E/C.18/2024/CRP.22

Distr.: General
30 September 2024

Original: English

Committee of Experts on International Cooperation in Tax Matters
Twenty-ninth Session
Geneva, 15-18 October 2024
Item 3(i) of the provisional agenda
Taxation issues related to the digitalized and globalized economy

Co-Coordinators' Report

Summary

The Subcommittee ***seeks the Committee's comments and guidance on the issues raised in this note, especially as to the following****:*

a. Annexes A and B – Proposed Article xx on Services: A new Article combining certain Articles on taxation of services into a single provision (provisionally referred to as Article xx) on cross-border services, with Commentary, was introduced for consideration at the Twenty-eighth Session (see (E/C.18/2024/CRP.8). ***A revised version of the Article, combining Articles 12A and 14, is included at Annex A (p. 7), with a view to final approval at this Session.***

A revised draft Commentary to the new article is at Annex B (pp. 8-43) for further consideration and general approval if the Committee so decides. A general approval of the draft Commentary should leave open for Committee members to carry on the work of seeking to perfect the draft Commentary in order to fully reflect all members' views without changing the fundamental principles contained in Annex B. At the Thirtieth Session the text will be completed if any such new text is presented by the Subcommittee and the Committee so agrees.

b. Annex C – Optional Article 15(4): Annex C provides the text of additional Commentary to Article 15 (Dependent Personal Services) addressing a possible alternative provision, a new paragraph 4, dealing with the taxation of income from employment derived by an employee resident in one contracting state and paid by an employer resident in the other contracting state. A proposal for such a paragraph of Article 15 was previously discussed at the Twenty-seventh Session, however the Committee decided that the proposal was not going to be introduced in the Model Tax Convention but rather as an option in the Commentary. ***Annex C (pp. 44-48) presents the draft commentary, with options for a paragraph 4 of Article 15, as agreed at the Twenty-seventh Session, for approval at this Session.***

c. Multilateralized Instrument: The draft of a multilateralized instrument (Fast Track Instrument) implementing specific provisions of the UN Model Tax Convention relevant to Workstream A, including schedules addressing particular provisions of the UN Model Tax Convention ***was finalized at the Twenty-Eighth Session.*** The next step is transmission to ECOSOC and it is ***proposed that the finalized text (Annex A to document E/C.18/2024/CRP.8 from that Session) – being a document which Member States that are interested in facilitating the implementation, in existing bilateral treaties, of specific provisions of the UN Model Tax Convention, could take forward in the form of a multilateral instrument – will be issued as an official document, translated into the six official UN languages. It is proposed that the Committee will, at this Session, ask ECOSOC to note the document and invite further action by interested Member States.*** *While, as indicated in the Report of the Twenty-Eighth Session, the Fast Track Instrument was supported by the Committee as a whole, not all Members supported the instrument.*

Note that the Annexes attached to this report should not be taken as necessarily representing concluded views of all Subcommittee participants.

Background and Subcommittee Mandate

1. At the Twenty-third Session of the Committee in October 2021, the secretariat provided a paper on taxation in a digitalized and globalized economy (E/C.18/2021/CRP.28). That paper provided an outline of the work of the previous Subcommittee on Tax Challenges Related to the Digitalization of the Economy, including with regard to Article 12B on automated digital services and its Commentary, which now form part of the 2021 United Nations Model Tax Convention.

2. As noted in the Report of the Twenty-third Session, the Committee established a Subcommittee on Taxation Issues Related to the Digitalized and Globalized Economy, with Mathew Gbonjubola and Liselott Kana as Co-Coordinators. The Subcommittee is mandated:

- To identify priority taxation issues related to the digitalized and globalized economy where the Committee may most usefully assist developing countries in differing situations, in particular;
- To initially report to the Committee on such issues no later than its Twenty-fourth Session, in 2022, with recommendations for consideration and a proposed general programme of work.

The Subcommittee may consult broadly, taking into account relevant work by other bodies.

Nineteen Committee Members are currently participating in the Subcommittee.

Subcommittee Workstreams

3. At the Twenty-sixth Session of the Committee, in March 2023, the workstreams undertaken by the Subcommittee were expressed as:

(a) Workstream A, which explores a more multilateralized implementation of specific Model Convention provisions, where States seek to implement them across a number of treaties;

(b) Workstream B, which addresses the function and relevance of physical presence tests; and

(c) Workstream C, approved at that Session, which addresses cross-border taxation issues involving remote workers.

4. At the Twenty-sixth and Twenty-seventh Sessions, the Committee decided that the Subcommittee would continue to consider the issues raised by all three workstreams. The discussion at the Committee's Twenty-seventh Session included consideration of the proposed fast track instrument, a combined cross-border business services article and a new Article 15(4) allowing the country in which the employer is resident to impose tax on the non-resident employee's income from employment exercised outside the employer's country, subject to an obligation to eliminate double taxation. At that Session it was agreed that any Article 15(4) would only be an option, provided in the Commentary.

5. At the Twenty-eighth Session, as noted in the report of that Session, the discussion was as follows:

> 48. The Co-Coordinator of the Subcommittee on Taxation Issues related to the Digitalized and Globalized Economy, Ms. Kana, presented the Co-Coordinators' report outlining the Subcommittee's progress in its three workstreams (E/C.18/2024/CRP.8).
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> 49. She highlighted that, for workstream A, annex A was being submitted for a second reading and finalization at the earliest possible stage and invited Phillip Baker to present the fast-track instrument highlighting the work done on the annex following the first reading. Mr. Baker indicated that the Subcommittee had worked on the following issues as requested at the previous session:
>
> (a) Simplification of the fast-track instrument;
>
> (b) Drafting changes;
>
> (c) Clarification on streamlining the amendment procedure.
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> 50. Where simplification of the fast-track instrument was concerned, as called for by some members, a number of steps had been taken. First, the number of separate documents had been reduced from three to two, namely, the instrument itself (plus its schedules) and the amending protocols set out in the schedules. Second, the output was

in the form of a single document: an amending protocol, rather than comprising, as before, protocols plus amending agreements. Third, there were only two procedures: the standard matching of positions set out in lists of covered tax agreements and enhanced matching, for those countries that wanted automatic amendments. In addition, an enhanced role was provided for the secretariat.

51. The Subcommittee made a number of drafting changes, including an option outlining conditions for agreeing on amendments and clarifying that the role of the secretariat would be at the discretion of Member States. The changes also clarified that the wording of the Model Convention could only be amended by the Committee of Experts on International Cooperation in Tax Matters and also provided that countries would have up to two years to prepare lists of covered tax agreements. For the streamlining of the amendment procedure, members were informed that the fast track instrument established both a process and a setting. The process was aimed at producing standardized documentation to simplify and narrow down the amendment process and also provided for future changes to the Model Convention, while the setting would be an intergovernmental conference of the parties, with the secretariat assisting the process.

52. Members congratulated the Subcommittee on the work accomplished and thanked Mr. Baker for his assistance in making the fast-track instrument an improved document that met the Committee's objective of facilitating the multilateral implementation of specific provisions of the Model Convention. A majority of members acknowledged that the instrument was now simpler and noted that it facilitated the incorporation of new changes, although some members expressed skepticism as to whether there was a need for the instrument at all and wondered how widely it would be used. It was noted, however, that the instrument would be open for uptake by countries that found it useful and there was no need at the current stage to evaluate how many might wish to avail themselves of it.

53. Some concerns were raised regarding the enhanced role proposed for the secretariat of the fast-track instrument. It was clarified that the enhanced role of the secretariat would only be applicable to countries that requested it, to enable them to take the process forward. In addition, members were informed that the provision of assistance to Member States would be the responsibility of the secretariat, while the Depositary would handle the receipt of documents such as notices and country lists of covered tax agreements.

54. Observers generally supported that work, noting that the fast-track instrument had the potential to greatly facilitate treaty negotiations, especially for developing countries. They also acknowledged the efforts to improve legal certainty and simplicity in the current version of the draft.

55. Upon concluding their work on that issue and recognizing that a minority of them remained opposed to the fast-track instrument, members were informed that the next step was the distinct stage of submitting the finalized text to the Economic and Social Council, a procedure which usually took the form of a draft resolution, enabling interested States to call for the negotiation of the instrument at an intergovernmental level. It was agreed that a transmitting document in a form appropriate to the Council would be circulated to members for comment under the written procedure before the instrument was finally submitted to the Council.

56. On workstream B, Ms. Kana presented for a second reading the Subcommittee's proposal for the text of the proposed article xx and, for a first reading, a proposed article xx commentary. She highlighted the following as the issues under consideration:

(a) The relationship with articles 5 (3) (a), 5 (3) (b), 12A, 12B and 14;

(b) Whether article xx would be an option in the commentary or added as a new article in the Model Convention;

(c) If article xx was included in the commentary, whether article 12A should be extended to services more generally.

57. Although there was broad support for the proposed new article xx, several members

raised concerns about it, remarking that it had very wide scope, which might lead to excessive taxation. To mitigate that eventuality, it was proposed that taxation in the article should be on a net basis. Some members pointed out, however, that a net option would be challenging for many developing countries to apply. Queries were raised as to why the proposed article xx excluded article 12B. Concerns were also expressed that dispensing with articles 5 (3) (b) and 14 might lead to a reduction of taxing rights, when that process was supposed to streamline the taxation of services and not to create new taxing rights or reduce existing taxing rights. One member expressed the view that the taxation of services at source would be unprincipled if the sale of goods was not taxed in a similar manner, since the compensation for the acquisition of a good was in essence a compensation for the service of preparing that good. Another member responded that cross-border sales of goods were in fact subject to excise taxes, so that source state taxation of services was consistent with the principles.

58. Finally, it was observed that there might be need for further study as to whether the proposal would have any real impact and what effect it would have on meeting the Sustainable Development Goals.

59. Observers welcomed the work on this issue, noting its importance as physical presence tests became increasingly less relevant in the current business environment. The proposed article would provide a way to restore lost taxing rights. It was also observed, however, that the proposal covered different incomes and it might be instructive to bear that in mind while endeavouring to streamline the taxation of services. In addition, attention was drawn to the risk of overtaxation, as the article's scope was very broad.

60. During the course of the meeting, Ms. Kana presented a redrafted version of article xx, noting that she and certain other members supporting the provision had sought to take into account some of the issues raised. It was agreed that the redrafted article would be discussed further by the Subcommittee and presented and decided on at the twenty-ninth session. Brian Arnold was thanked for assisting the Subcommittee in its work on article xx.

61. As noted in its report, the Subcommittee would also report on workstream C (remote workers) at the twenty-ninth session.

6. Following the Twenty-eighth Session, the Subcommittee met virtually on 28 and 30 August, as well as on 11, 16 and 23 September 2024, and held a back to back meeting with the Subcommittee on the UN Model kindly hosted by the IBFD in Amsterdam on 8-12 July 2024. The meetings were used to further develop the Subcommittee's proposals on the various workstreams, and to discuss with the consultants the further development of the texts annexed to this report.

7. This paper reflects the outcomes of, and direction taken, in the Subcommittee meetings. It should not necessarily be taken as reflecting unanimous views. The Annexes are intended to assist Committee discussion on the various workstreams and seek to incorporate comments by Subcommittee participants; they should not be taken as necessarily representing concluded views of all Subcommittee participants.

