

# The “other” tax club more ought to follow, part 2

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Johann Müller (Editor) (International tax professional)

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So what were the other discussions at the UN from 19 to 23 October this year? One of the main topics is the continuing work on a [withholding tax on technical services](#). The reason for developing countries is simple: it is a simple, effective way to protect the local tax base and prevent BEPS through technical service fees. It is obvious that developing countries are tired of seeing their tax bases eroded through management fees, engineering services, legal services and the like. One can therefore understand the desire to claw back a part of those losses through a withholding tax. However, considering the fact that profit margins on services may sometimes be large, but often very slim (think transfer pricing on low value adding services), one can also understand the concern of business that withholding taxes on gross service fees can easily outstrip profit margins, thus leading to double taxation. A low withholding tax rate will obviously alleviate the chances of double taxation, but it will leave a bad aftertaste for source countries in the case of highly profitable services and in cases where the residence country also gets to tax the high cost base itself. E.g. RCo in R provides engineering services of 100 to SCo in S. RCo employs engineers in R and pays them 90 so RCo’s profit is 10. If S levies 15% withholding tax on the service fees (15), RCo is  $(100 - 90 - 10) = 5$  out of pocket. However S’s overall tax base got eroded by 100, whereas R’s aggregate tax base suffered no erosion at all (RCo has a pre-tax base of 10 and the engineers of 90). So S may wonder why it should be limiting its withholding taxes, to prevent double taxation.

Besides being concerned about withholding taxes on services, one also has to bear in mind the interaction of this work with the work on service PE's under article 5, paragraph 3, letter b, of the UN Model Convention [discussed in my previous post](#), the ongoing work of the UN on royalties for [the use of equipment \(2 documents\)](#) and the view of some UN countries that corporations are covered by article 14 as well. With this many articles, potentially overlapping, the general UN rule may well become: gross withholding tax on services lasting less than 183 aggregated days; and net taxation on services lasting 183 aggregated days or more.

In the end though, it will depend on which of these articles get adopted into actual bilateral treaties and the here the rule is most likely to be: the more extreme the article, the less likely it is to ever see any incorporation.

An interesting side discussion arose with regard to services in the offshore sector. The discussion covered the scope of the convention with regard to the geographic area covered and article 7. Imagine oil company R in state R extracting oil on the continental shelf of state S, but outside state S's territorial waters (> 12 nautical miles from the coast) (see here for [a definition of terms](#)).