

*Fernando Souza de Man*

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# Taxation of Services in Treaties between Developed and Developing Countries

A Proposal for New Guidelines

IBFD DOCTORAL SERIES

39



# Taxation of Services in Treaties between Developed and Developing Countries

## A Proposal for New Guidelines

### Why this book?

The ease with which services are provided cross-border has increased considerably through the years, but this has not been reflected in the model conventions. Although this may not be an important issue when the flow of services between states is similar, it can have a huge impact on the collecting rights of states into which these services are mainly imported, such as developing countries. Nonetheless, developing countries' claims for more source taxation of services have been consistently neglected in model conventions. With the intent of analysing whether the claims of developing countries are valid, as well as examining how the current system was structured, the author studies the legal and economic theories that support source and residence taxation and the historical documents concerning model conventions drafted by the League of Nations, the OECD and the United Nations. Furthermore, to better grasp the perspective of developing countries, the author analyses the situations of Brazil and India regarding the taxation of services in their domestic legislation and in their tax treaties, comparing the provisions of the latter with the current provisions in model tax conventions. After ascertaining that the pleas of developing countries for more source taxation of services income are supported by legal and economic theory, above all by the right to development, which has been duly recognized by states in the United Nations sphere, and that the more powerful developing countries have been successful in mirroring their domestic law in their treaties, the author studies the proposals that have been made to increase source taxing rights regarding services income. Ultimately, after ascertaining that these measures are insufficient, he embarks on developing a new provision on the taxation of services that is in line with the right to development and that, he argues, should be adopted in double tax treaties between developed and developing countries. This book is volume 39 of the IBFD Doctoral Series.

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## Introduction

This book focuses on the rules concerning the taxation of services in double tax conventions (DTCs) and their applicability in conventions signed between developed and developing countries. The decision to study the taxation of services stems from the prominent position of these activities in today's economy: currently, services generate most of the GDP of both developed countries (e.g. the Netherlands, at 74.8%) and developing countries (e.g. Nicaragua, at 56.4%), comprising 62.5% of global GDP.<sup>1</sup> Furthermore, it is expected that this proportion will increase as countries develop and, as a consequence, actively participate in the global economy.<sup>2</sup> As a result of this service-oriented economic structure, both source and residence states are keen to guarantee themselves the right to tax this income, and this may lead to double taxation of income from services.

In that regard, even though the taxation of services has been under scrutiny for at least 30 years, since the 1980 UN Model Convention diverged from the 1977 OECD Model Convention, lately this issue has been brought to the forefront of international taxation mainly due to recent technological developments. The inclusion of a services permanent establishment (PE) alternative in the Commentaries on Article 5 of the OECD Model Conven-

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1. Central Intelligence Agency, The World Factbook, *GDP – Composition by Sector*, available at <<https://www.cia.gov/library/publications/resources/the-world-factbook/fields/2012.html#xx>>, accessed on 21 September 2015; Overseas Development Institute, United Kingdom, Department for International Development, OECD Global Forum on International Investment, *The Contribution of Services to the Development and the Role of Trade Liberalisation and Regulation*, 27-28 March 2008, p. 3, available at <<http://www.oecd.org/investment/globalforum/40302909.pdf>>, accessed on 21 September 2015; World Bank, “Industrialization and Postindustrialization”, *Beyond Economic Growth: An Introduction to Sustainable Development*, Second Edition, available at <<http://www.worldbank.org/depweb/english/beyond/global/beg-en.html#toc>>, accessed on 21 September 2015; Claire Jones, “Services Data Allay Fears on Economy”, *Financial Times*, 5 March 2013, available at <<http://www.ft.com/cms/s/0/896f4842-857c-11e2-bed4-00144feabdc0.html#axzz2Mm0OM6hv>>, accessed on 6 March 2013. The services sector makes up more than three quarters of the United Kingdom's GDP (78.8%, as mentioned in the CIA World Factbook); Natalie McCullough, “Services, Not Manufacturing, Will Revive the U.S. Work Force”, *Forbes*, 19 April 2012, available at <<http://www.forbes.com/sites/ciocentral/2012/04/19/services-not-manufacturing-will-revive-the-u-s-workforce/>>, accessed on 6 March 2013. According to the CIA World Factbook, the services sector makes up 77.7% of the GDP of the United States.

2. Overseas Development Institute, (note 1), p. 3.

tion<sup>3</sup> and the work being conducted by the UN concerning a revision of the tax treatment of services in general, with the initial focus on fees for technical services,<sup>4</sup> corroborate the idea that, today, the taxation of services is one of the most controversial topics as regards the allocation of taxing rights in DTCs signed between developed and developing countries.

The ongoing discussions in the OECD and UN forums on how to allocate taxing rights over income from services serve as background for the main research question of this book: *Should developing countries have taxing rights over income from services?*

In this book, in order to provide an answer to this question, the author will study the reasons for taxing income at residence and at source; the history of the taxation of services in model conventions; the domestic laws and DTCs entered into by Brazil and India; and the main points of conflict between developed and developing countries as regards the taxation of services. After assessing that there are various reasons that justify the taxation of income at source and verifying that, normally, model conventions do not allow for source taxation of income from services, the author will propose the inclusion of an article to regulate the taxation of services in DTCs between developed and developing countries in the OECD Model Convention.

The research methods applied in this book are the following: (i) descriptive – the author will describe the model conventions drafted by the League of Nations, the OECD, the United Nations, the Andean Community and the Latin American Institute of Tax Law, as well as the domestic legislation of Brazil and India; (ii) comparative – the author will compare the models conventions with the domestic laws of and the DTCs signed by Brazil and India, in order to assess whether they regulate the taxation of services in a similar manner and, if not, in what respects they diverge; and (iii) normative – the author will make a proposal for the inclusion of an article in the

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3. OECD, Commentaries on Article 5 2010 OECD MC, Taxation of Services, paragraphs 42.11-42.48, added in 2008, in Kees van Raad (ed.), *Materials on International & EC Tax Law*, 10th ed., International Tax Center, Leiden, 2010.

4. Brian J. Arnold, *Taxation of Fees for Technical Services*, United Nations Committee of Experts Meeting, Geneva, 15-16 October 2012, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2014/09/8STM\\_PPT\\_4.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2014/09/8STM_PPT_4.pdf)>, accessed on 21 September 2015; Brian J. Arnold, *Taxation of fees for technical and other services under the United Nations Model Convention (Note by the Secretariat)*, United Nations Committee of Experts on International Cooperation in Tax Matters, Eighth Session, Geneva, 15-19 October 2012, document E/C.18/2012/4, Geneva, 2012, available at <<http://www.un.org/esa/ffd/events/eighth-session-tax.html>>, accessed on 21 September 2015.

OECD Model Convention that could be used in DTCs between developed and developing countries.

The Andean Community Model and the recent model tax convention elaborated by the Latin American Institute of Tax Law will not be studied in detail (they will be briefly addressed in chapter 7), because these model conventions did not entail significant practical developments regarding the source taxation of services, since no developed country has ever signed a DTC based on either of them (as a matter of fact, up until now, no DTC of any description has been based on the work of the Latin American Institute of Tax Law).

The focus will be on the current Articles 5, 12 and 14 of the OECD and the UN Model Conventions. These articles were chosen because they: (i) set the requirements for the taxation of income from services at source (Article 5); (ii) generate discussions concerning the nature of the services rendered (Article 12); and (iii) deal specifically with situations in which the most important trait of the relation between the parties is the furnishing of services (Article 14). In addition, attention will also be paid to Article 7, but the study on this article will be limited to its interaction with Article 5; no mention will be made of the methods of attribution of profits to PEs, as this subject is outside the scope of this book.

Article 21 will not be addressed extensively in this book, because even though some countries may regularly make use of its provisions as a means of taxing income from services<sup>5</sup> - and this practice may be recognized by the United Nations in specific cases<sup>6</sup> - its application should be limited to situations in which it is considered that the income does not fall within the scope of any other article of the OECD Model Convention. That is to say, Article 21 is a catch-all clause to be used in residual cases. Hence, even though it cannot be concluded that this article is irrelevant to the taxation of services in all cases,<sup>7</sup> it cannot act as a general rule for the taxation of services.

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5. See secs. 6.1.1.1.1. and 6.1.1.2.1., regarding Brazil.

6. United Nations, Committee of Experts on International Cooperation in Tax Matters, *Note on the Taxation of Services under the United Nations Model Tax Convention*, document E/C.18/2010/CRP.7, paragraph 17, p. 6, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2014/10/6STM\\_NoteTaxationOfServices.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2014/10/6STM_NoteTaxationOfServices.pdf)>, accessed on 21 September 2015.

7. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 6), paragraph 17, p. 6.

The remaining articles concerning the provision of services (income from employment, director's fees, artistes and sportsmen, pensions and government services) will also not be analysed here, because, in each of their cases, the provision of services is not the determining factor for the allocation of taxing rights between states – in each case, there is an extra criterion influencing how these services will be taxed. As an example, in the case of income derived from employment, the employee (service provider) has a stable, enduring contractual relationship with an enterprise, which is regulated by labour law. The existence of this relationship influences the division of taxing rights between source and residence states, with taxation at source being dependent, apart from the employment being performed at source, on the residence of the employer/location of the PE of the employer.<sup>8</sup> Further, in the provision of services to government bodies, the principle of reciprocal non-taxation between states favours the exclusive taxation of the income by the state that is paying the income.<sup>9</sup>

Concerning the relationship between the model conventions elaborated by the international institutions mentioned above, the OECD Model Convention will be used as the paradigm of the current system of taxation of income from services, due to its widespread adoption and influence on other model conventions and DTCs. However, it should be borne in mind that there is no hierarchy between the model conventions: all model conventions have equal footing in the international sphere. Moreover, the OECD Model Convention does not reflect a consensual position on the topic, but is merely the system that was considered valid by the OECD member countries. As a counterpoint to this system, the author will scrutinize the model double tax convention elaborated by the United Nations and the DTCs signed by Brazil and India, two of the most prominent developing countries.

