E/C.18/2020/CRP.36

Distr.: General
7 October 2020

Original: English

Committee of Experts on International Cooperation in Tax Matters
Twenty-first session
Virtual informal meetings of 20-29 October 2020
Item 3 (b) of the provisional agenda
Update of the UN Model Double Taxation Convention between Developed and Developing Countries –Capital Gains on Offshore Indirect Transfers

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

Summary

This note, a previous version of which was discussed at the twentieth session, is presented FOR APPROVAL at the twenty-first session of the Committee.

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 which the Subcommittee recommends to be addressed by the next membership of the Committee.

At its twenty-first session, the Committee is invited to finalize its discussion and to approve the proposals and recommendations included in sections 1, 2 and 3 of this note.

1. At its nineteenth session (Geneva, 15-18 October 2019), the Committee discussed note E/C.18/2019/CRP.22 which dealt primarily with the issue of so-called offshore indirect transfers (OITs) and how the gains from such transfers should be dealt with in the UN Model.

2. After discussion, the Committee welcomed the Subcommittee's decision to work on a treaty provision that would allow source taxation of capital gains on OITs not already covered by Art. 13(4) without prejudging the question of whether that provision would be included in Article 13 of the UN Model or presented as an optional provision in the Commentary.

3. At its meeting of 14-16 February 2020, the Subcommittee discussed proposed changes to the UN Model and its Commentary that were prepared in accordance with these decisions. These changes were included in note E/C.18/2020/CRP.11, which was discussed at the twentieth session of the Committee (held online from 22 to 26 June 2020).

4. Part of the discussion during the meeting focussed on the drafting of paragraph 23 of the proposed Commentary included in the note and the Subcommittee was invited to examine alternative redrafts of that paragraph and of paragraph 22. It was also decided to invite written comments from all stakeholders on the proposals included in the note and, for that purpose, the note was released as a discussion draft on 22 July 2020 and comments were requested by 21 August 2020.

5. At its online meeting of 31 August and 1-2 September 2020, the Subcommittee discussed each of the comments received on the discussion draft and considered possible changes. It also discussed alternative redrafts of paragraphs 22 and 23 of the proposed Commentary included in the note.

6. This revised version of the note reflects the few changes made by the Subcommittee. Section 1 of the attached note contains draft changes to paragraph 18 of the existing Commentary on Article 13. Section 2 contains a draft provision (with its Commentary) that would allow for the taxation of gains from certain OITs by the Contracting State in which the underlying local assets are situated. Section 3 addresses the direct taxation of gains from the alienation of certain rights granted by the government of that State in accordance with the decisions made at previous sessions.

7. At its twenty-first session, the Committee is invited to finalize its discussion and to approve the proposals and recommendations included in sections 1, 2 and 3 of this note.

Capital gains on Offshore Indirect Transfers

Table of Contents

Introduction

8. At its 19th session (Geneva, 15-18 October 2019), the Committee discussed note E/C.18/2019/CRP.22 which dealt primarily with the issue of so-called offshore indirect transfers (OITs) and how the gains from such transfers should be dealt with in the UN Model.

9. The discussion at the meeting focussed on the following four questions included in paragraph 53 of the note and on the responses that the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries (the Subcommittee) provided to these questions at its meeting of 11-12 October 2019:

- *Should the UN Model be modified to allow for taxation at source of all capital gains, with the exception of gains from the alienation of ships or aircraft operated in international traffic?* The Subcommittee had responded no to that question.
- *Should paragraph 18 of the existing Commentary to Article 13 be redrafted to clarify the scope of the alternative that is provided in that paragraph?* The Subcommittee had agreed that paragraph 18 of the Commentary, which includes an alternative provision generally allowing the source taxation of capital gains, should be amended to clarify that this alternative provision, if read literally, would render paragraphs 1, 2, 4 and 5 useless and misleading. It had also agreed that no attempt should be made to amend the alternative provision in order to provide an agreed source rule for gains that would be subject to source taxation but that the difficulties that would arise from a mere reference to domestic source rules, particularly in relation to double taxation risks, should be briefly described.
- *If the Committee wishes to tax OITs only in cases of abuse, would the wide adoption of the PPT be sufficient to address the issue?* The Subcommittee had replied no to that question, as it did not want to restrict the work on possible changes related to the taxation of gains from OITs to cases of abuse.
- *Should a targeted provision for the source taxation of some OITs be drafted?* The Subcommittee had agreed that it should attempt to draft a specific provision allowing source taxation of gains on OITs. That provision would include an unspecified requisite level of ownership by the transferor. It would also include source rules in the same way as the current provisions of Article 13 include their own source rules. Unlike the draft alternative provision included in Annex B of the note, however, the provision would not replace Art. 13(4) but would be a stand-alone provision that would apply “subject to” Art. 13(4) and (5). That provision would only cover the indirect transfer of property with respect to which the source country has source taxing rights in case of a direct alienation. In this respect, the Subcommittee also discussed whether Article 13 of the UN Model should allow the source taxation of gains on a direct alienation of (1) derivatives and securities issued by resident companies (or related to resident companies) and (2) the type of property described in subparagraph d) of the provision

included in Annex B (i.e. “a right granted under the law of the other State that is used or exercised exclusively or almost exclusively in the other State”). While there was no agreement as to whether such provisions concerning direct alienations should be adopted and, if so, whether they should be included in Article 13 itself or in its Commentary, the Subcommittee had agreed that draft provisions to that effect should be discussed at its next meeting.

10. At its 19th session, the Committee welcomed the Subcommittee’s decision to work on a treaty provision that would allow source taxation of capital gains on OITs not already covered by Art. 13(4) without prejudging the question of whether that provision would be included in Article 13 of the UN Model or presented as an optional provision in the Commentary.

11. This note includes the changes that are proposed as a result of that work.

1. Draft changes to paragraph 18 of the Commentary

12. When the Subcommittee examined, during its meeting of 14-16 February 2020, a first draft of changes to paragraph 18 that reflected the decisions referred to in the second bullet of paragraph 2 above, it concluded that it would be awkward to suggest an alternative provision in the Commentary but to then describe various problems that this provision would raise. The Subcommittee concluded that a better approach would be to amend paragraph 18 so that the provision included therein would refer to gains from the alienation of property not mentioned in the other paragraphs of Article 13 (as opposed to gains not mentioned in these other paragraphs) and would include comments similar to those in paragraph 9 of the Commentary on Article 21 with respect to the phrase “in which they arise according to the law of that State”.

