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Item 3(i) of the provisional agenda

Taxation issues related to the digitalized and globalized economy

Co-Coordinator's Report

Summary

This paper is for (1) information and discussion, and also for first consideration of (2) proposed drafting of a Fast Track instrument and protocols and of (3) two proposed amended provisions in the UN Model Tax Convention as outlined below. It addresses the three workstreams approved for consideration by the Subcommittee on Taxation Issues Related to the Digitalized and Globalized Economy, as follows:

- **Workstream A** – options for a more multilateralized form of implementing specific provisions of the UN Model Tax Convention;
- **Workstream B** – the function and relevance or otherwise of physical presence tests in the context of an increasingly digitalized and globalized economy; and
- **Workstream C** – cross-border taxation issues involving remote workers.

The Subcommittee *seeks the Committee's comments and guidance on the issues raised in this paper, including the input notes in the numbered Annexes to this paper, requested by the Subcommittee to assist its work, namely:*

a. Memorandum by Philip Baker on a possible instrument relevant to Workstream A (Annex 1 – at pp. 10-12 of this paper) along with an updated draft of a possible type of instrument with protocols addressing particular provisions of the UN Model Tax Convention (both at Annex 2 – at pp. 13-62 of this note) The Subcommittee submits the Annex B texts for first consideration by the Committee;

b. Paper by Brian Arnold relating to Workstream B (Annex 3 – at pp. 63-89 of this paper). The Subcommittee supports the option of combining Articles 5(3)(b), 12A and 14 into a new provision (provisionally referred to as Article xx) dealing with cross-border business services. The reason for this would be simplification and increased coherence. The Subcommittee seeks a first consideration of the text of the proposed Article xx as provided in Para 3.3.1 of Annex 3.

c. Paper by Brian Arnold relating to the Workstream C regarding remote workers (Annex 4 – at pp. 90-120 of this paper dealing with matters that have received initial consideration by the Subcommittee) and other related matters that have not yet received that consideration (Annex 5 – at pp. 121-149 of this paper). In relation to this workstream the Subcommittee supports taking forward an amendment to Article 15 of the UN Model (a new paragraph 4) addressing reduction of the tax base to the country of an employer when an employee is fulfilling his or her duties in another country. It seeks a first consideration of the text of the proposed Article 15(4) as provided in Para 3.9 of Annex 4 and quoted at paragraph 18 of this report. It also seeks guidance on possible other options, including those outlined in Annex 5.

Background and Subcommittee Mandate

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

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

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

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

Nineteen Committee Members are currently participating in the Subcommittee.

Subcommittee Workstreams

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

- (a) Workstream A, which explores a more multilateralized implementation of specific Model Convention provisions, where States seek to implement them across a number of treaties;
- (b) Workstream B, which addresses the function and relevance of physical presence tests; and
- (c) Workstream C, which addresses cross-border taxation issues involving remote workers.

4. At the most recent (Twenty-sixth) Session of the Committee, the Committee decided that the Subcommittee would continue to consider the issues raised by all three workstreams. The discussion at the Committee's Twenty-sixth Session and the outcomes are as reflected in the [report of that Session](#):

65. The Co-Coordinator of the Subcommittee on Taxation Issues related to the Digitalized and Globalized Economy, Mr. Gbonjubola, presented the Co-Coordinator's report (E/C.18/2023/CRP.1).

66. He noted that the report included annexed papers by Philip Baker, Mr. Roelofsen and Brian Arnold on these issues. The Subcommittee sought the Committee's comments and guidance on the issues raised in the report, including its annexes.

67. On workstream A, Mr. Baker outlined the paper that he had prepared exploring a fast-track instrument for the streamlined amendments to multiple tax treaties through a process capable of repeated use. He directed members' attention to the proposed steps in streamlining the process of adopting new treaty provisions approved by the Committee in existing treaties.

68. Some members indicated that there would be constitutional impediments to adopting and implementing the instrument in their countries. Some suggested that the instrument was complex to administer, as it added multiple layers to the treaty, introducing legal uncertainty which would lead to a reduction in tax certainty. It was also observed that there might not be wide political buy-in, hence the fast-track instrument might not be a very efficient use of Committee resources

if it did not have wide acceptance. One member suggested an alternative approach, which she considered simpler, but which was still aimed at addressing developing country concerns about capacity and the ability to efficiently update tax treaties. The suggested approach would involve convening a conference for all interested countries to negotiate and agree bilateral protocols based on model provisions. Another member suggested that, as the net statutory outputs under both the latter alternative approach and Mr. Baker's proposed approach would be bilateral protocols, it would be worth considering the scope for a "middle way" representing a convergence of these two approaches.

69. Several questions were raised on the paper, including about the procedural elements of such an instrument, the likely United Nations steps before the finalization of such an instrument, the flexibility afforded and the relationship to other instruments, such as the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. One member expressed the view that the Instrument would only be fully effective if it was upgraded to a minimum standard.

70. There was, however, broad support for the workstream despite the concerns raised by some members. Some members and observers saw the proposed instrument as very innovative, future-oriented and dynamic. It was noted that the workstream was a long-term project aimed at benefiting like-minded countries that would be a success if it assisted even a small number of countries to more efficiently update treaty relationships, including between developing countries.

71. On workstream B, members' attention was drawn to the paper prepared by Mr. Roelofsen as presented at the twenty-fifth session and contained in Annex C. On the same workstream, Mr. Arnold presented his paper (Annex D).

72. There was broad acceptance that the topic was an important one to address, with observations that the workstream did not call for the granting of additional taxing rights but rather a revisiting of the criteria for determining those rights. It was noted that, whereas there was a place for physical tests, they needed to be re-examined in the light of current business practices, given that business was evolving and traditional modes of doing business were quickly morphing to embrace new technological possibilities. That evolution had an impact on countries' ability to tax business activities. Proponents of the approach considered it imperative that approaches to physical thresholds for taxation should be updated as business changed to be less physically dependent.

