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Item 3(i) of the provisional agenda
Taxation issues related to the digitalized and globalized economy

Co-Coordinators' Report

Summary

This paper addresses the remaining workstreams approved for consideration by the Subcommittee on Taxation Issues Related to the Digitalized and Globalized Economy.

The Subcommittee ***seeks Committee approval:***

(1) ***of what was previously approved as Article xx at the Twenty-ninth Session, pending a final decision on Article number, being designated as Article 12A***, attached as ***Annex A to this Report (page 7)***. The new Article combines existing Articles 12A and 14 into a new provision;

(2) ***of the proposed Commentary for the new Article 12A, as found at Annex B to this Report (pages 8-43). The Commentary was first considered at the Twenty-ninth Session and has been modified to address issues raised at that Session and in Subcommittee meetings since;***

(3) ***of the proposed consequential changes to the Model at Annex C to this Report (pages 44-53) as a result of the addition of the new Article 12A and the proposed deletion of the 2021 versions of Articles 12A and 14;***

(4) ***of the deletion of the 2021 versions of Articles 12A and 14;***

(5) ***that the 2021 versions of Articles 12A and 14 be kept available in the Model in Annex form*** (especially with many treaties likely to reflect their terms for some time) and;

(6) ***of the proposed Commentary change to Article 15 providing for an optional Article 15(4), attached as Annex D to this Report (at pages 54-60).*** Annex D 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.

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.

3. Nineteen Committee Members are currently participating in the Subcommittee, although all Committee members are invited to Subcommittee meetings.

Subcommittee Workstreams

4. 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.

5. At the Twenty-sixth to Twenty-eighth Sessions, the Committee decided that the Subcommittee would continue to consider the issues raised by all three workstreams, except that the work on Workstream A was completed at the Twenty-eighth Session – with further development into a final treaty being an intergovernmental matter - and is not further addressed in this paper.

6. At the Twenty-ninth Session, a revised version of what was provisionally entitled Article xx, combining Articles 12A and 14 (and no longer Article 5(3)(b), as in earlier drafts), received final approval from the Committee, and a revised draft Commentary to the new article was presented for further consideration and general approval should the Committee so decide. The Subcommittee also **p**rovided at that Session 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.

7. As noted in the Report of the Twenty-ninth Session:

> 40. 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.22). 41. Ms. Kana thanked the International Bureau of Fiscal Documentation for having hosted an important

joint Subcommittee meeting with the Subcommittee on Updating the United Nations Model Double Taxation Convention between Developed and Developing Countries. She also thanked the consultants to the Department of Economic and Social Affairs, Brian Arnold and Philip Baker, for assisting with the work of the Subcommittee. She highlighted that, for workstream B, which addressed the relevance of physical presence tests, the Committee had previously decided to work on the option of introducing a new article to the Model Convention (article xx), which would replace articles 12A and 14. The Co-Coordinators' report presented revised versions of article xx and of its commentary. The final numbering of the article would be decided later.

42. Most members taking the floor congratulated the Subcommittee on the work that had culminated in the introduction of the new article, noting that it was an important step forward in dealing with the digitalized and globalized economy, where physical presence was no longer essential to conduct services-related business, and in simplifying the taxation of services under the Model Convention. Other members maintained their objections to article xx.

43. During the discussion, some members raised concerns about the scope of the new article and its interaction with other provisions of the Model Convention, noting the challenge of consolidating multiple provisions into one while keeping an effective balance in key aspects such as simplification. Some members brought attention to the gross-based taxation in the draft of article xx, suggesting that net-based taxation would lead to a fairer scenario for most countries as well as avoid excessive taxation. Formulary apportionment was raised as one way to achieve that. Members agreed to recognize options in the commentary for countries to decide whether to apply gross-based taxation or net-based taxation. It was further suggested that the Committee consider keeping articles 12A and 14 in the commentary (with their existing commentary preserved) for countries that might find them useful when concluding tax treaties. It was suggested that an annex to the Model Convention might be one way to achieve that, an option that was widely supported.

44. It was suggested that, as with article 12A, individual use of services should be excluded from the application of article xx, given that it would be difficult to apply the article in practice. However, as article xx did not itself create a charge to tax, which depended on domestic law (where the coverage would be addressed), it was ultimately agreed that the exclusion was not necessary.

45. The relationship between article xx and article 5 (3) (b) was also raised as an issue, and it was agreed that paragraph 26 of the commentary explained that issue and would be maintained as it was. The relationship between article 12B and article xx was also raised. It was opined that, as the definition of "service" in article xx was rather broad, it would include automated digital services, but article 12B was accorded precedence over article xx, as it provided more specific and targeted provisions and guidance regarding automated digital services. It was agreed that the commentary would include a clarification on the relationship between the two articles.

46. A member requested a vote to decide the approval of article xx and its commentary, noting that several other members had expressed concerns. The vote took place in a closed meeting of the Committee. It was announced in the open meeting that, by a clear majority, the vote had been in favour of including the article and its commentary (with some small final adjustments and considerations) in the next version of the Model Convention. The related commentary, with some adjustments and considerations that the Subcommittee would consider, and the numbering of the article would be presented at the thirtieth session of the Committee.

47. Ms. Kana presented the current work on workstream C, which addressed cross border taxation issues involving remote workers. Some members of the Subcommittee had developed a proposal on incorporating an alternative provision dealing with that issue into the commentary on article 15 (dependent personal services), which was being presented

for approval. There was some discussion on the proposed commentary, including the proposed optional article 15 (4). Some concerns were raised about the complexities of applying the provision to triangular cases and the risk of unrelieved double taxation. An observer highlighted that, while the provision focused on preventing tax avoidance, it did not address all challenges related to the taxation of remote workers. While there was recognition that work had been done, there was also a view that it would benefit from further consideration and discussion. The Committee therefore decided to continue work on the commentary on article 15 and return to the issue at the thirtieth session, with a view to settling it at that time.

48. In relation to workstream A, in proposing a draft decision for adoption by the Council relating to the proposed fast-track instrument to provide for the streamlined amendment of bilateral double taxation treaties (see chap. I), as finalized by the Committee at its twenty-eighth session, the Committee recognized, as indicated in the report of that session (E/2024/45/Add.1-E/C.18/2024/2, para. 55), that a minority of Committee members remained opposed to the fast-track instrument.