13. The Subcommittee therefore proposes that paragraph 18 of the Commentary on Article 13 be amended as follows (changes to the existing version of the paragraph appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions):

> 18. However, as indicated in paragraph 2 above, most members from developing countries suggested the following alternative to Article 13, paragraph ***6[1] of the UN Model, which corresponds to paragraph*** 5~~,~~ of the OECD Model ***Tax*** Convention:
>
> > “6~~5~~. Gains from the alienation of any property other than ~~those gains~~***property*** mentioned in paragraphs 1, 2, 3***,*** ~~and~~ 4 ***and 5*** may also be taxed in the Contracting State in which they arise according to the law of that State.
>
> This alternative is equivalent to saying that either or both States may tax ***gains from the alienation of property not mentioned in paragraphs 1, 2, 3, 4 and 5*** according to their own laws and that the State of residence will eliminate double taxation under Article 23. ***The alternative, unlike the alternative previously suggested in this paragraph, refers to “property other than property mentioned” in the previous paragraphs of Article 13 rather than to “gains … other than those gains mentioned” in these paragraphs. This means that where property that is mentioned in paragraphs 1, 2, 4 or 5 is alienated but the provisions of these***

[1] The paragraph will be renumbered paragraph 7 if the proposal in section 2 below is approved.

paragraphs restrict the right of the State of source to tax the gain from the alienation of that type of property to certain situations, gains from the alienation of such property in situations not covered by these paragraphs shall be taxable only in the Contracting State of which the alienator is a resident*. *One example would be a gain from the alienation of immovable property situated in the State of residence of the alienator: since immovable property is mentioned in paragraph 1 but that paragraph only indicates that the other State may tax gains from the alienation of immovable property situated in that other State, the gain from the alienation of immovable property situated in the State of residence of the alienator would only be taxable in that State.

18.1 Countries choosing this alternative may wish through bilateral negotiations to clarify which particular source rules will apply to establish where a gain shall be considered to arise. ***If they do not do so, the domestic law of each Contracting State will determine the source of the gain. The domestic laws of the Contracting States may however differ and this may lead to double taxation (or non-taxation where the State of residence of the beneficiary applies Article 23 A to eliminate double taxation). Countries that want to address the issue may wish to replace the phrase "according to the law of that State" at the end of the alternative provision by a rule that would provide expressly when a gain would be deemed to arise in a Contracting State. The following is an example of such a rule which is based on the approach used in paragraph 5 of Articles 11, 12 and 12A:***

> ***For the purposes of this paragraph, a gain shall be deemed to arise in a Contracting State when the acquiror of the property is a resident of that State. Where, however, the person acquiring the property, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to acquire the property was incurred, and the consideration for the acquisition is borne by such permanent establishment or fixed base, then such gain shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.***

2. Draft provision for the source taxation of gains from certain OITs

14. The following draft provision and its Commentary have been prepared in accordance with the decisions concerning the drafting of a provision that would allow the source taxation of gains from certain OITs (see the fourth bullet of paragraph 2 above). The Subcommittee recommends that this provision be added as new paragraph 6 of Article 13 of the UN Model (consequential changes would be made to the numbering of existing paragraph 6 and to the Commentary). Some members of the Subcommittee, however, indicated a preference for either not including that provision in the UN Model or for including it as an alternative provision in the Commentary on Article 13. For these members, a minority view could be considered for inclusion in the Commentary.

New paragraph 6

6. Subject to paragraphs 4 and 5, gains derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests of an entity, such as interests in a partnership or trust, may be taxed in the other Contracting State if

a) the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least [ ] percent *[the percentage is to be established through bilateral negotiations]* of the capital of that company or entity; and

b) at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from

(i) a property any gain from which would have been taxable in that other State in accordance with the preceding provisions of this Article if that gain had been derived by a resident of the first-mentioned State from the alienation of that property at that time, or

(ii) any combination of property referred to in subdivision (i).

Commentary on the new paragraph 6

19. Since the application of paragraph 5 is restricted to shares or comparable interests in resident companies or entities (subject to the possible application of anti-abuse rules such as paragraph 9 of Article 29), a Contracting State may not tax gains derived by a resident of the other Contracting State from the alienation of shares or comparable interests of a non-resident company or similar entity unless these shares or comparable interests derive more than 50 per cent of their value directly or indirectly from immovable property situated in the first-mentioned State so as to fall within the scope of paragraph 4. This means that for non-abusive cases, unless paragraph 4 applies, gains derived by a non-resident from the alienation of shares or similar interests of a non-resident company or entity would fall under paragraph 7, which provides for the exclusive taxation of the gains by the State of residence, even if such non-resident company or entity derives the majority of its value from other types of assets situated in the other State (such as shares of a manufacturing company that is resident of, and operated in, that other State). Many developing countries consider that they should have the right to tax gains from such transactions, which are sometimes referred to as “offshore indirect transfers” (OITs).

20. Paragraph 6 addresses that issue by allowing for the taxation of gains from certain OITs by the Contracting State in which the underlying assets are situated. According to that paragraph, gains derived by a non-resident from the alienation of shares or comparable interests in a local or offshore company or entity may be taxed by a State if these shares or comparable interests derive at least 50 per cent of their value from property with respect to which that State would, under the other provisions of Article 13, have had the right to tax the gain from a direct alienation. The policy rationale for that paragraph is analogous to the policy rationale for paragraph 4 regarding immovable property. The following example illustrates the application of paragraph 6:

Example: Company A, a resident of State A, holds 30 per cent of the shares of company B, which is a resident of State B. The value of all the shares of company B is 100. Throughout all the relevant period, company B has no debt and the only assets owned by company B are a bank account of 30, shares representing 30 per cent of the capital of company X, shares representing 25 per cent of the capital of company Y and shares representing 15 per cent of the capital of company Z. Companies X, Y and Z are all residents of State C and the value of all the shares of each company is 100. Paragraphs 5 and 6 of Article 13 of the tax treaty between States A and C are based on paragraphs 5 and 6 of Article 13 of the UN Model; the percentages specified in paragraph 5 and in subparagraph *a*) of paragraph 6 are 20%.

Company A alienates part of the shares of company B that it owns. The condition in subparagraph *a*) of paragraph 6 is met since company A held more than 20 per cent of the capital of company B at at least one point in time during the 365-day period preceding the alienation. The condition of subparagraph *b*) is also met because, at at least one point in time during the 365-day period preceding the alienation, more than 50 per cent of the value of the shares of company B was derived from a combination of property (i.e. the 30 per cent of the shares of company X and the 25 per cent of the shares of company Y), which are property any gain from which would have been taxable in State C in accordance with paragraph 5 if that gain had been derived by a resident of State A from the alienation of these shares at that time. Since, throughout the relevant period, the value of the shares of company X owned by company B was 30 and the value of the shares of company Y owned by company B was 25, this meant that the shares of company B derived 55 per cent of their value from a combination of property referred to in subdivision (i) of paragraph *b*) of paragraph 6), namely the shares in company X and Y, even though the other property owned by company B (i.e. the bank account of 30 and the shareholding in company Z worth 15), did not constitute property referred to in subdivision (i). Since the conditions of subparagraphs *a*) and *b*) of paragraph 6 are both met, State C is entitled to tax the gain realized by company A on the alienation of the shares of company B.