The examination of the conventions signed by Brazil and India will be undertaken with the intent of verifying the divergences in the perspectives of developing and developed countries with regard to the principles enshrined in the OECD Model Convention concerning the allocation of taxing rights over income from services. Furthermore, this scrutiny may demonstrate how Brazil and India use their DTCs as instruments to assert their tax policies and their right to development. The analysis of the position of de-

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8. As expressed in Article 15(2) of the OECD and UN Model Conventions, income from employment may be taxed at source, as long as the employment is exercised therein. However, if the employee stays fewer than 183 days in the source state and the remuneration is not paid by an employer resident at source or borne by a PE of the employer at source, then this income shall be taxable only at the residence state.

9. Article 19(1) of the OECD and UN Model Conventions.

veloping countries is essential to the study of the topic, since, even if it is considered that taxation at source should be restricted to PE situations, developing countries may try to tax this income irrespective of the existence of a PE at source. Considering that there is no supranational organization that can enforce respect for the rules enshrined in model conventions, this disregard for the PE concept could lead to its erosion as a threshold for source taxation of services.<sup>10</sup>

The choice to study Brazil and India stems from their almost unique positions: they may not be considered developed countries yet, but, at the same time, it is increasingly difficult to view them as classical developing countries. As a result of their intermediate stages of development, exemplified by their recent economic surges, scrutiny of the DTCs entered into by these two states will allow for an analysis of whether, as argued by the OECD, the continuous development of a state will influence its predilection for the residence principle. If this assertion is correct, it should already be possible to note a shift in Brazilian and Indian tax treaty policy. Moreover, as will be seen in chapter 6, this unique position grants these states more leverage in treaty negotiations: they are in a better position to defend their interests in DTCs than most developing states.

Finally, following the analysis of the international rules on the taxation of income from services and the main issues concerning these rules, the author will provide his input on the matter, proposing the addition of a new article to the OECD Model Convention which, in his opinion, could help to avoid further discussions while also aligning the taxation of income from services with the economic and juridical reality underlying these activities.

The book consists of seven chapters plus a conclusion. Chapter 1 will focus on the importance of taxation for states and an analysis of the economic and juridical factors that justify taxation at source and residence. Lastly, the reasons for the emergence of DTCs as prime instruments for the avoidance of double taxation will be scrutinized.

While chapter 1 may initially appear to be a general overview of issues not directly linked to the research question at hand, this analysis in fact clarifies the reasons why source and residence states are eager to assert taxing rights over cross-border income, including income from services, and why

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10. Arvid A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle*, Series on International Taxation 13, Kluwer Law and Taxation Publishers, Deventer, Boston, 1991, p. 3.



this issue has been entrenched in DTCs. In addition, the right to development, a guiding principle of this research and the basis for the proposal to be made in chapter 7, will be studied in this initial chapter.

In chapter 2, the focus will be on the work undertaken by the League of Nations on the taxation of income from services. In that regard, as the current numbering of the articles in the OECD Model Convention is derived from the model convention drafted in Mexico, reference will be made, from chapter 2 on, to the previously mentioned Articles 5, 12 and 14.

The examination of the work conducted by international organizations will continue in chapter 3, with a study of the historical documents from the OEEC and the subsequent model conventions drafted by its successor, the OECD. Attention will also be paid to the reports elaborated after the update to the OECD Model Convention in 2010 and to the BEPS Actions that deal with issues related to the taxation of services. Furthermore, considering the nexus between the work of the League of Nations, the OEEC and the OECD, the chapter will include an assessment of whether the principles concerning taxation at source and residence were properly respected in the model conventions drafted by these organizations.

The model conventions drafted by the United Nations with the goal of providing more taxing rights to source states will be analysed in chapter 4. At this point, apart from the evaluation of the articles of this convention, as well as of the work conducted after the 2011 update, a comparison will be made between the tax treatment of income from services in accordance with the OECD and the UN Model Conventions. Moreover, the reasons for the residence state bias of the OECD Model Convention will be discussed.

Chapter 5 will be dedicated to the study of the main divergences as regards the taxation of income from services as prescribed by the OECD Model Conventions. The analysis will scrutinize whether the framework currently in place is capable of regulating activities marked by recent technological developments, with special attention paid to the influence of technology on the PE concept and the services PE alternative. The chapter will further discuss the relationship between royalties and income derived from technical assistance/services.

Subsequently, in order to clarify the main issues surrounding the taxation of income from services, chapter 6 will analyse the emerging-country perspectives of Brazil and India. The analysis of their tax policies will highlight the dissonances between the ideas prescribed in the OECD Model

Convention and the tax systems non-member countries aspire to in their negotiations of DTCs. In order to provide for a more complete examination of the topic, the chapter will include a study of the relationship between DTCs and the domestic legislation of these two countries, as well as an analysis of the influence of the principles proposed by the OECD on their tax policies. Furthermore, the author will undertake an examination of the DTCs so far signed by these states. (On 29 May 2017, Brazil submitted a formal request to join the OECD, so its status as a non-member country may change in the near future. It will be interesting to see what effect, if any, membership in the OECD will have on Brazilian treaty policy.)

Bearing in mind the mismatches in the tax treatment of income from services, in chapter 7 the author will analyse the proposal made for taxation of services and, ultimately, draft a proposal for the reallocation of taxing rights in respect of this income that is in line with the economic and juridical principles developed in the book. As a final point, the conclusion will provide a brief overview of the issues dealt with throughout.

Before proceeding with chapter 1, the author would like to present a clear definition of important concepts that will be used in this book. First of all, references to the phenomenon of double taxation are to be understood as references to juridical double taxation, i.e. the imposition of comparable taxes by two (or more) tax jurisdictions on the same taxpayer in respect of the same taxable income or capital.<sup>11</sup>

Furthermore, when referring to the stage of development of countries and the right to development, this book adopts the definition of “development” contained in the UN Declaration on the Right to Development,<sup>12</sup> namely “a comprehensive economic, social, cultural and political process, which aims at the constant improvement of the well-being of the entire population

11. Herbert Dorn, “*Das Recht der Internationalen Doppelbesteuerung*”, Teil I, *Vierteljahresschrift für Steuer- und Finanzrecht*, Berlin, 1927, p. 190; Benvenuto Grizziotti, “*L’Imposition Fiscale des Étrangers*”, *Recueil des Cours*, vol. 13, n. III, The Hague Academy of International Law, The Hague, 1926, p. 36; OECD, Introduction to the 2010 OECD MC, paragraphs 2 and 3, in Kees van Raad (ed.), (note 3), p. 47; Klaus Vogel, “Double Tax Treaties and their Interpretation”, *Berkeley Journal of International Law*, vol. 4, n. 1, 1986, p. 4, available at <<http://scholarship.law.berkeley.edu/bjil/vol4/iss1/1/>>, accessed on 7 March 2013; International Bureau of Fiscal Documentation, *International Tax Glossary*, available on the IBFD Tax Research Platform, at <[www.ibfd.org](http://www.ibfd.org)>, accessed on 4 December 2012.

12. United Nations, General Assembly, *Declaration on the Right to Development*, document A/RES/41/128, Geneva, 1986, available at <<http://www.un.org/documents/ga/res/41/a41r128.htm>>, accessed on 21 September 2015.

and of all individuals on the basis of their active, free and meaningful participation in development and in the fair distribution of benefits resulting therefrom”.<sup>13</sup> That is to say, development is not only viewed from an economic perspective; it is also understood in terms of social considerations.

Consequently, Brazil and India are still treated as developing countries, because, despite their recent economic development, they have not yet reached standards of living similar to developed nations, as represented by the Human Development Index created by the United Nations.<sup>14</sup> As a matter of fact, the term “developing country” encompasses a broad range of countries in different stages of development, including: (i) newly industrialized countries and oil-producing and exporting countries; (ii) medium-income developing countries; and (iii) least-developed developing countries, including most sub-Saharan African countries and some Asian and Latin American countries.<sup>15</sup> Despite their recent progress, Brazil and India are still part of tier (i).

Absent a definition of the term “services” in the OECD and UN Model Conventions or in tax treaties, the term has been variously defined in the scholarly literature as “any work done for another person for remuneration”;<sup>16</sup> “the act of doing something useful for a person or company for a fee”;<sup>17</sup> and “activities involving functions performed by one or more individuals at a particular location for the benefit of another person”.<sup>18</sup> Thus, the term refers to the performance of an economic activity by an individual

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13. United Nations, General Assembly, (note 12), Preamble.

14. According to the United Nations, Brazil is ranked 79 out of 187 countries, with an HDI of 0.744, while India is ranked 135, with an HDI of 0.586, United Nations, International Human Development Indicators, available at <<http://hdr.undp.org/en/countries/>>, accessed on 21 September 2015. The adoption of the HDI as a reference for development is in line with the idea that the concept of development must go beyond the accumulation of wealth and growth of GDP, as argued by Amartya Sen, *Development as Freedom*, Anchor books, New York, 2000, iPad version, p. 32.