8. This paper, including its Annexes. reflects the outcomes of, and direction taken, in the Subcommittee meetings. It should not necessarily be taken as reflecting unanimous views of all Subcommittee participants.

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

9. In relation to **Workstream B**, the Subcommittee 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. The approach ultimately chosen by the Subcommittee and Committee was to have a new Article combining Articles 12A and 14 into a new provision dealing with cross-border business services. (provisionally referred to as Article xx, but now proposed to be a new Article 12A)**.** As noted above, at the Twenty-ninth Session the Members voted in favour of including the Article and its Commentary (with some small final adjustments and considerations) in the 2025 version of the Model Convention. It was agreed that the related commentary, with some adjustments and considerations that the Subcommittee would consider, and the numbering of the article would be presented at the thirtieth session of the Committee.

10. ***Annex A*** ***(page 7)*** provides the text of the Article as already agreed by the Committee but with the proposal that ***it be renumbered as Article 12A.*** This number was seen as the most logical number for an Article that would in part replace existing Article 12A. ***Approval is sought only of the new Article number, as other aspects of the text were approved at the Twenty-ninth Session***.

11**.** ***Annex B*** ***(pages 8-43)*** provides the proposed draft Commentary to Article 12A,***for which approval is sought at this session.*** It is also proposed that ***the 2021 versions of Article 12A and Article 14 be deleted*** and that ***the 2021 versions of Articles 12A and 14 be kept available in the Model in Annex form*** (especially with many treaties likely to reflect their terms for some time

12. ***Annex C*** (***pages 44-53)***addresses ***consequential amendments to the Articles of the UN Model Double Tax Convention as a result of the addition of the new Article 12A and the deletion of the 2021 versions of Articles 12A and 14.*** Most proposed changes are simple ones and are often consequential to eliminating Article 14. ***The paper is presented for discussion, decisions and final approval.***

13. This workstream has involved consultation with the Subcommittee on the Update of the United Nations Model Tax Convention.

Workstream C (Remote Workers) – proposed optional Article 15(4)

14. This Workstream addresses where an employee "exercises" the work as an employee. The work under this workstream identified a mismatch in today's digitalized economy where an employee resident in State A but working as an employee for an employer in State B, is

taxed for employment income in State A, while State B will allow a tax deductible cost for the employee expense. The Subcommittee considered the potential mismatch between deductibility in one State and taxing rights in the other with regards to Article 18 and pension taxation, where Alternative A provides for the residence state of the pensioner to exclusive taxing right while the State of employer has allowed for deductions of the employee cost, and Alternative B allows for the employer State to share the taxing right with the residence State of the pensioner (ex-employee).

15. The Subcommittee recognized situations where countries are attracting highly paid individuals to become residents in their countries by offering low taxes. In other countries there are many individuals that perform cross border employment and non-employment services, without being highly paid. In some countries cross border employment contracts are not available due to employment laws, social security legislation and unclear tax rules. In some other countries employees are not in a position to travel and perform employment activities outside the jurisdiction of the employer country due to (un)clear tax rules.

16. The Subcommittee concluded that at this stage it could not deal specifically with so called "digital nomads" or with digital independent service providers (so called "digital freelancers") as they are outside the scope of Article 15. The work of the Subcommittee therefore confined its consideration to dealing with an "employee" (an individual with an employment contract) and the taxing of employment income in this workstream.

17. Having taken these factors (and others) into consideration the Subcommittee presented a proposal for a new Article 15(4) to the Committee, and the Committee decided that the proposal should not be introduced as a change in the Model but, as there were some Members favouring the proposal, as in all proceedings of the Committee, they could introduce a text to be included in the Commentary as an alternative. The latest draft of such Commentary text is at Annex D to this Report.

18. ***Annex D (pages 54-60) therefore 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. ***It is presented for approval by the Committee.***

Relationship to the Sustainable Development Goals

19. 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.

20. 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.

21. 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 12A ON FEES FOR SERVICES
(REVISED DRAFT OF FEBRUARY 2025)

Article 12A

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 12A ON FEES FOR SERVICES

(DRAFT OF FEBRUARY 2025)

Article 12A

FEES FOR SERVICES

ARTICLE 12A: DRAFT COMMENTARY (REVISED FEBRUARY, 2025)

A. General considerations

1. A new Article 12A was added to the Model Tax Convention in 2025 to replace the 2021 versions of Article 12A and Article 14.

2. Article 12A 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 12A 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 limits on a country's right to tax the income from those services that are no longer appropriate.

3. Article 12A is also intended to make the taxation of fees for cross-border services by source countries more consistent. Under the 2021 version of Article 14, a resident of one Contracting State providing professional or other independent services in the other Contracting State was subject to tax by the other Contracting 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 the 2021 version of Article 12A, fees for consulting, management and technical services provided by a resident of one Contracting 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 12A, a Contracting State is allowed to tax payments for services received from payers resident in the other Contracting State (and non-residents with a permanent establishment in that State that bears those fees) 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 the country in which the company paying such fees and remuneration is resident. Similarly, Article 12 of the Convention allows the taxation of rent paid by a resident of one Contracting State to a resident of the other State and arising in the first State for the use of commercial, industrial or scientific equipment.

5. 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 add a new article on fees for technical services (2017 and 2021 versions of Article 12A) allowing a

Contracting State to impose tax up to an agreed rate on the gross amount of fees for consultancy, management and technical services paid to a resident of the other Contracting State. The Convention was amended again in 2021 to add Article 12B (Income from automated digital services), allowing a State to impose tax up to an agreed rate on payments for automated digital services paid to a resident of the other State. 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.

6. In many circumstances, fees for cross-border services are deductible against a country's tax base, where the payer is a resident of the country or a non-resident with a permanent establishment or fixed base in the country, and the deduction results 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 tax imposed by that country on those fees.

7. 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 limitations on source countries' taxing rights with regard to fees for services, in 2025 the Committee decided to add Article 12A to the Convention and to delete the 2021 version of Article 12A and the 2021 version of 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.