21. States should weigh a number of factors when considering whether to include that paragraph in their treaties. For instance, they should consider whether and to what extent their domestic law allows the taxation of such OITs, especially when the shares or comparable interest of the non-resident company or entity derive more than 50 per cent of their value from assets other than immovable property situated in their territory. Also, the practical application of the paragraph may raise important administrative and collection challenges, especially when the shares or comparable interest are alienated by one non-resident to another non-resident.[2]

22. In addition, there could be situations of unrelieved double taxation. Assume, for instance, that company A, a resident of State A, owns all the shares of company B, a resident of State B which carries on business in State C through a permanent establishment situated therein. Using the profits realized through the permanent establishment, which have been fully taxed in State C, company B acquired all the shares of company D, a resident of State D that carries on business in that State. The shares of company D have increased in value after being acquired by company B. Assuming that the shares of companies A and B derive most of their value from the movable property of the permanent establishment in State C (even though there are no accrued gains on that property), paragraph 6 of the tax treaty between States A and C would allow both States to tax any gain realized by company A on the sale of the shares of company B even though the gain on these shares may be primarily attributable to the increase in value of the shares in company D. In addition, however, paragraph 5 of the tax treaty between States A and B would allow State B to tax the same gain since that gain arises from the sale of the shares of a company resident of that State. Since the tax treaty between States B and C is not applicable to the gain realized by company A, the double taxation resulting from the taxation of that gain by States B and C will

---

2 Other factors that would be relevant would include a country's revenue needs and desire to attract foreign investment, see Platform for Collaboration on Tax, *The Taxation of Offshore Indirect Transfers — A Toolkit*, *2020*, available at https://www.imf.org/~/media/Files/Miscellaneous/OIT.ashx?la=en, p. 54.

not be eliminated. Also, the subsequent alienation by company B of the shares of company D would generate a gain taxable in States B and D under paragraph 5 of the tax treaty between States B and D even though that gain, or part thereof, will have already been taxed in States A and C as indicated above, which would result in further unrelieved double taxation.

23. One possible way to address such situations could be to resort to the mutual agreement procedure under the second sentence of paragraph 3 of Article 25 through discussion between the competent authorities of the States involved. For instance, in the situation described in paragraph 22 above where State C taxes company A under paragraph 6 of the treaty between States A and C while State B taxes company A under paragraph 5 of the treaty between States A and B, the competent authorities of States B and C might consult under paragraph 3 of Article 25 of the treaty between States B and C for the elimination of the resulting double taxation of company A, resident in State A. Since the outcome from such consultation would not address the problem that would subsequently arise as a result of the taxation by State D of the gain realized by company B on the alienation of the shares of company D, a similar consultation might be necessary under the treaty between States C and D upon the subsequent alienation by company B of the shares of company D.[3] It should be noted that the second sentence of paragraph 3 of Article 25 does not, however, allow the Contracting States to eliminate double taxation where the provision of such relief would contravene their respective domestic laws or is not authorised by the provisions of other applicable tax treaties.[4] Alternatively, Contracting States may wish to make express provision for multilateral mutual agreement procedures covering such cases by using a different formulation of paragraph 2 of Article 25.

24. Since the paragraph applies with respect to the offshore indirect transfer of a property, or combination of property, to the extent that a State would have had the right to tax a direct alienation of such property in accordance with the preceding provisions of Article 13, any modification of the scope of these preceding provisions will indirectly impact the scope of the paragraph. Where, for instance, provisions such as those referred to in paragraph XX below [*this would include the possible provision discussed in section 3 below*], are included in Article 13 in order to allow the source taxation of a gain on the direct alienation of the types of property referred to in that paragraph, the inclusion of these provisions before the paragraph will allow the taxation of an indirect transfer of such property.

25. As indicated in paragraph 11 above with respect to paragraph 5, it will be up to the law of the State imposing the tax to determine the level of holdings of the alienator, in particular, how to determine an interest held indirectly. Anti-avoidance rules of the law of the State imposing the tax may also be relevant in determining the level of the alienator’s direct or indirect holdings.

26. States may consider modifying the scope of the paragraph in their bilateral negotiations. For example, as noted in paragraph 8.5 above with respect to paragraph 4, States could consider increasing or reducing the percentage of the value of the shares or comparable interests that must

---

3 See paragraphs 38.1, 38.2, 38.4, 55 and 55.1 of the OECD Model Commentary on Article 25 which describe how paragraph 3 of Article 25 might be used to consult to resolve double taxation in a multilateral situation.

4 See paragraph 10 of the Commentary on paragraph 3 of Article 25 of the UN Model (quoting, inter alia, paragraph 55.1 of the OECD Model Commentary on paragraph 3 of Article 25).

be derived directly or indirectly from the local asset for the provision to apply, which could be done by replacing "50 per cent" by the percentage that these States would agree to. Additionally, as is the case with paragraph 5 (see paragraph 16 above), States could choose to add an exception for gains derived in the course of corporate reorganizations. States could also consider amending subparagraph a) of the paragraph in order to provide that percentage of the capital that is held directly or indirectly is determined by taking into account not only the shares or comparable interests held by the alienator but also any shares or comparable interests held by a closely related person or enterprise as defined in paragraph 9 of Article 5.

15. In addition, the Subcommittee recommends that the following changes to the Commentary on Art. 13(4) be made in order to

- mention the possibility of restricting the scope of existing Art. 13(4) to situations where the alienator has a requisite level of ownership in the company or entity, which could be done by quoting the last part of paragraph 28.6 of the OECD Commentary on Art. 13, and
- mention the possibility of restricting the scope of existing Art. 13(4) in order to avoid its application to gains derived in the course of corporate reorganizations, as suggested in the case of Art. 13(5) and new Art. 13(6).

Draft Commentary changes

[Add the following new paragraphs 8.5 and 8.6 to the Commentary on Article 13]

8.5 Countries may also agree during bilateral negotiations to restrict the scope of paragraph 4, as is done in paragraph 6, to situations where the alienator holds directly or indirectly at least a certain percentage, to be established through bilateral negotiations, of the capital of the company or entity of which it alienates shares or comparable interests. As indicated in paragraph 28.6 of the relevant Commentary of the OECD Model Convention:

> … Another change that some States may agree to make is to restrict the application of the provision to cases where the alienator holds a certain level of participation in the company.