15. Klaus Vogel, “A Importância do Direito Tributário Internacional para os Países em Desenvolvimento” (translated by Brandão Machado), in Agostinho Toffoli Tavelaro, Brandão Machado and Ives Gandra da Silva Martins (coords.), *Princípios Tributários no Direito Brasileiro e Comparado: Estudos em Homenagem a Gilberto de Ulhôa Canto*, Forense, Rio de Janeiro, 1988, p. 470; International Bureau of Fiscal Documentation, (note 11), accessed on 4 December 2012.

16. Wim Wijnen, Jan de Goede and Andrea Alessi, “The Treatment of Services in Tax Treaties”, *Bulletin for International Taxation*, vol. 66, n. 1, IBFD, Amsterdam, 2012, pp. 27-28.

17. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 6), accessed on 10 October 2012, paragraph 3, p. 2.

18. Ariane Pickering, “General Report”, in Ariane Pickering et al., *Enterprise Services*, IFA Cahiers de Droit Fiscal International, vol. 97a, SDU, The Hague, 2012, p. 25.

in return for a payment. For the purposes of this book, this is the concept adopted by the author. Consequently, “services income” means the income earned by means of the performance of an activity in exchange for remuneration.

Moreover, considering that the crux of this book is the allocation of taxing rights over income from services between developing and developed countries, which are chiefly source and residence states,<sup>19</sup> respectively, it is paramount to define the source and residence principles. The source principle relates to the taxation of income that arises or is deemed to arise in a state. It does not matter whether this income is earned by a resident or non-resident; in both cases, the source state is entitled to tax.

The source principle should not be confused with the territoriality principle. While the source principle focuses on taxation in the source state, allowing for taxation as long as income is viewed as arising in the state (when, for example, income is received in this state or is paid by a resident of this state), the territoriality principle is a restriction on the taxation rights of the residence state; by adopting the territoriality principle, the residence state accepts the compromise of only taxing activities carried on in its territory. A state which adopts source taxation can still tax its residents on the activities they carry on abroad (worldwide taxation), but a state which chooses territoriality foregoes this possibility.

As for the relationship between the source and origin principles in income taxation, although one might say that these concepts differ – that origin taxation may only occur if it is considered that income was created in a state (i.e. is derived from an intellectual activity in this state), while the source principle does not have this requirement, being used anytime that the income is physically linked to a state<sup>20</sup> - the author considers that these concepts are actually similar.

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19. Although source and residence are not necessarily conflicting ideas, in this book, they are used to characterize states which mainly import capital (source) and export capital (residence). To learn more about the occasional correspondence between source and residence, see Klaus Vogel, in Klaus Vogel and Mohris Lehner, *Doppelbesteuerungsabkommen*, 5. Auflage, Beck, München, 2008, *Einleitung des OECD-MA*, Erläuterung, Randnummer 92-93; Klaus Vogel, “‘State of Residence’ may as well be ‘State of Source’ – There is no Contradiction”, *Bulletin for International Fiscal Documentation*, vol. 59, n. 10, IBFD, Amsterdam, 2005, pp. 420-423.

20. Eric Kemmeren, *Principle of Origin in Tax Conventions: A Rethinking of Models*, 2001, pp. 33-36, available at <<http://webwijs.uvt.nl/publications/304239.pdf>>, accessed on 4 December 2012.

“Source” is a broad concept that encompasses diverse situations. The place where the intellectual activities were performed can definitely be considered a source of income, since taxing rights are a consequence of this income-generating activity. The recourse to a different terminology and the assertion of a causal link between the income and the activity does not alter the fact that this state is the source of income, i.e. income arises in this state. In the same manner, the state in which payments are deducted is also a source state, since the earning of income is dependent on those payments, irrespective of where the income has been produced/activities have been performed.<sup>21</sup> Thus, the source and origin principles are inter-related; it may be said that the origin principle in income taxation refers to the source of production,<sup>22</sup> while the source principle is focused on the source of payments. Therefore, the idea behind the origin principle may be seen as a subcategory of a broad source principle.<sup>23</sup> As a result, in this book, both situations – source of production and source of taxation – will be considered as creating a source state liability.

Naturally the recognition of a source of production and a source of payment can create a cumbersome situation; the sources of production and payment for a service may differ, and both states may claim taxing rights over the same income. In that situation, considering that the source of production will most likely also be the residence state of the service provider, this state should, in line with the guidance usually given in model conventions, either provide a credit for the taxes paid abroad or exempt the income earned abroad. If the residence state and the source of payment coincide but the source of production is abroad (as, for example, in the case of services performed abroad but borne by a PE of the non-resident established in the residence state of the service provider), then the state in which the payments are made would be responsible for crediting the taxes paid abroad, since in this case it would also be the residence state of the income earner. Finally, if the source of production/source of payment is in a third state, the issue would have to be solved on a case-by-case basis.

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21. Luís Eduardo Schoueri, “*Imposto de Renda e o Comércio Eletrônico*”, in Luís Eduardo Schoueri (org.), *Internet: o direito na era virtual*, Rio de Janeiro, Forense, 2001, p. 51.

22. In order to avoid confusion with the terminology used on indirect taxation, in this book, preference will be given to the use of the term “source of production” instead of “origin”.

23. Despite using the concepts of source of production and source of payments, Alberto Xavier argues that there is a causal link between the production place and the income, which does not exist in the place of payment, so these situations would only appear to be similar, in Alberto Xavier, *Direito Tributário Internacional do Brasil*, 6th ed., Forense, Rio de Janeiro, 2007, p. 304.

Moreover, considering countries' practices, the following situations could also be viewed as defining a source state: (i) it is the place in which activities are developed through a PE; (ii) it is the place in which a person benefits or makes use of services or equipment provided by a non-resident; and (iii) it is the place in which contracts are entered into.<sup>24</sup>

As for the residence principle, it is established under the assumption that a state is entitled to tax the income earned by a resident, irrespective of the place where this income was earned. Therefore, it allows for taxation of income earned abroad, i.e. worldwide income. This concept is extremely similar to the domicile principle, which is normally viewed as a residence with a higher degree of permanence; thus, they are used interchangeably in this book.

Finally, it should be borne in mind that references to the PE concept are based on the general rule, i.e. the fixed-place-of-business concept. In this book, the building site PE and the dependent agent PE are not studied further as, even though they are part of the PE article, they are already deviations from the fixed-place-of-business definition which characterizes the PE concept.

The legislation, case law and works conducted by international organizations referred to in this book are as stated on 1 November 2016. Thus, subsequent developments have not been taken into account (but may be reported in the footnotes on occasion).

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24. Ariane Pickering, (note 18), pp. 30-31.

**Sample Content**



the UN embraced the update in its Model Convention with the aim of adjusting it to the advance of globalization of trade and investment and the tax policies of developing and developed countries.<sup>489</sup> The update was also mirrored in the doctrine and comments by tax negotiators/administrators.<sup>490</sup>

The modifications made to the UN Model Convention were based on the same principles of its predecessor, namely that the convention strived for net taxation at source that would not discourage investments. Therefore, this model was structured as a balance between the taxing rights of source states and the hindering effects of high source-state taxes on international business.

Interestingly, it took the UN longer to update its model than it took the OECD (21 years for the former compared with an average of 14-15 years for the latter until the 1992 update). Moreover, since the adoption of the loose-leaf format by the OECD, the OECD Model Convention has been revised more regularly than its UN counterpart. The faster pace of the updates to the OECD Model Convention can be unmistakably attributed to the piecemeal consideration of articles instead of a complete revision, as done by the UN.

#### 4.2.1. Taxation of services in the 2001 UN Model Convention

Considering that the 2001 UN Model Convention was fine-tuned to the practice of countries, it provided a good overview of how developed and developing states were dealing with the source versus residence controversy in practice. Further, the analysis of the influence of technological improvements on the allocation of taxing rights shed light on the direction in which the UN was going, with regard to whether the UN was still a valid option for source states as regards the expansion of their taxing rights or whether it was captured by the interests of residence states expressed in the OECD Model Convention.

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489. United Nations, *Commentaries on the Articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries*, New York, 2001, available on the IBFD Tax Research Platform at <[www.ibfd.org](http://www.ibfd.org)>, accessed on 8 October 2012, Introduction, point 13, p. XII.

490. United Nations, (note 489), Introduction, point 45, p. 23.

#### 4.2.1.1. Permanent establishment concept

Article 5 of the 2001 UN Model Convention was almost a carbon copy of its predecessor. But there were two important modifications that deserve closer attention: (i) the inclusion of subparagraph (f) to paragraph 4; and (ii) the adoption of the arm's length principle in paragraph 7, as follows:

Article 5  
Permanent Establishment

[...]

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

[...]

(f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

[...]

7. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.<sup>491</sup>

The idea expressed in Article 5(4)(f), although new to the UN Model Convention, has been part of the OECD Model Convention since the 1977 update. As explained above,<sup>492</sup> the crux of the subparagraph is that activities that individually will not lead to a PE should also not form a PE when developed together, as long as the final result of the combination of these activities maintains its auxiliary nature.

Bearing in mind that countries opted not to include this provision in the 1980 UN Model Convention, its insertion in the 2001 UN Model Convention is surprising. Furthermore, this alignment with the 1977 OECD Model Convention augmented the exceptions to the PE concept, potentially reducing source taxing rights. As the UN Model Convention was thought of as an instrument to allow for more source taxation, the inclusion of Ar-

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491. United Nations, *Articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries*, New York, 2001, Article 5, pp. 6-8, available on the IBFD Tax Research Platform at <[www.ibfd.org](http://www.ibfd.org)>, accessed on 8 October 2012.