Proposed Actions

Workstream A (Fast-track Instrument – "FTI")

8. The draft of a multilateralized instrument (Fast Track Instrument) implementing specific provisions of the UN Model Tax Convention relevant to Workstream A, including schedules addressing particular provisions of the UN Model Tax Convention ***was finalized at the Twenty-Eighth Session.*** The next step is transmission to ECOSOC and it is ***proposed that the finalized text (Annex A to document E/C.18/2024/CRP.8 from that Session) – being a document which Member States that are interested in facilitating the implementation, in existing bilateral treaties, of specific provisions of the UN Model Tax Convention, could take forward in the form of a multilateral instrument – will be issued as an official document, translated into the six official UN languages. It is proposed that the Committee will, at this Session, ask ECOSOC to note the document and invite further action by interested Member States.***

9. While, as indicated in the Report of the Twenty-Eighth Session, the Fast Track Instrument was supported by the Committee as a whole, not all Members supported the instrument.

Workstream B (Options relating to the function and relevance of physical presence tests)

10. In relation to Workstream B, the Subcommittee has previously identified a lack of consistency of physical presence tests in the UN Model and noted some possible options for change in the short term and the longer term while prioritizing each option. A new Article combining certain Articles on taxation of services into a single provision (provisionally referred to as Article xx) on cross-border services, with Commentary, was introduced for consideration at the Twenty-eighth Session (see (E/C.18/2024/CRP.8). ***A revised version of the Article, combining Articles 12A and 14, is included at Annex A (p. 7 below) with a view to approval at this Session.***

11. ***A revised draft Commentary to the new article is at Annex B (pp. 8-43 below) for further consideration and general approval if the Committee so decides.*** A general approval of the draft Commentary should leave open for Committee members to carry on the work of seeking to perfect the draft Commentary in order to fully reflect all members' views without changing the fundamental principles contained in Annex B.

12. In particular, note that some parts of this draft, such as the minority view expressed in paragraphs 18-27, some drafting corresponding to some members concerns regarding the scope of article XX and Article 8 (the draft is included as an optional paragraph 62.1 of the draft commentary), and an alternative source rule that provisionally has been inserted as an optional paragraph 113.1, have not been fully discussed at the Subcommittee level. At the Thirtieth Session the text will be completed if any such new text is presented by the Subcommittee and the Committee so agrees.

13. Work in this area will continue to involve consultation with the Subcommittee on the Update of the United Nations Model Tax Convention.

Workstream B (physical presence) / Workstream C (remote workers)

14. ***Annex C (pp. 44-48) provides the text of additional Commentary to Article 15*** (Dependent Personal Services) addressing a possible alternative provision, a new paragraph 4, dealing with the taxation of income from employment derived by an employee resident in one contracting state and paid by an employer resident in the other contracting state.

15. A proposal for such a paragraph in Article 15 was previously discussed at the Twenty-seventh Session, however the Committee decided that the proposal was not going to be introduced in the Model Tax Convention but rather as an option in the Commentary. Therefore a reduced text has been drafted by a small group of interested members now presented in Annex C, with options for a paragraph 4 of Article 15, as agreed at the Twenty-seventh Session, for approval at this Session. ***Annex C presents the draft commentary, with options for a paragraph 4 of Article 15, as agreed at the Twenty-seventh Session, for approval at this Session.***

16. Work in this area will also continue to involve consultation with the Subcommittee on the Update of the United Nations Model Tax Convention.

Relationship to the Sustainable Development Goals

17. As noted in the Report of the Committee's Twenty-third Session, held in October 2021, the Committee agreed:

(a) To continue to discuss taxation and the Sustainable Development Goals regularly during sessions, as a permanent agenda item;

(b) To request the secretariat to provide regular updates on taxation and the Sustainable Development Goals, at each session:

(i) To preserve the focus of the Committee's work in the area;

(ii) To identify any gaps in guidance;

(iii) To establish priorities for technical work to be carried out by the secretariat; and

(c) To have subcommittees reflect on the link between their work and the Goals.

18. In addressing paragraph (c) of that conclusion, the Subcommittee recognizes that, by promoting fair and effective tax systems, which support both revenue and trade and investment for development, through guidance products and through advising UN DESA on capacity building activities, the Committee's work contributes to achieving the interlinked SDGs as a totality. More specifically, in relation to the work of the Subcommittee, an effective guidance effort in this area will promote the balance of revenue needs and the development-focused investment climate which many countries seek, by promoting whole-of-government, informed and practical real-world approaches to the issues involved. This builds greater certainty for all stakeholders in tax systems.

19. While contributing to achieving all the interlinked SDGs, this work will particularly contribute to SDG 16 (Peace, Justice and Strong Institutions) in terms of helping develop effective, accountable and transparent institutions at all levels and SDG 17 (Global Partnerships for the Goals), in terms of strengthening domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.

ANNEX A

DRAFT ARTICLE XX ON DEALING WITH CROSS-BORDER SERVICES (REVISED DRAFT OF SEPTEMBER 2024)

Article xx

FEES FOR SERVICES

1. Fees for services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, subject to the provisions of Articles 8, 12B, 15, 16, 17, 18 and 19, fees for services arising in a Contracting State may also be taxed in that Contracting State and according to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent [the percentage is to be established through bilateral negotiations] of the gross amount of the fees.

3. The term "fees for services" as used in this Article means any payment in consideration for any service.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of fees for services, being a resident of a Contracting State, carries on business in the other Contracting State in which the fees for services arise through a permanent establishment situated in that other State, and the fees for services are effectively connected with:

(a) *such permanent establishment, or*

(b) *business activities referred to in (c) of paragraph 1 of Article 7 .*

In such cases the provisions of Article 7 shall apply.

5. For the purposes of this Article, subject to paragraph 6, fees for services shall be deemed to arise in a Contracting State if the payer is a resident of that State or if the person paying the fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the fees was incurred, and such fees are borne by the permanent establishment.

6. For the purposes of this Article, fees for services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State through a permanent establishment situated in that other State and such fees are borne by that permanent establishment.

7. Where, by reason of a special relationship between the payer and the beneficial owner of the fees for services or between both of them and some other person, the amount of the fees, having regard to the services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the fees shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

ANNEX B

DRAFT COMMENTARY FOR ARTICLE XX ON DEALING WITH CROSS-BORDER SERVICES

(DRAFT OF SEPTEMBER 2024)

Article xx

FEES FOR SERVICES

A. General considerations

1. Article xx was added to the Model Tax Convention in 2025 to allow a Contracting State to tax fees for services paid to a resident of the other Contracting State on a gross basis up to a rate to be negotiated by the Contracting States. Under this Article, a Contracting State is entitled to tax fees for services where the fees are paid by a resident of that State or by a non-resident with a permanent establishment in that State if the fees are borne by the permanent establishment; it is not necessary for the services to be provided in that State. Fees for services are defined broadly to mean "*any payment in consideration for any service.*" Article xx does not apply where a resident of one Contracting State provides services through a permanent establishment in the other State.

2. Article xx is intended to remove some of the limitations on a country's right to tax income from cross-border services under the provisions of the Model Tax Convention as it read before the 2025 update. Article xx allows a country to tax payments for cross-border services irrespective of where the services are performed and without any minimum threshold requirement such as a permanent establishment or fixed base in the country or the physical presence of the service provider in the country for a minimum number of days. The previous requirements for a country to tax income from services performed by residents of the other Contracting State placed arguably inappropriate limits on a country's right to tax the income from those services.

3. Article xx is also intended to make the taxation of fees for cross-border services by source countries more consistent. Under former Article 14, a resident of one Contracting State providing professional or other independent services in the other State was subject to tax by the other State

only if the service provider had a fixed base in the other State that was regularly available to the service provider or was present in the other state for 183 days or more in any 12-month period. Under former Article 12A, fees for consulting, management and technical services provided by a resident of one State to a resident of the other Contracting State (or to a non-resident with a permanent establishment in the other Contracting State that bears those fees) were taxable by the other State; however, the scope of the meaning of "fees for technical services" was far from clear. In contrast, under Article xx, a resident of one Contracting State is subject to tax on payments for services received from payers resident in the other State (and non-residents with a permanent establishment in that State) irrespective of the nature of those services (whether independent personal services or technical services) or the place where services are performed, unless those services are provided through a permanent establishment in the other Contracting State.

4. The digitalisation of the economy has enabled residents of one state to provide substantial business services in other states without establishing any taxable presence in those states. Physical presence has increasingly been questioned as an appropriate basis for the allocation of taxing rights pursuant to bilateral tax treaties. An alternative basis for the taxation of income from services is to allocate taxing rights to the country in which the services are used or consumed rather than the country in which the services are performed. The country in which services are used or consumed is generally the country where the person paying for the services is resident or has a permanent establishment, and where that person is carrying on business, the fees paid for services to non-resident service providers are usually deductible in computing that payer's income for purposes of that country's tax. The reduction of a country's tax base by the deduction of fees for services paid to non-residents can be seen as sufficient justification for that country to impose tax on the fees derived by those non-residents. For example, Article 16 allows the taxation of directors' fees and the remuneration of top-level managerial officials by a country in which the company paying such fees and remuneration is resident. Similarly, Article 12 allows the taxation of rent paid by a resident of one Contracting State to a resident of the other State for the use of commercial, industrial or scientific equipment.

5. Before the addition of Article xx, income from cross-border services derived by an enterprise of a Contracting State was taxable in accordance with a wide range of provisions of the Model Tax Convention, including Article 8 (International shipping and air transport), Article 12A (Fees for technical services), Article 12B (Income from automated digital services), Article 14 (Independent personal services), and Article 17 (Artistes and sportspersons). Where fees for services were not

covered by one of the specific provisions dealing with services, fees for services were taxable exclusively by the State in which the enterprise was resident in accordance with Article 7 (Business profits) or Article 14 (Independent personal services) unless the enterprise carried on business through a permanent establishment or fixed base in the other State (the source State) and the fees for services were attributable to the permanent establishment or fixed base. Under special rules in paragraph 3 of Article 5, a resident of a Contracting State is considered to have a permanent establishment in the other State where (a) the resident provides construction and related services in the other State for more than 6 months, or (b) the resident performs services in the other State for more than 183 days in any 12-month period. A supplementary rule in Article 14 also allowed a Contracting State to tax income from independent personal services derived by a resident of the other State where that resident was present in the first State for 183 days or more in any 12-month period.

6. With the rapid changes in modern economies, particularly with respect to cross-border services and the digitalisation of the economy, it became possible for an enterprise resident in one State to be substantially involved in another State's economy without a permanent establishment or fixed base in that State and without any physical presence in that State. In particular, the advancements in means of communication and information technology enable an enterprise of one Contracting State to provide services to customers in the other Contracting State, deriving substantial profits in that State, without having any fixed place of business in that State and without being present in that State for any substantial period.

7. In response to the increasing ability of multinational enterprises to provide a wide range of cross-border services remotely, the Model Tax Convention was amended in 2017 to insert Article 12A (Fees for technical services), allowing a State to impose tax up to an agreed rate on the gross amount of fees for consultancy, management and technical services. The Convention was amended again in 2021 to insert Article 12B (Income from automated digital services), allowing a State to impose tax up to an agreed rate on income derived from automated digital services. These changes, as well as other changes made in the 2025 update of the Convention, mark a shift away from reliance on physical presence as a condition for source country taxation of income from cross-border services.