8.6 Additionally, as is the case with paragraphs 5 and 6 (see paragraphs 16 and 24 below), States could choose to add an exception for gains derived in the course of corporate reorganizations.

3. Draft provision for the taxation of gains from the direct transfer of certain property

16. As mentioned in the fourth bullet of paragraph 2 above, the Subcommittee, at its meeting of 11-12 October 2019, discussed whether Article 13 of the UN Model should allow the source taxation of gains on a direct alienation of (1) derivatives and securities issued by resident companies (or related to resident companies) and (2) a right granted under the law of the other State that is used or exercised exclusively or almost exclusively in the other State. While there was no agreement as to whether such provisions concerning direct alienations

should be adopted, the Subcommittee agreed that draft provisions to that effect should be discussed at its next meeting.

17. In accordance with that decision, the Subcommittee, at its meeting of 14-16 February 2020, discussed possible draft provisions that would allow the source taxation of gains on a direct alienation of these two types of property.

18. After discussion of a provision that would allow the taxation of gains on the direct alienation of derivatives and securities issued by resident companies, the Subcommittee decided not to recommend the inclusion of such a provision in Article 13 or its Commentary. It was observed in that respect that difficulties in designing a rule for the taxation of gains on derivative contracts related to securities issued by resident companies arose from the fact that such contracts are often negotiated by third parties without the involvement of the companies, which raise nexus issues and administrative problems. Some members of the Subcommittee, however, supported doing additional work on such a provision.

19. The Subcommittee, however, decided to recommend that further work be done with respect to the draft provision that would allow the taxation of gains on the direct alienation of a right granted under the law of the other State that is used or exercised exclusively or almost exclusively in the other State, without prejudging the issue of whether such a provision should be included in Article 13 of the UN Model or in its Commentary. One issue, in particular, where the Subcommittee highlighted further work was required was a better understanding of what rights would be covered by such a provision. The idea for such a provision is partly based on the examples used in the *Toolkit on the Taxation of Offshore Indirect Transfers* prepared by the Platform for Collaboration on Tax, which refer to rights such as a telecommunications operating licence and a licence to extract natural resources. In such cases (that is, telecommunications operating licence and a licence to extract natural resources), source taxation of the gain seems justified because, as recognized by the toolkit "[v]alue is thus manifestly tied to particular jurisdictions, and largely consists of what are recognizably location-specific rents deriving from some government-issued license."[5]

20. Some members of the Committee observed that it was unclear which rights would be covered by the alternative provision and questioned whether the provision should be more narrowly drafted. They also noted that such a provision would raise serious valuation issues as it would often be unclear to what extent the value of a business should be attributed to a license granted by the government as opposed to other intangibles, such as marketing intangibles.

21. The following revised narrower version of the draft provision that the Subcommittee examined during its meeting has been prepared by the Secretariat as a basis for discussion at the Committee's meeting:

> Gains derived by a resident of a Contracting State from the alienation of a right granted under the law of the other Contracting State which allows the use of resources that are naturally present in

5 Page 26 of the Toolkit.

that other State and that are under the jurisdiction of that other State, may be taxed in that other State.

22. The following are additional explanations on the above provision which could be included in the Commentary.

1. The provision allows a State to tax gains from the alienation of rights granted under the law of that State as long as these rights allow the use of resources that are naturally present in that State and that are under the jurisdiction of that State. This would cover, for example, the alienation of rights such as fishing quotas granted by the State; the right to fell timber in a forest; the right to extract water; the right to explore part of a territory of the State for oil, gas or minerals; the right to install wind or tidal stream turbines in part of the territory of the State as well as the right to use all or part of the radiofrequency spectrum in the State, including for cell phone purposes. The common features of these rights are that they allow the commercial exploitation of resources that are inextricably linked to the territory of a State and that the value of these rights consists of what are recognizably location-specific rents deriving from some government-issued license.

2. The provision does not cover rights granted contractually between private parties even if these rights are protected under the law of a State. Thus, the alienation of the exclusive right to use know-how in a given State would not be covered by the provision as that right granted by the owner of the know-how is not granted under the law of the State. Also, rights allowing the use of property developed by private parties, such as a copyright or patent license, would not be covered by the provision because they do not relate to the use of resources that are naturally present in that other State and that are under the jurisdiction of that State.

3. The provision only applies where the right referred to therein is itself alienated. Subject to the possible application of anti-abuse rules such as those of paragraph 9 of Article 29, it would not apply in the case of an "indirect transfer" of such a right, e.g. where the right is held by a company and the shares of that company are alienated. Depending on the circumstances, however, such indirect transfers could fall within the scope of paragraph 4, 5 or 6.

4. In many cases, the rights to which the provision applies will also constitute immovable property, as defined in paragraph 2 of Article 6, and the provisions of paragraph 1 of Article 13 will apply to the alienation of such rights. This would be the case, for example, of a mining license granted by a State that would constitute immovable property within the meaning of the term "immovable property" under the domestic law of that State or under the phrase "rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources" in paragraph 2 of Article 6. In such a case, nothing in the provision would prevent the application of paragraph 1 of Article 13 and vice-versa. In other situations, however, the provision will allow a State to tax rights that relate to the exploitation of its natural resources where these rights do not constitute immovable property. This would the case, for example, if exploration rights granted by a State do not fall within the meaning of "immovable property" under its domestic law.

5. Also, while paragraph 2 of Article 13 would cover cases where an enterprise of a Contracting State alienates rights granted under the law of the other Contracting State to which the provision applies to the extent that such rights form part of the movable property of a

permanent establishment of the enterprise situated in that other State, the provision ensures the same treatment for cases where the right is not attributable to such a permanent establishment, for example where the right that is alienated does not belong to the enterprise that owns the permanent establishment but belongs to a closely related person.

ANNEX

COMMENTS RECEIVED ON THE DISCUSSION DRAFT

INTERNATIONAL CHAMBER OF COMMERCE

General comments

ICC notes that some concerns regarding the Platform handbook were not addressed, and consequently issues remain in the proposal from the UN Committee.

In particular (and recognising that some of these would be better dealt with under domestic rule improvements, but are not):

– There should to be a listed company exemption for indirect share transfers (and if there are concerns re anti-avoidance it could be caveated that the parties must also be unrelated?). Without this, it will be impossible for listed groups to comply with.

– Similarly, exclusions for intra-group reorganisations should be included – there should be no need to tax where the asset has not been truly alienated.