8. In effect, new Article 12A replaces the 2021 version of Article 12A and the 2021 version of Article 14, with the result that fees for services previously taxable under those provisions are usually taxable in accordance with the provisions of new Article 12A 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 12A, 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 of any type without any exclusions.

9. The adoption of Article 12A 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 under former subparagraph (*b*) of paragraph 1 of the 2021 version of Article 14). 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 12A 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.

10. The elimination of threshold requirements based on physical presence for source country taxation of certain cross-border services is the fundamental goal of Article 12A. That goal incorporates two distinct but complementary objectives: to make the provisions of the Convention dealing with those services more consistent and to expand source country taxing rights with respect to income from such services by removing some of the limits on those taxing rights imposed by the 2021 version of Article 12A and the 2021 version of Article 14.

11. Replacing the 2021 version of Article 12A and the 2021 version of Article 14 by new Article 12A 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

the 2021 version of Article 12A and certain other services, or between professional and other independent services taxable in accordance with former 2021 version of Article 14 and certain 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 12A and services also covered by either subparagraph (*a*) or (*b*) of paragraph 3 of Article 5 and in this regard to determine 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 12A unless they amend their domestic law to impose tax on non-residents deriving income from services provided to residents of their country (and non-resident payers with a permanent establishment in the country) and also impose an obligation on those payers 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 are no longer required to 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.

12. Article 12A 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 cross-border services derived by non-residents.

13. Article 12A 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 to offset the tax imposed on the fees for services by the source country. However, such grossing up may not happen if it would make the non-resident service provider uncompetitive. On the argument that the tax may be passed on to the service recipient, the Committee noted that this may not be the case. The actual (economic) incidence of the tax as distinct from its legal incidence, as in case of any tax, may fall on labour, consumers or capital depending on supply and demand and market conditions. Countries should consider all these aspects in assessing the possibility that some fees for services may be grossed up, in the same way that they would assess the possibility of similar grossing-up with respect to interest and royalties under Article 11 and Article 12 of the Convention, respectively. The possibility of grossing up 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 12A, as discussed in paragraph 31.

14. The taxation of fees for services on a gross basis without any deductions under Article 12A should not result in double taxation, as that would be reduced or eliminated under Article 23 (Methods for the elimination of double taxation). The taxation of fees for services on a gross basis under Article 12A should also not result in excessive taxation. The possibility of excessive taxation can be taken into account when negotiating the maximum rate of tax, under paragraph 2 of Article 12A, that can be imposed by a Contracting State on fees for services and, depending on the maximum rate negotiated, the risk of excessive taxation may be reduced or completely eliminated. While Article 12A allows for gross taxation of fees for services, where service providers qualify under paragraph 4 of Article 12A, Article 7 and, generally, net taxation will apply.

15. Despite the inclusion of Article 12A in the Model Tax Convention, a minority of the members of the Committee did not agree with the policy justifications set forth above for Article 12A. Fundamentally, these members did not agree that changes in modern economies, particularly with respect to cross-border services which have 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 of the payments. It was the view of these members that, as a policy matter, the taxation of fees for services by a State is justified only when a service provider has a sufficient nexus to the payer's State and that such a sufficient nexus generally means the services must be physically performed in that State. In other words, they believed 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 the 2021 version of Article 14 (Independent personal services).

16. However, in the opinion of those members, some countries might be willing to agree to include Article 12A in their bilateral treaties if Article 12A were limited to fees for services performed in a Contracting State. Accordingly, Article 12A 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 12A 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. Such an alternative, along with others, is described in paragraphs 108 and 109 below.

17. In addition, they were 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.

18. These members also disagreed with the argument that the introduction of Article 12A can be justified because the uncertainty concerning the treatment of fees for cross-border services under prior versions of the Model Tax Convention may have resulted in difficult disputes, consuming scarce resources.

19. These members of the Committee were also concerned that the taxation of fees for services on a gross basis under Article 12A can lead to excessive or double taxation. Article 12A allows the taxation of certain fees for services to be shifted 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 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.

20. 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 to 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.

21. In the opinion of these members, countries sharing these 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.

22. These members were also concerned that certain design choices (such as retaining subparagraph (*b*) of paragraph 3 of Article 5, applying Article 12A 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 12A with subparagraph (*b*) of paragraph 3 of Article 5 will create administrative challenges both for the taxpayer and the tax administration resulting in tax withheld on a gross basis in accordance with Article 12A having to be refunded and offset against the net taxation on a permanent establishment under subparagraph (*b*) of paragraph 3 of Article 5. 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 subparagraph (*b*) of paragraph 3 of Article 5, including a threshold and/or excluding payments by individuals acquiring services for personal use from the application of Article 12A, similar to the exclusion that was provided for in subparagraph (*c*) of paragraph 3 of the 2021 version of Article 12A (Fees for technical services). Such simplifications and other alternatives proposed by these members are set out in paragraphs 16, 21 and this paragraph of this Commentary.

23. In summary, these members did not accept the arguments in paragraphs 9 to 14 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.-In their opinion, countries sharing these concerns may wish not to include Article 12A in their bilateral tax treaties.

B. Commentary on the paragraphs of Article 12A

Paragraph 1

24. 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.

25. In most cases, the person who provides services receives fees for those services. If the person who receives fees for services is not the person who provides those services, it is a matter for the domestic law of the country in which the recipient of the fees is resident 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, paragraph 1 of Article 12A applies to the fees as long as the recipient is a resident of the other Contracting State.

26. The expression “fees for services” is defined in paragraph 3 of Article 12A 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 and paragraph 6 of the Commentary on Article 11, 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.

27. Article 12A 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 12A 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

28. 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.

29. 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 12A. 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, 12A, 12B, or 12C.

30. The decision not to recommend a maximum rate of tax on fees for services is consistent with Articles 10, 11, 12, 12B, and 12C of the Convention dealing with dividends, interest, royalties, income from automated digital services, and insurance premiums, respectively, as well as the 2021 version of Article 12A dealing with fees for technical services. 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.