8. The uncertainty concerning the treatment of fees for cross-border services under the provisions of the Model Tax Convention as it read before 2025 was undesirable for both taxpayers and tax

authorities, potentially resulting in difficult disputes, consuming scarce resources, as well as causing double non-taxation or unrelieved double taxation.

9. In many circumstances, fees for cross-border services were deductible against a country's tax base, where the payer was a resident of the country or a non-resident with a permanent establishment or fixed base in the country, and resulted in the reduction of the country's tax base. Nevertheless, the provisions of the Model Tax Convention, as it read before the 2025 update, often prevented countries from taxing such deductible fees for services. The reduction of a country's tax base by deductible fees for services is not, in principle, objectionable. If the payer is an enterprise, the payments represent legitimate expenses incurred by the payer for the purpose of earning income and should be deductible (assuming, of course, that the amount of the payments is reasonable and subject to anti-abuse provisions to deal with double non-taxation). If the country is entitled to tax the non-resident service provider with respect to the fees earned from providing the services, the reduction of the country's tax base by the deductible payments would be offset by the country's tax on those fees.

10. As a result of these considerations, the Committee identified fees for cross-border services as a matter of priority to be dealt with as part of its project on the taxation of income from services under the Model Tax Convention. After considerable debate, having due regard to all the arguments for and against the allocation of taxing rights with regard to fees for services, in 2025 the Committee decided to add Article xx to the Convention and to delete Article 12A and Article 14 in order to further reduce the reliance on physical presence as a condition for source country taxation of income from cross-border services.

11. In effect, Article xx replaces Article 12A and Article 14, with the result that fees for services previously taxable under those provisions are usually taxable in accordance with the provisions of Article xx by the Contracting State in which the fees arise up to the rate agreed through the negotiations of the Contracting States applied to the gross amount of the fees. If, however, a resident of one Contracting State who provides services to customers in the other State has a permanent establishment in that other State in which the fees for services arise and the fees are effectively connected with that permanent establishment, the fees are taxable in accordance with Article 7 of the Convention. Under paragraph 5 of Article xx, fees for services arise in a Contracting State where the payer of the fees for services is a resident of that State or where a non-resident payer has a

permanent establishment in that State that bears the fees. The term “fees for services” is broadly defined in paragraph 3 to mean any payments in consideration for services,

12. The adoption of Article xx is consistent with a shift away from threshold and physical presence requirements for source country taxation of income from cross-border services. Previously, a source country was entitled to tax income from cross-border services only where the service provider had a permanent establishment or a fixed base in the source country through which the services were provided (or where the service provider stayed in the source country for 183 days or more in a 12-month period). The Committee has decided that these threshold and physical presence requirements are inappropriate conditions for source country taxation of income from cross-border services in light of new business models for delivering services. As a result, these threshold requirements are not included in Article xx under which most fees for cross-border services are taxable by a country if the fees are paid by a resident of that country or by a non-resident with a permanent establishment in that country that bears those fees.

13. The elimination of threshold requirements based on physical presence for source country taxation of certain cross-border services is the fundamental goal of Article xx. That goal is supplemented by two additional objectives: to rationalize the provisions of the Convention dealing with business services and to expand source country taxing rights with respect to income from such services.

14. Replacing Article 12A and Article 14 by Article xx simplifies the Convention significantly. It is no longer necessary for taxpayers and tax officials to distinguish between fees for technical services taxable in accordance with former Article 12A and other services, or between professional and other independent services taxable in accordance with former Article 14 and other services. The difficulties caused by the concept of a fixed base are eliminated completely. However, it remains necessary to distinguish between services covered by Article xx and services covered by either subparagraph (*a*) or (*b*) of paragraph 3 of Article 5 and in this regard to count the days during which a non-resident service provider furnishes construction or other services in a country. Some source countries may not be able to impose tax in accordance with Article xx unless they amend their domestic law to impose an obligation on resident payers (and non-resident payers with a permanent establishment in the country) paying for services provided by non-residents to withhold tax from the payments. The obligation to withhold from payments to non-resident service providers may be simplified for some payers because they no longer must determine whether their payments are for

technical services, professional or other independent services, or other services. Payments for many services may be subject to tax at the same rate.

15. Article xx allows fees for services to be taxed by a Contracting State on a gross basis at a limited rate, which provides a simple, reliable and efficient method to enforce tax imposed on income from services derived by non-residents.

16. Article xx may result in residents of some Contracting States providing services to residents of other Contracting States requiring the grossing-up of the cost of those services. Countries should be aware of this possibility, in the same way that they should be aware of the possibility of similar grossing-up with respect to interest and royalties under Articles 11 and 12 of the Model Tax Convention, respectively. The possibility that fees for services may be grossed up is a factor to be taken into account in this regard, along with many other factors. It is also a factor to be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for services under paragraph 2 of Article xx.

17. The taxation of fees for services on a gross basis under Article xx may result in excessive or double taxation. However, the possibility of double taxation is reduced or eliminated under Article 23 (Methods for the elimination of double taxation). In addition, the possibility of excessive taxation can be taken into account in establishing the maximum rate of tax imposed by a Contracting State on fees for services under paragraph 2 of Article xx and, depending on the negotiated rate, the risk of excessive taxation may be completely eliminated.

18. Despite the inclusion of Article xx in the Model Tax Convention, a minority of the members of the Committee did not agree with the policy justifications set forth above for the Article. Fundamentally, these members did not agree that changes in modern economies, particularly with respect to cross-border services which has enabled some non-resident service providers to be substantially involved in another State’s economy without any physical presence in that State, justify the introduction of this Article. Rather, these members were of the view that in cases of payments for services that are not provided in the payer’s State, there is not a sufficient nexus to that State that warrants taxation by that State on the payments.

19. In the view of these members of the Committee, as a policy matter, taxation of fees for services by a State is justified only when a service provider has a sufficient nexus to the payer’s State, which typically is in the form of a permanent establishment or fixed base in that State and the services are

physically performed in that State. In other words, they believe that, to justify taxation of services by a State, the services must be physically provided in that State with the degree of nexus required by Article 7 (Business profits) and Article 14 (Independent personal services).

20. However, as a compromise, some countries might be willing to agree to include Article xx in their bilateral treaties if Article xx were limited to fees for services performed in a Contracting State. Accordingly, Article xx would apply to fees for services paid by a resident of one Contracting State to a resident of the other Contracting State under paragraph 2 of Article xx without any threshold requirement, such as a permanent establishment or fixed base in the first State, but the Article would apply only to fees for services performed in a Contracting State.

21. In addition, they are of the opinion that the reduction of the tax base of a Contracting State by the deduction of commercially justified payments for services is not a justification for that State to impose tax on those payments. Moreover, they disagree with the assumption that non-resident service providers may have, in certain circumstances, had a tax advantage over domestic service providers because the payments for services may have been subject to low or no tax in the residence State. Further, in most cases, service providers are subject to domestic tax in their State of residence at ordinary rates on the income they earn. This risk of low or no tax should be taken into account when deciding to conclude a treaty.

22. These members also disagree with the argument that the introduction of Article xx can be justified because the uncertainty concerning the treatment of fees for cross-border services under prior versions of the Model may have resulted in difficult disputes, consuming scarce resources, as well as causing double non-taxation or unrelieved double taxation (and note that no practical examples of such difficulties were provided).

23. These members of the Committee were also concerned that the taxation of fees for services on a gross basis under Article xx can lead to excessive or double taxation. Article xx shifts from net to gross taxation. These members considered that the imposition of tax on a gross basis denies the taxpayer the ability to take into account expenses that were incurred in connection with the provision of the services, which would have been deductible if tax was imposed on a net basis. Thus, it is possible that the residence State's remedies with a view to relieving double taxation may not be adequate to fully relieve the gross-basis taxation imposed by the other State. Taxation on a gross basis is especially problematic because different types of service providers will have different levels

of expenses and the Article does not distinguish between high and low margin/loss-making businesses; gross-based taxation could exceed the profit margin and make the provision of the service unprofitable. For example, it could have unintended impacts on countries that export services such as low-value added services. In practice, it will be very difficult to set the maximum rate of the taxation under this Article that will achieve a fair level of taxation for a wide variety of service providers across all industry sectors. Further, the imposition of a gross-basis withholding tax (applied solely on payments before expense deductions) could hamper cross-border-trade in services, increase compliance costs and impede the growth of start-up businesses, important in an increasingly digitalized economy, and which often have losses in the early years.

24. As a matter of broader economic policy, these members were also concerned that, as a result of a gross-based tax on fees for services, consumers of services in the source State may encounter higher prices for services, including all financial services, because foreign service providers could pass added tax costs on to the consumer through means such as "gross-up" clauses in contracts. Typically, a gross-up clause will specify a net amount that the provider will receive, effectively passing the burden of any withholding tax on the consumer of the services. The use of gross-up clauses could result in the tax being shifted to the consumer, making it more expensive to purchase the services. This can put a foreign service provider at a competitive disadvantage, effectively foreclosing access to a market that imposes such a withholding tax and restricting the consumer's legitimate choice of suppliers.

25. Countries sharing the concerns about the negative economic impact of taxation on a gross basis may wish to consider including an option for taxation on a net basis or an option similar to what is provided for in paragraph 3 of Article 12B.

26. These members were also concerned that certain design choices (such as retaining Article 5 (3)(b), applying Article xx to small payments~~,~~ and payments by individuals acquiring services for personal use, even if the service is provided, paid for and consumed outside the individual's state of residence) are inconsistent with the stated arguments for the policy objective and may significantly increase the administrative burden of the Article's application by some developing countries that have limited administrative capacity, without a clear indication that such choices will increase potential revenues to outweigh the cost of such choices. For example, the interaction of Article xx with Article 5(3)(b) will create administrative challenges both for the taxpayer and the tax administration resulting in tax withheld on a gross basis in accordance with Article xx having to be

refunded and offset against the net taxation under an Article 5(3)(b) permanent establishment. Further, introducing withholding obligations on individuals acquiring services for personal use will impose a significant administrative burden on individuals and be very difficult to control by the tax administration. Countries sharing these concerns may wish to consider not including Article 5(3)(b), including a threshold and excluding payments by individuals acquiring services for personal use from the application of Article xx provided for individuals acquiring services for personal use, similar to the exclusion that prior to 2025 was provided for in paragraph 3(c) of former Article 12A (Fees for technical services). Such simplifications and other alternatives for simplification proposed by these members are set out in paragraphs 20, 25 and 26 of this Commentary.

27. In summary, these members did not accept the arguments in paragraphs 12 to 17 above, and regarded any expanded taxing jurisdiction on payments for services as an unjustified shift in the balance of taxation from the place where the services are provided to the residence of the payer. Countries sharing these concerns may wish not to include Article xx in their bilateral tax treaties.

B. Commentary on the paragraphs of Article xx

Paragraph 1

28. This paragraph establishes that fees for services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in the other Contracting State. It does not, however, provide that such fees are taxable exclusively by the State of residence.

29. In most cases, the person who provides services will receive fees for those services. If the person who receives fees for services is not the person who provides those services, it is a matter of domestic law as to who is the proper taxpayer with respect to those fees. If fees for services are paid to a person, other than the person who provides the services, Article xx applies to the fees as long as the recipient is a resident of the other Contracting State.