– The examples suggest that a 20% ownership threshold is appropriate for the tax to apply (even though the model wording does not specify). This is an unhelpful example because 20% is an extremely low percentage. It would be helpful if the example focused on a treaty rule with a 50% ownership clause (with appropriate anti-avoidance), because this would demonstrate genuine control.

– Some regimes have joint and several liability requirements (which is the recommended approach in the Platform handbook). Treaties should seek to address this (and limit the J&S application).

UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS (USCIB)

USCIB[6] appreciates the opportunity to comment on the proposals concerning modifications to Article 13 and its commentary, including the proposals on Offshore Indirect Transfers (OIT). We recognize the concern of some countries that OITs may be used to avoid local country tax on the effective disposition of local assets. We believe, however, that an overbroad rule on OITs may discourage foreign direct investment because broad OIT rules can result in taxation in inappropriate circumstances and unrelieved double taxation. We have discussed these issues in more detail in our comment letters to the Platform for Collaboration on Tax.[7]

---

6 USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide and works to facilitate international trade and investment.

7 https://www.uscib.org/uscib-content/uploads/2017/10/USCIB_Comments_on_the_Taxation_of_Offshore_Indirect_Transfers_FINAL_10_19_2017.pdf https://www.uscib.org/uscib-content/uploads/2018/09/Toolkit_Comments-USCIB-September_11_2018-final.pdf

USCIB also recognizes the confusion created by paragraph 18 of the current Commentary. We find the clarifications suggested by the draft are also unclear and should be revised.

These topics are discussed in more detail below.

Offshore Indirect Transfers

Paragraph 21 of the draft Commentary (which we believe should be moved to earlier in the discussion) urges countries to consider a number of factors when considering whether to include the paragraph covering OIT transfer in their treaties. Unfortunately, only two factors are mentioned: 1) whether and to what extent domestic law permits taxation of OITs and 2) the administrative and collection challenges raised by OITs. USCIB believes that other factors should be considered including the impact on foreign direct investment and the difficulty of eliminating double taxation. Countries should also consider how business routinely structures foreign operating investments. While cases that have raised concerns in developing countries could be captured by a more limited scope rule , an overbroad rule might distort business investment in order to avoid the onerous administrative rules or double taxation risks. We believe the final rule should balance these objectives to provide reasonable protection for the tax base of developing countries while not discouraging foreign investment in those same countries.

The UN proposal does not address the potential domestic law consequences for a country adopting the provisions concerning OIT. In one sense this is appropriate, since the UN is not the forum for determining domestic tax policy. However, failure to raise these issues (for example, the treatment of corporate reorganizations, minority interests, losses etc.) may result in a provision that discourages foreign investment because it increases the likelihood of double taxation with no appropriate means of eliminating double taxation. It is also important that any country that is considering adopting such rules provide an appropriate opportunity for stakeholder comment and should consider transition rules that exempt existing investments.

Application of the Ownership and Value Tests

The draft treaty and commentary language begin on page 6 with a new draft paragraph 6. The test for whether the source country is permitted to tax OITs is two part: a percentage of ownership threshold and a percentage of value threshold.

While the actual percentage of ownership is left for negotiation between treaty partners, an example uses a 20% threshold. The example thus implies that 20% is a reasonable threshold. This threshold seems far too low given the burdens potentially imposed on OITs, including the need for significant information about the nature and value of assets held at lower tiers of the ownership chain. The threshold is determined by aggregating direct and indirect ownership. There is no guidance, however, on how indirect ownership would be determined. Thus, a person with a very small direct ownership interest might be liable for tax on an OIT if stock was attributed through and across chains of entities. Small stock interests might be held in "street name" by a bank or brokerage firm, and looking through these interests is extremely difficult. The ownership test is satisfied if at any time during the 365-day period preceding the alienation of the shares, the alienator held directly or indirectly the relevant percentage of stock. This implies that the test would have to be performed on each of those 365 days to disprove ownership of stock. This requirement creates a significant burden which may decrease investment.

The percentage of value threshold is that more than 50 percent of the shares' value at any time during the 365 days preceding the alienation of the shares is attributable to property that would be taxable in the source State if gains from the alienation the property would have been taxable in the hands of the resident of the other State at the time of the alienation of the shares. There is no pro rata limitation, so 100% of any gain would be taxable even if only 50+% of the value is attributable to taxable property. There is also no requirement that the gain be attributable to the taxable property. That is, the underlying property that creates the tax liability might have little or no gain (or even a loss) and the gain might be attributable to other property held by the corporation. Nevertheless, 100% of the gain would be taxable in the "source" jurisdiction. Further, the issue of determining the value of the relevant properties is unaddressed. Using fair market value would be effectively impossible since it would require valuations and possibly appraisals of many assets, whether individually or in the aggregate. The only method that might be able to be applied would be cost for financial accounting purposes. Even then, in a large corporation there may be thousands of assets that would need to be valued and evaluated to determine the source of any gain from bulk disposition of those assets. This would need to be done to determine whether at any time during the 365-day period preceding alienation the value test was satisfied; this implies a test that is applied daily for that 365-day period. This information will not be available on a daily basis. These difficulties arise even before turning to the directly or indirectly part of the valuation test and to the potentially low ownership threshold referenced above. It is not clear how it is manageable to determine the test's required percentage results if assets and their values have to be attributed through relatively small minority interests. Minority shareholders may have no ability to compel a corporation to provide this information.

These difficulties argue for only applying these rules when dispositions are likely to be structured primarily to avoid underlying tax liabilities. If the UN decides to go forward with this proposal, there should be thresholds and carve-outs. Corporate reorganizations should be carved-out. Corporate reorganizations usually require a substantial continuity of interest and therefore are unlikely to raise the change of ownership/disposition concerns that rules addressing OIT are supposed to address. Thresholds should be high enough to make the rules administrable while addressing any concerns. USCIB does not have recommendations on thresholds, but 20% stock ownership is too low. One suggestion may be establishing cut offs based on percentages after multiplying ownership interests. For example, there is no further attribution of either stock or assets if the ownership percentages when multiplied together are under a certain percentage. Similarly, assets should not be attributed to another company if the value of the assets owned by one company attributable to the source jurisdiction is under a set percentage (say 25%).

Further work would also be needed to explain the interaction between this new paragraph 6 and existing paragraphs 4 and 5. While the proposal says new paragraph 6 is "subject to" paragraphs 4 and 5, it does not explain what this means. Are paragraphs 4 and 5, respectively, intended to limit a "source" State's taxation of offshore indirect transfers of immovable property situated in that State or of stock in corporations resident in that State to the circumstances described in those paragraphs (even though both provisions are drafted as confirming positive taxing rights rather than limiting such rights)? Is the proposed language intended simply to mean that new paragraph 6 will not limit the "source" State taxing rights already existing in paragraphs 4 and 5?