31. 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 tax revenue at the expense of its own residents rather than the residents of the other State. However, as discussed in paragraph 13, such an eventuality is not inevitable and would depend on supply and demand and the market conditions.
- 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. There is also the possibility that a very low tax rate on the gross fees may result in an inappropriately low effective tax rate for the source country on the net income from high margin services. The countries should therefore consider both these competing scenarios and agree to a tax rate that works in most situations for both countries.

- The potential benefit of applying the same rate of tax both to royalties under Article 12, payments for automated digital services under Article 12B, and fees for services under Article 12A (see example 6 in paragraphs 76 to 78 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 between countries.

32. Paragraph 2 of Article 12A 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. This is the case 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 12A, 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 12A.

33. Paragraph 2 is expressly subject to the provisions of Articles 8, 12B, 12C, 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 12A. Where, however, fees for services are outside the scope of those Articles, the fees are potentially taxable under Article 12A. 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 12A 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 within the scope of 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), the other State is entitled to tax those payments in accordance with paragraph 2 of Article 12A.

34. Where one of the provisions to which paragraph 2 of Article 12A is subject is not included in a bilateral tax treaty, paragraph 2 of Article 12A applies to the services that would have been covered by that article. For example, where a bilateral treaty includes Article 12A but does not include Article 12B or Article 12C, paragraph 2 of Article 12A will not refer to Article 12B or Article 12C and as a result, any payments underlying income from automated digital services or any insurance premiums that would have been covered by Article 12B or by Article 12C will be within the scope of Article 12A.

35. The beneficial owner requirement 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.

36. 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.

37. 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 12A even if they are not the beneficial owners under the relevant trust law.

38. 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.

39. 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.

40. 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.

41. 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.

42. 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 subparagraph (*a*) of paragraph 2 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, 12A, 12B, and 12C, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to

dividends, interest, royalties, fees for services, income from automated digital services, and insurance premiums, 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".

43. 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 Convention, procedural questions are not dealt with in the Article. Each State is able to apply the procedure provided in domestic law.

44. The following examples illustrate the application of paragraph 2 of Article 12A.

45. 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 12A. The payments made by the patient, a resident of State S, to X would be considered to be "fees for services" as defined in paragraph 3 that arise in State S. As a result, the payments would be taxable by State S in accordance with paragraph 2 of Article 12A.

46. 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 12A.

47. 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 12A. Under paragraph 3 of Article 12A, 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 12A. If, however, X were an employee of the health services company, the payments to X would not be taxable by State S under Article 12A because the application of paragraph 2 is expressly subject to Article 15.

48. 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 12A. 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 12A (assuming that the services are not automated digital services within the meaning of Article 12B). Article 12A would also apply to the fees payable by S Company to R Company for the services performed by R Company in creating and providing access to 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

49. This paragraph specifies the meaning of the phrase "fees for services" for purposes of Article 12A. The definition of "fees for services" in paragraph 3 is intended to be exhaustive. However, the application of paragraph 2 of Article 12A to fees for services is limited to the payments described in paragraph 3 of Article 12A that are not within the scope of other specific Articles of the Convention, namely, Article 8, 12B, 12C, 15, 16, 17, 18, or 19 because paragraph 2 is expressly stated to be subject to the application of those other Articles; (see the examples in paragraphs 73 to 82 below).

50. 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, 12C, 15, 16, 17, 18, or 19 of the Model Tax Convention are not within the scope of Article 12A because paragraph 2 is subject to those Articles.

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

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

52. Although the term "services" in the phrase "fees for services" is undefined in the context of Article 12A, it 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 12A, to the extent that such services fall within the definition of "fees for services" in paragraph 3.

53. Although paragraph 2 of Article 3 of the Model Tax Convention provides that, as regards the application of the Convention at any time, the meaning of an undefined term in the Convention should be the meaning at that 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 12A 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, it would nevertheless be required to provide relief from double taxation under Article 23 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 12A, and the context of Article 12A and the Convention as a whole would require a broader

meaning. Conversely, it would be similarly inconsistent with the treaty for a Contracting State to apply a domestic law meaning of “services” which includes sources of income that are not within the ordinary meaning of services.

54. Although the term “services” is intended to have a broad meaning, it is not intended to include activities where one person provides the use of immovable, tangible or intangible property, or lends money, to another person. The activity of leasing or licencing the use of property does 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 13 of the Commentary on Article 12 for more guidance on such mixed contracts.

55. Similarly, the lending of money does not involve the lender providing services to the borrower; the lender simply provides the use of the funds to the borrower for a period of time. However, other financial services, such as the provision of a guarantee, may be services subject to Article 12A.

56. Although the provision of insurance by an insurer to a person is within the broad meaning of services for purposes of Article 12A, insurance premiums within the scope of Article 12C are effectively excluded from paragraph 2 of Article 12A because paragraph 2 is subject to Article 12C. However, fees for insurance services that are not covered by Article 12C are potentially within the scope of paragraph 2 of Article 12A. For example, Article 12C applies only to insurance premiums paid to an “insurer”, defined in paragraph 3(b) of Article 12C as a person or arrangement that derives the majority of its income from insurance premiums, reinsurance, and annuity contracts and investment income related thereto. As a result, fees for insurance paid by a resident of a Contracting State to a person resident in the other Contracting State, other than such an insurer, may be taxed in the first State in accordance with Article 12A. The definition of “insurance premiums” in subparagraph (*a*) of paragraph 3 of Article 12C excludes amounts paid for an annuity or insurance contract that has a substantial investment component. Although such amounts are excluded from Article 12C and, as a result, are not covered by the wording of paragraph 2 of Article 12A, which makes that paragraph subject to Article 12C, such amounts would not be covered by Article 12A because they represent acquisitions of property rather than fees for services.

57. By reason of the broad definition of "fees for services" in paragraph 3, Article 12A 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 12A 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 12A does not prevent countries from doing so.

58. Countries that wish to exclude payments by individuals for services used or consumed by an individual or other payments from Article 12A 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 in consideration for services for the personal use of an individual.*

The meaning of the phrase "services for the personal use of an individual" is not defined. 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.