73. The link between the workstream and transfer pricing was highlighted, with observations that profit allocation to permanent establishments would be affected, with complexities envisaged in any change of thresholds. It was also expressed that there was no need or reason to grant additional taxing rights to source countries; permanent establishment rules were sufficient as they were. However, if a review of the permanent establishment rules were conducted, it would have to apply to all taxpayers, not just a few select sectors.

74. Concerns were also raised that it might be counterproductive to embark on the work as framed, given the probability that gains obtained by developing countries from taxation of passive income would be rolled back.

75. It was also considered by some that the workstream was a long-term project that the Committee membership may not complete in the time left in its tenure. However, it was observed that there was great value in starting the journey given the importance of the workstream, even if some of the benefits would accrue further down the road.

76. On workstream C, Mr. Arnold presented his paper on cross-border taxation issues involving remote workers (E/C.18/2023/CRP.1, Annex E). Observers

noted the importance of addressing the issue and suggested that there was a lack of legal guidance to assist stakeholders. It was also suggested that the COVID-19 pandemic had fast-tracked an already growing trend of remote working, and technological advances meant that the process would continue.

77. It was widely recognized that the specific issue fell under the broad ambit of workstream B on the relevance of physical presence tests. Some members proposed that the issue should be addressed from a clarification point of view as opposed to a facilitative one and that guidance issued should address the question of when remote workers meet the Model Convention threshold in relation to a fixed base.

78. However, some members and observers did not see the issue as requiring the Committee's attention, considering that it was not a big problem for many countries, especially developing countries.

79. On the basis of the discussions, it was decided that the Subcommittee would continue to consider the issues raised by all three workstreams and address them in a paper for the twenty-seventh session. The Committee called for comments to be submitted by 1 May 2023.

5. Following the Twenty-sixth Session, the Subcommittee met virtually on 23 May and 29 May 2023; in person from 7 to 9 August 2023, kindly hosted by the International Bureau for Fiscal Documentation (IBFD) in Amsterdam; and virtually on 11 and 14 September. The meetings served to further develop the Subcommittee's proposals on the various workstreams, and, in particular, to discuss with the authors the development of the papers annexed to this report.

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

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

7. The initial **Workstream A** focus of the Subcommittee has been largely on the substantive requirements for a proposed FTI. The Secretariat advises that the Committee role at this stage should remain focused on suggesting an approach and text for the proposed instrument. Public international law advice is in the process of being sought through the Secretariat on the proposed text, with a view to further facilitating its transformation by later processes into treaty language text. The substantive issues are the main current issues for discussion at the Twenty-seventh Session. **Annex 1 is a note from Philip Baker on the latest changes to the draft FTI and some issues arising.**

8. Once the Committee concluded its work as an expert, but not intergovernmental, body, it would then depend on UN Member States as to whether, and in what form, such approach was taken forward as a treaty-level document, such as through an *ad hoc* working group set up to finalize the text of any instrument. It is not contemplated by the Subcommittee as a whole that anything approaching universal participation would be needed for the FTI to be successful; assisting a number of developing countries to update their treaty networks, even with other developing countries, could be a significant contribution.

9. As to the likely provisions that could be the initial focus for inclusion as protocols for like-minded states to adopt in a Fast Track Instrument, whether or not in the context of other agreed changes, the Co-Coordinator's report to the Twenty-fourth Session included: Article 12B on Automated Digital Services; Article 12A on Fees for Technical Services; and the proposed UN Model Subject to Tax Rule.

10. Other possible provisions mentioned in Subcommittee discussions have included:
- Paragraphs 6 and 7 of Article 13 (Capital gains) added to the 2021 UN Model relating to taxation of gains on the direct transfer of some types of property that are inextricably linked to their territory as well as gains on so-called “offshore indirect transfers”;
 - The removal of the words “(for the same or a connected project)” in subparagraph (3)(b) of Article 5 (Permanent establishment) as in the 2017 version of the UN Model;
 - The changes made to the 2021 Model relating to the Model’s application to collective investment vehicles and pension funds;
 - The Subject to Tax Rule that the Committee has agreed will be in the next version of the UN Model; and
 - The UN Model arbitration provisions.

11. **Annex 2 to this paper gives a draft prepared by Philip Baker in consultation, of an FTI and some examples of how some of these topics might be addressed in specific protocols to such an instrument.** Whatever protocols are attached to such an Instrument initially, it is presumed that new protocols would be added over time, by the agreement of participating states, to update the FTI in the future in response to what are seen as important new provisions of the UN Model.

12. Views from Committee Members are currently sought on this workstream, especially on Annexes 1 and 2, including as to which aspects are likely to be most effective as well as (for example) whether:

- Does the proposed approach (including the use of specific protocols):
 - achieve sufficient simplicity, but with adequate choice of options?
 - sufficiently streamline the process of updating treaties for developing countries, in particular?
 - preserve enough flexibility to allow the FTI to develop and grow, and for treaties to be adapted to new conditions?
- Is a system of participants being formally able to state “positions” on the protocols helpful to the adoption and implementation of the FTI or would it complicate the FTI’s operation and reduce consistency of interpretation?

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

13. In relation to **Workstream B**, the Subcommittee, with the help of Mr. Arnold, has identified a lack of consistency of physical presence tests in the UN Model and noted some possible options for change in the short term and the longer term. **Annex 3 focuses on the option of combining Articles 5(3)(b), 12A and 14 into a new provision (provisionally referred to as Article xx)** dealing with cross-border business services. The reason for this would be simplification and increased coherence.

14. Mr. Arnold’s paper provides possible draft wording for such a new provision and analyzes the implications of such a new provision with respect to the allocation of taxing rights under the United Nations Model Convention. It notes the need for consequential amendments to the other provisions of the Model if the new provision were to be adopted.

15. The Subcommittee proposes to take forward the possibility of an amalgamated article and to this end it seeks a **first consideration of the text of the proposed Article xx as provided in Para 3.3.1 of Annex 3.** The Subcommittee proposes to put forward text of **the accompanying Commentary** for a first consideration at the Twenty-eighth Session of the Committee. Work in this area would involve continuing consultations with the Subcommittee responsible for updating the UN Model.