Elimination of Double Taxation

Paragraph 22 of the proposed Commentary describes a number of cases that could create the risk of unrelieved double taxation. Paragraph 23 suggests that one way to address such situations would be to resort to the mutual agreement procedure, in particular the discretionary ability of competent authorities under Article 25(3), second sentence, to address cases of double taxation not addressed in the treaty (e.g., so as to deal with triangular cases of the type referenced in the proposed Commentary). USCIB is skeptical that the mutual agreement procedure would result in any relief if the countries believe that the treaty has preserved their right to tax the OIT. We note, in particular, the limitations on the potential usefulness of Article 25(3) noted in paragraph 55.1 of the Commentary on Article 25, as a result of domestic law constraints. In order to prevent double (or multiple) taxation of the same gain, there need to be clear priority rules. There also need to be rules for stepping-up the basis of the underlying assets that generate the gain on the OIT (not just the stock that is disposed of). Basis step-ups may also be needed for the shares in intermediate corporations if multiple taxation is to be effectively avoided, further illustrating the complications that can result from efforts to tax indirect transfers.

Higher ownership percentage thresholds would eliminate some of these problems by reducing the number of transfers that would be subject to taxation.

Proposed revisions to paragraph 18 of the Commentary

The proposed amendments to paragraph 18 of the Commentary paragraph 18 are confusing. The revisions seem to be attempting to describe the residual source-based taxing right retained through the Commentary's alternative to Article 13(6) by reference to "property" that is not mentioned in the preceding paragraphs (rather than by reference to "gains" not mentioned in the preceding paragraphs). But in doing so they create confusion about what is the scope of the "property" mentioned in the preceding paragraphs. For example, Article 13(1) allows source State taxation of gains realized by a resident of a Contracting State "from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State". The proposed new Commentary says:

> *The alternative, unlike the alternative previously suggested in this paragraph, refers to "property other than property mentioned" in the previous paragraphs of Article 13 rather than to "gains ... other than those gains mentioned" in these paragraphs. This means that where property that is mentioned in paragraphs 1, 2, 4 or 5 is alienated but the provisions of these paragraphs restrict the right of the State of source to tax the gain from the alienation of that type of property to certain situations, gains from the alienation of such property in situations not covered by these paragraphs shall be taxable only in the Contracting State of which the alienator is a resident. One example would be a gain from the alienation of immovable property situated in the State of residence of the alienator: since immovable property is mentioned in paragraph 1 but that paragraph only indicates that the other State may tax gains from the alienation of immovable property situated in that other State, the gain from the alienation of immovable property situated in the State of residence of the alienator would only be taxable in that State.*

It is not clear what this language implies about, for example, a gain from the alienation of immovable property situated in a third State -- is that "immovable property" mentioned in paragraph 1 and therefore not taxable by the "source" State under the residual taxing right in the Article 13(6) alternative (as the proposed Commentary seems to suggest), or is it potentially taxable in the "source" State because it's other than immovable property situated in the "source" State? As another example, is the property mentioned in Article 13(2) "movable property", "movable property forming part of the business property of a permanent establishment", or "movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State"?

USCIB agrees that the existing language for the Article 13(6) alternative is in need of improvement, but we believe the proposed language needs to be clarified to ensure that it reflects the intentions of the Committee.

Direct Transfer of certain property

USCIB supports the decision (page 10, paragraph 12) of the Subcommittee not to recommend the inclusion of a provision covering the alienation of derivatives and securities issued by resident companies.

RADHAKISHAN RAWAL[8]

These comments are given in response to the Discussion Draft titled Possible Changes to the United Nations Model Double Taxation Convention between Developed and Developing Countries Concerning Capital Gains on Offshore Indirect Transfers (hereinafter referred to as "UN Capital Gains discussion draft"), released by the UN Tax Committee after its 20th session June 2020.

1. *Comments on proposed changes to Para 18 of the UN Commentary on Article 13*

1.1 Addressing the deficiency without reducing taxing rights of the source countries

Para 7 of the UN Capital Gains discussion draft proposes alternative paragraph for insertion in paragraph 18 of the UN Commentary on Article 13. The existing and proposed provision are reproduced hereunder:

Existing provision	*Gains from the alienation of any property other than those gains mentioned in paragraphs 1, 2, 3 and 4 may be taxed in the Contracting State in which they arise according to the law of that State.*
Proposed provision	*"6~~5~~. Gains from the alienation of any property other than ~~those gains~~**property** mentioned in paragraphs 1, 2, 3**,** ~~and 4~~ **and 5** may also be taxed in the Contracting State in which they arise according to the law of that State.*

The proposed changes to the commentary in para 18 clearly suggests that this change has ***the effect of reducing taxing rights of the source country*** as compared to the rights available under the existing provision.

The UN Tax Committee may wish to discuss and agree, whether the intention of the Committee at a policy level is to reduce taxing rights of the source countries?

The second bullet of paragraph 2 of the UN Capital Gains discussion draft notes that the literal reading of existing provision could make paragraphs 1, 2, 4 and 5 ***useless and misleading***. It may be possible to address this deficiency without reducing taxing rights of the source countries.

If the intention of the Committee is not to reduce taxing rights of the source countries, the following alternative formulation may be considered:

Alternative formulation of Article 13	1. Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or of movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.
	2. Gains from the alienation of any property other than those gains mentioned in paragraphs 1 may be taxed in the Contracting State in which they arise according to the law of that State.

8 Radhakishan Rawal is a Mumbai, India based Chartered Accountant. Comments given in this note are given in personal capacity and do not represents views of any organization.

1.2 Is unrelieved double taxation possible?

Proposed para 18.1 contains the following sentence:

> "If they do not do so, the domestic law of each Contracting State will determine the source of the gain. The domestic laws of the Contracting States may however differ and this may lead to double taxation (or non-taxation where the State of residence of the beneficiary applies Article 23 A to eliminate double taxation)."