59. Some members of the Committee were concerned that different sourcing rules of Article 12A and Article 8 (Alternative A) may create the possibility of multiple source taxation with respect to the income from the operation of ships or aircraft in international traffic. In their bilateral treaties that include Article 8 (Alternative A), countries that share this concern could delete the phrase "Article 8" in paragraph 2 of Article 12A, and revise paragraph 3 to exclude such income from the definition of "fees for services" by adding the following wording at the end of paragraph 3: "unless the payment is made in respect of income from the operation of ships or aircraft in international traffic as defined in paragraph 3 of Article 8." With this exclusion, income as defined in paragraph 3 of Article 8 (Alternative A) would not be subject to different sourcing rules, thus avoiding multiple source taxation.

60. 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 the 2021 version of 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 as 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 12A. 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 12A 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.

61. 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 the 2021 version of Article 12A.

62. The treatment of reimbursements of expenses for purposes of the definition of “fees for services” in paragraph 3 of Article 12A 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.

63. 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 12A.

64. First, a person may be reimbursed for expenses incurred in connection with providing services, but may not receive any other compensation 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 other compensation. In these circumstances, it seems difficult to justify imposing tax on a person who receives only the reimbursement of actual expenses incurred. However, unless reimbursements are explicitly excluded from the definition of "fees for services", paragraph 2 would permit the State in which the reimbursement arises to impose tax on the reimbursement at the rate specified in the treaty.

65. 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 12A 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 providing 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.

66. Third, a resident of one State providing 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.

67. The issues discussed in paragraphs 63 to 66 above are illustrated in the example in paragraph 68 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.

68. Example 4: X, a resident of State 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 State 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 State A and State B have entered into a tax treaty with provisions identical to those of Article 12A, 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, State B would be entitled to impose tax of 15,000 of the fees received by X, which represents a tax rate of 5 percent on X's net profit earned in State B, although State A would be entitled to impose tax on X's fees for services subject to an obligation to provide a credit for the tax imposed by State B on those fees. 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 12A, State 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, State 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 12A as fees for services.

69. It appears to be extremely difficult to predict to what extent, on average, persons providing services are expressly and separately 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.

70. 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 12A. 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 12A.

71. It is sometimes necessary to distinguish between fees for services and royalties in order to determine whether Article 12 or Article 12A 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 one person allowing another person to use property or any transfer of the right to use property to another person. 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).

72. The following examples illustrate the application of the definition of "fees for services" in paragraph 3.

73. 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 12A.

74. The payments received for services provided by a financial institution are clearly fees for services within the meaning of paragraph 3 of Article 12A. Note, however, that if 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 12A by virtue of paragraph 4 of Article 12A.

75. 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, as explained in paragraph 55, 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.

76. 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.

77. 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 12A.

78. 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 12A.

79. The addition of Article 12A to the Model Tax Convention in 2025 not only eliminates the necessity to distinguish between fees for consulting, technical, and management and certain other services but may also reduce 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 12A 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 12A are not the same, it is important to determine whether a particular payment is a royalty or fees for services,

80. 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 13 of the Commentary on Article 12.

81. Example 7: S Company, a resident of State S, enters into a contractual arrangement with R Company, a resident of State 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 12A.

82. 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 12A. 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 12A.

Paragraph 4

83. 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 12A is similar to paragraph 4 of Articles 10, 11 and 12, paragraph 8 of Article 12B, and paragraph 4 of Article 12C. 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 12A.

84. 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 of Article 12A 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.

85. 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 subparagraph (*c*) of paragraph 1 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.

86. 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 12A. 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).

87. Construction activities provided by a resident of one Contracting State in the other Contracting State to a resident of that State or a non-resident with a permanent establishment in that 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 12A, as a result of paragraph 4 of Article 12A. However, where the construction activities are not performed in the other State for more than six months, the conditions of subparagraph (*a*) of paragraph 3 of Article 5 are not met and paragraph 4 of Article 12A would not apply. As a result, paragraph 2 of Article 12A would apply 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. Article 12A does not apply to construction activities by a resident of one Contracting State in the other State where the activities involve property owned by that resident since in this situation no services are provided by one person to another person as required by Article 12A.

88. 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 15 of the Commentary on Article 5). 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.

89. On one hand, to avoid the obligation to refund withholding taxes, states might consider not imposing any obligation to withhold from fees for construction services for the first six months of any construction project. On the other hand, states should be aware of the risk that if there is no obligation to withhold tax and 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.

90. Similar issues are more likely to arise in connection with permanent establishments under subparagraph (*b*) of paragraph 3 of Article 5 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 12A 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.

91. To effectively collect tax imposed in accordance with Article 12A, countries may consider imposing an obligation on the payer to withhold tax from all payments for services made to non-residents (other than payments for any services expressly excluded from the scope of Article 12A). However, the services may have been 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 15 of the Commentary on Article 5). 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 12A applied to the fees for services would normally be treated as a payment on account of the tax payable. The non-resident person providing the services would be required to pay the amount of any shortfall or would be entitled to a refund with respect to any excess tax withheld.

92. Any tax imposed by a State in accordance with Article 12A 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

93. Paragraph 5 lays down the principle that the State in which fees for services arise for purposes of Article 12A 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 12A is determined in accordance with the provisions of Article 4 of the Convention.

94. 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.

95. 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 12A 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.

96. 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 12A.

97. 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.

98. 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.

99. 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.

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

101. 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 12A. 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.

102. 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 12A.

103. 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.

104. 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 12A 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 12A but are taxable exclusively by State R under paragraph 1 of Article 12A.

105. In Example 9, Article 12A of the Convention denies State S the right to tax the fees for services although 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.

106. 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 12A.

107. 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 12A.

108. 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 12A. 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.

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

- The Contracting States might decide not to include paragraph 6. If paragraph 6 were omitted from Article 12A, 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 12A. 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.

110. 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.

111. As explained in paragraph 27 of the Commentary on Article 11, 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 110 above may do so by agreeing, in their bilateral conventions, to the alternative formulation of paragraph 6 suggested in paragraph 112 below.

112. As mentioned in paragraph 111, 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 110 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.

113. 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

114. The purpose of paragraph 7 is to restrict the operation of Article 12A 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.

115. 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.

116. 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.

117. 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.