30. The expression “fees for services” is defined in paragraph 3 to mean any “payment” for any services. The term “payment” has a broad meaning consistent with the meaning of the related term “paid” in Articles 10 and 11. As indicated in paragraph 3 of the Commentary on Article 10 (quoting paragraph 7 of the Commentary on Article 10 of the 2017 OECD Model Tax Convention) and paragraph 6 of the Commentary on Article 11 (quoting paragraph 5 of the Commentary on Article 11 of the 2017 OECD Model Tax Convention), the concept of payment means the fulfilment of the

obligation to put funds at the disposal of the service provider in the manner required by contract or custom.

31. Article xx deals only with fees for services arising in a Contracting State and paid to a resident of the other Contracting State. It does not, therefore, apply to fees for services arising in a third State. Paragraph 5 and paragraph 6 of Article xx specify when fees for services are deemed to arise in a Contracting State and are deemed not to arise in a Contracting State, respectively. Under paragraph 5, fees for services are considered to arise in a Contracting State if they are paid by a resident of that State or if they are borne by a permanent establishment in that State of a person resident in another State. However, under paragraph 6, fees for services paid by a resident of a Contracting State are deemed not to arise in that State if they are borne by a permanent establishment that the resident has in the other Contracting State.

Paragraph 2

32. This paragraph lays down the principle that the Contracting State in which fees for services arise may tax those payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the fees is a resident of the other Contracting State, the amount of tax imposed by the State in which the fees for services arise may not exceed a maximum percentage, to be established through bilateral negotiations, of the gross amount of the fees.

33. When considered in conjunction with Article 23 (Methods for the elimination of double taxation), paragraph 2 establishes the primary right of the country in which fees for services arise to tax those payments in accordance with its domestic law (subject to the limitation on the maximum rate of tax if the beneficial owner of the fees is a resident of the other Contracting State). Accordingly, the country in which the recipient of the fees is resident is obligated to prevent double taxation of those fees. Under Article 23 A or Article 23 B, the residence country is required to provide relief from double taxation through the exemption from tax of the fees for services or through the granting of a credit against tax payable to the residence country on the fees for services for any tax imposed on those fees by the other Contracting State in accordance with Article xx. In this regard, where a country applies the exemption method under Article 23 A, it is entitled to apply the credit method under paragraph 2 of Article 23 A with respect to items of income taxable under Article 10, 11, 12, xx or 12B.

34. The decision not to recommend a maximum rate of tax on fees for services is consistent with Articles 10, 11, 12 and 12B of the Convention dealing with dividends, interest, royalties, and income from automated digital services, respectively. This decision can be justified under current treaty practice. The tax rates on fees for services adopted in bilateral tax treaties between developed and developing countries may vary widely. Thus, the maximum rate of tax on fees for services is to be established through the bilateral negotiations of the Contracting States. As a result, for example, countries may consider adopting a lower maximum rate of tax on low-value services that generate relatively low profit margins.

35. In determining the maximum rate of tax on fees for cross-border services, countries should take into account several factors, including the following:

- The possibility that a high rate of tax imposed by a Contracting State might cause residents of the other State providing services to pass on the cost of the tax to customers in the first State, which would mean that the first State would increase its revenue at the expense of its own residents rather than the residents of the other State.
- The possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter some residents of that country from carrying on their business of providing services in the other country.
- The possibility that some persons providing services may incur high costs in providing services, so that a high rate of tax on the gross fees may result in an excessive effective tax rate on the net income derived from the services.

- The potential benefit of applying the same rate of tax both to royalties under Article 12, income from automated digital services under Article 12B, and fees for services under Article xx (see example 6 in paragraphs 79 to 81 below).
- The fact that a reduction of the rate of tax has revenue and foreign-exchange consequences for the country imposing withholding tax, and
- The relative flows of fees for cross-border services (e.g., from developing to developed countries).

36. Paragraph 2 of Article xx applies in priority to Article 7 as a result of paragraph 6 of Article 7. Thus, the conditions for the taxation of the business profits of an enterprise under Article 7 do not apply to fees for services covered by paragraph 2. Fees for services are taxable by a Contracting

State under paragraph 2 if the fees arise in that State irrespective of whether the enterprise providing the services has a permanent establishment in that State, provides services that are similar to those effected through the permanent establishment or provides the services in that State. However, by virtue of paragraph 4 of Article xx, if an enterprise of a Contracting State provides services that are effectively connected with a permanent establishment in the other Contracting State and receives fees for those services within the meaning of paragraph 3, Article 7 applies to those payments instead of paragraph 2 of Article xx.

37. Paragraph 2 is expressly subject to the provisions of Articles 8, 12B, 15, 16, 17, 18, and 19. As a result, where fees for services are within the scope of the provisions of one of those listed Articles, that Article applies to those services instead of Article xx. Where, however, fees for services are outside the scope of those Articles, the fees are potentially taxable under Article xx. For example, where an individual resident in one Contracting State receives directors' fees or remuneration as a top-level managerial official paid by a company resident in the other Contracting State, Article xx does not apply to the fees or remuneration because paragraph 2 is expressly subject to the provisions of Article 16. If, however, the payments are not taxable under Article 16 (because, for example, the payments are made with respect to services provided by the individual in a capacity other than that of a director or top-level managerial official of the company, such as an independent contractor), the other State is entitled to tax those payments in accordance with paragraph 2 of Article xx.

38. Some countries may prefer to expressly exclude certain fees for services from taxation under Article xx even where those services are outside the scope the provisions of Articles 8, 12B, 15, 16, 17, 18 or 19. Such an exclusion would prevent the Contracting State in which the payer of the fees is resident or has a permanent establishment that bears the fees from taxing those fees under Article xx. As a result, the fees would be taxable exclusively by the Contracting State in which the service provider is a resident. See paragraphs 61 to 62 below for some possible wording that could be added to paragraph 3 of Article xx to exclude certain fees for services.

39. The requirement of beneficial owner is included in paragraph 2 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It clarifies that a Contracting State is not obliged to give up taxing rights over fees for services merely because those fees were paid directly to a resident of another State with which the first State had concluded a convention.

40. Since the term "beneficial owner" is included in paragraph 2 to address potential difficulties arising from the use of the words "paid to a resident" in paragraph 1, it is intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country. The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[57]), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

41. For example, where the trustees of a discretionary trust do not distribute fees for technical services earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such fees for the purposes of Article xx even if they are not the beneficial owners under the relevant trust law.

42. Relief or exemption in respect of an item of income is granted by a State to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for a State to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income qualifies as a resident but no potential double taxation arises as a consequence of that status, since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

43. It would be equally inconsistent with the object and purpose of the Convention for a State to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the OECD's Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has as a practical matter very narrow powers which render it in relation to the income concerned a mere fiduciary or administrator acting on account of the interested parties.

44. In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the fees for services is not the "beneficial owner" because that recipient's right to use and enjoy the fees is constrained by a contractual or legal obligation to pass on the fees received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the fees by the direct recipient such as an obligation that is not dependent on the receipt of the fees and which the direct recipient has as a debtor or as a party to financial transactions. Where the recipient of fees for services does have the right to use and enjoy the fees unconstrained by a contractual or legal obligation to pass on the fees received to another person, the recipient is the "beneficial owner" of those fees.

45. The fact that the recipient of fees for services is considered to be the beneficial owner of those fees does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision. As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company structures and, more generally, treaty shopping situations. These include specific anti-abuse provisions in domestic law and treaties, general anti-abuse rules in domestic law and tax treaties, judicial doctrines, such as substance-over-form or economic substance approaches, and the interpretation of tax treaty provisions. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on fees for services to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

46. The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of paragraph 2(*a*) of Article 10 which refers to the situation

where a company is the beneficial owner of a dividend. In the context of Articles 10, 11, 12, xx and 12B, the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends, interest, royalties and fees for services rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement”.

47. The paragraph lays down nothing about the mode of taxation in the State in which fees for services arise. Therefore, it leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment. As with other provisions of the United Nations Model Tax Convention, procedural questions are not dealt with in the Article. Each State is able to apply the procedure provided in domestic law.

48. The following examples illustrate the application of paragraph 2 of Article xx.

49. Example 1: X is a resident of State R and a heart surgeon. X’s practice is carried on primarily in State R, although X occasionally travels to other countries to perform heart surgery. X performs surgery in State R on an individual resident in State S. The tax treaty between State R and State S contains a provision identical to Article xx. The payments made by the patient, a resident of State S, to X would be considered to be fees for services that arise in State S, and those payments are not excluded from the definition of “fees for services” in paragraph 3. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article xx.

50. The result in Example 1 would be the same if X travelled to State S and performed the surgery in State S unless the services provided by X were effectively connected with a permanent establishment in State S through which X carried on business, in which case Article 7 would apply by virtue of paragraph 4 of Article xx.

51. Example 2: X is a resident of State R and a heart surgeon. X’s practice is carried on primarily in State R, although X occasionally travels to other countries to perform heart surgery. X enters into a contract with a health services company resident of State S under which X agrees to perform heart surgery on patients referred to her by the health services corporation. X is not an employee of the health services company. The surgeries are performed both in State S and in State R. The tax treaty between State R and State S contains a provision identical to Article xx. Under paragraph 3 of Article

xx, the payments made by the health services company, a resident of State S, to X would be considered to be fees for services that arise in State S under paragraph 5, irrespective of whether the surgery is provided in State S, State R or a third State. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article xx. If, however, X were an employee of the health services company, the payments to X would be taxable by State S under Article xx only to the extent that the services are performed in State S because the application of paragraph 2 is expressly subject to Article 15.

52. Example 3: R Company is a resident of State R. R Company's business is the collection, organization and maintenance of various databases. R Company sells access to these databases to its clients. One of R Company's clients is Company S, a resident of State S. State R and State S have entered into a tax treaty that contains a provision identical to Article xx. The payments that R Company receives from S Company for access to its databases would be fees for services within the meaning of paragraph 3. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article xx (assuming that the services are not automated digital services within the meaning of Article 12B). Article xx would also apply to the fees payable by S Company to R Company for the creation of a specialized database customized for S Company. It would not matter whether R Company performed all or any part of the work involved in creating the database in State S.

Paragraph 3

53. This paragraph specifies the meaning of the phrase "fees for services" for purposes of Article xx. The definition of "fees for services" in paragraph 3 is intended to be exhaustive. "Fees for services" are limited to the payments described in paragraph 3 of Article xx that are not taxable under another Article of the Convention, namely, Article 8, 12B, 15, 16, 17, 18, or 19 because, under paragraph 2, Article xx is expressly subject to the application of those other Articles; (see the examples in paragraphs 76 to 85 below).

54. Paragraph 3 defines "fees for services" broadly as "any payment in consideration for any service." However, fees for services that are within the scope of Article 8, 12B, 15, 16, 17, 18, or 19 of the Model Tax Convention are not taxable under Article xx because paragraph 2 is subject to those Articles.

55. The definition of "fees for services" does not include a reference to the domestic law of a Contracting State. The lack of any reference to domestic law is justified because:

(*a*) the definition in paragraph 3 generally covers most payments that are regarded as payments for services under the domestic law of most countries;

(*b*) such a reference could introduce a large element of uncertainty;

(*c*) otherwise, future changes in a country's domestic law with respect to the taxation of fees for services could have an effect on the Convention; and

(*d*) in the Model Tax Convention, reference to domestic laws should be avoided as far as possible.