492. See sec. 3.3.1.1.

article 5(4)(f) and the consequent restriction on situations in which a PE will arise appears to be not in line with the goal of the UN Model Convention.

Furthermore, the practice of countries illustrates that even when the UN Model Convention grants preferential treatment to source states, this is not necessarily reflected in the DTCs that are signed. For example, although the “delivery of goods” was not part of Articles 5(4)(a) and 5(4)(b) of the 1980 UN Model Convention, most of the DTCs signed by developing countries contained this term as an exception to the PE concept.<sup>493</sup> Therefore, despite the advantages prescribed by the UN Model Convention, its guidance was not sufficient to empower developing countries in their negotiations with more developed countries. Hence, source taxation was still restricted.

The shift in Article 5(4) of the 2001 UN Model Convention towards the position of developed countries and the fact that DTCs signed between developed and developing countries mainly reflect the interest of the developed partners demonstrates that the developing countries are still at the mercy of developed countries as regards their taxation rights in an international setting.

As for the amendment to Article 5(7), since the 2001 UN Model Convention, the test to define whether an agent is dependent or independent is not focused on the number of enterprises for which this person works, but on the actual relationship maintained between the agent and the enterprise. Accordingly, when an agent carries on his own business and his relationship with an enterprise is no different than his relationship with third parties, his independent status will be preserved. Thus, arm’s length considerations have been added to Article 5 of the UN Model Convention.

The move to the assertion of an arm’s length relationship obscures the situation, since the requirement of working for more than one enterprise is more easily verifiable than whether relationships are kept at arm’s length. Considering that developing countries are less familiar with transfer pricing issues, it may be difficult for them to assert the existence of a dependent PE relationship that would allow for taxation at source.

Taking into account that the UN Model Conventions are drafted with the intention of expanding the possibilities for source taxation and serving as a counterpoint to the OECD documents, it can be said that the shift of Article 5 of the 2001 UN Model Convention towards the ideas prescribed in

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493. United Nations, (note 489), Commentaries on Article 5, para. 4, point 18, p. 80.

the OECD documents did not comply with these goals. Nonetheless, this deviation towards the OECD guidelines did not influence the taxation of income from services. There was no change in the tax treatment of these activities when comparing the 2001 UN Model Convention to the 1980 UN Model Convention. Therefore, the taxation of the furnishing of services was still allowed, if a fixed place of business was absent, as long as the time threshold was surpassed. Additionally, insurance services were also taxed at source regardless of a fixed place of business, but in this case the *discrimen* was the insurance of risks or collection of premiums at source.

### 4.2.1.2. Royalties

Article 12 mostly mirrored Article 12 of the 1980 UN Model Convention, with the exception of Articles 12(2) and 12(5), *in verbis*:

Article 12  
Royalties

(...)

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties 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 royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

(...)

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State.<sup>494</sup>

The amendment to Article 12(2) was quite substantial. The 1980 UN Model Convention stated that taxation at source should be limited if the recipient in another state was also the beneficial owner of the income in question. However, the 2001 UN Model Convention prescribed that taxation should be limited whenever the beneficial owner of the royalties was resident in the source state, meaning there was no need for the beneficial owner to be the direct recipient of the income. The discussion is similar to the one explained when analysing the 1977 OECD Model Convention<sup>495</sup> and the 1980 UN Model Convention.<sup>496</sup> The possibility for restriction of source taxation

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494. United Nations, (note 491), Article 12. pp. 14-15.

495. See sec. 3.3.1.2.

496. See sec. 4.1.1.2.

even if the income had been received by an intermediary approximated once more the provisions of the OECD and UN Model Conventions.

As for Article 12(5), it contained a minor amendment to its wording, the deletion of “that State itself, a political subdivision, a local authority or”, which was included in the definition of residence in Article 4.<sup>497</sup>

After examining Article 12 of the 2001 UN Model Convention, it can be asserted that this provision followed the trend set in the PE article and its amendments approximated its wording to its counterpart in the OECD Model Convention. However, the guidelines concerning the classification of technical services as business profits did not change and there was still no mention of this activity in the royalty definition and the Commentaries on Article 12 reassured that these services could not, in general, be treated as royalties.<sup>498</sup>

#### 4.2.1.3. Independent personal services

Article 14 of the 2001 UN Model Convention maintained the general framework of the 1980 UN Model Convention, but it altered the conditions for source taxation to arise by the amendment of Article 14(1)(b), transcribed below, and the deletion of Article 14(1)(c):

Article 14  
Independent Personal Services

[...]

(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.<sup>499</sup>

497. United Nations, (note 491), pp. 5-6. Article 4 of the 2001 UN MC: “For the purposes of this Convention, the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.”

498. An exception to this guidance is provided in the Commentaries on Article 12 in the case of mixed contracts in which the technical services are an ancillary part of the royalty payments and these cannot be separated, United Nations (note 489), Commentaries on Article 12, para. 3, point 12, pp. 189-190.

499. United Nations, (note 491), art. 14, p. 16.

The revision of Article 14(1)(b) broadened its scope, increasing the possibilities for taxation at source. In accordance with the wording of the 1980 UN Model Convention, a person would need to stay more than 183 days of a fiscal year in the state in order for source tax liability to arise. On the other hand, Article 14 of the 2001 UN Model Convention referred to 183 days in any 12-month period, so even if the time period included 2 fiscal years, the person would still be taxed at source.

For example, assuming that the fiscal year is equal to a calendar year in State A, a person that renders services for 60 days in this state during the months of November through December and continues his work for another 150 days from January through May of the next year would not be taxed at source in accordance with Article 14 of the 1980 UN Model Convention because this person never stayed more than 183 days of a fiscal year in the source state. However, the adoption of the wording transcribed above would allow for source taxation, as the time threshold would be surpassed by the addition of the time spent in the source state in the 2 fiscal years in question.

As for Article 14(1)(c), which provided for source taxation of payments above a certain threshold made by residents or borne by PEs or fixed bases, it was deleted because countries thought that a monetary threshold would: (i) become meaningless due to inflation; and (ii) limit the import of services at the source states. Moreover, research showed that this provision was inserted only in 6% of the DTCs signed between 1980 and 1997.<sup>500</sup> Therefore, practical and economic considerations led to the removal of this provision, reducing the possibilities for source taxation of income from independent personal services.

Although the arguments for the deletion of Article 14(1)(c) are valid, it must not be underestimated that the exclusion of this provision represents an important revision of a trend by the UN. As mentioned in the section concerning Article 14 of the 1980 UN Model Convention,<sup>501</sup> Article 14(1)(c) was the sole provision that allowed for the taxation of independent personal services at source irrespective of a physical connection between the taxpayer and the source state. While paragraph (a) was based on the fixed-base concept and paragraph (b) demanded the physical presence of the individual, paragraph (c) focused on the payment for the services.

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500. United Nations, (note 489), Commentaries on Article 14, point 8, p. 214.

501. See sec. 4.1.1.3.

Given that nowadays it is possible to regularly perform services abroad without any physical link to the state in which the beneficiary of the service is located, Article 14(1)(c) would be the most adequate provision to regulate the taxation of these activities at source. Consequently, its deletion considerably restricted the possibility for source taxation of independent personal services at a time in which economic activities that are dependent on a physical criterion, such as a fixed place of business or physical presence in a state, are becoming increasingly irrelevant.

Hence, even though the amendments to Article 14 were quite balanced, with one of them limiting source taxing rights while the other increased source taxation, there was a swing of taxation rights towards the OECD Model Convention, as the sole provision that allowed for taxation of independent personal service regardless of any physical connection to the source state has been deleted. Further, the increase of taxation rights caused by the reference to “any 12-month period” was in line with a similar amendment to Article 15 of the OECD Model Convention in 1977, so it can hardly be said that it represented the prevalence of the interests of developing countries on the topic.

### **4.3. 2011 UN Model Convention**

Aware of the need to undertake recurrent updates to its Model Convention and stirred by the work performed by the OECD, the UN decided that, from 2005 on, the ad hoc group of the Committee of Experts on International Cooperation in Tax Matters should gather annually in Geneva<sup>502</sup> in order to discuss the outstanding issues of the 2001 UN Model Convention. In these early meetings, the taxation of services has been constantly addressed, with a focus on whether: (i) Article 5 of the UN Model Convention should be amended; (ii) Article 14 should be deleted; and (iii) changes to the OECD Model Convention should influence the UN Model Convention.

#### **4.3.1. Taxation of services in the 2011 UN Model Convention**

The treatment to be granted to the taxation of services was widely discussed prior to the release of the 2011 UN Model Convention, especially

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502. United Nations, Economic and Social Council, *Resolution 2004/9*, available at <<http://www.un.org/en/ecosoc/docs/2004/resolution%202004-69.pdf>>, accessed on 22 May 2012.



during the sixth session of the Committee of Experts.<sup>503</sup> In that meeting, the Committee of Experts set the requirements for source taxation of the income from services, establishing that source countries should: (i) be limited to taxing income from services performed in the source country; (ii) tax non-resident service providers only if their involvement in the economic life of the source country exceeds a minimum threshold; (iii) be entitled to tax income from services derived by non-residents if the payments are deductible by the payers against the source country's tax base; (iv) be given taxation rights over income from services only if those rights can be enforced effectively; and (v) be required to tax income from services derived by non-residents on a net basis unless the expenses incurred in earning the income are not significant. Alternatively, if gross basis tax is permitted, the rate of tax should be limited,<sup>504</sup> as it is with respect to dividends, interest and royalties.<sup>505</sup>

Taking these criteria into consideration, the Committee of Experts concluded that the tax treatment of services in the UN Model Convention was inconsistent and that the source principle was not yet fully recognized in regard to business services.<sup>506</sup> It was within this context that the Committee of Experts updated the UN Model Convention. Now it is time to check whether the acknowledgement of the principles that regulate the taxation of services at source and the issues surrounding the taxation of services resulted in further changes to this model.