Workstream C (Remote Workers)

Possible amendment to Article 15

16. In relation to Workstream C, the Subcommittee, with the help of Brian Arnold, has identified a lack of consistency in physical presence tests as a part of the requirements for taxation on non-resident employees by the country where employment is exercised. The Subcommittee has also identified that when a resident employer pays salaries to remote workers abroad, the employer's country of residence may not tax the employee's employment income, even though it may be allowing the employer to deduct employment costs.

17. The Subcommittee noted some possible options to address this loss of tax base, and Mr. Arnold's **paper at Annex 4 addresses options for Committee consideration at this Session.**

18. The main option, which the Subcommittee supports taking forward, is **an amendment to Article 15 of the UN Model that would address the reduction of the tax base to the country of an employer when an employee is fulfilling his or her duties in another country.** The proposed change – a new paragraph 15(4) – would be to provide that the country where an employer is resident can tax the remuneration of a non-resident employee irrespective of whether the employer has a PE or fixed base in the other country. It is expected to be along the following lines, as outlined in **paragraph 3.9 of Annex 4:**

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

19. As noted in the paper at Annex 4, such an amendment **should be designed to allow the contracting state in which the employer is resident to tax the employment income that is paid to the nonresident employee and deductible by the employer, irrespective of whether the employment is exercised in the other contracting state.** Employment income paid by a resident employer to a nonresident employee that is not deductible for income tax purposes in the employer's country of residence (for example, nonresident employees of non-taxable entities such as charities, not-for-profit entities, etc.) could be excluded from the scope of this new provision because there is no reduction of the country's tax base.

20. As noted in the Annexed paper, draft Article 15(4) would have no effect on State B's existing taxing rights under Article 15 of the UN Model with respect to income derived by an employee resident in State A from employment exercised in State B. Instead, draft Article 15(4) allows the contracting state where an employer is resident (State B) to impose tax on the employment income derived by employees resident in State A from employment exercised in State A or in a third state, as long as the remuneration paid by the employer is deductible in computing the employer's income for purposes of taxation by State B. This additional taxing right would be accompanied by a corresponding obligation imposed on State B under Article 23B(3) of the UN Model to grant a foreign tax credit for the taxes paid by an employee to State A on the employment income taxable by State B under proposed article 15(4).

21. **The Subcommittee proposes, subject to Committee views, to: further develop the draft provision, to be submitted for final approval at the Twenty-eighth Session; and develop draft accompanying Commentary, to be submitted for a first consideration at the Twenty-eighth Session of the Committee.** The Subcommittee will consult as necessary with the Subcommittee on the Update of the UN Model Tax Convention.

Other remote worker issues

22. **Annex 5** addresses other Workstream C (remote worker) issues. In this paper, Mr. Arnold addresses issues relating to the treatment of:

- employees resident in one contracting state and working remotely in the other contracting state;
- directors and top-level managerial officials employed by a company resident in one contracting state but working in the other contracting state;
- employees of the government of one contracting state working in the other contracting state;
- situations where remote working employees of an employer resident in one contracting state might create a PE or fixed base for their employers as a result of their working in the other contracting state; and
- so called “digital nomads” – highly in-demand individuals who can work from anywhere and move periodically from one country to another without creating a taxable presence in any country.

23. Mr. Arnold proposed the following reform options discussed in the paper as matters that could be given further consideration by the Subcommittee and Committee (“Group A options”):

- provide guidance in the Commentary on Article 15 of the United Nations Model Convention with respect to the treatment of employees who work remotely (paragraph 4.3.11);
- provide guidance in the Commentary on Article 5, or separately, with respect to the risk that remote working employees may create a PE or fixed base for their employers (section 5); and
- continue working on the development of practical solutions for the effective taxation of “digital nomads” (section 6).

24. On this last issue of “digital nomads” – workers moving periodically from country to country – Mr. Arnold found a low risk of double taxation of such workers, but a higher risk of double non-taxation. He notes the informational and other difficulties in effectively taxing such digital nomads and concludes that it seems premature to take any action at this time to impose tax on the income of digital nomads. However, he notes that the possibility of requiring residents to withhold tax from payments for services provided by digital nomads deserves further study to determine whether it is a feasible option.

25. Other reform options mentioned for possible consideration by the Subcommittee, but not discussed extensively in the paper (“Group B options”), include the following:

- reduce the time threshold of 183 days in Article 15(2)(a) to lesser number of days, say, 60 or 90 days;
- eliminate the exclusive taxing rights under Article 15 for countries in which employees are resident by allowing countries in which employees work to tax the income from such work without any minimum threshold; and
- add an alternative provision to the Commentary on Article 15 to make it easier for employees resident in one contracting state to work remotely in the other contracting state where the flows of cross-border employees between the two states are equal or almost equal.

26. **The Subcommittee seeks guidance from the Committee on which if any of these options should be further worked on, with a view in particular to: work that could be completed in the current term of the Committee’s Membership of the Committee; or, at least, work that could be done to assist the next Membership in deciding its areas of work.**

27. Any such work would involve consulting as necessary with the Subcommittee on the Update of the UN Model Tax Convention.

Relationship to the Sustainable Development Goals

28. As noted in the [Report of the Committee's Twenty-third Session](#), held in October 2021, the Committee agreed:

- (a) To continue to discuss taxation and the Sustainable Development Goals regularly during sessions, as a permanent agenda item;
- (b) To request the secretariat to provide regular updates on taxation and the Sustainable Development Goals, at each session:
 - (i) To preserve the focus of the Committee's work in the area;
 - (ii) To identify any gaps in guidance;
 - (iii) To establish priorities for technical work to be carried out by the secretariat; and
- (c) To have subcommittees reflect on the link between their work and the Goals.