56. Although the term "services" in the phrase "fees for services" is undefined in the context of Article xx, the term "services" should be understood to have a broad meaning in accordance with ordinary usage to include activities carried on by one person for the benefit of another person in consideration for a fee. Such activities can be carried out in a wide variety of ways and the manner in which such services are provided does not alter their character for the purpose of Article xx, to the extent that such services fall within the definition of "fees for services" in paragraph 3.

57. Although paragraph 2 of Article 3 of the Convention provides that the meaning of an undefined term in the Convention should be determined from time to time under the domestic law of the Contracting State applying the Convention, that rule is expressly subject to the caveat "unless the context requires otherwise." A state may choose not to impose tax on certain fees for services under its domestic law because the definition of "services" under its domestic law is narrower than the definition in paragraph 3 of Article xx of the Convention without creating any conflict between its domestic law and the Convention. However, if the Contracting State in which the recipient of fees for services is resident applies a narrow domestic law meaning and, as a result, denies relief from double taxation for the tax imposed by the other State on the fees, the context of the treaty would require a broader meaning of services for purposes of the treaty. Thus, a domestic law meaning of services that is limited to certain types of services would be inconsistent with the purpose of Article xx, and the context of Article xx and the Convention as a whole would require a broader meaning. Conversely, it would be equally inappropriate for a Contracting State to adopt a domestic law

meaning of "services" which includes sources of income that are not within the ordinary meaning of services.

58. Although the term "services" is intended to have a broad meaning, it is not intended to include payments of rent or royalties for the use of immovable, tangible or intangible property or payments of interest for the use of money. Payments of rent or royalties for the use of property do not usually involve the furnishing of services by the owner of the property or, where the owner of the property does provide services, those services are usually ancillary to the use of the property. Where the owner of property provides extensive services to the lessee that go beyond ancillary services, it may be necessary to apportion the payments by the lessee between the consideration for the use of the property and the consideration for the services. See paragraph __ of the Commentary on Article 12 for more guidance on such mixed contracts.

59. Similarly, payments of interest do not involve the lender providing any services to the borrower; the lender simply provides the use of the funds to the borrower for a period of time. However, fees for other financial services, such as guarantee fees, may be fees for services subject to Article xx.

60. By reason of the broad definition of "fees for services" in paragraph 3, Article xx applies to all payments for services, including payments by individuals for services for the personal use of an individual. The inclusion of payments by individuals for services for the personal use of an individual within the scope of Article xx is consistent with Article 12B, which applies to payments by individuals for automated digital services. Many countries are unlikely to impose tax under their domestic law on payments by individuals for personal services provided outside their territory by non-residents. However, Article xx does not prevent countries from doing so.

61. Countries that wish to exclude payments by individuals for services used or consumed by an individual or other payments from Article xx could do so by adding the words "unless the payments are" or "except for" at the end of paragraph 3 and then listing the payments for services to be excluded in a general manner. For example, countries that prefer not to tax fees paid by an individual for services for the personal use of an individual could revise paragraph 3 to read as follows:

> *3. The term "fees for services" as used in this Article means any payment in consideration for any service, unless the payment is made by an individual for the personal use of an individual.*

It has not been considered necessary to define what services are for the personal use of an individual. Such services would include services related to a person's health, education, maintenance, and

entertainment. The exclusion is not limited to services provided to the individual who pays for them but includes payments for the benefit of other individuals, such as family members.

62. Similarly, for example, some countries that prefer not to tax fees for the operation of ships or aircraft in international traffic under Article xx even where such fees that are outside the scope of Article 8 might exclude such services from the definition of "fees for services" in paragraph 3 by adding the following wording at the end of paragraph 3: *"unless the payment [except for] is made for the* [wording from Article 8 to be added here]

[62.1. Optional paragraph] In the 2025 update of the Model Tax Convention, Article 8 (Alternative A) was revised to allow a Contracting State to tax income arising in a Contracting State from the operation of ships or aircraft in international traffic by a resident of the other Contracting State. Under paragraph X of Article 8 (Alternative A), such income is considered to arise in a Contracting State if it is received in consideration of the carriage of passengers, livestock, mail or goods which begins from or ends in that State. However, where the income is received in consideration of carriage of passengers, livestock, mail or goods between States other than the two Contracting States, such income would be outside of the scope of Article 8 (Alternative A), and Article xx would potentially apply. Some members are concerned with this outcome since it would create multiple source taxation on income from the operation of ships or aircraft in international traffic, which is inconsistent with the intention of Article 8 (Alternative A), as reflected in paragraph ? of the Commentary on Article 8 (Alternative A). Countries that share this concern could delete "Article 8" in paragraph 2, and revise paragraph 3 to exclude such services from the definition of "fees for services" in paragraph 3 by adding the following wording at the end of paragraph 3: "unless the payment is made in consideration of income from the operation of ships or aircraft in international traffic as defined in paragraph 3 of Article 8 (Alternative A).]

63. The definition of "fees for services" does not exclude payments for teaching in an educational institution or teaching by an educational institution, although the definition of "fees for technical services" in paragraph 3 of former Article 12A excluded such services. Thus, if an educational institution established in one Contracting State pays for teaching services provided by an individual, other than an employee, or by an enterprise resident in the other Contracting State, the payments made by the educational institution for those teaching services are taxable by the first State in accordance with paragraph 2. Similarly, if an educational institution established in one Contracting State receives payments from an enterprise resident in the other Contracting State for teaching

services provided by that institution to some of the enterprise's employees, the payments received by the educational institution for those teaching services are fees for services taxable under paragraph 2 of Article xx. Payments (such as tuition fees) by an individual to an educational institution for services provided by that institution to an individual are also subject to Article xx because payments by individuals for services, even services of a personal nature, are not excluded from the definition of "fees for services" in paragraph 3.

64. Some countries may be concerned about taxing educational institutions on fees for teaching services provided by such institutions or about taxing fees for teaching services paid by such institutions. These countries may wish to include a provision in paragraph 3 to exclude payments made "by an educational institution for teaching in an educational institution or received for teaching by an educational institution," similar to the exclusion in paragraph 3 of former Article 12A.

65. The treatment of reimbursements of expenses for purposes of the definition of "fees for services" in paragraph 3 poses special difficulties. As an initial matter, it is important to distinguish between an allowance for expenses and the reimbursement of expenses. An allowance is an amount usually established in advance for which the recipient of the allowance is not obligated to account; a per diem allowance for meals and accommodation is an example of a typical allowance. Since the recipient of an allowance does not have to account for the actual expenses incurred, any allowance received by a person for services performed by that person is included within the meaning of "fees for services" under paragraph 3.

66. The reimbursement of expenses is different from an allowance because the person must account for the actual expenses incurred, and only those actual expenses qualify for reimbursement. The issue is whether payments received in reimbursement of actual expenses incurred in connection with the provision of services are included in the definition of "fees for services" for purposes of Article xx.

67. First, a person may be reimbursed for expenses incurred in connection with providing services, but may not receive any fee for those services. For example, an individual resident in one Contracting State might be invited to speak at a conference or participate in a meeting in the other Contracting State and might be reimbursed for his or her travel expenses, but not receive any fee. In these circumstances, it seems difficult to justify the application of tax to the reimbursement. However, unless reimbursements are explicitly excluded from the definition of "fees for services",

paragraph 2 would permit the State in which the fees arise to impose tax on the reimbursement at the rate specified in the treaty.

68. Second, a resident of one Contracting State may be paid a fee and separately reimbursed for all the expenses incurred in providing services to a resident of the other Contracting State. In these circumstances, if reimbursements are excluded from the definition of “fees for services,” the tax imposed by the State in which the fees arise would be limited to the amount of the fee. On these facts, the fee represents the entire net profit of the taxpayer performing the services. However, the maximum limit on the tax imposed under paragraph 2 is based on the gross amount of the payments, and the rate of tax specified in Article xx may have been established on the assumption that the fees represent the non-resident’s gross revenue. As a result, if reimbursements are excluded from the definition of “fees for services,” the maximum rate of tax agreed to by the Contracting States may be too low. Moreover, the exclusion of reimbursements from the definition of “fees for services” might lead to abuses. For example, in order to reduce the source country’s tax, a taxpayer proving services might receive payments labeled as reimbursements that are actually fees, or might be reimbursed for expenses for which they would not ordinarily be reimbursed. Preventing these types of abuses would impose a significant administrative burden on the tax authorities.

69. Third, a resident of one State proving services to a resident of the other Contracting State might not be reimbursed for any of the expenses incurred in providing the services. In this case, the amount of the payment received by the resident providing the services may be greater than the amount of that resident’s net profit. The maximum rate of withholding tax in paragraph 2 may have been agreed to on the assumption that some of the expenses incurred by the person providing the services would be reimbursed. On this assumption, the maximum rate of withholding tax may be established at a higher rate than it otherwise would be in order to approximate the amount of tax on the person’s net profit. Therefore, if reimbursements are excluded from the definition of “fees for services”, the rate established in the treaty might be too high for a person providing services that receives no reimbursement for expenses.

70. The issues discussed in paragraphs 65 to 69 above are illustrated in the example in paragraph 71 below, which shows that the effect of a gross-based tax on fees for services depends, in part, on whether payments in reimbursement of expenses are subject to tax and the extent to which service providers are reimbursed for their expenses.

71. Example 4: X, a resident of Country A, is a management consultant, who provides advice to companies concerning best practices for corporate governance. X enters into a contract to provide services to BCo, a public company resident in Country B, for a period of 60 days for fees of 5,000 per day plus the reimbursement of all reasonable expenses incurred in providing the services. X receives fees of 300,000 from BCo and a payment of 250,000 in reimbursement for expenses. As a result, in this situation, X's net profit from the services provided to BCo is 300,000. Assume that Country A and Country B have entered into a tax treaty with provisions identical to those of Article xx, which allows the imposition of tax on fees for services at a maximum rate of 5 per cent. On these facts, assuming that the payment in reimbursement for X's expenses is not considered to be fees for services, Country B would be entitled to impose tax of 15,000 of the fees received by X, which represents a relatively low tax rate of 5 percent on X's net profit. Alternatively, assuming that the payment of 250,000 in reimbursement of X's expenses is also considered to be part of X's fees for services subject to tax under Article xx, Country B would be entitled to impose tax of 27,500, which represents a tax rate of over 9 per cent on X's net profit. If X did not receive any reimbursement for expenses, Country B's tax would be 15,000, representing a tax rate of 30 percent on X's net profit of 50,000 irrespective of whether payments in reimbursement of expenses are subject to tax under Article xx as fees for services.

72. It appears to be extremely difficult to predict to what extent, on average, persons providing services are reimbursed for their expenses. As a result, any single rule for the treatment of reimbursements will operate improperly in some situations. On the one hand, if reimbursements are excluded from the definition of "fees for services", the rate of tax agreed to in the treaty might be too low where most or all of a taxpayer's expenses are reimbursed, but too high where none of the expenses are reimbursed. Also, if reimbursements are excluded, taxpayers might try to disguise part of their fees as reimbursements of expenses and it might be difficult for the tax authorities to detect such abuses. On the other hand, if reimbursements are not excluded, the rate of tax agreed to in the treaty might be too high where a taxpayer's expenses are reimbursed, but too low where they are not reimbursed.