### 4.3.1.1. Permanent establishment concept

As for Article 5 of the UN Model Convention, it is striking that a discussion arose already in the first meeting of the Committee of Experts due to a remark that the article was flawed and needed to be rewritten. This assertion was questioned and, to prove that the assertion was incorrect, several

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503. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 4), accessed on 10 October 2012; United Nations, Committee of Experts on International Cooperation in Tax Matters, *Note by the Secretariat: Additional Note by Mr. Brian Arnold on the Tax Treatment of Services*, document E/C.18/2010/CRP.7/Add.1, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2014/10/6STM\\_CRP7\\_Add1.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2014/10/6STM_CRP7_Add1.pdf)>, accessed on 21 September 2015.

504. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 503), para. 7, p. 4.

505. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 503), para. 85, p. 26.

506. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 503), para. 11, pp. 5-6.

experts referred to the long-standing tradition of the article in DTCs.<sup>507</sup> Consequently, the 2011 UN Model Convention was guided by the idea that the PE concept should be maintained but that new developments in the international field should be subject to debate in the UN forum.

On this matter, significant amendments were proposed to Article 5(3)(b). It was thought that this article should be substituted by an article similar to the services PE alternative inserted in the Commentaries on the OECD Model, which will be examined further in this book, and that the threshold for taxation at source should be reduced to 90 or 120 days.<sup>508</sup> In spite of these recommendations, the sole amendment to the provision regarded the adoption of the 183-day threshold, as follows:

Article 5  
Permanent Establishment

[...]

5. The term “permanent establishment” also encompasses:

[...]

b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.<sup>509</sup>

In contrast to its forerunners, which prescribed a 6-month threshold, Article 5(3)(b) of the 2011 UN Model Convention opted for a threshold of 183 days. This amendment, even though not substantial, brought more coherence to the UN Model Convention by assimilating the services PE threshold to the one prescribed in Article 14(1)(b). Thus, although the modification did not alter the allocation of taxation rights between source and residence, it produced beneficial results for the consistency of the 2011 UN Model Convention.

507. United Nations, Committee of Experts on International Cooperation in Tax Matters, *Report on the First Session (5-9 December 2005)*, document E/2005/45 E/C.18/2005/11, p. 14, available at <[http://www.un.org/ga/search/view\\_doc.asp?symbol=E/C.18/2005/11&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=E/C.18/2005/11&Lang=E)>, accessed on 22 October 2015.

508. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 503), *Policy Changes*, pp. 30-31.

509. United Nations, *United Nations Model Double Tax Convention between Developed and Developing Countries*, New York, 2011, available at <[http://www.un.org/esa/ffd/documents/UN\\_Model\\_2011\\_Update.pdf](http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf)>, accessed on 10 October 2015, pp. 9-11.

Despite the reference to the 183-day period, Articles 5(3)(b) and 14(1)(b) of the 2011 UN Model Convention prescribe a different threshold for taxation at source. The former refers to activities conducted at source for more than 183 days, while the latter states that the person has to be present at source for more than 183 days, irrespective of whether this person is indeed conducting business during the whole period. Therefore, while in the case of Article 5, the rendering of services for 160 days followed by a vacation of 30 days would not create source taxation rights, this income would be taxed at source under Article 14(1)(b).

The maintenance of a time threshold for the services PE was subject to intense discussions, with source states asserting once again that the attainment of profits at source did not depend on the existence of a PE and that entitlement to taxation was not subject to the time spent at source. However, in line with the idea that the time threshold would limit taxation at source to substantial economic activities, avoiding the immediate liability of the taxpayer in case preparatory activities were conducted at source, it was decided that the threshold should be maintained.<sup>510</sup>

Apart from this amendment, there were no developments in the UN Model Convention as regards the taxation of services. Hence, it can be affirmed that countries were still trying to cope with the source taxation of this income with the PE concept. Also, the upholding of Article 5 almost in its entirety fortifies the position of the UN Model Convention as an established model that can be used by developing countries, to the detriment of the OECD Model Convention. Moreover, it strengthens the option for source taxation of income from services as such taxation has been consistently prescribed since the 1980 UN Model Convention. In spite of this positive outcome, it still needs to be asserted whether the UN, as the main forum for developing countries to express their interests, should not be bolder in its defence of the principle of source taxation of the income from services.

### 4.3.1.2. Royalties

The royalty article in the 2011 UN Model Convention is a reproduction of the provision on the 2001 UN Model Convention and thus the author will not expand on the analysis of the former. However, it is worth mentioning that in the discussions maintained by the Committee of Experts there was no consensus on whether technical services should be viewed as royalties

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510. United Nations, (note 509), Commentaries on Article 5, para. 10, p. 108.

or business income. Similarly to the position adopted by the OECD in the Commentaries on its Model Convention, the Committee of Experts argued that Article 12 should only be applicable in case of intangible property,<sup>511</sup> thus excluding fees for technical services from the scope of this provision.

Nevertheless, developing countries argued that technical services fall under the scope of the royalty provision.<sup>512</sup> As will be seen below, some of these states even provide for an equal treatment of royalties and fees for technical services on their double taxation conventions.

In answer to the position of developing states, the Committee of Experts pointed out that if source taxation of technical services were intended, countries should make use of an expanded PE concept. Moreover, the Committee of Experts pledged for a coherent rule for income from services; if countries wish to tax technical services at source, all services should receive the same treatment.<sup>513</sup>

Although the adoption of a broad PE concept can be disputed, the author is pleased that the Committee of Experts vouches for the coherent treatment of all types of services; the author agrees with this assertion and believes that taxation of services at source should be a general rule in model conventions. Bearing in mind that Article 12 of the 2011 UN Model Convention replicated the existing guidelines on the matter, it remains clear that there were no changes in the allocation of taxing rights as regards income from technical services, meaning they were viewed as business profits and subject to tax only if related to a PE at source.

#### 4.3.1.3. Independent personal services

Shortly after the deletion of Article 14 from the OECD Model Convention, the UN conducted studies on whether it should also exclude Article 14 from its Model Convention. The arguments in favour of this deletion de-

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511. United Nations, Committee of Experts on International Cooperation in Tax Matters, Third Session, Geneva, 29 October-2 November 2007, *Proposal for Amendments to Article 5 of the United Nations Model Double Taxation Convention between Developed and Developing Countries: Further Issues Relating to Permanent Establishment*, document E/C.18/2007/CRP.4, p. 22, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2014/10/3STM\\_EC18\\_2007\\_CRP4.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2014/10/3STM_EC18_2007_CRP4.pdf)>, accessed on 10 October 2015. The same idea was restated in the fourth session, held in 2008.

512. United Nations, (note 509), p. 222.

513. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 511), p. 26.

rived from the OECD report on Article 14,<sup>514</sup> and the subcommittee responsible for the study of this issue favoured the exclusion.<sup>515</sup> Nonetheless, recognizing that source states were keen on preserving the article in their DTCs, the Committee of Experts decided on the maintenance of this provision.<sup>516</sup>

However, accepting that states may wish to follow the guidance of the OECD Model Convention and remove Article 14 from their DTCs, the Committee of Experts recommended that in this case the provision of Article 14(1)(b), concerning taxation due to the performance of services at source for more than 183 days, should be transposed into Article 5 as Article 5(3)(c).<sup>517</sup> Hence, even if Article 14 were taken out, countries should still recognize that the performance of services for a certain period in the source state entitles this state to tax the proceeds derived from the rendering of services.

To conclude, it can be ascertained that Article 14 of the 2011 UN Model Convention is in line with the UN's intention to increase source taxing rights in relation to the OECD Model Convention. The only negative remark about this provision is that, by following the 2001 UN Model Convention, it denies the possibility for taxation of income from independent personal services at source if there is no significant physical presence therein. Considering the ease with which services can be performed without the need for any physical presence in the source state, it would have been better if the article had focused on ascertaining source taxation rights even when no fixed place of business exists, meaning the article should contain a provision similar to Article 14(1)(c) of the 1980 UN Model Convention.

### **4.4. The continuous work on the taxation of services**

In the Introduction to the 2011 update of its Model Convention, the UN recognized that further work should be undertaken as regards the tax treatment of services.<sup>518</sup> Consequently, a subcommittee was established with

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514. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 511), pp. 4-8.

515. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 511), p. 14.

