa, gives the partner of a partnership the right to opt for taxation as the owner of holdings in a company.

28. Payments regarded as dividends may include not only distributions of profits decided by annual general meetings of shareholders, but also other benefits in money or money's worth, such as bonus shares, bonuses, profits on a liquidation ***or redemption of shares (see paragraph 31 of the Commentary on Article 13)*** and disguised distributions of profits. The reliefs provided in the Article apply so long as the State of which the paying company is a resident taxes such benefits as dividends. It is immaterial whether any such benefits are paid out of current profits made by the company or are derived, for example, from reserves, i.e. profits of previous financial years. Normally, distributions by a company which have the effect of reducing the membership rights, for instance, payments constituting a reimbursement of capital in any form whatever, are not regarded as dividends.

29. The benefits to which a holding in a company confer entitlement are, as a general rule, available solely to the shareholders themselves. Should, however, certain of such benefits be made available to persons who are not shareholders within the meaning of company law, they may constitute dividends if:

- the legal relations between such persons and the company are assimilated to a holding in a company ("concealed holdings"); and

– the persons receiving such benefits are closely connected with a shareholder; this is the case, for example, where the recipient is a relative of the shareholder or is a company belonging to the same group as the company owning the shares.

30. When the shareholder and the person receiving such benefits are residents of two different States with which the State of source has concluded conventions, differences of views may arise as to which of these conventions is applicable. A similar problem may arise when the State of source has concluded a convention with one of the States but not with the other. This, however, is a conflict which may affect other types of income, and the solution to it can be found only through an arrangement under the mutual agreement procedure.

Commentary on Article 13

17. This paragraph reproduces Article 13, paragraph 5, of the OECD Model Convention with a drafting adjustment replacing the words "in paragraphs 1, 2, 3 and 4" with "in paragraphs 1, 2, 3, 4 and 5". ***The Committee considers that the following part of the Commentary on paragraph 5 of the 2017 OECD Model Convention is applicable, with the minor changes shown below between brackets, to paragraph 6 of the UN Model***~~The Commentary on Article 13, paragraph 4, of the 2010 OECD Model Convention is therefore relevant, mutatis mutandis, to paragraph 6. That Commentary reads as follows~~:

29. As regards gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and [5], paragraph [6] provides that they are taxable only in the State of which the alienator is a resident […].

30. The Article does not contain special rules for gains from the alienation of shares in a company (other than shares of a company dealt with in paragraph[s] 4 [and 5]) or of securities, bonds, debentures and the like. Such gains are, therefore, taxable only in the State of which the alienator is a resident.

31. If shares are ~~sold~~***alienated*** by a shareholder ~~to the issuing company~~ in connection with the liquidation of ~~such~~***the issuing*** company or the ***redemption of shares or*** reduction of ~~its~~***[the]*** paid-up capital ***of that company,*** the difference between the ~~selling price~~***proceeds obtained by the shareholder*** and the par value of the shares may be treated in the State of which the company is a resident as a distribution of accumulated profits and not as a capital gain. The Article does not prevent the State of residence of the company from taxing such distributions at the rates provided for in Article 10: such taxation is permitted because such difference is covered by the definition of the term "dividends" contained in paragraph 3 of Article 10 and interpreted in paragraph 28 of the Commentary relating thereto***, to the extent that the domestic law of that State treats that difference as income from shares. As explained in paragraphs 32.1 to 32.7 of the Commentary on Articles 23 A and 23 B, where the State of the issuing company treats the difference as a dividend, the State of residence of the shareholder is required to provide relief of double taxation even though such a difference constitutes a capital gain under its own domestic law.*** The same interpretation may apply if bonds or debentures are redeemed by the debtor at a price which is higher than the par value or the value at which the bonds or debentures have been issued; in such a case, the difference may represent interest and, therefore, be subjected to a limited

tax in the State of source of the interest in accordance with Article 11 (see also paragraphs 20 and 21 of the Commentary on Article 11).

32. There is a need to distinguish the capital gain that may be derived from the alienation of shares acquired upon the exercise of a stock-option granted to an employee or member of a board of directors from the benefit derived from the stock-option that is covered by Articles 15 or 16. The principles on which that distinction is based are discussed in paragraphs 12.2 to 12.5 of the Commentary on Article 15 and paragraph 3.1 of the Commentary on Article 16 [of the OECD Model Convention].

H. Clarification of the meaning of the phrase "fiscal year concerned" in Art. 15(2)(a)

17. In 2014, a new paragraph 4.1 was added to the Commentary on Article 15 of the OECD Model in order to clarify that the reference to the "fiscal year concerned" found in Art. 15(2)*a*) was a reference to the fiscal year during which the relevant employment services are rendered rather than a reference to the year in which the taxation of the remuneration takes place.