118. 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

CONSEQUENTIAL AMENDMENTS TO THE ARTICLES OF THE UNITED NATIONS MODEL TAX CONVENTION AS A RESULT OF THE ADDITION OF ARTICLE 12A AND THE DELETION OF THE 2021 VERSIONS OF ARTICLES 12A AND 14

(DRAFT OF 9 MARCH 2025)

This note describes the amendments to the provisions of the United Nations Model Tax Convention that are required as a result of the replacement of the 2021 version of Article 12A (Fees for Technical Services) and former Article 14 (Independent Personal Services) by new Article 12A (Fees for Services). The note tries to identify all the necessary consequential changes and the nature of the required change, which is often simply the deletion of the references to the 2021 versions of Article 12A or Article 14. At the meeting of the Subcommittee on the Digitalised and Globalised Economy on December 18, 2024, it was decided that new Article xx should be numbered as Article 12A (Fees for Services) and former Articles 12A (Fees for Technical Services) and 14 (Independent Personal Services) would be referred to as the 2021 version of Article 12A and the 2021 version of Article 14 both of which, together with their Commentary, will be included in an Annex to the 2025 Model Tax Convention.

The additions to the Commentary have not been assigned numbers since it seemed premature to do so.

Consequential Changes to the Articles of the United Nations Model Tax Convention and the Commentary

Amendments to the Articles are shown in bold**.** Additions to the Commentary are shown in italics. Other comments are in ordinary typeface.

1. Article 3, paragraph 1: a definition of the term “enterprise” should be added to Article 3, paragraph 1 similar to the definition in Article 1 of the OECD Model. Existing subparagraphs 1(*c*) to (*g*) of Article 3 should be renumbered as paragraphs 1(*d*) to (*i*) and the following new subparagraphs (*c*) and (*h*) added

(*c*) The term “enterprise” applies to the carrying on of any business;

Commentary on Article 3, subparagraph 1(c):
The question whether an activity is performed within an enterprise or is deemed to constitute, in itself, an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term “enterprise” has therefore been attempted in this Article. However, it is provided that the term “enterprise” applies to the carrying on of any business. Since the term “business” is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional activities and other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term “enterprise” from their bilateral conventions.

2. Article 3, subparagraph 1(h): a definition of the term “business” should be added to Article 3, paragraph 1 as a result of the deletion of Article 14 to include any activities that would previously have been considered to be independent personal services under Article 14.

(*h*) The term “business” includes the performance of professional services and of other activities of an independent character.
Commentary on Article 3, subparagraph 1(h):

The Convention does not contain an exhaustive definition of the term “business”, which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Subparagraph h), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in 2025 at the same time as Article 14,

which dealt with Independent Personal Services, was deleted from the Convention. This addition, which ensures that the term "business" includes the performance of the activities which were previously covered by Article 14 was intended to prevent that the term "business" be interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition.

3. Article 5(3)(b): delete the words "including consultancy services"

No additions to the Commentary are required. Alternatively, one sentence could be added to indicate: "The phrase "including consultancy services" was deleted because a distinction between consultancy and other services is no longer relevant under the Convention as a result of the addition of Article 12A to replace the 2021 versions of Article 12A and Article 14."

4. Article 6(4): Deletions are shown in brackets and underlined

> 4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise (<u>and to income from immovable property used for the performance of independent personal services</u>).

This change is necessary to remove the reference to "income from . . . independent personal services" as article 14 is deleted.

The following sentence could be added to the Commentary to explain the change: "The change to the wording of Article 6(4) in the 2025 update was necessary to reflect the deletion of the 2021 version of Article 14."

5. Article 10(4) and (5): Deletions are shown in brackets and underlined

> 4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein <u>(, or performs in that other State independent personal services from a fixed base situated therein,)</u> and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment (<u>or fixed base</u>). In such case the provisions of Article 7 (<u>or Article 14, as the case may be,)</u> shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are
paid is effectively connected with a permanent establishment (or a fixed base) situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

These changes are necessary to reflect the deletion of Article 14.

No additions to the Commentary are necessary although one sentence could be added to the Commentary to explain the changes: "The changes to the wording of Article 10(4) and (5) in the 2025 update were necessary to reflect the deletion of the 2021 version of Article 14."

6. Article 11(4) and (5): Deletions are shown in brackets and underlined

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein (, or performs in that other State independent personal services from a fixed base situated therein,) and the debt claim in respect of which the interest is paid is effectively connected with

(a) such permanent establishment (or fixed base,) or with

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

In such cases the provisions of Article 7 (or Article 14, as the case may be,) shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment (or a fixed base) in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment (or fixed base), then such interest shall be deemed to arise in the State in which the permanent establishment (or fixed base) is situated.

These changes are necessary to reflect the deletion of Article 14.

No additions to the Commentary are necessary although one sentence could be added to the Commentary to explain the changes: "The changes to the wording of Article 11(4) and (5) in the 2025 update were necessary to reflect the deletion of the 2021 version of Article 14."

7. Article 12(4) and (5): Deletions are shown in brackets and underlined

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein (, or performs in that other State independent personal services from a fixed base situated therein,) and the right or property in respect of which the royalties are paid is effectively connected with

(a) such permanent establishment (or fixed base), or with

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

In such cases the provisions of Article 7 (or Article 14, as the case may be,) shall apply.

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment (or a fixed base) in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment (or fixed base), then such royalties shall be deemed to arise in the State in which the permanent establishment (or fixed base) is situated.

These changes are necessary to reflect the deletion of Article 14.

The following sentence could be added to the Commentary to explain the change: "The changes to the wording of Article 12(4) and (5) in the 2025 update were necessary to reflect the deletion of the 2021 version of Article 14."

8. **Article 12A:** the 2021 version of Article 12A should be deleted and replaced by new Article 12A.

9. **Article 12B: Deletions are shown in brackets and underlined**

3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article 8 (and notwithstanding the provisions of Article 14), the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be 30 per cent of the amount resulting from applying the profitability ratio of that beneficial owner's automated digital services business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits. However, where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be that of the business segment of the group relating to the income covered by this Article, or of the group as a whole in case segmental accounts are not maintained by the group, provided such profitability ratio of the multinational enterprise group is higher than the aforesaid profitability ratio of the beneficial owner. Where the segmental profitability ratio or, as the case

may be, the overall profitability ratio of the multinational enterprise group to which the beneficial owner belongs is not available to the Contracting State in which the income from automated digital services arises, the provisions of this paragraph shall not apply; in such a case, the provisions of paragraph 2 shall apply.