516. United Nations, (note 509), p. 112.

517. United Nations, (note 509), p. 114.

518. United Nations, (note 509), para. 17, p. X.

the goal of providing a report on the taxation of technical services.<sup>519</sup> This work was performed by Prof. Brian Arnold and his conclusions were presented at the eighth session of the Committee of Experts.<sup>520</sup>

According to Prof. Arnold, the lack of a specific article dealing with technical services and the subjection of this income to taxation in accordance with Article 7 or Article 14 allows enterprises to earn significant income at source, payments that are deductible by the payer, while still avoiding taxation at source. Moreover, in case of intra-group payments, these services can be used to skim profits out of the source country.<sup>521</sup>

In order to tackle this issue, several options were forwarded to the Committee of Experts, such as: (i) inclusion in the commentaries of a neutral discussion with arguments in favour of and against a technical services provision; (ii) inclusion of the discussion mentioned previously with examples of articles which have been added to DTCs; (iii) revision of the commentary and inclusion of alternative provisions; (iv) reduction of the time threshold of 183 days necessary for the characterization of a services PE and the application of Article 14(1)(b); (v) inclusion of technical services under Article 12; (vi) revision of Article 14 in order to allow for taxation at source if payments are made by a resident or borne by a PE in this state; (vii) inclusion of technical services in the other income article; (viii) adding a new article and commentary dealing specifically with technical services; and (ix) deeming a subsidiary to be a PE of the non-resident parent company.<sup>522</sup>

Since most of the members of the subcommittee supported the adoption of a new article and commentary,<sup>523</sup> a follow-up note was prepared to ana-

519. United Nations, Committee of Experts on International Cooperation in Tax Matters, *Report on the Seventh Session of the Committee of Experts on International Cooperation in Tax Matters*, document E/2011/45-E/C.18/2011/6, Geneva, 2011, para. 97, p. 19, available at <[http://www.un.org/ga/search/view\\_doc.asp?symbol=E/2011/45&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=E/2011/45&Lang=E)>, accessed on 8 September 2015.

520. United Nations, Committee of Experts on International Cooperation in Tax Matters, (note 4); Brian J. Arnold, (note 4).

521. Brian J. Arnold, (note 4), p. 7.

522. United Nations, Committee of Experts on International Cooperation in Tax Matters, *Report on the Eighth Session of the Committee of Experts on International Cooperation in Tax Matters*, document E/2012/45-E/C.18/2012/6, Geneva, 2012, para. 55, pp. 11-12, available at <[http://www.un.org/ga/search/view\\_doc.asp?symbol=E/2012/45&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=E/2012/45&Lang=E)>, accessed on 8 September 2015.

523. Brian J. Arnold, *Follow Up Note on Taxation of Fees for Technical Services and Comments on that Note*, Committee of Experts on International Cooperation in Tax Matters, Eighth Session, Geneva, 15-19 October 2012, document E/C.18/2012/CRP.4, Geneva, 2012, p. 2, available at <<http://www.un.org/esa/ffd/wp-content/>

lyse the issues involved in the prescription of this article, namely (i) the threshold for taxation; (ii) the source of income; (iii) the type of services rendered; (iv) the amount of income derived; (v) the payer; and (vi) in the case of an enterprise, the definition of who provides the services.<sup>524</sup> It is interesting to note that even though the inclusion of a specific provision was the preferred choice, in the UN documents there are no lengthy discussions concerning the pros and cons of the new provision as regards the other alternatives.<sup>525</sup>

In general, it may be said that this note provided the framework for the new article as follows: (i) if a threshold for source taxation were adopted, it should be lower than the ones already present in the UN Model Convention;<sup>526</sup> (ii) before drafting the article, countries should agree on the source of income, that is, whether services not performed at source could also be taxed therein when paid by residents;<sup>527</sup> (iii) it is paramount to have a clear definition of what constitutes technical services;<sup>528</sup> (iv) it must be decided whether net or gross taxation should be preferred;<sup>529</sup> and (v) the adoption of anti-avoidance rules must be discussed.<sup>530</sup>

Concerning the definition of technical services, it was clarified that it is difficult to provide a definition that would justify a different treatment between these and other services.<sup>531</sup> This is not surprising, since there is still no internationally recognized definition of the term.<sup>532</sup> Guidance on the matter can only be found in certain DTCs and in countries' domestic laws. As a result, the definitions contained in DTCs signed by the United

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uploads/2014/09/8STM\_CRP4-Fees-for-Technical-Services-Follow-Up-Note021012.pdf >, accessed on 8 March 2013.

524. Brian J. Arnold, (note 523).

525. Andrés Báez Moreno, (note 41), p. 5.

526. Brian J. Arnold, (note 523), pp. 3-4. Since a threshold does not exist in the case of dividends, interest and royalties, it should also not be applied for technical services; Anita Kapur, "Annex 2: Comments by Anita Kapur on the Note at Annex 1", (note 523), p. 13.

527. Brian J. Arnold, (note 523), p. 4. According to Anita Kapur, source taxing rights should arise if the payments are made by a resident, PE or fixed base or when services are used in a state; Anita Kapur, (note 523), p. 13.

528. Brian J. Arnold, (note 523), pp. 4-7.

529. Brian J. Arnold, (note 523), p. 7.

530. Brian J. Arnold, (note 523), pp. 7-8.

531. Brian J. Arnold, (note 523), p. 6; Claudine Devillet, "Annex 3: Comments by Claudine Devillet on the Note at Annex 1", (note 523), p. 16.

532. Ariane Pickering, (note 18), p. 33; Michael Krause, "Tax Treatment of the Provision of Services", in Ramon Valdés Costa [et al.], *International Taxation of Services*, IFA Congress Seminar Series vol. 14a, Kluwer Law and Taxation, Deventer, 1991, p. 35.



States<sup>533</sup> and India<sup>534</sup> were proposed as possible benchmarks to limit the scope of the draft article.

Taking into account the uncertainty surrounding the concept, it is indeed questionable whether the UN Model Convention should prescribe different treatment between technical services and other types of services. Although the draft of an article to deal with the taxation of technical services can be viewed as a welcome addition to the discussion on the allocation of taxing rights in respect of income from services, the author is of the opinion that the schism between technical services and services in general is not justifiable, since the fact that a service is of a technical nature does not alter its essence – it is still similar to other services. Moreover, an artificial differentiation between services and technical services could generate an unjustified difference in the tax treatment of similar activities. Thus, it might be said that the focus should be on the taxation of services in general, not only technical services.

As for the debate regarding gross and net taxation, it was proposed that if gross taxation is chosen, enterprises could be given the chance to request taxation on a net basis.<sup>535</sup> Despite the argument that the option for taxation on a net basis would increase complexity and entail disputes,<sup>536</sup> this seems to be a good option, since it would strike a compromise between developing states, which prefer gross taxation due to its practicability, and developed states, which advocate for net taxation of income at source.

Based on the ideas expressed above, a draft article was included as an appendix to the follow-up note, *in verbis*:

Article \_\_\_\_ (Income from Technical Services)

1. Income derived [payments received] by a resident of a Contracting State in respect of technical services or other similar activities shall be taxable only in that State unless the income arises in the other Contracting State, in which case such income may also be taxed in the other Contracting

533. El Hadji Ibrahima Diop, “Remarks on the Note on the Taxation of Fees for Technical Services and other Services Under the United Nations Model Convention”, *Additional Comments on Follow Up Note on Taxation of Fees For Technical Services*, Committee of Experts on International Cooperation in International Tax Matters, Eighth Session, Geneva, 15-19 October 2012, document E/C.18/2012/CRP.4/Add. 1, p. 5, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2014/09/8STM\\_CRP4\\_Add1.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2014/09/8STM_CRP4_Add1.pdf)>, accessed on 8 September 2015.

534. Anita Kapur, (note 523), pp. 13-14.

535. Brian J. Arnold, (note 523), p. 7.

536. Anita Kapur, (note 523), p. 14.

State; [however, the tax so charged shall not exceed \_\_\_ percent of the gross amount of such payments.]

2. Threshold if necessary
3. Deduction for expenses if necessary
4. Income in respect of technical services or other similar activities shall be deemed to arise in a Contracting State [when the services or activities are performed in that State] [when the payer is a resident of that State]
5. The provisions of paragraphs 1 and 2 shall not apply if the resident carries on business in the other Contracting State in which the income arises, through a permanent establishment situated therein, or performs in that other independent personal services from a fixed based therein, and the income is effectively connected with such permanent establishment or with business activities referred to in (c) of paragraph 1 of Article 7. In such cases, the provisions of Article 7 shall apply.
6. The provisions of this Article shall not apply in any case where the provisions of Article 14 [or Article 12] apply.
7. The term “technical services” [“technical services or other similar activities”] [means...] [includes...] [but does not include...] ...

This draft article was examined by the Committee of Experts when analysing the options proposed by Prof. Arnold for the taxation of technical services. The detractors of a new article argued that its draft was premature, since the issue of profit-skimming is not limited to technical services and services in general. Further, the non-taxation of significant revenue at source could also be solved by a reduction in the PE thresholds. It was also pointed out that taxation should occur on a net basis or, in case a gross basis was adopted, the rate should be low, as technical services involve significant costs, such as the remuneration of highly skilled labour.<sup>537</sup>

Despite these criticisms, ultimately the preference garnered in the subcommittee for the draft of a new article was also reflected in the opinion of the Committee of Experts, which decided for a specific provision on technical services<sup>538</sup> based on the following arguments: (i) services represent a bigger share<sup>539</sup> of the GDP of most countries; (ii) while developing countries

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537. United Nations, (note 522), para. 57, pp. 12-13; Claudine Devillet, (note 531), p. 16.