73. As a result of the difficulties described in the foregoing paragraphs, the solution that has been adopted is to omit any reference to the reimbursement of expenses in the definition of "fees for services" in paragraph 3 of Article xx. However, countries are encouraged to consider adopting a common approach for the treatment of reimbursements in their bilateral treaties and to take the issue into account in establishing the maximum rate of tax under paragraph 2 of Article xx.

74. It is sometimes necessary to distinguish between fees for services and royalties in order to determine whether Article 12 or Article xx of the Convention is applicable. The distinction between fees for services and royalties is clear in principle. Under paragraph 3 of Article 12, royalties are payments for the use, or the right to use, certain types of property or for information concerning industrial, commercial or scientific experience (so-called know-how). In contrast, the performance of services does not involve any transfer of the use of, or the right to use, property. However, in practice, it is often difficult to distinguish between royalties and fees for services, especially with respect to so-called mixed contracts. Guidance with respect to the distinction between fees for services and royalties is provided in paragraph 13 of the Commentary on Article 12 of this Model, which reproduces paragraphs 11.2–11.6 of the Commentary on Article 12 of the 2017 OECD Model Tax Convention (see also Examples 6 and 7 below).

75. The following examples illustrate the application of the definition of “fees for services” in paragraph 3.

76. Example 5: R Company is a financial institution resident of State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, credit and debit cards, payment and transmission services, banker’s drafts, guarantees, foreign exchange, negotiable instruments, derivative products, investment research and advisory services. R Company’s business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty that includes Article xx.

77. The payments received for services provided by a financial institution are clearly fees for services within the meaning of paragraph 3 of Article xx. If, however, R Company provides the services through a permanent establishment located in State S, the fees received for those services would be taxable by State S in accordance with Article 7 rather than Article xx by virtue of paragraph 4 of Article xx.

78. However, where a financial institution receives interest in consideration for lending funds to a client for a period, the interest is not considered to be fees for services because the financial institution has simply allowed its client to use its property for a period; it has not performed any services for the client. This result would also apply where an enterprise resident of one State receives rent for allowing a client resident in another State to use property owned or leased by the enterprise for a period.

79. Example 6: S Company, a resident of State S, enters into a contractual arrangement with R Company, a resident of State R, for the right to use a patented chemical formula owned by R Company for the production of an industrial substance. The contract also requires R Company to use its specialized knowledge and expertise to assist S Company in producing the industrial substance in accordance with specifications set out in the contract. In particular, R Company will provide the following services to S Company:

— provide the production procedures and assist S Company in carrying out those procedures and

— provide specifications concerning the necessary materials, tools, and containers used in the production process.

80. R Company also agrees to use its best efforts to ensure that S Company is able to produce the industrial substance in the quantities and with the characteristics that S Company expects. State S and State R have entered into a tax treaty with a provision identical to Article xx.

81. In Example 6, the payments by S Company to R Company for the right to use the patented formula would be royalties within the meaning of paragraph 3 of Article 12, and not fees for services. However, the payments for the services provided by R Company to S Company would not be royalties assuming that R Company is not transferring any property or right to use property to S Company. On the facts of Example 6, R Company is using its specialized knowledge, skill and experience on behalf of S Company and guaranteeing the result of S Company's use of the patented chemical formula. Consequently, the payments made by S Company to R Company for the services are fees for services within the meaning of paragraph 3 and State S would be entitled to impose tax on those fees under paragraph 2 of Article xx.

82. The addition of Article xx in 2025 not only eliminates the necessity to distinguish between fees for consulting, technical, and management and other services but also minimizes the significance of the distinction between royalties and fees for services. If the limits on the rate of tax in paragraph 2 of Article 12 and in paragraph 2 of Article xx are the same, it does not matter whether a particular payment is characterized as a royalty or as fees for services. However, where the limits on the rates of tax in paragraph 2 of Article 12 and in paragraph 2 of Article xx are not the same, it is important to determine whether a particular payment is a royalty or fees for services,

83. The following example illustrates the distinction between payments for the transfer of know-how and fees for services. The considerations to be taken into account in making this distinction are discussed in paragraph __ of the Commentary on Article 12.

84. Example 7: S Company, a resident of Country S, enters into a contractual arrangement with R Company, a resident of Country R, to acquire the use of a secret formula or process developed by R Company. The contract requires R Company to provide the information to S Company subject to strict confidentiality conditions and to use its specialized knowledge and expertise to train employees of S Company with respect to the use of the secret formula or process. State R and State S have entered into a tax treaty with provisions identical to those of the Model Tax Convention, including those of Article 12 and Article xx.

85. In Example 7, the payments made by S Company to R Company for the right to use the secret formula or process would be payments for "information concerning industrial, commercial or scientific experience" within the meaning of the definition of "royalty" in paragraph 3 of Article 12. This would be the case even if the information represents know-how that is not patented or otherwise protected by intellectual property laws. Similarly, the payments made by S Company to R Company for the training of S Company's employees would also be payments for "information concerning industrial, commercial or scientific experience" within the meaning of the definition of "royalty" in paragraph 3 of Article 12, since the training is necessary to transfer R Company's know-how to S Company. Therefore, irrespective of whether the payments for the training are provided separately from the payments for the secret formula or process or whether the contract provides for a single payment for both, the payments for the training would be considered to be royalties under Article 12 rather than fees for services under Article xx. However, if the training provided by R Company was not necessary to transfer the secret formula or process to S Company and S Company could obtain such training from other sources, the training would not be considered to be a transfer of know-how and the payments for the services would be considered fees for services within the definition in paragraph 3 of Article xx.

Paragraph 4

86. This paragraph provides that paragraphs 1 and 2 do not apply to fees for services if the person who provides the services has a permanent establishment in the State in which the fees arise and the fees are effectively connected with that permanent establishment. In this regard, paragraph 4 of

Article xx is similar to paragraph 4 of Articles 10, 11 and 12 and paragraph 8 of Article 12B. Thus, if a resident of one Contracting State provides services through a permanent establishment located in the other Contracting State, the fees received for those services are taxable by the State in which the permanent establishment is located in accordance with Article 7, rather than in accordance with Article xx.

87. Since Article 7 of the Model Tax Convention adopts a limited force-of-attraction rule, which expands the range of income that may be taxed as business profits, paragraph 4 also makes paragraphs 1 and 2 inapplicable if the fees for services are effectively connected with business activities in the State in which the fees arise that are of the same or similar kind as those effected through the permanent establishment.

88. The paragraph does not define the meaning of the expression "effectively connected." As a result, whether fees for services are effectively connected with a permanent establishment or business activities similar to those carried on through a permanent establishment must be determined on the basis of all the relevant facts and circumstances of each case. In general, fees for services would be considered to be effectively connected with a permanent establishment if the services are closely related to or connected with the permanent establishment. Also, fees for services would be effectively connected with business activities referred to in paragraph 1(*c*) of Article 7 where the services are provided by an enterprise as part of that enterprise's business activities carried on in a Contracting State where a permanent establishment of that enterprise is situated, and these activities are of the same or similar kind as the business activities performed through that permanent establishment.

89. Where paragraph 4 applies, fees for services are taxable by the State in which the fees arise as part of the profits attributable to the permanent establishment in accordance with Article 7. Thus, paragraph 4 relieves the Contracting State in which the fees for services arise from the limitations on its taxing rights imposed by Article xx. Where Article 7 applies as a result of the application of paragraph 4, most countries consider that the State in which the permanent establishment is located is allowed to tax only the profits from the services attributable to the permanent establishment determined on a net basis, although the rate of tax is not limited. Article 7 does not preclude taxation of business profits attributable to a permanent establishment on a gross basis as long as that tax does not exceed the tax that would have been imposed on the profits attributable to the permanent

establishment determined on a net basis. In addition, a Contracting State must not discriminate against residents of the other State in violation of paragraph 3 of Article 24 (Non-discrimination).

90. Construction services provided by a resident of one Contracting State in the other State in connection with a construction, assembly or installation project or supervisory activities connected with such a project for more than six months are considered to be a permanent establishment under subparagraph (*a*) of paragraph 3 of Article 5 of the Model Tax Convention. In this situation, any profits attributable to the permanent establishment are taxable in accordance with Article 7, instead of Article xx, as a result of paragraph 4 of Article xx. However, where the construction services are not performed in the other State for more than six months, subparagraph (*a*) of paragraph 3 of Article 5 does not apply and paragraph 4 of Article xx does not apply. As a result, paragraph 2 of Article xx applies to allow the Contracting State in which the payer is resident or has a permanent establishment that bears the fees for the construction services to tax those fees at the applicable rate on the gross amount of the fees irrespective of whether the services are performed inside or outside that State.

91. To summarize, fees for construction services provided by a resident of one Contracting State to a resident of the other State (or a nonresident with a permanent establishment in that other State) where the person providing the construction services does not have a permanent establishment in the other State are taxable by the other State under paragraph 2 of Article xx. However, where the person providing the construction services has a permanent establishment in the other State, any profits attributable to the permanent establishment are taxable in accordance with Article 7 on a net basis rather than on a gross basis under Article xx. Whether a person providing construction services has a permanent establishment under subparagraph (*a*) of paragraph 3 of Article 5 with respect to those construction services is dependent on the period during which the services are provided in the source country; if the services are provided for more than six months, a permanent establishment exists; if not, no permanent establishment exists and the fees for the services are taxable under Article xx.

92. Countries may wish to impose tax on fees for construction services paid to a resident of the other Contracting State from the first day on which such fees are payable, on the basis that the construction project may not last for more than six months. Accordingly, they may impose an obligation on the payer to withhold the required amount of tax from the fees. However, if the construction project lasts for more than six months, as explained above, the fees attributable to the

permanent establishment are taxable on a net basis under Article 7 and the permanent establishment is considered to exist from the start of the construction project (see paragraph 3 of the Commentary on Article 5 quoting paragraph 11 of the OECD Commentary). As a result, the amounts collected by those countries through withholding at source during the first six months would have to be applied to the tax payable by the service provider under Article 7 and any excess would have to be refunded to the service provider.

93. To avoid the obligation to refund withholding taxes, countries might consider not imposing any obligation to withhold from fees for construction services for the first six months of any construction project. However, if a construction project does not last for six months, it may be difficult to collect the tax from non-resident persons providing the construction services after it is determined that the project has not resulted in a permanent establishment. Alternatively, countries could consider adopting rules to require non-resident persons providing construction services to certify in advance how long the project is estimated to last so that the appropriate domestic tax regime (tax on the gross amount of the fees under Article xx or taxation on the profits attributable to the permanent establishment on a net basis under Article 7) can be applied from the outset of the construction activities.

94. Similar issues arise in connection with permanent establishments under subparagraph (*b*) of paragraph 3 of Article 5, and are likely to arise more frequently than construction project permanent establishments because subparagraph (*b*) of paragraph 3 of Article 5 applies to all types of services unlike subparagraph (*a*) of paragraph 3 of Article 5 which is limited to construction and related activities. Whether subparagraph (*b*) of paragraph 3 of Article 5 applies to consider a resident of one Contracting State providing services in the other Contracting State to have a permanent establishment in that other State depends solely on the number of days that the services are furnished in the other State. As a result, Article xx applies where a resident of one Contracting State provides services to a resident of the other State (or to a nonresident with a permanent establishment in the other State that bears the fees) if the services are provided:

(a) outside the other State, or

(b) inside the other State for 183 days or less in any 12-month period.