7. The provisions of this Article shall not apply if the payments underlying the income from automated digital services qualify as "royalties" (or "fees for (technical) services") under Article 12 (or Article 12A as the case may be).

8. The provisions of paragraphs 1, 2 and 3 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, carries on business in the other Contracting State in which the income from automated digital services arises through a permanent establishment situated in that other State (, or performs in the other Contracting State independent personal services from a fixed base situated in that other State,) and the income from automated digital services is effectively connected with:

(a) such permanent establishment (or fixed base,) or

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

In such cases the provisions of Article 7 (or Article 14, as the case may be,) shall apply.

9. For the purposes of this Article and subject to paragraph 10, income from automated digital services shall be deemed to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State or if the person making the underlying payments for the automated digital services, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment (or a fixed base) in connection with which the obligation to make the payments was incurred, and such payments are borne by the permanent establishment (or fixed base).

10. For the purposes of this Article, income from automated digital services shall be deemed not to arise in a Contracting State if the underlying payments for the income from automated digital services are made by a resident of that State which carries on business in the other Contracting State through a permanent establishment situated in that other State (or performs independent personal services through a fixed base situated in that other State) and such underlying payments towards automated digital services are borne by that permanent establishment (or fixed base).

These changes are necessary to reflect the addition of a new Article 12A (Fees for Services) and the deletion of the 2021 version of Article 12A (Fees for Technical Services) and former Article 14.

No additions to the Commentary are necessary although sentences could be added to the Commentary to explain the changes: "The change to the wording of Article 12B(7) in the 2025 update, was necessary because Article 12B applies in priority to paragraph 2 of Article 12A." "The changes to the wording of paragraphs (3), (8), (9), and (10) of Article 12B were necessary to reflect the deletion of the 2021 version of Article 14 of the Convention."

10. Article 13(2): Deletions are shown in brackets and underlined

> 2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, (or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services) including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) (or of such fixed base), may be taxed in that other State.

These changes are necessary to reflect the deletion of Article 14.

No additions to the Commentary are necessary although one sentence could be added to the Commentary to explain the changes: "The changes to the wording of Article 13(2) in the 2025 update were necessary to reflect the deletion of the 2021 version of Article 14."

11. Article 14: Deleted

12. Article 15: consider changing the title to "Income from Employment"

13. Article 15(2)(c): Deletions are shown in brackets and underlined

> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
>
> (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and
>
> (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
>
> (c) the remuneration is not borne by a permanent establishment (or a fixed base) which the employer has in the other State.

This change is necessary to reflect the deletion of Article 14.

The following sentence could be added to the Commentary to explain the change: "The changes to the title of the article and to the wording of Article 15(2)(c) in the 2025 update are necessary to reflect the deletion of the 2021 version of Article 14."

14. Article 17: Deletions are shown in brackets and underlined

> 1. Notwithstanding the provisions of Article(s 14 and) 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of Articles 7(,14) and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

These changes are necessary to reflect the deletion of Article 14.

15. Article 18 (Alternative B): Deletions are shown in brackets and underlined

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

This change is necessary to reflect the deletion of Article 14.

The following sentence could be added to the Commentary to explain the change: "The changes to the wording of Article 18 (Alternative B) in the 2025 update are necessary to reflect the deletion of the 2021 version of Article 14."

16. Article 21: Deletions are shown in brackets and underlined

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein (, or performs in that other State independent personal services from a fixed base situated therein,) and the right or property in respect of which the income is paid is effectively connected with such permanent establishment (or fixed base). In such case the provisions of Article 7 (or Article 14, as the case may be,) shall apply.

This change is necessary to reflect the deletion of Article 14.

The following sentence could be added to the Commentary to explain the change: "The changes to the wording of Article 21 in the 2025 update are necessary to reflect the deletion of the 2021 version of Article 14."

17. Article 22(2): Deletions are shown in brackets and underlined

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State (or by movable property pertaining to a fixed base available to a

> resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services) may be taxed in that other State.

This change is necessary to reflect the deletion of Article 14.

The following sentence could be added to the Commentary to explain the change: "The change to the wording of Article 22(2) in the 2025 update is necessary to reflect the deletion of the 2021 version of Article 14."

18. Article 23A(2) and (4): No change necessary because the references to Article 12A continue to be correct.

19. Article 24(4): Deletions are shown in brackets and underlined

> 4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, paragraph 6 of Article 12, paragraph 7 of Article 12A or paragraph 11 of Article 12B apply, interest, royalties, fees for (technical) services, payments underlying income from automated digital services, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise,
> be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

This change is necessary to reflect the deletion of the 2021 version of Article 12A.

The following sentence could be added to the Commentary to explain the change: "The change to the wording of Article 24(4) in the 2025 update is necessary to reflect the deletion of the 2021 version of Article 12A, which eliminated any distinction between technical and other services."

Since paragraph 7 of new Article 12A is the paragraph of that Article dealing with related parties, the reference to paragraph 7 of Article 12A is correct.

20. Article 29(7)(e)(B)(1): No change is necessary because the reference to Article 12A remains correct.

Alternative Articles in the Commentary

21. Commentary on Article 13, paragraph 47

The alternative article set out in paragraph 47 of the Commentary on Article 13 does not require any changes because the references to Article 12A remain correct and paragraph 5 of the new Article 12A is the same as paragraph 5 of the 2021 version of Article 12A. However, the alternative provision must be revised to delete the references to a fixed base.

Deletions are shown in brackets and underlined.