18. The Subcommittee recommends that the new paragraph 4.1 of the OECD Model Commentary be quoted in the UN Model since it also produces the right result in the context of the UN Model, in particular where remuneration is taxed in a year other than that in which the employment services are rendered (as is often the case where remuneration is paid in the form of stock-options). The Subcommittee therefore recommends that paragraph 1 of the Commentary on Article 15 UN Model be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

1. Article 15 of the United Nations Model Convention reproduces Article 15 of the OECD Model Convention. The only differences are that the heading of the OECD Article now reads "INCOME FROM EMPLOYMENT" and the reference to "fixed base" in paragraph 2, subparagraph *c*) has been taken out. These changes stem from the elimination of Article 14 from the OECD Model Convention in 2000. ~~The Commentary on Article 15 of the 2010 OECD Model Convention reads as follows~~***The Committee considers that the following part of the Commentary on Article 15 of the 2010 OECD Model Convention is applicable with respect to paragraph 1 of the UN Model:***

[Currently quoted paragraphs 1 to 2.2, which are not reproduced here, would remain unchanged but quoted paragraphs 3 to 6.2 would be moved to paragraph 1.1 below].

1.1 The Committee considers that the following part of the Commentary on Article 15 of the 2017 OECD Model Convention is applicable with respect to paragraph 2 of the UN Model:

3. Paragraph 2 contains a general exception to the rule in paragraph 1. This exception covers all individuals rendering [dependent personal] services in the course of an employment (sales representatives, construction workers, engineers, etc.), to the extent that their remuneration does not fall under the provisions of other Articles, such as those applying to government services or entertainers and sportspersons.

4. The three conditions prescribed in this paragraph must be satisfied for the remuneration to qualify for the exemption. The first condition is that the exemption is limited to the 183 day period. It is further stipulated that this time period may not be

exceeded "in any twelve month period commencing or ending in the fiscal year concerned". This contrasts with the 1963 Draft Convention and the 1977 Model Convention which provided that the 183 day period[44] should not be exceeded "in the fiscal year concerned", a formulation that created difficulties where the fiscal years of the Contracting States did not coincide and which opened up opportunities in the sense that operations were sometimes organised in such a way that, for example, workers stayed in the State concerned for the last 5 ½ months of one year and the first 5 ½ months of the following year. The present wording of subparagraph 2 a) does away with such opportunities for tax avoidance. In applying that wording, all possible periods of twelve consecutive months must be considered, even periods which overlap others to a certain extent. For instance, if an employee is present in a State during 150 days between 1 April 01 and 31 March 02 but is present there during 210 days between 1 August 01 and 31 July 02, the employee will have been present for a period exceeding 183 days during the second 12 month period identified above even though he did not meet the minimum presence test during the first period considered and that first period partly overlaps the second.

4.1 The reference to the "fiscal year concerned" must be interpreted as a reference to a fiscal year of the Contracting State in which a resident of the other Contracting State has exercised his employment and during which the relevant employment services have been rendered. Assume, for example, that the fiscal year of State S runs from 1 January to 31 December and that a resident of State R is present and performs employment services in State S between 1 August 00 and 28 February 01. For the purposes of subparagraph 2 a), any twelve-month period that begins between 1 January and 31 December 00 or ends between 1 January and 31 December 01 and that includes any part of the period of employment services would be relevant. For instance, the twelve month period of 1 August 00 to 31 July 01, which begins in the fiscal year 00 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 August and 31 December 00; similarly, the twelve month period of 1 March 00 to 28 February 01, which ends in the fiscal year 01 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 January and 28 February 01. The taxation of the remuneration for the relevant services need not take place in the fiscal year concerned: as explained in paragraphs 2.2 above and 12.1 below, the Article allows a State to tax the remuneration derived from employment exercised in that State in a particular year even if the remuneration for these employment services is acquired, or the tax is levied, in a different year.

5. Although various formulas have been used by member countries to calculate the 183 day period, there is only one way which is consistent with the wording of this paragraph: the "days of physical presence" method. The application of this method is straightforward as the individual is either present in a country or he is not. The presence could also relatively easily be documented by the taxpayer when evidence is required by the tax authorities. Under this method the following days are included in the calculation: part of a day, day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before, during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption) and death or sickness in the family. However, days spent in the State of

activity in transit in the course of a trip between two points outside the State of activity should be excluded from the computation. It follows from these principles that any entire day spent outside the State of activity, whether for holidays, business trips, or any other reason, should not be taken into account. A day during any part of which, however brief, the taxpayer is present in a State counts as a day of presence in that State for purposes of computing the 183 day period.