95. To effectively collect tax imposed in accordance with Article xx, countries may consider imposing an obligation on the payer to withhold tax from all payments for services made to non-

residents (other than any services expressly excluded from the scope of Article xx). If so, a problem may arise where the services are provided in a Contracting State for more than 183 days in which case the resident of the other Contracting State providing the services would be deemed to have a permanent establishment in that country (assuming that the treaty contains a provision comparable to subparagraph (*b*) of paragraph 3 of Article 5). Since the person providing the services has a permanent establishment in the other State in this situation, the fees for services are taxable by that other State under Article 7 to the extent they are attributable to the permanent establishment (which may include fees for services performed in that other State). Once the 183-day threshold in subparagraph (*b*) of paragraph 3 of Article 5 is met, the permanent establishment is deemed to have existed from the first day during which services were performed by the service provider in that State (paragraph 3 of the Commentary on Article 5 quoting paragraph 11 of the OECD Commentary). Ordinarily, the non-resident person providing the services would be required to file a tax return to determine the amount of tax payable on the profits attributable to the permanent establishment under the domestic law of the country in which the permanent establishment is located. Any tax withheld on the basis that Article xx applied to the fees for services would be treated as a payment on account of the tax payable. The non-resident person providing the services would be required to pay any shortfall or would be entitled to a refund with respect to any excess tax withheld.

96. Any tax imposed by a State in accordance with Article xx on fees for services performed by a resident of the other Contracting State with a permanent establishment in the first State is not pre-empted by Article 7 where the fees are not attributable to the permanent establishment. This may be the case where the services are performed outside the State in which the permanent establishment is located (for example, where the services are performed in the State where the person providing the services is resident). Withholding agents in one Contracting State cannot reasonably be expected to know whether or to what extent fees for services paid to a resident of another Contracting State are attributable to that resident's permanent establishment in the first state; as a result, countries may wish to impose an obligation on payers to withhold from all payments for services made to nonresidents. However, such countries would need to establish an administrative system to refund taxes withheld inappropriately where it is established subsequently that the non-resident providing the services has a permanent establishment in their country to the extent that the amount withheld exceeds the tax payable on the profits attributable to the permanent establishment.

Paragraphs 5 and 6

97. Paragraph 5 lays down the principle that the State in which fees for services arise for purposes of Article xx is the State of which the payer of the fees is a resident or the State in which the payer has a permanent establishment if the fees for services are borne by the permanent establishment. It is not necessary under paragraph 2 for the services to be provided in the Contracting State in which the payer is resident or has a permanent establishment. Whether a person is a resident of a Contracting State for purposes of Article xx is determined in accordance with the provisions of Article 4 of the Convention.

98. Where there is an obvious economic link between services being provided and the permanent establishment of the payer to which the services are provided, the fees for services are considered to arise in the Contracting State in which the permanent establishment is situated. This result applies irrespective of the residence of the person to which the permanent establishment belongs, even where that person resides in a third State.

99. Where there is no economic link between the services and the permanent establishment, the payments for services are considered to arise in the Contracting State in which the payer is resident. If the payer of fees for services is not a resident of a Contracting State, Article xx does not apply to the fees for services unless the payer has a permanent establishment in that State and there is a clear economic link between the services and the permanent establishment. Otherwise, there would be, in effect, a force-of-attraction principle for fees for services, which would be inconsistent with other provisions of the Model Tax Convention.

100. Paragraph 5 is subject to paragraph 6, which provides an exception to the source rule in paragraph 5. Paragraph 6 deems fees for services paid by a resident of a Contracting State not to arise in that State where that resident (the payer) carries on business through a permanent establishment in the other Contracting State and the fees for services are borne by that permanent establishment. As a result, in these circumstances, the Contracting State in which the payer is resident is not allowed to tax the payments for services under paragraph 2 of Article xx.

101. The phrase "borne by" must be interpreted in the light of the underlying purpose of paragraphs 5 and 6, which is to provide source rules for fees for services. A Contracting State is entitled to tax fees for services under paragraph 2 only if the fees arise in that State. The basic source rule in paragraph 5 is that fees for services arise in a Contracting State where the payer is a resident of that

State or the payer has a permanent establishment in that State and the fees for services are borne by that permanent establishment. However, the basic rule is limited by the deeming rule in paragraph 6 where the payer is a resident of a Contracting State but the fees for services are borne by a permanent establishment that the payer has in the other Contracting State.

102. Where fees for services are incurred for the purpose of a business carried on through a permanent establishment, those fees usually qualify for deduction in computing the profits attributable to the permanent establishment under Article 7. The deductibility of the fees for services provides an objective standard for determining that the payments have a close economic connection to the State in which the permanent establishment is situated.

103. The fact that the payer has, or has not, actually claimed a deduction for the fees for services in computing the profits of the permanent establishment is not necessarily conclusive, since the proper test is whether any deduction available for those fees should be taken into account in determining the profits attributable to the permanent establishment. For example, that test would be met even if no amount were actually deducted as a result of the permanent establishment being exempt from tax or as a result of the payer simply deciding not to claim a deduction to which it was entitled. The test would also be met where the fees for services are not deductible for some reason other than the fact that the fees for services should not be allocated to the permanent establishment.

104. The application of paragraphs 5 and 6 can be illustrated by the following examples.

105. Example 8: R Enterprise is carried on by a resident of State R. R Enterprise provides services to S Company, a resident of State S. The tax treaty between State R and State S is identical to the Model Tax Convention, including Article xx. S Company carries on business in State S and in State R through a permanent establishment situated in State R. However, the services provided by R Enterprise to S Company are related to S Company's business carried on in State S, not to the business carried on through S Company's permanent establishment in State R.

106. In Example 8, since the payments are made by S Company, a resident of State S, and are not borne by a permanent establishment of S Company in State R, the fees for services would be considered to arise in State S in accordance with paragraph 5. Therefore, State S would be entitled to tax the fees for services under paragraph 2 of Article xx.

107. Example 9: The facts are the same as in Example 8, except that the fees for services are borne by S Company's permanent establishment in State R.

108. In Example 9, since the fees for services are borne by a permanent establishment of S Company situated in State R, paragraph 6 of Article xx applies to deem the fees for services not to arise in State S. Consequently, the fees for services are not taxable by State S under paragraph 2 of Article xx but are taxable exclusively by State R under paragraph 1 of Article xx.

109. In Example 9, Article xx of the Convention denies State S the right to tax the fees for services despite the fact that the fees are paid by a resident of State S. This result is justified because the fees relate to a business carried on by a resident of State S through a permanent establishment in State R. In such a situation, where fees for services are deductible in computing the profits of a business attributable to a permanent establishment situated in State R, those payments have a closer economic connection to the activities carried on in State R than to State S.

110. Example 10: T Enterprise is carried on by a resident of State T. T Enterprise carries on business through a permanent establishment situated in State S. T Enterprise pays R Company, a resident of State R, for services provided by R Company for T Enterprise in connection with its income-earning activities carried on in State S. The payments made by T Enterprise to R Company for the services are deductible in computing the profits attributable to the permanent establishment of T Enterprise in State S. The tax treaty between State S and State T includes a provision identical to Article xx.

111. In Example 10, although the fees for services are not paid by a resident of State S, the fees are borne by the permanent establishment that T Enterprise has in State S. In these circumstances, the fees for services have a close economic connection to the income-earning activities of T Enterprise carried on in State S. Thus, the fees are deemed to arise in State S in accordance with paragraph 5 and State S is entitled to tax the payments in accordance with paragraph 2 of Article xx.

112. In the case of interest and royalties, paragraph 21 of the Commentary on Article 11 and paragraph 19 of the Commentary on Article 12 of the Model Tax Convention indicate that countries might substitute a rule that would identify the source of interest or royalties as the State in which the loan giving rise to the interest or the property or right giving rise to the royalties was used. An equivalent source rule might be substituted for purposes of Article xx. Similarly, as suggested in the Commentary on Articles 11 and 12, where, in bilateral negotiations, the parties differ on the appropriate rule, a possible solution would be a rule that, in general, would accept the payer's place

of residence as the source of fees for services, but where the services are used or consumed in a State having a place-of-use rule, the payment would be deemed to arise in that State.

113. Other alternative source rules for fees for services are possible. Such alternatives include:

- A Contracting States might decide not to include paragraph 6. If paragraph 6 were omitted from Article xx, fees for services would be considered to arise in the State in which the payer is resident, even where those fees are incurred for purposes of a permanent establishment of the payer in the other Contracting State.
- The Contracting States might decide not to include paragraph 6 and to revise paragraph 5 so that fees for services would be considered to arise in a Contracting State only if the payer is a resident of that State and the services are used or consumed by the payer in that State; or if the payer is not a resident of a Contracting State, the payer has a permanent establishment situated in a Contracting State and the fees for services are borne by that permanent establishment. In this case, services used or consumed by a resident of a Contracting State outside that State would not be considered to arise in that State, and that State would not be entitled to tax fees for such services under Article xx. Paragraph 6 would be unnecessary because services used or consumed outside a Contracting State would include any services incurred for the purposes of a resident's permanent establishment situated in the other Contracting State.
- Fees for services could be considered to arise in a Contracting State only if the payer is a resident of that State and the services are provided in that State or if the payer, not being a resident of a Contracting State, has a permanent establishment situated in a Contracting State, the fees for services are borne by that permanent establishment, [and the services are provided in that State]. In this case, a Contracting State would be entitled to tax fees for services paid by its residents to residents of the other Contracting State if the services are provided in the State. In this situation, paragraph 6 would be unnecessary.

[113.1. Optional paragraph] Some Contracting States might embrace the taxation of fees for services paid by a resident of one Contracting State to a resident of the other Contracting State under paragraph 2 of Article xx without any threshold requirement, such as a permanent establishment or fixed base in the first State. Some of these States might prefer to limit the application of Article xx to fees for services performed in a Contracting State. These States could decide not to include paragraph 6 and to revise paragraph 5 so that fees for services would be considered to arise in a

Contracting State only if the payer is a resident of that State and the services are performed in that State; or if the payer is not a resident of a Contracting State, the payer has a permanent establishment situated in a Contracting State that bears the fees, and the services are performed in that State.]

114. Paragraph 6 provides no solution for the case where the beneficiary and the payer are residents of the Contracting States, but the fees for services were incurred for the benefit of a permanent establishment of the payer situated in a third State and the fees for services are borne by that permanent establishment. In such a case, the fees for services are deemed to arise in the Contracting State of which the payer is a resident under paragraph 5 and not in the third State in which the permanent establishment is situated. Thus, the fees for services may be taxed both in the Contracting State of which the payer is a resident and in the Contracting State of which the beneficiary is a resident. Although double taxation will be avoided between these two States, it will not be avoided between them and the third State if the third State taxes the fees for services because they are borne by the permanent establishment in its territory. Paragraph 6 is consistent in this regard with paragraph 5 of Article 11 and paragraph 5 of Article 12.