538. United Nations, (note 522), para. 60, pp. 13-14.

539. Services already contribute to more than 50% of the GDP of a considerable number of countries, amounting to 63% of the world GDP. *See* Central Intelligence Agency, (note 1).

need revenue for their development, they are losing a considerable part of their tax base due to profit-skimming by multinationals; and (iii) a similar provision is already being used by the Southern African Development Community.<sup>540</sup>

It is interesting to note that two of the justifications for the adoption of an article on technical services are in line with the arguments given in this research in favour of source taxation of services, namely the importance of services for the GDP of a country and the idea that taxation at source is part of a state's right to development.

Continuing his work on the drafting of a treaty provision focused on the taxation of technical services, and recognizing that such an article was not supported by all members of the Committee, Prof. Arnold presented draft alternatives to be included in DTCs signed by countries that want a specific tax treaty provision on the matter, but suggested that it could be made clear in the Commentaries that not all countries favour the inclusion of such an article in the UN Model Convention.<sup>541</sup>

Moreover, Prof. Arnold established that prior to drafting an article on fees for technical services it was necessary to deal with four key issues: (i) the definition of services to which the article will apply; (ii) whether taxation should be limited to technical services performed at source; (iii) whether source taxation should be subject to any threshold; and (iv) whether taxation would occur on a gross or net basis.<sup>542</sup>

As these issues were still undecided at the ninth meeting of the Committee of Experts, Prof. Arnold presented three alternatives for a new article. Alternative A was broad, allowing for source taxation of all payments for technical services in a manner similar to Article 12 of the UN Model Convention, with taxation on a gross basis. Alternative B limited taxation, also on a gross basis, to the technical services performed at source, and it was similar to Article 17 of the UN Model Convention. Lastly, alternative C resembled article 14 of the UN Model Convention, establishing taxation on a net basis and only after services continued for more than a minimum

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540. United Nations, (note 522), para. 58, p. 13.

541. Brian Arnold, *Note on a New Article of the UN Model Convention Dealing with the Taxation of Fees for Technical and Other Services*, Committee of Experts on International Cooperation in Tax Matters, Ninth Session, Geneva, 21-25 October 2013, document E/C.18/2013/CRP.5, available at <[http://www.un.org/esa/ffd/tax/ninthsession/CRP5\\_Services.pdf](http://www.un.org/esa/ffd/tax/ninthsession/CRP5_Services.pdf)>, accessed on 21 November 2015, p. 3.

542. Brian Arnold, (note 541), p. 4.

period in any 12-month period.<sup>543</sup> As discussed below, the article proposed in the tenth meeting is largely based on alternative A.

In addition, it is worth mentioning that, building on the idea that the taxation of technical services is just the start of the issue, the Committee of Experts entrusted two of its members with the task of studying the taxation of services in general,<sup>544</sup> and their work was presented at the ninth meeting of the Committee of Experts.<sup>545</sup>

In this work, it was established that, although the UN Model Convention already includes a service PE provision, it is questionable whether a service PE, which is based on physical presence, is a fair threshold for the taxation of income from services,<sup>546</sup> since current technological developments dissociate the provision of services from a fixed place of business, considerably reducing the source taxation of income.

Additionally, the experts concluded that in order to strike a more equitable balance between source and residence taxation, it may be necessary to amend the model conventions, for example, by altering the thresholds for source taxation on income from services or including an article on taxation of technical services or a more general article on taxation of services. Irrespective of the option chosen, it is crucial that this new balance of taxing rights should not create a schism between the taxation of services and goods.<sup>547</sup>

The Subcommittee on Services also engaged in the study of the taxation of cyber-based services.<sup>548</sup> For the purpose of the report, cyber-based services were defined as services produced, delivered and consumed in the com-

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543. Brian Arnold, (note 541), pp. 7-12.

544. United Nations, (note 522), para. 60, p. 14. These members are Mr Sasseville and Mr Liao.

545. Tizhong Liao, *Taxation of Cross-Border Trade in Service: A Review of the Current International Tax Landscape and the Possible Future Policy Options*, Committee of Experts on International Cooperation in Tax Matters, Ninth Session, Geneva, 21-25 October 2013 document E/C.18/2013/CRP.16, available at <[http://www.un.org/esa/ffd/tax/ninthsession/CRP16\\_CrossBorderTrade.pdf](http://www.un.org/esa/ffd/tax/ninthsession/CRP16_CrossBorderTrade.pdf)>, accessed on 21 November 2015.

546. Tzihong Liao, (note 545), p. 16.

547. Tzihong Liao, (note 545), p. 4.

548. Yansheng Zhu, *Proposed Changes to the UN Model Tax Convention Dealing with the Cyber-Based Services*, Committee of Experts on International Cooperation in Tax Matters, Tenth Session, Geneva, 27-31 October 2014, document E/C.18/2014/CRP.9, available at <[http://www.un.org/esa/ffd/tax/tenthsession/CRP9\\_CyberServices.pdf](http://www.un.org/esa/ffd/tax/tenthsession/CRP9_CyberServices.pdf)>, accessed on 21 October 2015.

puter network through the computer software.<sup>549</sup> Hence, they are virtual services and do not demand any physical presence in the source state.

Current treaty rules on the taxation of services prescribe source taxation only when services are provided in the source state and the individual providing the service is physically present therein. It remains clear therefore that such rules are not appropriate for the taxation of cyber-based services, as they are based on a characteristic (physical presence) that is hardly important for the provision of cyber-based services. Moreover, these rules favour taxation by countries in which the provider of cyber-based services is established, usually developed states, considerably restricting the taxation rights of source countries, which are mainly developing states. As a result, since 2011, the UN Committee of Experts is making interpretative amendments to the Commentaries on the UN Model Convention in order to allow for the source taxation of income derived from the digital economy.<sup>550</sup> However, this approach has its limitations, since, as already mentioned, these services are not related to a physical presence in a state, which is the cornerstone of the current international taxation of business profits.

With the goal of establishing a more balanced allocation of taxing rights as regards the taxation of the digital economy, Prof. Zhu proposed that the UN Model Convention could expand the source taxation of income from cyber-based services by adopting one or more of the following proposals: (i) addition of a separate provision for cyber-based technical services; (ii) expansion of the royalty article to include “use of or right to use industrial, commercial or scientific online databases”; (iii) addition of a separate provision for all types of cyber-based services; and (iv) considering the website a virtual PE.<sup>551</sup>

It is interesting to note that although special attention is being given to cyber-based services, the proposals do not considerably differ from proposals already made in the past concerning other types of services or activities. For instance, as mentioned above, most members of the Committee of Experts favour the inclusion of a new article on technical services on the UN Model Convention and the Committee of Experts is currently drafting such an article, which will be studied in further detail in chapter 7, when dealing with proposals for the taxation of services in the 21st century. Prior to the decision of drafting a specific article on technical services, the Committee

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549. Yansheng Zhu, (note 548), p. 4.

550. Yansheng Zhu, (note 548), p. 8.

551. Yansheng Zhu, (note 548), pp. 9-13.

of Experts also dealt with the issue of having a specific article to deal with all types of services, not only ones of a technical nature.

Additionally, the inclusion of “use of or right to use industrial, commercial or scientific online databases” in the royalties article resembles the “use of, or the right to use, industrial, commercial, or scientific equipment” present in the current Article 12 of the UN Model Convention. Also, the possibility to consider websites as virtual PEs has already been discussed, and ultimately rejected, in the OECD Commentaries, which are transcribed in the UN Commentaries.

Therefore, although it is considered that cyber-based services present a new challenge to the current treaty rules on the taxation of services, which are viewed as prejudicial to source states, the remedies proposed to grant source states more taxing rights are not new. Taking into account the track record of previous proposals, it is questionable whether the proposals on cyber-based services would make their way into the UN Model Convention and, most importantly, whether they would indeed generate a balanced allocation of taxing rights between source and residence states.

While analysing the possibilities for a new balance on the taxation of services, the Committee of Experts has also sought to diminish controversies concerning the existing provisions of the UN Model Convention. In that respect, the Committee of Experts analysed whether the physical presence of the service provider at the source state was a condition for the application of Article 5(3)(b).

Some Committee members, in accordance with the report presented at the ninth of the Committee of Experts on the taxation of services, mentioned above, proposed an amendment to Article 5(3)(b) in order to remove the necessity of a physical presence of the service provider in the source state. According to these individuals, as the digital economy facilitates the provision of services with limited or no physical presence in a state, such threshold would be obsolete.<sup>552</sup> Nonetheless, the majority of the Committee members considered that Article 5(3)(b) is linked to the physical presence requirement, so source taxation would only arise if the employees of the service provider were effectively in the source state while furnishing services. Con-

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552. Andrew Dawson, *Article 5: the Meaning of “the Same or a Connected Project”*, Committee of Experts on International Cooperation in Tax Matters, Tenth Session, Geneva, 27-31 October 2014, document E/C.18/2014/CRP.11, available at <[http://www.un.org/esa/ffd/tax/tenthsession/CRP11\\_Art5Project.pdf](http://www.un.org/esa/ffd/tax/tenthsession/CRP11_Art5Project.pdf)>, accessed on 21 November 2015, p. 3.

sequently, the Committee proposed including a paragraph on the Commentaries on the UN Model Convention to clarify this issue.<sup>553</sup> Furthermore, the Committee stated that countries that do not agree with the majority view should state their position in a mutual agreement procedure.<sup>554</sup>

As regards software-related payments, the Committee of Experts has been studying whether these amounts should be included under the royalty concept, analyzing as well whether the substitution of taxation on a gross basis for a modified net basis would not garner further support for the source taxation of software payments.<sup>555</sup> In its latest document, the Committee favours the adoption of a broad interpretation of royalties which, deviating from the OECD guidance, includes payments for the use or right to use software under the scope of Article 12.<sup>556</sup>

Bearing this in mind, it remains clear that, notwithstanding the position of the Committee of Experts as regards the application of article 5(3)(b), the Committee has been duly studying the development of the digital economy and its consequences to the allocation of taxing rights between source and residence states.