5.1 Days during which the taxpayer is a resident of the source State should not, however, be taken into account in the calculation. Subparagraph a) has to be read in the context of the first part of paragraph 2, which refers to “remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State”, which does not apply to a person who resides and works in the same State. The words “the recipient is present”, found in subparagraph *a*), refer to the recipient of such remuneration and, during a period of residence in the source State, a person cannot be said to be the recipient of remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State. The following examples illustrate this conclusion:

- Example 1: From January 01 to December 01, X lives in, and is a resident of, State S. On 1 January 02, X is hired by an employer who is a resident of State R and moves to State R where he becomes a resident. X is subsequently sent to State S by his employer from 15 to 31 March 02. In that case, X is present in State S for 292 days between 1 April 01 and 31 March 02 but since he is a resident of State S between 1 April 01 and 31 December 01, this first period is not taken into account for purposes of the calculation of the periods referred to in subparagraph *a*).
- Example 2: From 15 to 31 October 01, Y, a resident of State R, is present in State S to prepare the expansion in that country of the business of ACO, also a resident of State R. On 1 May 02, Y moves to State S where she becomes a resident and works as the manager of a newly created subsidiary of ACO resident of State S. In that case, Y is present in State S for 184 days between 15 October 01 and 14 October 02 but since she is a resident of State S between 1 May and 14 October 02, this last period is not taken into account for purposes of the calculation of the periods referred to in subparagraph *a*).

6. The second condition is that the employer paying the remuneration must not be a resident of the State in which the employment is exercised. Some member countries may, however, consider that it is inappropriate to extend the exception of paragraph 2 to cases where the employer is not a resident of the State of residence of the employee, as there might then be administrative difficulties in determining the employment income of the employee or in enforcing withholding obligations on the employer. Contracting States that share this view are free to adopt bilaterally the following alternative wording of subparagraph 2 *b*):

> *b*) the remuneration is paid by, or on behalf of, an employer who is a resident of the first-mentioned State, and

6.1 The application of the second condition in the case of fiscally transparent partnerships presents difficulties since such partnerships cannot qualify as a resident of a Contracting State under Article 4 (see paragraph 8.~~2~~***8*** of the Commentary on Article 4). While it is clear that such a partnership could qualify as an "employer" (especially under the domestic law definitions of the term in some countries, e.g. where an employer is defined as a person liable for a wage tax), the application of the condition at the level of the partnership regardless of the situation of the partners would therefore render the condition totally meaningless.

6.2 The object and purpose of subparagraphs *b*) and *c*) of paragraph 2 are to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the State of source because the employer is not taxable in that State as ~~he~~***it*** neither is a resident nor has a permanent establishment therein. These subparagraphs can also be justified by the fact that imposing source deduction requirements with respect to short-term employments in a given State may be considered to constitute an excessive administrative burden where the employer neither resides nor has a permanent establishment in that State. In order to achieve a meaningful interpretation of subparagraph b) that would accord with its context and its object, it should therefore be considered that, in the case of fiscally transparent ***entities or arrangements such as*** partnerships, that subparagraph applies at the level of the partners ***or members***. Thus, the concepts of "employer" and "resident", as found in subparagraph b), are applied at the level of the partners ***or members*** rather than at the level of a fiscally transparent ~~partnership.~~***entity or arrangement.*** This approach is consistent with ~~that~~ ***the approach under paragraph 2 of Article 1*** under which ***the benefit of*** other provisions of tax conventions must be ~~applied~~***granted with respect to income that is taxed*** at the partners' ***or members' level*** rather than at the ~~partnership's level.~~***level of an entity or arrangement that is treated as fiscally transparent.*** While this interpretation could create difficulties where the partners ***or members*** reside in different States, such difficulties could be addressed through the mutual agreement procedure by determining, for example, the State in which the partners ***or members*** who own the majority of the interests in the ~~partnership~~***entity or arrangement*** reside (i.e. the State in which the greatest part of the deduction will be claimed).

[Footnote 44] The same change was made in 1999 in the United Nations Model Convention.

I. Clarification of the treatment of payments from domestic sources in the Commentary on Article 20

19. Article 20 of the UN Model applies to some payments that a student or business apprentice receives from abroad. In 2014, paragraph 4 of the Commentary on Article 20 of the OECD Model was amended to clarify the treatment of payments from domestic sources, which are not covered by Article 20.