This sentence appears to be suggesting that this will result in unrelieved double taxation. However, that may not be the case. In such cases when tax is levied in accordance with the provisions of the domestic law of the source country, such taxation will be treated "in accordance with the provisions of the convention" and the residence country is obliged to relieve such double taxation. The following paragraphs of the OECD Commentary on Article 23A and 23B of the OECD Model 2017 need to be noted:

> *32.1 Both Articles 23 A and 23 B require that relief be granted, through the exemption or credit method, as the case may be, where an item of income or capital may be taxed by the State of source in accordance with the provisions of the Convention. Thus, the State of residence has the obligation to apply the exemption or credit method in relation to an item of income or capital where the Convention authorises taxation of that item by the State of source.*
>
> *32.2 The interpretation of the phrase "may be taxed in the other Contracting State in accordance with the provisions of this Convention", which is used in both Articles, is particularly important when dealing with cases where the State of residence and the State of source classify the same item of income or capital differently for purposes of the provisions of the Convention.*

These paragraphs are also adopted in the UN Commentary 2017 (refer para 14).

1.3 Express provision

Notwithstanding the comments in the preceding paragraph, specific rule, on the lines of what is contained in Articles 10,11,12 and 12A, would be desirable.

2. Taxation of Offshore Indirect Transfers

2.1 Grandfathering of existing structures

Paragraph 19 of the UN Capital Gains discussion draft suggests that the proposed provision is for non-abusive cases. Accordingly, at a policy level, it would be appropriate to grandfather existing structures / investments from the scope of application of the new provisions.

The Committee may evaluate the possibility of adding a new paragraph in the Commentary suggesting that the countries may bilaterally agree on grandfathering existing structures.

2.2 Monetary threshold for value

OIT provisions are inherently complex and difficult to apply. Accordingly, at a policy level it would be appropriate to set a monetary threshold and apply such provisions only to high value transactions.

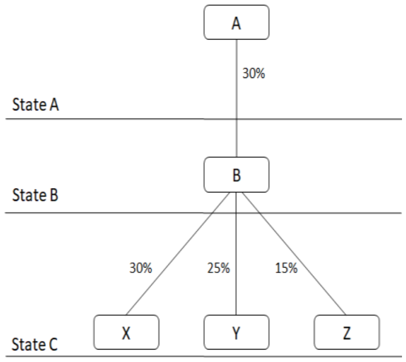
The Committee may evaluate the possibility of adding a new paragraph in the Commentary suggesting that the countries may bilaterally agree on a monetary threshold. Thus OIT provisions can be applied only when the value derived from the assets in source country exceeds the monetary threshold.

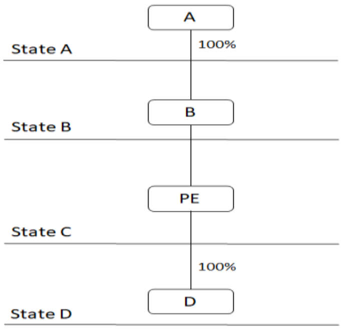
2.3 Method for determination of value of assets

The Committee may consider giving some guidance in the Commentary on the manner in which the value of assets is to be determined for the purpose of 50% threshold. Should it be balance sheet value, open market value? Balance sheet as on which date?

2.4 Inclusion of a diagram

The Committee may consider inserting diagrams for easy reading of the examples.



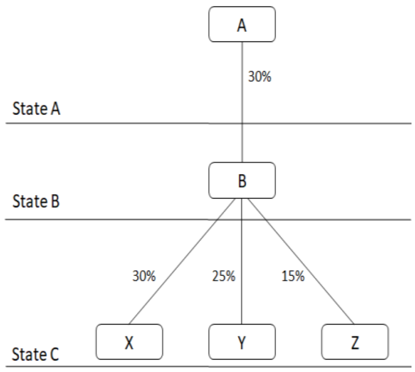


2.5 Comment on para 22

In paragraph 22 of the UN Capital Gains discussion draft it may be clarified that shares of Company D are forming part of the assets of PE of Company B in State C.

2.6 More guidance on deeming fiction - Satisfaction of Article 13(4) or Article 13(5) conditions

One of the main conditions to be satisfied for application of the proposed OIT provisions is that the source country should otherwise have the ability to tax on direct transfer in terms of Article 13[clause (b)(i)]. This contains a deeming fiction and more guidance is required. This can be explained on the basis of the following example.



Company A transfers shares of Company B. The proposed OIT provision creates a deeming fiction or gives taxing rights on the basis of a deeming fiction according to which Company A has sold shares of Company X.

State C can levy tax on the gains earned by Company A from sale of Company B shares, if State C has the ability to levy tax on alienation of shares of Company X in terms of Article 13(5) of its tax treaty with State A. The proposed OIT provision creates a deeming fiction that Company A has sold shares of Company X.

As per Article 13(5):

> *"Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company."*

Article 13(5) of State A-State C tax treaty gives a threshold of 20%.

If Company A owns 100% in Company B, it is possible to say that Company A also owns 30% in Company X. However, when Company A owns only 30% in Company B (assuming balance 70% is owned by CompanyA-1), the following interpretations need to be evaluated:

Interpretation X	Company A owns 9% [30% x 30%] in Company X and hence Article 13(5) of State A - State C tax treaty does not give taxing right to State C
Interpretation Y	Company A owns 30% in Company X and hence Article 13(5) of State A - State C tax treaty does give taxing right to State C

The justification for adoption of Interpretation Y could be that if Company B had sold directly sold shares of Company X, the conditions of Article 13(5) of State B-State C tax treaty are satisfied and hence State C would hence taxed the gains. Instead of directly transferring shares of Company X, such shares are indirectly transferred by selling shares of Company B.

The justification for adopting Interpretation X could be as follows:

- Company A does not have the ability to transfer shares of Company C. With 30% holding in Company B, Company A would not be in a position to influence / to cause Company B to transfer shares of Company X. Only Company A1, which owns majority shares (70%) in Company B, has such ability.
- When A1 sells its stake in Company B, would State C again get rights to levy tax as per the proposed OIT provisions? That would be double taxation.

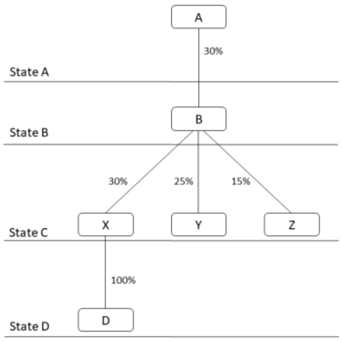
The Committee will have to give more guidance addressing this issue. In strict sense this issue pertains to interpretation of Article 13(5).

2.7 Reference to indirect holding

It is understood that in the opening part of the proposed new paragraph 6 transfer of direct holding is contemplated. If that be the case, the Committee may want to reconsider necessity of the words "directly or indirectly" in clause (a) of paragraph 6.

Alternatively, in the Commentary in may be clarified that the word "indirectly" is used only to include shares held by a related person as contemplated in paragraph 11 of the UN Commentary on Article 13.