#### **4.5. The influence of the OECD BEPS Project on the work of the UN**

Aware of the importance of the OECD work on the BEPS Project and its potential to affect the taxing rights of source states, as well as the fact that issues important to developing states were not being tackled by the BEPS Action Plan and that developing countries have views that differ from developed countries as regards measures to avoid base erosion and

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553. United Nations, Committee of Experts on International Cooperation in Tax Matter, (note 552), p. 2.

554. United Nations, Committee of Experts on International Cooperation in Tax Matter, (note 552), p. 3.

555. J. Scott Wilkie, *The Character and Purpose of Article 12 with Reference to "Industrial, Commercial and Scientific Equipment" and Software-Payment related Issues*, Committee of Experts on International Cooperation in Tax Matters, Eleventh Session, Geneva, 19-23 October 2015, document E/C.18/2015/CRP.6, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM\\_CRP6\\_Article12\\_Royalties.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP6_Article12_Royalties.pdf)>, accessed on 21 October 2015.

556. United Nations, Committee of Experts on International Cooperation in Tax Matters, Twelfth Session, Geneva, 11-14 October 2016, Agenda Item 3(a)(iii), Article 12 (Royalties): possible amendments to the commentary on Article 12, document E/C.18/2016/CRP.8, available at <<http://www.un.org/esa/ffd/events/event/twelfth-session-tax.html>>, accessed on 21 October 2016, para. 40, p. 48.

profit shifting, in 2013, the UN Committee of Experts established a Subcommittee on BEPS in order to assess the impact of the BEPS Action Plan on developing countries.<sup>557</sup>

Initially, the Subcommittee had the goal of informing the officials of developing countries of the matters being discussed in the OECD BEPS Project and to act as a liaison between these officials and the OECD, making sure that the interests of these countries were also taken into consideration in the BEPS discussions. With the progress of the BEPS Project, this Subcommittee was also granted the power to propose updates to the UN Model Convention in line with the BEPS Action Plan.<sup>558</sup>

One of the first actions of the Subcommittee was to send developing countries a questionnaire regarding their experience with BEPS, how this affects them, what measures are taken to avoid BEPS and which are the most important action plans for the developing countries.<sup>559</sup> The replies from 11 countries<sup>560</sup> and two international organizations<sup>561</sup> gave the Subcommittee a better understanding of how developing countries view the BEPS Action Plan.

It was pointed out in the replies that developing countries are affected by BEPS through the excessive payment to foreign affiliated companies of interest, service charges, management and technical fees, royalties, by the artificial avoidance of PE status and by restrictions imposed on source state taxation of the income from the digital economy.<sup>562</sup>

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557. Michael Lennard, "Update on the United Nations Tax Committee Developments", *Asia-Pacific Tax Bulletin*, vol. 20, n. 1, 2014, Amsterdam, IBFD, p. 22.

558. Carmel Peters, *Subcommittee on Base Erosion and Profit Shifting for Developing Countries*, Committee of Excerpts on International Cooperation in Tax Matters, Eleventh Session, Geneva, 19-23 October 2015, document E/C.18/2015/CRP.11, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM\\_CRP11\\_beps.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP11_beps.pdf)>, accessed on 21 October 2015, pp. 1-2.

559. United Nations, *Questionnaire Countries' Experiences Regarding Base Erosion and Profit Shifting Issues*, Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, available at <[http://www.un.org/esa/ffd/tax/BEPS\\_questionnaire.pdf](http://www.un.org/esa/ffd/tax/BEPS_questionnaire.pdf)>, accessed on 21 October 2015.

560. Brazil, Chile, China, Ghana, India, Malaysia, Mexico, Singapore, Thailand, Tonga and Zambia.

561. Christian Aid and Action Aid and Economic Justice Network and Oxfam South Africa

562. Indian Revenue Service, *Countries' Experiences Regarding Base Erosion and Profit Shifting Issues*, Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, available at <[http://www.un.org/esa/ffd/tax/Beps/Comment-India\\_BEPS.pdf](http://www.un.org/esa/ffd/tax/Beps/Comment-India_BEPS.pdf)>, accessed on 21 October 2015, p. 3.



With regards to that matter, India stated that BEPS Action 1 deserves greater consideration from the UN and OECD<sup>563</sup> and that the goal of the UN as regards the BEPS Project should be to protect the taxing rights of developing countries and prevent the adoption of rules biased in favour of residence state taxation.<sup>564</sup>

The importance of BEPS Actions 1 (taxation of the digital economy) and 7 (artificial avoidance of PE status) for developing countries cannot be overstated, as these BEPS Actions were considered in almost all submissions as key areas that were not mentioned in the BEPS Subcommittee questionnaire.<sup>565</sup> Brazil<sup>566</sup> and India<sup>567</sup>, for instance, clarified in their replies that these are crucial areas for developing countries.

Ultimately, the developing countries acknowledged that the measures proposed in the BEPS Actions would not amount to a considerable rebalancing of source and residence taxation in DTCs, so they suggested that the UN and OECD should strive for a new allocation of taxing rights in tax treaties.<sup>568</sup>

It is important to emphasize that, even though the Committee of Experts created a special subcommittee to deal exclusively with BEPS, the issues currently discussed in the BEPS Project are also studied in other UN arenas. This includes the UN work concerning cyber-based services, a facet of the digital economy, which is conducted by the Subcommittee on Services. Another example of such an interaction can be seen in a paper presented at the Workshop on Tax Base Protection of Developing Countries, which took place in Paris in September 2014.<sup>569</sup>

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563. Indian Revenue Service, (note 562), p. 7.

564. Indian Revenue Service, (note 562), p. 2.

565. Carmel Peters, (note 558), p. 3; United Nations, *Responses to Questionnaire for Developing Countries from the UN Subcommittee on Base Erosion and Profit Shifting*, Committee of Experts on International Cooperation in Tax Matters, Tenth Session, Geneva, 27-31 October 2014, document E/C.18/2014/CRP.12, available at <[http://www.un.org/esa/ffd/wp-content/uploads/2015/01/10STM\\_CRP12\\_BEPS.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2015/01/10STM_CRP12_BEPS.pdf)>, accessed on 21 October 2015, p. 8.

566. Brazilian Federal Revenue, *Comments from Brazil*, Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, available at <[http://www.un.org/esa/ffd/tax/Beps/CommentsBrazil\\_BEPS.pdf](http://www.un.org/esa/ffd/tax/Beps/CommentsBrazil_BEPS.pdf)>, accessed on 21 October 2015, p. 3.

567. Indian Revenue Service (note 562), p. 6.

568. United Nations, (note 565), pp. 8-9.

569. Adolfo Martín Jiménez, *Preventing the Artificial Avoidance of PE Status*, Papers on Selected Topics in Protecting the Tax Base of Developing Countries, available at <[http://www.un.org/esa/ffd/tax/2014TBP2/Paper\\_PE\\_Status.pdf](http://www.un.org/esa/ffd/tax/2014TBP2/Paper_PE_Status.pdf)>, accessed on 21 October 2015.

In his paper, Prof. Jiménez analysed the proposals made in BEPS Action 7 to combat the artificial avoidance of the PE status, concluding that even though the discussion on source versus residence taxing rights is not one of the goals of the BEPS Project, the lowering of the PE threshold to deal with commissionaire arrangements and the splitting up of contracts may, as seen before,<sup>570</sup> lead to this debate, since a lower threshold would undeniably increase source taxation. Although focusing on BEPS Action 7, Prof. Jiménez correctly noted that this issue may also arise in BEPS Action 1.<sup>571</sup> Hence, it can be said that when developing countries emphasize the importance of BEPS Actions 1 and 7, as they did in their replies to the UN Subcommittee on BEPS, these countries are actually focusing on striking a new balance of taxing rights between source and residence states, an issue which would not be discussed in the BEPS project, as clarified in the BEPS Action Plan.

Most recently, the Subcommittee on BEPS has proposed, in line with the conclusions of the final report on BEPS Action 7, amendments to Article 5 of the UN Model Convention. These amendments confirm that, even though BEPS Actions are not focused on a new allocation of taxation rights between source and residence states, this may be a consequence of the adoption of the proposals contained in the report, since these changes would guarantee taxation rights to source states. These proposals are now being analysed by the Committee of Experts.<sup>572</sup>

Taking the above into consideration, it can be stated that the UN is indeed looking to guarantee that the position of developing countries is taken into account in the BEPS discussions and that developing countries are completely aware of the possible consequences and shortcomings of adhering to the BEPS Project.

### 4.6. The UN Model Convention and the principles justifying source and residence taxation

Please note that this sample chapter is limited to 24 pages.  
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570. See sec. 3.4.1.

571. Adolfo Martín Jiménez, (note 569), p. 8.

572. United Nations, Committee of Experts on International Cooperation in Tax Matters, Twelfth Session, Geneva 11-14 October 2016, Agenda item 3(a)(vii), Base Erosion and Profit Shifting, document E/C.18/2016/CRP.10, available at <<http://www.un.org/esa/ffd/events/event/twelfth-session-tax.html>>, accessed on 21 October 2016.



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