20. The Subcommittee considers that the clarification made in the Commentary of the OECD Model is equally relevant for the purposes of the interpretation of Article 20 of the UN Model. It therefore recommends that paragraph 2 of the Commentary on Article 20 UN Model be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

2. Since Article 20 of the United Nations Model Convention reproduces Article 20 of the OECD Model Convention, ***the Committee considers that*** the following Commentary on the latter Article ***of the 2017 OECD Model Convention, with the modifications shown in square brackets below that reflect differences between the OECD and UN Model,*** is applicable ***with respect to the UN Model***:

> 1. The rule established in this Article concerns certain payments received by students or business ***[trainees or]*** apprentices for the purpose of their maintenance, education or training. All such payments received from sources outside the State in which the student or business ***[trainee or]*** apprentice concerned is staying shall be exempted from tax in that State.
>
> 2. The word "immediately" was inserted in the 1977 Model Convention in order to make clear that the Article does not cover a person who has once been a resident of a Contracting State but has subsequently moved his residence to a third State before visiting the other Contracting State.
>
> 3. The Article covers only payments received for the purpose of the recipient's maintenance, education or training. It does not, therefore, apply to a payment, or any part thereof, that is remuneration for services rendered by the recipient and which is covered by Article 15 (or by [14 or] Article 7 in the case of independent services). Where the recipient's training involves work experience, however, there is a need to distinguish between a payment for services and a payment for the recipient's maintenance, education or training. The fact that the amount paid is similar to that paid to persons who provide similar services and are not students or business ***[trainees or]*** apprentices would generally indicate that the payment is a remuneration for services. Also, payments for maintenance, education or training should not exceed the level of expenses that are likely to be incurred to ensure the recipient's maintenance, education or training.
>
> 4. ***The Article only applies to payments arising from sources outside the State where the student or business trainee or apprentice is present solely for the purposes of education or training. Payments arising from sources within that State are covered by other Articles of the Convention: for instance, if, during his presence in the first-mentioned State, the student or business apprentice remains a resident of the other State according to Article 4, payments such as grants or scholarships that are not covered by other provisions of the Convention (such as Article 15) [may be taxed in both States under paragraphs 1 and 3 of Article 21].*** For the purpose of the Article, payments that are made by or on behalf of a resident of a Contracting State or that are borne by a permanent establishment which a person has in that State are not considered to arise from sources outside that State.

J. Clarification concerning relief of double taxation where a resident of a Contracting State derives income from sources in that state that is attributable to a permanent establishment in the other state

21. In 2017, paragraph 4 of the Commentary on Article 21 of the OECD Model, which deals with the situation where a resident of a Contracting State derives income from sources in its State of residence that is attributable to a permanent establishment in the other state, was amended in order to remove a confusing statement concerning the relief of double taxation that

was previously included in that paragraph. At the same time, paragraph 9 of the Commentary on Articles 23 A and 23 B was replaced so as to cover the issue of relief of double taxation in a more precise manner.

22. The Subcommittee considers that the above changes made to the Commentary on Articles 21 and 23A and 23B of the OECD Model are equally applicable to the UN Model. The Subcommittee therefore recommends that paragraph 4 of the Commentary on Article 21 UN Model and paragraph 14 of the Commentary on Articles 23A and 23B UN Model be replaced by the following (changes to the existing version of the paragraphs appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

Commentary on Article 21

4. This paragraph reproduces Article 21, paragraph 2, of the OECD Model Convention with the difference that paragraph 2 of Article 21 of the United Nations Model Convention also covers the case where the income is attributed to a fixed base which the beneficiary of the income has in the other Contracting State according to Article 14. The Committee considers that the following part of the ***2017*** OECD Commentary is applicable (the additional comments that appear in square brackets, which are not part of the OECD Commentary, have been inserted in order to reflect the difference described):

[Currently quoted paragraph 4, which is not reproduced here, would remain unchanged]

5. The paragraph also covers the case***s not dealt with in the previous Articles of the Convention*** where the beneficiary and the payer of the income are both residents of the same Contracting State, and the income is attributed to a permanent establishment [or a fixed base,] which the beneficiary of the income has in the other Contracting State. In such a case a right to tax is given to the Contracting State in which the permanent establishment [or the fixed base] is situated. Where double taxation occurs, the State of residence should give relief under the provisions of Article 23 A or 23 B ***(see paragraph 9 of the Commentary on these Articles)***. ~~However, a problem may arise as regards the taxation of dividends and interest in the State of residence as the State of source: the combination of Articles 7 and 23 A prevents that State from levying tax on that income, whereas if it were paid to a resident of the other State, the first State, being the State of source of the dividends or interest, could tax such dividends or interest at the rates provided for in paragraph 2 of Articles 10 and 11. Contracting States which find this position unacceptable may include in their conventions a provision according to which the State of residence would be entitled, as State of source of the dividends or interest, to levy a tax on such income at the rates provided for in paragraph 2 of Articles 10 and 11. The State where the permanent establishment is situated would give a credit for such tax on the lines of the provisions of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B; of course, this credit should not be given in cases where the State in which the permanent establishment is situated does not tax the dividends or interest attributed to the permanent establishment, in accordance with its domestic laws.~~

