

**United Nations Committee of Experts  
on International Cooperation in Tax Matters**

**DISCUSSION DRAFT:**

**Possible Changes to the United Nations Model Double Taxation  
Convention Between Developed and Developing Countries Concerning  
Capital Gains on Offshore Indirect Transfers**

**Period for comments:**

22 July 2020 to 21 August 2020

The UN Tax Committee invites public comments on the attached discussion draft which includes proposals for changes to the United Nations Model Double Taxation Convention Between Developed and Developing Countries concerning capital gains on offshore indirect transfers.

These proposals do not represent the consensus views of the members of the United Nations Committee of Experts on International Cooperation in Tax Matters but are intended to allow stakeholders to comment on these proposals before they are considered by the Committee at its 21st session currently scheduled for October 2020.

Comments should be sent **by 21 August 2020 at the latest** by email to [taxcommittee@un.org](mailto:taxcommittee@un.org) in Word format (in order to facilitate their inclusion in a revised version of the note that will be distributed to members of the Committee). These emails should be entitled “Comments on discussion draft Capital Gains on OITs” and the comments should be addressed to the “Subcommittee on the United Nations Model Tax Convention between Developed and Developing Countries”.

Please note that, with the exception of comments from United Nations member States, all comments received regarding this discussion draft will be made publicly available.

# Capital gains on Offshore Indirect Transfers

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## Introduction

1. 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.

2. 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.

3. At its 19<sup>th</sup> 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.

4. The attached note was prepared by the Subcommittee for a first discussion at the Committee’s 20<sup>th</sup> session (held online on 22-26 June 2020). During that session, the Committee agreed to invite comments from all stakeholders on that note. These comments will be examined at the September online meeting of the Subcommittee with a view to continuing the discussion of the proposed changes at the Committee’s 21<sup>st</sup> session in October 2020.

5. In accordance with these decisions, public comments are requested on the proposed changes to the UN Model included in the attached note. Section 1 of the attached note contains draft changes to paragraph 18 of the existing Commentary on Article 13 prepared in accordance with the decision referred to in the second bullet of paragraph 2 above. 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 financial assets and of certain rights granted by the government of that State in accordance with the decision referred to in the fourth bullet of paragraph 2 above.

## 1. Draft changes to paragraph 18 of the Commentary

6. 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”.

7. 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~~ ***of the UN Model, which corresponds to paragraph 5***, of the OECD Model *Tax* Convention:

“65. 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 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***

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

*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**

8. 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.

22. In addition, the paragraph creates risks 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 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 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 States 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. 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.

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 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.

9. 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**

10. 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.

11. 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.

12. 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.

13. 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.”<sup>2</sup>

14. 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.

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

16. 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 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.

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<sup>2</sup> Page 26 of the Toolkit.

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 be 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.