The term "indirect" holding may otherwise have a very broad application. The following example may be considered:



In this example A directly holds shares of B. A can also be said to be indirectly holding shares of X and D.

2.8 Exclusion for specific sectors / categories of investors

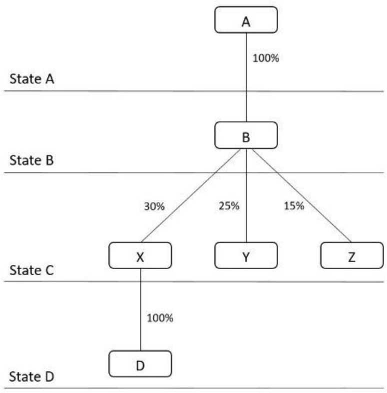
The Committee may consider including a specific paragraph in the Commentary indicating that the countries may bilaterally agree not to apply OIT provisions to certain strategic transactions or investments in accordance with specific domestic law / policies. Alternatively, the domestic law may ensure that tax is not levied on such alienation under the domestic law.

2.9 Double Taxation

As recognized in paragraph 22 of the UN Capital Gains discussion draft application of OIT is likely to result in double taxation. While MAP is suggested for this, the endeavours of the Competent Authorities may not always be successful, especially when more than two States are involved.

2.9.1 Problem of more than single taxation (double, triple, quadruplicate taxation)

This can be explained on the basis of the following example:



Company A sells shares of Company B. Taxing rights of the States are as follows:

State	Relevant Article	Reason for right to tax
State A	Article 13 of State A – State B tax treaty	Country of residence

State B	Article 13(5) of State A – State B tax treaty	Company A holds 100% shares in Company B. The threshold is 25%.
State C	Article 13(5) of State A – State C tax treaty	**Taxing right 1** Company A “indirectly” holds 30% in Company X. The threshold is 25%. [***Interpretation A***]
	Article 13(6) of State A – State C tax treaty [new OIT provision]	**Taxing right 2** The conditions of new OIT provision is met. State C would have taxed gains on alienation of shares of Company X if Company A were to sell such shares.
State D	Article 13(5) of State A – State D tax treaty	**Taxing right 1** Company A “indirectly” holds 30% in Company D. The threshold is 25%. [***Interpretation A***]
	Article 13(6) of State A – State D tax treaty [new OIT provision]	**Taxing right 2** The conditions of new OIT provision is met. State D would have taxed gains on alienation of shares of Company D if Company A were to sell such shares.

If the word "indirectly" in Article 13(5) of the UN Model is not to be interpreted to mean that Company A indirectly owns shares in Company C and Company D in this case [Interpretation A], the Committee should categorically clarify this issue in the Commentary. The guidance given in paragraph 11 of the UN Commentary 2017 is not adequate and suggests that the term "indirectly" is to be interpreted as per the domestic law. Interpretation A can be rejected simply on the basis that Article 13(5) gives taxing rights to the source country only when shares of a company resident of source country are sold. Company B is not resident in State C or State D and hence these countries cannot invoke Article 13(5).

It also needs to be noted that if the meaning of "indirectly holding", as given in the table, is to be adopted, one probably may not need insertion of new OIT provision.

If the **Interpretation A** is rejected, then State C may explore the possibility of invoking Taxing right 2 i.e. it would invoke the new OIT provisions. Similarly, State D will also invoke new OIT provisions. As a result of this all four countries will get right to levy tax on the gains made by Company A.

2.9.2 Probable approaches for addressing more than single taxation

The following two approaches can be considered for addressing the issue:

2.9.2.1 Approach 1 - Deterrence to tax planning

Under this approach, the possibility of double or more than double taxation works as a deterrence for the tax payer. The tax payer has to protect his own interest and ensure that he does not create structures or enter into transactions which result in such double taxation.

Under this approach, the UN Tax Committee may not attempt to address tax inefficiencies which are self-inflicted.

2.9.2.2 Approach 2 - Further refinement of OIT provisions

Double taxation can be avoided by specifically providing that in such circumstances State B or State C shall not levy tax.

Inclusion of (improvised version of) the following sentence as a part of proposed OIT provision may be evaluated:

> *Where a third state is entitled to levy tax on the gains earned by resident of a Contracting State in terms of the provisions of Article 13, paragraph 6 of tax treaty between the third state and such Contracting State, the other Contracting State shall not be entitled to levy tax on such gains. This provision is to be applied to give taxing right to the state in which the property giving taxing rights in terms of paragraph 4 or 5 is situated and such property does not derive value from property in any other country.*

The above draft may require significant improvement. Additionally or alternatively, detailed example may be included in the Commentary to explain this.

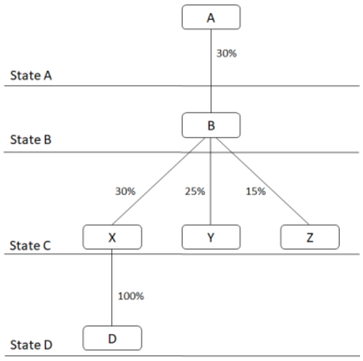
2.10 Reporting obligation

The tax administration of the source country, which is entitled to levy tax in accordance with the proposed OIT provisions, may not come to know when the transactions happen at the top level in other country and when it has to exercise right to tax.

To address his issue, the domestic law of the source country may place an obligation on the local entity to report transfer of stakes at a higher levels.

2.11 More clarity, more examples

To bring more clarity on the application of OIT provisions, the Committee may consider giving more examples in the Commentary. One such example could be as follows:



Whether OIT provisions will be triggered by State C or State D or both need to be clarified.

3. Taxation of gains from rights granted by government

The UN Tax Committee may consider the following:

3.1 Exploration, Exploitation, Extraction of natural resources

In the draft provision given in paragraph 15 of the UN Capital Gains discussion draft, replace the words "the use of resources that are naturally present" by the words "the use, exploration, extraction or exploitation of natural resources that are present". The revised draft provision will read as follows:

> *Gains derived by a resident of a Contracting State from the alienation of a right granted under the law of the other Contracting State which allows the use, exploration, extraction or exploitation of natural resources that are present in that other State and that are under the jurisdiction of that other State, may be taxed in that other State.*

3.2 Alienation by sub-contractors

There are several sub-contractors involved in extractive industries. The government will give rights to the main contractor, which is obviously covered by the proposed provisions. The main contractor may appoint sub-contractors. What happens when such sub-contractor alienates the sub-contract? Whether the source country should also get rights to tax gains from such alienation? Whether the proposed draft provision and commentary is sufficient to cover such alienation by the sub-contractors? This issue arises for the reason that the sub-contractors gets the rights not from the government but from a private party.