[Currently quoted paragraph 6, which is not reproduced here, would remain unchanged]

Commentary on Articles 23A and 23B

14. The following extracts from the Commentary on Article 23 A and 23 B of the ***2017*** OECD Model Convention are applicable to Articles 23 A and 23 B (the additional comments that appear between square brackets, which are not part of the Commentary on the OECD Model Convention, have been inserted in order to provide additional clarification, to reflect the differences between the provisions of the OECD Model Convention and those of this Model and also to specify the applicable paragraph/subparagraph of this Model):

I. Preliminary remarks

A. The scope of the Articles

[Except for paragraphs 9 and 9.1, the paragraphs currently quoted, which are not reproduced here, would remain unchanged]

9. Where a resident of the Contracting State R derives income from the same State R through a permanent establishment [or a fixed base] which he has in the other Contracting State E, State E may tax such income (except income from immovable property situated in State R) if it is attributable to the said permanent establishment [or fixed base] (paragraph 1 of Article 7 and paragraph 2 of Article 21). In this instance too, State R must give relief under Article 23 A or Article 23 B for income attributable to the permanent establishment [or fixed base] situated in State E, notwithstanding the fact that the income in question originally arises in State R ~~[…]~~ ***(see also paragraph 5 of the Commentary on Article 21)***. However, where ***[that income is interest, royalties or fees for technical services that State R taxes because it is the State of residence or because]*** the Contracting States agree to give to State R a limited right to tax as the State of source of ***[such]*** dividends ~~or interest~~***[, interest, royalties or fees for technical services]*** within the limits fixed in paragraph 2 of ~~the~~ Articles 10 ~~or 11 or 12 [or 12A]~~***[, 11, 12 or 12A (see paragraph 9.1 below),] […]*** a credit ***[should]*** be given by State E for the tax levied by State R, along the lines of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B***[, on the basis of paragraph 3 of Article 24]***.

9.1 Where, however, State R applies the exemption method, a problem may arise as regards the taxation of dividends ~~and~~ ***[,*** interest***, royalties and fees for technical services]*** in the State of residence as the State of source: the combination of Articles 7 and 23 A prevents that State from levying tax on that income, whereas if it were paid to a resident of the other State, State R, being the State of source of the dividends ~~or~~***[,*** interest***, royalties or fees for technical services]***, could tax such dividends ~~or~~***[,*** interest***, royalties or fees for technical services]*** at the rates provided for in paragraph 2 of Articles 10 ~~and~~***[,*** 11***, 12 and 12A]***. Contracting States which find this position unacceptable may include in their conventions a provision according to which the State of residence would be entitled, as State of source of the dividends***[,*** interest***, royalties or fees for technical services]***, to levy a tax on such income at the rates provided for in paragraph 2 of Articles 10 ~~and~~***[,*** 11***, 12 and 12A]*** notwithstanding the fact that it applies the exemption method. The State where the permanent establishment [or fixed base] is situated would give a credit for such tax along the lines of the provisions of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B; of course, this credit would not be given in cases where the State in which the permanent establishment [or fixed base] is situated does not tax the dividends ~~or~~***[,*** interest***,***

royalties or fees for technical services] attributed to the permanent establishment [or fixed base], in accordance with its domestic laws.

K. Reference to a full credit in paragraph 63 of the Commentary on Article 23B

23. In 2014, paragraph 63 of the Commentary on Article 23B of the OECD Model was modified to remove a reference to full credit as a solution to the situation where taxation in the State of source exceeds taxation in the State of residence.

24. The Subcommittee considers that this change is also appropriate for the UN Model because developing countries should not be left with the impression that high withholding taxes will be credited by States of residence beyond the tax payable on the relevant income in these States. It therefore recommends that paragraph 63 of the Commentary on Article 23B of the OECD Model quoted under paragraph 16.7 of the Commentary on Articles 23A and 23B of UN Model be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 63. The maximum deduction is normally computed as the tax on net income, i.e. on the income from State E (or S) less allowable deductions (specified or proportional) connected with such income ~~[…]~~***(see paragraph 40 above)***. For such reason, the maximum deduction in many cases may be lower than the tax effectively paid in State E (or S). This may especially be true in the case where, for instance, a resident of State R deriving interest from State S has borrowed funds from a third person to finance the interest-producing loan. As the interest due on such borrowed money may be offset against the interest derived from State S, the amount of net income subject to tax in State R may be very small, or there may even be no net income at all. ~~[…] [This problem could be solved by using the full credit method in State R as mentioned in paragraph 48 above. Another solution would be to exempt such income from tax in State S, as it is proposed in the Commentary in respect of interest on credit sales and on loans granted by banks.]~~ ***As explained in paragraph 7.1 of the Commentary on Article 11, the problem, in that case, cannot be solved by State R, since little or no tax will be levied in that State. One solution would be to exempt such interest from tax in State S, as is [explained in paragraph 12] of the Commentary on Article 11 [of the UN Model].***