115. As explained in paragraph 27 of the Commentary on Article 11 (quoting paragraphs 29 and 30 of the Commentary on Article 11 of the 2017 OECD Model Tax Convention), if the third State did not subject the fees for services to tax, there could be attempts to avoid taxation in the Contracting State of which the payer is a resident through the use of a permanent establishment situated in such a third State. States for which this is not a concern and that wish to address the issue described in paragraph 114 above may do so by agreeing, in their bilateral conventions, to the alternative formulation of paragraph 6 suggested in paragraph 116 below.

116. As mentioned in paragraph 115, the State of which the beneficiary is a resident and the State of which the payer of fees for services is a resident may avoid the double taxation described in paragraph 111 above by agreeing to the following wording of paragraph 6:

> 6. For the purposes of this Article, fees for services shall be deemed not to arise in a Contracting State if the payer is a resident of that State and carries on business in the other Contracting State or a third State through a permanent establishment situated in that other State or the third State and such fees are borne by that permanent establishment.

117. This wording would have the effect of ensuring that paragraphs 1 and 2 would not apply to such fees for services because they would not arise in a Contracting State. As a result, such fees for services would typically fall under Article 7.

Paragraph 7

118. The purpose of paragraph 7 is to restrict the operation of Article xx concerning the taxation of fees for services in cases where, by reason of a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person, the amount of the fees paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length. Paragraph 7 provides that in such a case the provisions of the Article apply only to the last-mentioned amount and the excess part of the fees for services would remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

119. It is clear from the text of paragraph 7 that in order for this paragraph to apply, the fees for services held to be excessive must be due to a special relationship between the payer and the beneficial owner of the fees or between both of them and some other person. There may be cited as examples of such a special relationship cases where fees for services are paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by the payer or is subordinate to a group having common interest with the payer. These examples, moreover, are similar or analogous to the cases contemplated by Article 9.

120. However, the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationships giving rise to the fees for services.

121. With regard to the taxation treatment to be applied to the excess part of the fees for services, the exact nature of such excess will need to be ascertained according to the circumstances of each case, in order to determine the category of income into which it should be classified for the purposes of applying the provisions of the tax laws of the States concerned and the provisions of the Convention. Unlike paragraph 6 of Article 11, which, because of the limiting phrase "having regard to the debt claim for which it is paid," permits only the adjustment of the rate at which interest is charged, paragraph 7 permits the reclassification of the [excess part of the] fees for services in such a way as to give them a different character. This paragraph can affect not only the recipient of the

fees, but also the payer of excessive fees for services; if the law of the State where the payer is resident or has a permanent establishment permits, the excess amount can be disallowed as a deduction, due regard being had to other applicable provisions of the Convention. If two Contracting States have difficulty in determining the other provisions of the Convention applicable, as cases require, to the excess part of the fees for services, there would be nothing to prevent them from introducing additional clarifications in the last sentence of paragraph 7, as long as they do not alter its general purport.

122. Where the principles and rules of their respective laws oblige the two Contracting States to apply different Articles of the Convention for the purpose of taxing the excess part of fees for services, it will be necessary to resort to the mutual agreement procedure provided by the Convention in order to resolve the difficulty.

ANNEX C

PROPOSAL TO ADD AN ALTERNATIVE PROVISION (ARTICLE 15(4)) TO THE COMMENTARY ON THE UNITED NATIONS MODEL TAX CONVENTION

(REVISED DRAFT OF SEPTEMBER 2024)

Introduction

This note provides the text of a possible alternative provision dealing with the taxation of income from employment derived by an employee resident in one Contracting State and paid by an employer resident in the other Contracting State. The alternative provision (proposed Article 15(4), which the Subcommittee has previously discussed in connection with Workstream C) allows the country in which the employer is resident to impose tax on the non-resident employee's income from employment exercised outside the employer's country, subject to the elimination of double taxation. A draft version of Article 15(4) was presented to the Committee at its March 2024 meeting and the Committee decided that it should not be added to the Model Tax Convention. However, in accordance with the Rules on Methods and Procedure, some members of the Committee wish to present a provision similar to Article 15(4) for inclusion in the Commentary to Article 15. The proposal has been discussed by the members that are interested in the provisions and the draft is as follows (the numbering of the Commentary paragraphs will depend on placement in the Commentary):

Draft Addition to the Commentary on Article 15

1. Due to the introduction and expansion of new digital technologies and tools in recent years, remote working arrangements will continue to expand. This may create difficult policy issues for developing and developed countries. One issue identified by some members of the Committee is the case where an individual X is employed by a company resident in State B but X is resident and, by being physically present there, exercises the employment duties in State A. The tax treaty between A and B has an article identical to Article 15 of the Convention. X's income from employment would be taxable exclusively by State A and State B would be prohibited from taxing X's income. On the other hand, X's employer, resident in State B, would usually be entitled to deduct the salary, wages and other remuneration paid to X for purposes of computing the

employer's corporate profits tax payable in State B, thereby reducing the tax payable by the employer to State B. The resulting asymmetry – the deductibility of the employment income against State B's tax base without any right to tax that employment income derived by the non-resident employee – may be a concern for some countries, which may be exacerbated by the growing trend of remote working for longer periods. This asymmetry may be of most concern where employers resident in one Contracting State have many non-resident employees who have chosen to become resident in a country that imposes tax on them at a rate that is significantly lower than the tax rate imposed by the country in which the employer is resident.

2. Some countries may therefore wish to include a provision in their bilateral treaties that enables them, as a Contracting State, to impose tax on the income from employment derived by an employee resident in the other Contracting State from employment exercised in the other state (or in a third state) where the employee is employed by an employer resident in the first State. Such a provision might be worded as follows:

> ***4. Notwithstanding the provisions of paragraphs 1 and 2, remuneration derived by a resident of a Contracting State in respect of an employment exercised in that State or in a third State may be taxed in the other Contracting State to the extent that the remuneration is paid by, or on behalf of, an employer who is a resident of that other State.***

3. The alternative provision in paragraph 4 of Article 15 does not impose any limit on the taxing rights of either Contracting State under existing Article 15 of the Model Tax Convention. Where the non-resident employees concerned do not enjoy a reduced, incentivised, rate of tax in their State of residence, the absence of a limit on the taxation of the remuneration by the State of residence of the employer may result in excessive taxation by that State. In order to reduce that risk of excessive employer-State taxation, an alternative approach to paragraph 4 of Article 15 could limit the tax imposed by the employer's State of residence to a fixed percentage (to be agreed by the Contracting States) of the gross amount of the remuneration. Such a limit is similar to the limits under Articles 10, 11, 12, 12A and 12B of the Convention and paragraph 4 of Article 15 could be altered as follows:

> ***4. Notwithstanding the provisions of paragraphs 1 and 2, remuneration derived by a resident of a Contracting State in respect of an employment exercised in that State or in a third State may be taxed in the other Contracting State in accordance with the laws of that***

State to the extent that the remuneration is paid by, or on behalf of, an employer who is a resident of that other State, but the tax so charged shall not exceed ____ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the remuneration.

4. How the parties to a bilateral treaty provide for the elimination of double taxation in relation to paragraph 4 of Article 15 will depend on the purpose they assign to that paragraph.

4.1 If they identify the primary purpose as addressing the asymmetry, described above, that arises in the case of remote-working employees, the Contracting States may assign the obligation to relieve the Article 15.4 foreign tax to the employee's State of residence: On that basis, the employer State will retain the Article 15.4 tax that is intended to balance the reduction in its corporate tax base from the deduction of the relevant remuneration paid to the remote-working employees. Where paragraph 4 of Article 15 includes a limitation on the rate of tax that may be charged in the employer State, this will make the net outcome, after double taxation relief is given by the employee State, more likely to be the receipt of tax by *both* Contracting State in respect of the remuneration concerned. Where the Contracting States identify the purpose of paragraph 4 of Article 15 in accordance with this paragraph and the applicable method of double taxation relief is the credit method under Article 23B, no change will be required to Article 23B in relation to Article 15.4. Where such Contracting States have agreed a maximum rate of tax for Article 15.4 and the exemption method under Article 23A is the applicable method of double taxation relief, they should amend paragraphs 2 and 4 of Article 23A as follows:

2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10, 11, 12, 12A, 12B and paragraph 4 of Article 15, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the

> ***provisions of paragraph 2 of Article 10, 11, 12 or 12A, or the provisions of Article 12B or paragraph 4 of Article 15, to such income; in the case where the other Contracting State does not exempt the income, the first mentioned State shall allow the deduction of tax as provided for by paragraph 2.***

4.2. However, in other bilateral treaties the primary purpose of the inclusion of paragraph 4 in Article 15 may be to counteract the incentive to remote working provided by a very low personal income tax rate for the employees concerned. If the purpose is to neutralize that incentive to remote working provided by a very low tax rate in one Contracting State, rather than to address tax asymmetry or share taxing rights as in paragraph 4.1, the employer State taxation of the remuneration concerned should have the effect of *topping-up* the employee State tax, so as to remove any tax saving to the employees concerned. This topping-up will be achieved by the employer State crediting the tax paid in the employee State on the remuneration from the employment exercised there. The employee State retains its tax on remuneration from the employment exercised there but the incentive of the very low rate is, nevertheless, neutralized. A new paragraph 3 of Article 23B, aligned with that approach, would read as follows:

> ***3. Where an employee is a resident of a Contracting State and derives remuneration in respect of an employment by an employer who is a resident of the other Contracting State, which may be taxed in the other Contracting State in accordance with paragraph 4 of Article 15 of this Convention, the other Contracting State shall allow as a deduction from the tax on that remuneration of that employee an amount equal to the income tax paid in the Contracting State of which the employee is a resident on the remuneration from the exercise of the employment in that State.***
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> ***Such deduction shall not, however, exceed that part of the income tax, as computed before the deduction is given, which is attributable to the remuneration which may be taxed in the State of which the employee is a resident.***

4.3. Paragraph 3 of Article 23 B requires a Contracting State that is entitled, in accordance with paragraph 4 of Article 15, to tax the income from employment of an employee resident in the other State, to allow a deduction against its tax payable on that income for the tax imposed by that other State on the income from the exercise of the employment in that other State. Paragraph 3 of Article 23 B applies only with respect to tax imposed on income from employment "*in accordance with paragraph 4 of Article 15*". As a result, it does not overlap with the foreign tax credit allowed under paragraph 1 of Article 23 B by the Contracting State in which an employee is resident for the tax paid to the other State with respect to remuneration derived by the employee from the exercise of

the employment in that other State where the employer is resident. The second sentence of paragraph 3 of Article 23 B ensures that the foreign tax credit does not exceed the amount of tax imposed by the Contracting State where the employer is resident on the remuneration earned in the State in which the employee is resident. In summary, the Contracting State in which the employer is resident is not obligated to provide a credit for all the tax imposed by the other State on all of the employee's income from the employment.

4.4 Where the parties to a bilateral treaty are primarily concerned with tax competition and, therefore, relieve double taxation by adding paragraph 3 to Article 23B, a further amendment to the model Article 23B text may also be advisable for the avoidance of doubt: To prevent any claim to a foreign tax credit by a remote-working employee resident in one Contracting State, in respect of any tax charged in accordance with paragraph 4 of Article 15 by the other Contracting State, in which the employer is resident, the words "***other than in accordance with paragraph 4 of Article 15***" should be added at the end of subparagraph (a) of paragraph 1 of Article 23B.