29. In addressing paragraph (c) of that conclusion, the Subcommittee recognizes that, by promoting fair and effective tax systems, which support both revenue and trade and investment for development, through guidance products and through advising UN DESA on capacity building activities, the Committee's work contributes to achieving the interlinked SDGs as a totality.

30. More specifically, in relation to the work of the Subcommittee, an effective guidance effort in this area will promote the balance of revenue needs and the development-focused investment climate which many countries seek, by promoting whole-of-government, informed and practical real-world approaches to the issues involved. This builds greater certainty for all stakeholders in tax systems.

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

Proposed Next Steps

32. The Subcommittee intends to continue to work on Workstreams A, B and C after this Twenty-seventh Session of the Committee, drawing upon the guidance of the Committee on general approaches and specific comments on the issues raised in this paper and its Annexes.

33. In particular, the Subcommittee proposes the following, subject to Committee guidance:

- In relation to **Workstream A** – the Subcommittee will take into account the discussion at this session of the draft FTI including its Protocols and work towards a further draft to be submitted for final approval at the Twenty-eighth Session.
- In relation to **Workstream B** – taking into account the discussion at this session on the text of a provision combining Articles 5(3)(b), 12A and 14 into a new provision (provisionally called “Article xx”) dealing with taxation of cross-border business services, and outlined in Annex C, the Subcommittee will provide draft Commentary, with a view to a first consideration of the Commentary at the Twenty-eighth Session, and finalization of the text of the Article itself at the same Session. The Subcommittee also proposes to keep under consideration other options for dealing with physical presence tests and will report back on these issues at the Twenty-eighth Session.
- In relation to **Workstream C**, the Subcommittee will take into account comments on proposed new Article 15(4), as outlined above and in Annex D, and work further on the

draft provision to be submitted for final approval at the Twenty-eighth Session and the proposed Commentary to be submitted for first consideration at the same session. The Subcommittee also proposes to keep under consideration other options for dealing with issues relating to remote workers and will report back to the Committee on these issues at the Twenty-eighth Session.

34. Work in these areas involves possible updates to the UN Model and will include consultation with the Subcommittee on the Update of the United Nations Model Tax Convention.

ANNEX 1

Possible UN Fast Track Instrument

Memorandum on amendments in the draft dated 22nd September 2023

1. I have made some further amendments to the draft FTI following on the discussion at the online meeting on the 11th September 2023. They are highlighted in the redlined version of the draft dated 22nd September 2023.
2. The main amendments are as follows:
 - a) I have included an optional “enhanced procedure for automatic matching and conclusion of an Amending Agreement” in new Article 7. This is described separately below.
 - b) I have added a footnote that the application of the FTI to jurisdictions that are not independent states is to be subject to further discussion and that the current draft is simply a placeholder for further agreed wording.
 - c) I have included in Article 5 (matching procedure) the possibility that the provision of a list of Covered Tax Treaties may be optional rather than mandatory.
 - d) In Article 8 (alternative procedure for drafting model bilateral amending protocols) I have included references to Articles 3 to 7.
 - e) In Article 15 (additional protocols) I have included wording that an Additional Protocol should only be drafted if there is a substantive amendment to the UN Model and if the Secretariat determines that it is expedient to draft such an Additional Protocol.
3. The optional enhanced procedure in Article 7 reflects the discussion on 11th September where it was thought that some countries might be willing to have a matching procedure that would automatically result in an amendment to the relevant bilateral treaties. Under the enhanced procedure as drafted, any State could, when depositing its list of Covered Tax Treaties, indicate with regard to one or more of those treaties that it was willing to have the enhanced procedure applied to that treaty. In that case, the State concerned

- would also supply all the necessary information to conclude an Amending Agreement implementing the relevant Protocol with the other State party to that Double Tax Treaty.
4. Under the matching procedure to be carried out by the Secretariat, if two States both opted to apply the enhanced procedure, and the information supplied by the two States matched (in the sense defined in the Article), then the Secretariat would notify the two parties that the information supplied matches and this would constitute a binding Amending Agreement between them taking effect two months after the notification by the Secretariat. I have made provision for a one-month *locus poenitentiae* during which the States could decide not to go ahead with the automatic Amending Agreement (or could negotiate an alternative Amending Agreement if they wish). Members of the Committee may or may not wish to include that.
 5. This optional enhanced procedure may possibly appeal to some countries. It would require somewhat more preparatory work than the “light touch” matching in the procedure in Article 5. A State, in lodging its list of Covered Tax Treaties, would need to identify those for which it was willing to apply the enhanced procedure, and the terms under which it would be willing to reach an agreement with the other party to the relevant treaty. Once that work is carried out, however, there is an automatic process resulting in a deemed Amending Agreement which then implements the amendments to that bilateral tax treaty.
 6. This enhanced procedure is entirely optional, and may only appeal to a small number of countries. Nevertheless, for those countries, it could result in several amendments to their respective tax treaties all being agreed in a streamlined and automated fashion.
 7. There remain several issues for discussion at the meeting of the Committee in October:
 - a) Should the matching procedure in Article 5 be optional or mandatory, and does the “light touch” approach to matching offer the best approach? Should the FTI include the optional, enhanced procedure?
 - b) If it is mandatory to provide a list of Covered Tax Treaties, is it necessary to have each State Party to the FTI signing the protocols that it would be willing to consider applying to some of its treaties? Alternatively, if some States wish to indicate that they did not, under any circumstances, accept a particular protocol, would some system of reservations be necessary instead?

- c) Above all, have we developed the best product that we can to achieve the task of streamlining the amendment of tax treaties to take account of amendments to the UN Model (including future amendments)?

ANNEX 2

FTI (Revised draft 22nd September 2023)

Philip Baker KC

22 September 2023

Title of instrument:

Fast Track Instrument to Provide for the Streamlined Amendment of Bilateral Double Taxation Treaties

Preamble

The Parties to this Fast Track Instrument

Desiring to establish a procedure for the streamlined amendment of existing bilateral double taxation treaties by States wishing to make such changes, and to do so in a fast and effective manner.