L. Update of the Commentary on Art. 24(2) dealing with "stateless persons"

25. In 2014, paragraph 31 of the Commentary on Article 24(2) of the OECD Model, which deals with stateless persons, was amended in order to remove the phrase "[i]t is possible that in the future certain States will take exception to the provisions of paragraph 2". That phrase, which made sense when it was inserted in the OECD Model shortly after the adoption of the 1954 *Convention Relating to the Status of Stateless Persons*, is now outdated since the current treaty practice show that many countries do not include Art. 24(2) in their tax treaties. The Subcommittee therefore recommends that paragraph 31 of the Commentary on Article 24 of the 2010 OECD Model, as quoted in paragraph 2 of the Commentary on Article 24 UN Model, be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

31. ~~[…] [It is possible that in the future certain States will take exception to~~ ***Some States may consider that*** the provisions of paragraph 2 ~~as being~~***are*** too liberal insofar as they entitle stateless persons who are residents of one State to claim equality of treatment not only in the other State but also in their State of residence and thus benefit in particular in the latter from the provisions of double taxation conventions concluded by it with third States. ~~If such~~ States wish***ing***~~ed~~ to avoid this latter consequence~~, they would have]~~ ***are free*** to modify paragraph 2 as follows:

> Stateless persons who are residents of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.

M. Application of Article 13 to capital gains that accrue before a new or amended treaty is concluded

26. In 2014, a new paragraph 3.1 was added to the Commentary on Article 13 of the OECD Model and the following sentence was included in that paragraph in order to clarify that nothing in Article 13 prevents the taxation of capital gains that accrued before a treaty was amended to allow the taxation of capital gains but that are realized after the entry into force of the new treaty:

> Also, where the Article allows a Contracting State to tax a capital gain, this right applies to the entire gain and not only to the part thereof that has accrued after the entry into force of a treaty (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.

27. The UN Model still quotes the 2010 version of paragraph 3 of the Commentary on Article 13 OECD Model, which does not include that clarification. The Subcommittee recommends that the new paragraph 3.1 of the OECD Model be quoted in the UN Model since a number of countries have modified their tax law to allow for the taxation of capital gains and it is important to clarify that any consequential changes to their tax treaties do not prevent the taxation of gains accrued before, but realized after, such changes. The Subcommittee therefore recommends that paragraph 3 of the Commentary on Article 13 UN Model be replaced by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 3. ***The Committee considers that*** ~~Concerning the taxation of capital gains in both developed and developing countries,~~ the following ~~remarks from the~~ preliminary remarks in the Commentary on Article 13 of the ~~2010~~ ***2017*** OECD Model Convention are ~~pertinent~~***relevant to the taxation of capital gains in both developed and developing countries and are therefore applicable to Article 13 of the UN Model***:
>
> > 1. A comparison of the tax laws of the OECD member countries shows that the taxation of capital gains varies considerably from country to country:
> >
> > – in some countries capital gains are not deemed to be taxable income;

- in other countries capital gains accrued to an enterprise are taxed, but capital gains made by an individual outside the course of his trade or business are not taxed;
- even where capital gains made by an individual outside the course of his trade or business are taxed, such taxation often applies only in specified cases, e.g. profits from the sale of immovable property or speculative gains (where an asset was bought to be resold).

> 2. Moreover, the taxes on capital gains vary from country to country. In some OECD member countries, capital gains are taxed as ordinary income and therefore added to the income from other sources. This applies especially to the capital gains made by the alienation of assets of an enterprise. In a number of member countries, however, capital gains are subjected to special taxes, such as taxes on profits from the alienation of immovable property, or general capital gains taxes, or taxes on capital appreciation (increment taxes). Such taxes are levied on each capital gain or on the sum of the capital gains accrued during a year, mostly at special rates, which do not take into account the other income (or losses) of the taxpayer. It does not seem necessary to describe all those taxes.
>
> 3. The Article does not deal with the above-mentioned questions. It is left to the domestic law of each Contracting State to decide whether capital gains should be taxed and, if they are taxable, how they are to be taxed. The Article can in no way be construed as giving a State the right to tax capital gains if such right is not provided for in its domestic law.
>
> ***3.1*** The Article does not specify to what kind of tax it applies. It is understood that the Article must apply to all kinds of taxes levied by a Contracting State on capital gains. The wording of Article 2 is large enough to achieve this aim and to include also special taxes on capital gains. ***Also, where the Article allows a Contracting State to tax a capital gain, this right applies to the entire gain and not only to the part thereof that has accrued after the entry into force of a treaty (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.***

