News from “the other tax club”

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It is the annual Session of the UN Committee of Experts on International Cooperation in Tax Matters. This Ad Hoc subsidiary body of the Economic and Social Council of the UN (ECOSOC) is responsible for the UN Model Double Taxation Convention and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries and the UN Practical Manual on Transfer Pricing for Developing Countries. The Committee consists of 25 members nominated by Governments and acting in their expert capacity. They are appointed by the Secretary-General for four years and are selected from the fields of tax policy and tax administration to reflect an adequate equitable geographical distribution, representing different tax systems.
For one week a year the Committee discuss the work done by its various sub-committees during the past year and to decide the next year’s tasks for those committees. The frequency of meetings is to be extended to two four day meetings a year, going forward.

Besides the 25 members, “everyone” is there: the OECD, the EU (or at least their plaque), various country delegates, business, lawyers representing business, NGO’s and professors and other observers. Unlike events at e.g. the OECD, the discussions are more informal and everyone that has something to say, usually gets the opportunity to do so.

This year the agenda includes the following main topics:

- Hybrid entities
- The meaning of “the same or a connected project” under article 5
- International transport and the meaning of “auxiliary activities”

- The taxation of services and a new treaty article on withholding taxes
- Capacity building
- (Alternative) dispute resolution
- Article 9 on transfer pricing
- Article 12 on royalties
- Taxation of the extractive industry

Background material is still being uploaded for discussion as the week progresses.

The first day already kicked off with enough food for thought.

Hybrids

It was noted that not having an article dealing with hybrids does not make the issue go away: instead it leaves the issue to be solved (or not) by various (and possibly conflicting) national court decisions. Therefore, a new article 1, paragraph 2, will deal with hybrid entities to ensure that their treaty entitlement remain restricted to income which is treated as the income of a resident for tax purposes.

This does not mean that the same income cannot be taxed under two treaties. E.g. partner A, in country A, can participate in partnership B in country, which holds assets in country C. Assume country A treats partnership B as transparent and country B does not. Country C would then see itself forced to limit its taxing rights to the lower of those rights under its tax treaty with either country A or country B.

Work on this article is to be continued and discussed at the next Committee meeting.

Article 5 and "same or connected projects"

This paper has already been discussed for a couple of years and – unless the discussion on withholding taxes on services lead to drastic changes – is set to be adopted and incorporated into the next version of the UN Model Double taxation Convention. In short, the UN sets out to extend the work of the OECD under BEPS action 7 on the Artificial Avoidance of Permanent Establishment Status on service PE's.

Unlike the OECD article 5, paragraph 3, which only covers construction sites lasting more than 12 months, the UN article 5, paragraph 3, covers construction sites in letter a, and service PE's in letter b, where either activity exceeds 183 days. The

current UN amendment concerns the service PE's of article 5, paragraph 3, letter b. (One should also remember that in addition to article 5, paragraph 3, letter b, the UN model still contains a fixed base provision under article 14, and that some UN countries believe article 14 to be applicable to corporate taxpayers as well. This latter view is hidden underneath the text of paragraph 11 of the UN Commentary to article 14).

Discussions from previous years have already settled that, in spite of a minority view to the contrary, a service PE does require the physical presence of personnel in the source state, notwithstanding the BEPS exacerbation of the digital economy. However, discussions from previous years have also settled that the question whether projects are connected should be determined from the perspective of BOTH the service provider and the customer. A connection from the perspective of either, would lead to projects being connected with regard to the 183 day threshold.

Factors which could evidence such a connection include whether projects are covered by a single contract, or would have been in the absence of tax considerations; whether those contracts were concluded by the same or related persons; whether contracts logically stem from each other; whether the nature of the services provided are similar; and whether those services are performed by the same individuals.

I find this customer perspective development regrettable and I wonder how taxpayers will apply this in practice (if this condition was ever to make it into any tax treaty in the first place). I can also not think of any other example in the treaty where the status of customer group determines the tax status of a service provide.

Effectively it will require that a service provider will need more information about its customer and its customer group than before. According to one of the examples given medical devices are sold to a customer. The customer also concludes maintenance contracts for those devices and training for its personnel on those devices. The customer sees the maintenance and training contracts as part of the same project but the seller does not. Hence, the days spent on maintenance and those on training must be added together to see if the 183 day threshold is passed. The service provider would only know that it is supposed to file a PE tax return for both activities, if it asked the both the customer's maintenance department and HR/Training departments whether they could

objectively view these activities as connected.

I would argue that possible differences in views of the seller and the buyer is contrived and that there should be one objective determination of whether the services are connected. This is all the more so, now the proposed article 12, paragraph 4 of the UN Commentary to article 5, paragraph 3, letter b, states that looking at both perspectives does not depend on reading the mind(s) of the customer, but on the conclusions a reasonable person would draw.

More about this meeting, later this week.