47. Countries choosing this alternative may wish through bilateral negotiations to clarify which particular source rules will apply to establish where a gain shall be considered to arise. If they do not do so, the domestic laws of each Contracting State will determine the source of the gain. However, the domestic laws of the Contracting States may differ and this may lead to double taxation (or non-taxation where the State of residence of the beneficiary applies Article 23 A to eliminate double taxation). Countries that want to address the issue may wish to replace the phrase "according to the law of that State" at the end of the alternative provision by a rule that would provide expressly when a gain would be deemed to arise in a Contracting State. The following is an example of such a rule which is based on the approach used in paragraph 5 of Articles 11, 12 and 12A as well as in paragraph 9 of Article 12B:

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

ANNEX D

PROPOSAL TO ADD AN ALTERNATIVE PROVISION (PARAGRAPH 4 OF ARTICLE 15) TO THE COMMENTARY ON THE UNITED NATIONS MODEL TAX CONVENTION (REVISED DRAFT OF FEBRUARY 2025)

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 paragraph 4 to Article 15), which the Subcommittee has previously discussed in connection with Workstream C) allows the State in which the employer is resident to impose tax on the non-resident employee's income from employment exercised outside the employer's State of residence, subject to the elimination of double taxation. A draft version of paragraph 4 of Article 15 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 Committee's *Practices and Working Methods*, some members of the Committee wish to present a provision similar to paragraph 4 of Article 15 for inclusion in the Commentary to Article 15. The proposal has been discussed by the members that are interested in the provisions, with some other members also giving their input in order to have a text that is as balanced as possible, 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. The introduction and expansion of new digital technologies and tools in recent years have facilitated the adoption of remote working arrangements. While the ability to work remotely may assist in meeting the particular challenges presented by restrictions and barriers to labor mobility, especially from developing to developed countries, remote working may also create difficult policy issues for countries. A [small minority] of Members of the Committee are concerned regarding the taxation issues involved, such as in

the following case: 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 is identical to the Model Convention. If X is not in a top-level managerial position, in respect of which Article 16 applies, 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 or 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. This concern may be exacerbated by technological advances facilitating remote working abroad as a long-term arrangement for specific employments, the duties of which are unrelated to physical presence, as the location of the employee and the exercise of the employment may be independent of the location of the employer. This asymmetry may be viewed as a greater concern where non-resident employees are resident in a Contracting State that imposes tax on them at a rate that is significantly lower than the tax rate imposed by the Contracting State in which the employer is resident.

2. To address such asymmetry arising from remote working arrangements, some countries may therefore wish to include a provision in their bilateral treaties that allows 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. However, if the remuneration, although paid by an employer in the first Contracting State, is borne by an employer resident in the same State as the employee – the *other Contracting State* – or by a permanent establishment in that State, any tax cost of the deduction of the remuneration for tax purposes would not arise in the State of residence of the employer but rather in the State of residence of the employee, so that asymmetry should not arise. A provision taking account of both these considerations might be worded as follows:

4. Notwithstanding the provisions of paragraphs 1 and 2 and subject to the provisions of paragraph 3 and Articles 16, 18 and 19, salaries, wages and other similar

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 and such remuneration is not borne by a resident of the first-mentioned Contracting State or a permanent establishment situated therein.

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, a limit on the taxation of the remuneration by the State of residence of the employer would be appropriate to the extent that paragraph 4 of Article 15 is primarily considered to be a provision allowing source-State taxation. Consistent with that view of paragraph 4 of Article 15, a variant of the alternative provision in paragraph 4 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 and subject to the provisions of paragraph 3 and Articles 16, 18 and 19, salaries, wages and other similar 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 and such remuneration is not borne by a resident of the first-mentioned Contracting State or a permanent establishment situated therein, 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. A number of broad considerations arise in connection with this alternative provision: First, the decision to introduce such a provision, as in paragraph 2 or 3 above, in a bilateral treaty would warrant careful evaluation by the States concerned, in particular with reference to their different situations regarding cross-border flows of employment income between employer and employee. In addition to imbalances in economic development between countries, such differences may originate from various factors specifically affecting the inward and outward mobility of labour for the country concerned, including significant

barriers to entry; limited periods of permitted presence; or a reduced scope of activities to be performed by foreign individuals (in general or of a specific nationality). Second, in cases of under-taxation of employment income by jurisdictions seeking to attract mobile employees to work remotely there, the potential effectiveness of anti-abuse measures could also be considered. Third, from their respective perspectives as States of residence of employees, who work remotely for an employer in another State, Contracting States may wish to address difficulties, in getting information detailing the remuneration of those employees, by developing spontaneous exchanges of information about such employees with other States.

5. 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.

5.1 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 <u>and paragraph 4 of Article 15</u>, 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.

5.2 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 and/or to address remote working schemes without limiting the right of the residence country of the employee to tax. 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 6, 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 or in a third State.

> ***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.***

5.3 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 or in a third 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 or in a third State. 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.

5.4 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.

5.5 The elimination of double taxation in relation to paragraph 4 of Article 15 would be more complex in a triangular situation where the employee is a resident of State A, whose employer is a resident of State B, and part of whose employment is exercised and taxed in State C., One scenario is that the ordinary Article 23B or the alternative Article 23A (as set

out in paragraph 5.1 above) is adopted in the Convention between States A and B. State B taxes the remuneration derived from the employment exercised in State C in accordance with Article 15.4 of the Convention between State A and B, while State C taxes the same remuneration in accordance with Article 15.2 of the Convention between State A and C, then double taxation occurs. State A is obligated to provide double taxation relief in respect of the tax paid in both State B and State C. If State A cannot fully relieve the double taxation, it may also lead to over-taxation. Another scenario is that the elimination of double taxation provision as set out in paragraph 5.2 is adopted. Under the Convention between States A and B, it does not provide any relief for *State C tax* on the employee's remuneration from the exercise of the employment in State C. Where such taxation is relieved by a Convention between States A and C, the reduction of tax paid in State A may, in turn, result in a reduction of double taxation relief under Article 23B.3 of the Convention between States A and B, resulting in excessive cumulative taxation of the employee's remuneration across States A, B and C. To prevent, or mitigate, such an outcome, relief could be provided by the domestic law of State B, i.e. the employer's State of residence, providing unilateral relief for taxation imposed by third States, such as State C, in which an employment is exercised by an employee who is a resident of a Contracting State, such as State A, for the purposes of a Double Taxation Convention with State B that includes an Article 15.4 as set out in paragraph 2 above. Negotiators interested in introducing the alternative provision of Article 15.4 into bilateral tax treaties should consider the complexities that arise when a third State is involved, along with the risks of double taxation, over-taxation and potential disputes.