N. Source rule for Art. 18 Alternative B (Pensions and social security payments)

28. At its meeting of 14-16 February 2020, the Subcommittee discussed a short note that was brought to its attention and that identified a drafting issue with respect to Article 18 Alternative B (Pensions and social security payments) of the UN Model.

29. The first two paragraphs of Article 18 (alternative B) currently read as follows:

> 1. Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment may be taxed in that State.
>
> 2. However, such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by a resident of that other State or a permanent establishment situated therein.

30. These two paragraphs are intended to allow both the State of residence and the State of source to tax pensions and other similar remuneration paid to a resident of a Contracting State (the State of residence having to eliminate any resulting double taxation under the provisions of Article 23). Unlike Articles 10, 11, 12 and 12A, which also allow both States to tax, Article 18 Alternative B, however, does not use the concept of "arising in" in order to determine the source of a pension or similar remuneration. The source is rather determined by the following part of paragraph 2: "if a payment is made by a resident of that other State or a permanent establishment situated therein."

31. A first problem with that formulation is the reference to "a payment … made by a permanent establishment". Recognizing that a permanent establishment is not an entity that can make payments and that the source rules should also be applicable to payments attributable to fixed bases, the source rules included in Articles 11, 12 and 12A use the phrase "borne by a permanent establishment or fixed base".

32. A second possible problem with that formulation is that by not using the concept of "arising in" as is done in Articles 11, 12 and 12A, paragraph 2 of Article 18 Alternative B could leave open the possibility that a Contracting State might argue that Article 21(3) of the UN Model allows it to tax pension payments that are not made by a resident or a permanent establishment of that State but that otherwise arises in that State.

33. The Subcommittee concluded that, while the second issue was not a practical problem because Art. 21(3) did not apply to items of income not dealt with in other Articles of the UN Model, the first issue could be addressed by a drafting change. This could be done by replacing paragraph 2 of Article 18 Alternative B by the following (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 2. However, such pensions and other similar remuneration may also be taxed in the other Contracting State if the payment is made by a resident of that other State or ***if the person paying the pensions or similar remuneration, whether he is a resident of a Contracting State or not, has in that other State a permanent establishment or a fixed base in connection with which the obligation to pay the pensions or similar remuneration was incurred, and such pensions or similar remuneration are borne by such permanent establishment or fixed base.***

34. If these changes are made, the following consequential changes to paragraph 15 of the Commentary on Article 18 Alternative B should also be made (changes to the existing version of the paragraph appear in ***bold italics*** for additions):

> 15. As indicated above, the State of source may tax pensions and other similar remuneration paid in consideration of past employment if the payments involved are made by a resident of that State or ***are borne by*** a permanent establishment ***or fixed base*** situated therein.

2. Topics that the next membership may wish to consider

35. The following are other technical issues related to the UN Model that were mentioned in note E/C.18/2018/CRP.8 or that were otherwise considered by the Subcommittee but which the Subcommittee did not address due to time constraints and the amount of work that would be required by the Subcommittee to approve changes related to these topics. These issues may be considered by the next membership of the Committee.

A. Article 5(6) of the UN Model – Permanent establishment with respect to insurance activities, including the treatment of reinsurance

36. At its fourteenth session (New York, April 2017) the previous membership of the Committee discussed possible changes to Article 5(6) of the UN Model, which deems a permanent establishment to exist with respect to certain insurance activities, and to its Commentary. While it was decided not to make any change as part of the 2017 update of the UN Model, it was also agreed that the issue should be added to the provisional agenda of the next session of the Committee (see paragraph 52-54 of the Report on the Fourteenth Session). Due to other priorities, the present membership of the Committee has not examined the issue.

B. Article 3 – Reference to MAP for interpretation of undefined terms

37. Paragraph 2 of Article 3 of the OECD Model was amended in 2017 to clarify that where the competent authorities have agreed to a meaning of an undefined term under Art. 25, the domestic law meaning will not apply. A number of consequential changes were also made to the Commentary on Article 3 and Article 25. The Committee did not reach a decision as to whether that change should be made to the UN Model.