Intending that this procedure will be established to give effect to amendments to the provisions of the UN Model Double Taxation Convention between Developed and Developing Countries as implemented in the double taxation treaties concluded between the Parties to this Instrument.

Seeking to achieve a greater degree of standardisation and uniformity in the double taxation treaties concluded between Parties to this Instrument in respect of both the wording and the contents of those treaties.

Have agreed as follows:

Part I: Definitions and Purpose

Article 1: Definitions

[This Article will contain a number of definitions, including the following]

For the purposes of this Instrument, the Protocols, and any Amending Agreement concluded pursuant to it, the following definitions apply:

a) The term “Amending Agreement” means an agreement concluded by two or more Parties to this Instrument in accordance with the terms of a Protocol to this Instrument [and includes an Amending Agreement concluded under the enhanced procedure in Article [7]].

b) The term “Committee of Experts” means the United Nations Committee of Experts on International Cooperation in Tax Matters and any successor body tasked by the United Nations with updating the UN Model.

c) the term “Depository” means the Secretary-General of the United Nations.

d) The term “Double Taxation Treaty” means a bilateral treaty for the elimination of double taxation whether concluded prior to the date of entry into force of this Instrument or subsequently.

e) The term “Party” means:

(i) Any State for which this Instrument is in force pursuant to Article [14] (Entry into Force); or

(ii) Any jurisdiction in respect of which a declaration has been made in accordance with Article [8] (Territorial Application).¹

¹ The issue of Parties to the Instrument that are not independent states will need further discussion. The current text is for preliminary discussion only.

f) The term “Signatory” means a State or jurisdiction which has signed this Instrument but for which the Instrument is not yet in force.

g) The term “UN Model” means the United Nations Model Double Taxation Convention between Developed and Developing Countries as amended from time to time.

Article 2 : Purpose

(1) The purpose of this Instrument is to establish a procedure for the amendment of bilateral Double Taxation Treaties (whether existing at the date of this Instrument or subsequently concluded) in force between Parties to this Instrument.

(2) The amendments to be implemented by this Instrument reflect amendments to the UN Model which have been or will in the future be made by the Committee of Experts.

Part II: The Procedure and its Operation

Article 3: The Procedure established by this Instrument.

(i) The procedure established by this Instrument for the amendment of Double Taxation Treaties consists of the following elements:

a) The framework for the implementation of amendments to Double Taxation Treaties, as provided for in this Instrument;

b) The specific amendments provided for in each of the Protocols to this Instrument;
and

c) The Amending Agreements concluded between two or more Parties to this Instrument in the form prescribed by any such Protocol.

(ii) For the purposes of the procedure established by this Instrument:

- a) Participation as a Party to this Instrument indicates the willingness of that Party to participate in the procedure set out in this Instrument. Signature, ratification, [acceptance or approval] of this Instrument pursuant to Article [7] does not in any way restrict a Party from amending any Double Taxation Treaty to which it is a party through other means or procedures agreed between the parties to that Treaty.
- b) The signature of a Party to a Protocol indicates the willingness of that Party to consider applying the amendments in that Protocol to the Double Taxation Treaties to which it is a party by concluding an Amending Agreement with any other Party to this Instrument with respect to those amendments in that Protocol.
- c) The amendment of a Double Taxation Treaty provided for in a Protocol shall take effect only when an Amending Agreement has entered into force between the parties to that Double Taxation Treaty.

Article 4: Operation of this Instrument

Where two or more Parties to this Instrument conclude an Amending Agreement in relation to a Protocol, the amendments set out in that Protocol shall be given effect in the Double Taxation Treaties between those Parties that are identified in the Amending Agreement in accordance with the terms of the Protocol and of the Amending Agreement.

Article 5: Matching Procedure

(i) Where a Party has signed this Instrument and one or more of the Protocols, that Party shall / [may]² as soon as possible [*Alternative*: within six months] after signing a Protocol deposit with the Depository a list of its existing Double Taxation Treaties in respect of which it is willing to consider applying the Protocol that it has signed (referred to as its list of “Covered Tax Treaties”). A Party may at any time amend its list of Covered Tax Treaties, and in particular shall do so as soon as possible [*Alternative*: within six months] after it has signed any additional Protocols to this Instrument.

² For discussion whether this matching procedure should be optional or compulsory for all Parties.

(ii) Where a Protocol contains an amendment that requires any terms or rates of tax to be agreed in an Amending Agreement, the list of Covered Tax Treaties shall also indicate the terms or rates of taxes on the basis of which that Party would be willing to enter into an Amending Agreement with other parties to its Covered Tax Treaties. The terms or rate of tax may include alternative terms or a range of rates of tax within which that Party may be willing to conclude an Amending Agreement.

(iii) Within three months of a Party depositing a list of its Covered Tax Treaties (or amending such a list), the Secretariat shall compare that list with the lists of Covered Tax Treaties deposited by other Parties. Where the lists of two Parties match, the Secretariat shall inform those Parties and shall provide all assistance and encouragement to those Parties to conclude an Amending Agreement between them.

Article 6: Multiple Amendments in an Amending Agreement

(i) Where two Parties agree that the amendments made by two or more Protocols shall apply to the Double Taxation Treaty between those Parties, they may conclude an Amending Agreement giving effect to the amendments made by all those Protocols. The Amending Agreement giving effect to multiple amendments shall contain the relevant information specified in the Schedules to each of the relevant Protocols.

(ii) Where more than two Parties agree that the same amendments made by one or more Protocols shall apply to all the Double Taxation Treaties between all those Parties, they may conclude a multilateral Amending Agreement giving effect to those amendments. The multilateral Amending Agreement giving effect to multiple amendments shall contain the relevant information specified in the Schedules to each of the relevant Protocols.