C. Commentary on Articles 7, 9 and 25 – Self-initiated adjustments

38. The OECD Commentaries on Articles 7, 9 and 25 were amended in 2017 to recognize that competent authorities can use the mutual agreement procedure to relieve double taxation, using the corresponding adjustment provisions of both Articles, in situations where a taxpayer amends a previously filed return in order to adjust previously-reported profits that did not reflect the arm's length principle. These changes, made as a result of the OECD-G20 work on BEPS Action 14, have not been examined by the Committee.

D. Time limits for profit adjustments under Articles 7 and 9

39. In 2017, new paragraphs were added to the Commentaries on Article 7 and 9 of the OECD Model in order to provide an alternative provision to be used by States wishing to put a time limit on profit adjustments made pursuant to Art. 7(2) and Art. 9(1). These changes, made as a result of the OECD-G20 work on BEPS Action 14, have not been examined by the Committee.

E. Changes to Article 25 (Mutual Agreement Procedure)

40. In 2017, a number of changes were made to Article 25 of the OECD Model. For instance, paragraph 1 of Article 25 was modified to allow a taxpayer to start the MAP process by approaching the competent authority of either Contracting State, the start-date for the period for arbitration (paragraph 5) was modified to begin when all information required by the competent authorities has been provided (rather than from the presentation of the case) and wording was inserted in paragraph 5 requiring a case to be submitted for arbitration in writing. A number of changes were also made to the Sample Mutual Agreement for arbitration. These changes have not been considered by the Committee.

F. Amendments to the Commentary on Article 15 related to payments made upon termination of employment

41. In 2017, a number of changes were made to the OECD Model to address the tax treaty treatment of various payments made following the termination of employment. These changes have not been considered by the Committee.

G. Article 17 – Clarifications on the application of Article 17 (Artistes and Sportspersons)

42. In its 2014 update, the OECD dealt with a number of issues related to the interpretation and application of Article 17. The changes that were then made to the OECD Article and its Commentary have not been considered by the Committee.

H. Tax treaty issues relating to emissions permits/credits

43. In its 2014 Update, the OECD dealt with a number of treaty issues related to the trading of emission permits. These issues are not dealt with in the UN Model.

I. Possible issues related to Article 1(2) dealing with transparent entities.

44. After the decision was made by the previous membership to include in the UN Model Article 1(2) dealing with transparent entities, an observer suggested that the provision could give rise to unintended consequences. It was then agreed that this issue could be examined by the Committee in the future.

J. Application of the UN Model to sovereign wealth funds

45. In 2010, changes were made to the Commentaries on Article 1 and 4 OECD Model to clarify how tax treaties applied to sovereign wealth funds. These changes have not been considered by the Committee.

K. Treatment of accrued interest in the Commentary on Article 11

46. In 2014, changes were made to the Commentary on Article 11 OECD Model to clarify how the Article applied to interest accrued at the time of the alienation of a debt-claim. These changes have not been considered by the Committee.

L. Tax treaty provisions related to the exploration and extraction of natural resources

47. At the October 2019 meeting of the Subcommittee, the representative from ATAF suggested that the Subcommittee should explore the drafting of special treaty provisions dealing with the exploration and extraction of natural resources. It was then agreed that since the OECD was currently working on that issue, it was better to wait for the outcome of that work as long as it was clear that the Subcommittee would not be bound in any way to follow any guidance that would be provided by the OECD in that area.

M. To what extent a tax treaty can result in increased taxation

48. Some countries have incorporated in their domestic tax law provisions that result in items of income that would not otherwise be taxable becoming taxable if these items of income may be taxed in accordance with the provisions of a tax treaty. One member of the Subcommittee has suggested that the application of such provisions should be examined.

N. Whether MAP should deal with issues that have already been decided by the courts of one of the States

49. While the Commentary on Article 25 UN Model already indicates that the competent authorities of a Contracting State may be constrained by a court decision rendered in that State, it suggests that access to MAP cannot be denied in that case without directly addressing the situation of the other competent authority (see paragraph 9 of the Commentary on Article 25, quoting paragraphs 7, 27, 28, 42 of the OECD Commentary). One member of the Subcommittee has suggested that this question should be examined.

O. Whether Article 8 should be fundamentally revised

50. This issue was brought to the attention of the Committee by Dr. Muhammad Ashfaq Ahmed, Director General (International Taxes), Federal Board of Revenue of Pakistan. In an email to the Secretariat and to a member of the Committee, Dr. Ashfaq Ahmed called for Article 8 to be put on the agenda of the UN Tax Committee in order to have the principle of exclusive taxation in the State of residence changed. In support for that request, Dr. Ashfaq Ahmed included a copy of an article he wrote for *Intertax (see Intertax, volume 49 (2020), Issue 1, p. 103).*