Article 7: Enhanced Procedure for Automatic Matching and Conclusion of an Amending Agreement

(i) When a Party deposits a list of Covered Tax Treaties in accordance with Article 5 above, that Party may indicate on the list that it is willing for the enhanced procedure in this Article to apply to one or more of the treaties on that list. That Party shall, in addition to identifying the treaty, also include in the list all the information specified in the Schedule to the relevant

Protocol that would be required from that Party to conclude an Amending Agreement giving effect to that Protocol in respect of that treaty.

(ii) When the Secretariat carries out the comparison process in Article 5 above and identifies that two Parties have both indicated that they are willing to apply the enhanced procedure in this Article, the Secretariat shall also compare the information specified by each Party in respect of that Protocol. If the information supplied by both parties matches (as explained in paragraph (iii) below), then the Secretariat shall within one month notify the two Parties of that matching.

(iii) For the purposes of this Article information “matches” if both Parties have supplied such information that would constitute a binding Amending Agreement between those Parties. Where one or both Parties has indicated a range of rates or percentages at which they would be willing to agree an Amending Agreement, the rate or percentage shall be regarded as matched at the highest common level acceptable to both Parties.³

(iv) Where the Secretariat has notified both Parties that the information they have supplied in their list of Covered Tax Agreements has been matched in accordance with the procedure in this Article, then, subject to paragraph (v) below, the Parties shall be regarded as having concluded an Amending Agreement having binding effect two months from the date on which the Secretariat notifies the Parties in accordance with paragraph (ii) above.

(v) Where the Secretariat has notified two Parties that the information they have supplied has been matched in accordance with this Article, then either Party may, within one month of being so notified, serve notice on the Secretariat and the other Party that it has decided not to conclude an Amending Agreement on those terms with the other Party.

(vi) Where the Secretariat has notified two Parties that the information they have supplied has been matched, and neither party has served a notice in accordance with paragraph (v), then the Secretariat shall inform the Depository that an Amending Agreement has been concluded between the Parties, the terms of that Amending Agreement, and the date from which it takes

³ For example, if State A has indicated it would agree to include Article 12A of the Model at a rate in the range 3%-5%, and State B has indicated a range of 4%-7%, the information would be matched at 5%, being the highest common percentage acceptable to both States. The States are, of course, at liberty to reject this and agree an Amending Agreement that differs from this (e.g. to reduce the rate to 4%).

effect. The Depository shall then issue a public notice containing the information provided by the Secretariat.

(vii) Where the Secretariat carries out the comparison process in accordance with Article 5 and the procedure in this Article, and the information provided by the two Parties does not match or some information is missing, the Secretariat shall notify both Parties and shall then use its best endeavours to assist the Parties to amend the information they have supplied or to provide the missing information or to conclude an Amending Agreement.

Article 8: Alternative Procedure for Drafting Model Bilateral Amending Protocols

(i) As an additional and alternative procedure to the procedure established by Articles [3] to [7] above, the Conference of the Parties shall, at the request of no less than five Parties, instruct the Secretariat established under Article [13] to draft one or more Model Bilateral Amending Protocols to give effect to amendments to the UN Model.

(ii) Each Model Bilateral Amending Protocol shall be drafted in each of the official languages of the United Nations and shall be submitted to the Conference of the Parties for approval and adoption.

(iii) If adopted by a majority of the members of the Conference of the Parties the Model Bilateral Amending Protocol shall be made available to all Parties to assist them in negotiating amending protocols to their Double Taxation Treaties.

(iv) Each Model Bilateral Amending Protocol shall not become a Protocol to this Instrument but shall be made available to Parties solely for the purpose of assisting those Parties wishing to use such Model Bilateral Amending Protocols in negotiating amending protocols to their Double Taxation Treaties.

Part III: Final provisions

Article 9: Signature and Ratification, Acceptance or Approval

- (i) As of the [] day of [], this Instrument shall be open for signature [at the Offices of the United Nations in Geneva] by all States.
- (ii) This Instrument is subject to ratification, [acceptance or approval].

Article 10: Territorial application of this Instrument

Any State may, at the time of signature, when depositing its instrument of ratification, acceptance, or approval, or at any later date, deposit a declaration specifying a jurisdiction for whose international relations it is responsible and to which this Instrument shall apply. The Instrument shall enter into force in respect of such a jurisdiction on the later of the date of entry into force of this Instrument for the State and the first day of the month following the expiration of a period of three calendar months beginning on the date of the deposit of the declaration.

Article 11: Reservations

No reservations are permitted to this Instrument.

Article 12: Notifications

- (i) Instruments of ratification, [acceptance or approval] shall be deposited with the Depository.
- (ii) Any Party signing a Protocol shall notify that signature to the Depository and deposit a signed copy of the Protocol with the Depository.
- (iii) Except where the enhanced procedure in Article [7] applies, two or more Parties concluding an Amending Agreement shall each promptly deposit a signed copy of the Amending Agreement with the Depository.

Article 13: Domestic procedure to give effect to this Instrument

Each Signatory or Party to this Instrument shall undertake such procedure under its domestic or constitutional law as are required to give effect to this Instrument, and to any Amending Agreement concluded by that Party.

Article 14: Conference of the Parties

(i) The Parties shall convene a Conference of the Parties for the purpose of taking any decisions or exercising any functions as may be required or appropriate under the provisions of this Instrument.

(ii) The Conference of the Parties shall within six months of the entry into force of this Instrument establish a Secretariat to administer this Instrument. The Secretariat shall consist of such number of Parties (being not less than five Parties) and such members of staff of the United Nations as the Conference of Parties shall from time to time specify.

(iii) A meeting of the Conference of the Parties shall be convened at least once a year at such time and place as is notified to the Parties by the Secretariat. At each meeting of the Conference of the Parties the Secretariat shall ensure that the agenda includes adequate time for Parties to discuss and conclude Amending Agreements, in particular where the possibility of such an Amending Agreement has been identified by the matching procedure in Article [5]

(iv) The Conference of the Parties shall be served by the Depository.

(v) Any Party may request a meeting of the Conference of the Parties by communicating a request to the Depository. The Depository shall inform all Parties of any such request. Thereafter, the Secretariat shall convene a meeting of the Conference of the Parties, provided that the request is supported by one third of the Parties within six calendar months of the communication by the Depository of the request.

Article 15: Additional Protocols to this Instrument

(i) If the Committee of Experts adopts a substantive amendment to the UN Model after the date that this Instrument is opened for signature, and the Secretariat determines that it is expedient to do so, the Secretariat shall prepare a draft Additional Protocol to this Instrument and a draft Amending Agreement to give effect to that amendment and shall submit such draft Additional Protocol and Amending Agreement to a meeting of the Conference of Parties within one year of the adoption of the amendment by the Committee of Experts.

(ii) The Committee of Experts may amend the draft Additional Protocol and Amending Agreement prepared by the Secretariat.

(iii) If a majority of Parties present at the meeting of the Conference of Parties called to consider the draft Additional Protocol and Amending Agreement approve the draft Additional Protocol and Amending Agreement, then that Additional Protocol and Amending Agreement shall immediately become a Protocol and Amending Agreement to this Instrument and the Protocol shall be open for signature in accordance with the provisions of this Instrument.

(iv) The adoption of an Additional Protocol and Amending Agreement shall not require ratification.

Article 16: Amendment

(i) Any Party may propose an amendment to this Instrument or to a Protocol thereto by submitting the proposed amendment to the Depository.

(ii) A meeting of the Conference of the Parties may be convened to consider the proposed amendment in accordance with Article [14] (Conference of the Parties).

(iii) An amendment to this Instrument shall be adopted by a majority of the Parties voting in favour at the meeting convened for the purpose of considering that amendment. The amendment shall enter into force for ratifying Parties ninety days after a majority of Parties have deposited instruments of ratification, and subsequently for any Party ninety days after that Party has deposited its instrument of ratification.

Article 17: Entry into force

(i) This Instrument shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of deposit of the [fifth] instrument of ratification, [acceptance or approval].

(ii) For each Signatory ratifying, [accepting or approving] this Instrument after the deposit of the fifth instrument of ratification, acceptance or approval, the Instrument shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of the deposit by such Signatory of its instrument of ratification, [acceptance or approval].

Article 18: Entry into effect of an Amending Agreement

An amendment to a Double Taxation Treaty which is made by an Amending Agreement shall have effect in each Party that has signed that Amending Agreement on the dates specified in the Amending Agreement [(including any Amending Agreement concluded under the enhanced procedure in Article [7]].

Article 19: Withdrawal

(i) Any Party may, at any time, withdraw from this Instrument or a Protocol by means of a notification addressed to the Depository.

(ii) Withdrawal pursuant to paragraph (i) shall become effective on the date of the receipt of the notification by the Depository.

(iii) Where this Instrument has entered into force with respect to all parties to a Double Taxation Treaty and an Amending Agreement has been concluded between those Parties before the date on which a Party's withdrawal becomes effective, that Double Taxation Treaty shall remain as amended by this Instrument and that Amending Agreement notwithstanding the withdrawal of that Party.

Article 20: Depository

(i) The Secretary-General of the United Nations shall be the Depository of this Instrument and any amendments thereto, and of any Protocol or Amending Agreement.

(ii) The Depository shall notify the Parties and Signatories within one calendar month of:

a) Any signature pursuant to Article [9] (Signature and Ratification, [Acceptance or Approval]) and Article [12] (Notifications);

b) The deposit of any instrument of ratification, [acceptance or approval] pursuant to Article [9] (Signature and Ratification, [Acceptance or Approval]) and Article [12] (Notifications);

c) Any notification pursuant to Article [12] (Notifications);

d) Any proposed amendment to this Instrument or its Protocols pursuant to Article [16] (Amendment) and the adoption of any such amendment;

e) Any withdrawal from this Instrument pursuant to Article [19] (Withdrawal);
and

f) Any other communication related to this Instrument.

(iii) The Depository shall maintain publicly available lists of Parties and notifications made by Parties.

IN WITNESS WHEREOF the undersigned, being duly authorised thereto, have signed this Instrument.

Done at [], the day of ,
in [all official languages of the United Nations], all texts being equally authentic, in a single copy which shall be deposited in the archives of the United Nations.

First Protocol to the Fast Track Instrument: Pension Funds

Desiring to give effect to the changes to the UN Model to include pension funds within the scope of their Double Taxation Treaties

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement which shall be written in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties that have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following Articles of this Protocol.

Article 3: modification of the General Definitions of the Relevant Double Taxation Treaty

In the Article of the relevant Double Taxation Treaty containing General Definitions, the following wording shall be included in the list of defined terms:

“(4) the term “recognized pension fund” of a Contracting State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and:

- (i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities, or

⁴ Number or letter to be in accordance with the numbering or lettering of the paragraph into which this wording is inserted.

- (ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements to which subdivision (i) applies.”

Article 4: Modification of the Definition of a Person

In the relevant Double Taxation Treaty, the definition of a Person shall be modified by the inclusion of the words “and a recognised pension fund of that State” if the Parties signing an Amending Agreement elect that the provisions of this Article shall apply.

Article 5: Modification of the Definition of a Resident

In the relevant Double Taxation Treaty, the definition of a Resident of a Contracting State shall be modified by the inclusion of the words “and a recognised pension fund of that State”.

Article 6: Modification of the Provisions on Entitlement to Benefits

In the relevant Double Taxation Treaty, the provisions relating to the Entitlement to Benefits shall be modified by the inclusion in the definition of “qualified persons” of “a recognised pension fund”.

Article 7: Signature and Notifications

- (i) The Depository shall maintain a list of signatories to this Protocol. Any Party to the Instrument may sign this Protocol.
- (ii) The Parties that conclude an Amending Agreement in accordance with this Protocol shall notify each other when all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force have been completed. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Second Protocol to the Fast Track Instrument: Gains in relation to Natural Resources and Offshore Indirect Capital Gains

Desiring to give effect to the changes to the UN Model in respect to the taxation of capital gains in relation to natural resources and to indirect disposals within the scope of their Double Taxation Treaties

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties that have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following Articles of this Protocol.

Article 3: Amendment of the Capital Gains Article of the Relevant Double Taxation Treaty in respect of the Taxation of Natural Resources

In the Article of the relevant Double Taxation Treaty relating to the taxation of Capital Gains, the following wording shall be inserted:

“(5). Gains derived by a resident of a Contracting State from the alienation of a right granted under the law of the other Contracting State which allows the use of resources that are naturally present in that other State and that are under the jurisdiction of that other State, may be taxed in that other State.”

⁵ Number or letter to be in accordance with the numbering or lettering of the paragraph into which this wording is inserted.

Article 4: Amendment of the Capital Gains Article of the Relevant Double Taxation Treaty in respect of the Taxation of Indirect Disposals

In the Article of the relevant Double Taxation Treaty relating to the taxation of Capital Gains, the following wording shall be inserted:

“(6). Subject to paragraphs [7] and [8], gains derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests of an entity, such as interests in a partnership or trust, may be taxed in the other Contracting State if

(a) the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least ___⁹ per cent [*the percentage is to be established through bilateral negotiations*] of the capital of that company or entity; and

(b) at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from

(i) a property any gain from which would have been taxable in that other State in accordance with the preceding provisions of this Article if that gain had been derived by a resident of the first-mentioned State from the alienation of that property at that time, or

(ii) any combination of property referred to in subdivision (i).

Article 5: Adjustment to the Numbering of Provision in the Relevant Double Taxation Treaty

Any provision of the relevant Double Taxation Treaty to the effect that gains other than those contained in specified paragraphs of the Capital Gains Article shall be taxable only in the State of residence of the alienator shall be amended so that the paragraphs specified shall be those identified in the Amending Agreement.

⁶ Number or letter to be an accordance with the numbering or lettering of the paragraph into which this wording is inserted.

⁷ Number to be agreed between the parties and included in the Memorandum of Agreement.

⁸ Number to be agreed between the parties and included in the Memorandum of Agreement.

⁹ Percentage to be agreed between the parties and included in the Memorandum of Agreement.

Article 6: Signature and Notifications

- (iii) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.
- (iv) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Second Protocol to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]
2. Details of the relevant Double Taxation Treaty: [E.g., “The Convention between the Government of State A and Government of the Republic of B for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains signed on the 14th July 1955 [*Fn to citation in UN Treaty Series or other official series of published treaties*].”]
3. Whether the parties to this Memorandum of Agreement have agreed to apply the amendments contained in Article 3 (capital gains in respect of natural resources) or Article 4 (indirect disposals) or both Articles: [E.g., “The amendments in Articles 3 (capital gains in respect of natural resources) or Article 4 (indirect disposals) of the Second Protocol shall both apply”.]

Third Protocol to the Fast Track Instrument: Fees for Technical Services

Desiring to give effect to the changes to the UN Model in respect to the taxation of fees for technical services within the scope of their Double Taxation Treaties

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties that have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Convention”) shall be amended in accordance with the following articles of this Protocol.

Article 3: Amendment of the Relevant Double Taxation Treaty in respect of Fees for Technical Services

The relevant Double Taxation Treaty shall be amended by the insertion of the following wording in accordance with the Amending Agreement:

“Article []¹⁰

FEES FOR TECHNICAL SERVICES

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

¹⁰ Number to be agreed between the parties and included in the Amending Agreement.

2. However, notwithstanding the provisions of Article [11] and subject to the provisions of Articles [12], fees for technical services arising in a Contracting State 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 fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent [*the percentage is to be established through bilateral negotiations*] of the gross amount of the fees.

3. The term “fees for technical services” as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:

(a) to an employee of the person making the payment;

(b) for teaching in an educational institution or for teaching by an educational institution; or

(c) by an individual for services for the personal use of an individual.

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

(a) such permanent establishment or fixed base, or

(b) business activities referred to in (c) of paragraph 1 of Article [13] .

In such cases the provisions of Article [14] or Article [15], as the case may be, shall apply.

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

¹¹ Number to be agreed between the parties and included in the Amending Agreement.

¹² Number to be agreed between the parties and included in the Amending Agreement.

¹³ Number to be agreed between the parties and included in the Amending Agreement.

¹⁴ Number to be agreed between the parties and included in the Amending Agreement.

¹⁵ Number to be agreed between the parties and included in the Amending Agreement.

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

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

Article 4: Alternative Wording: Alternative Provision for “Fees for Services”¹⁶

Where the parties to an Amending Agreement so provide, the following wording shall apply in place of the wording in this Protocol:

(i) References to “fees for technical services” shall be replaced by “fees for services” wherever they occur in this Protocol.

(ii) The following wording shall be substituted for paragraphs 3, 5 and 6 of the wording contained in Article 3 above:

“3. The term “fees for services” as used in this Article means any payment in consideration for any service, unless the payment is made:

(a) to an employee of the person making the payment;

(b) for teaching in an educational institution or for teaching by an educational institution; or

(c) by an individual for services for the personal use of an individual.

5. For the purposes of this Article, fees for services shall be deemed to arise in a Contracting State if:

¹⁶ This reflects the provisions of paragraph 26 of the Commentary to Article 12A of the UN Model.

- (a) the services are performed in that State; or
- (b) the payer is a resident of that State and the fees are paid to a closely related enterprise or person unless the payer carries on business in the other Contracting State through a permanent establishment situated in that State, or performs independent personal services through a fixed base situated in the other Contracting State and such fees are borne by that permanent establishment or fixed base; or
- (c) the payer has in that State a permanent establishment or a fixed base in connection with which the obligation to pay the fees for services was incurred, and such fees are borne by such permanent establishment or fixed base, and are paid to a closely related enterprise or person.

6. For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise. For the purposes of this Article, an individual shall be a closely related person with respect to another individual if the individual is related to that other individual by blood relationship, marriage or adoption.”

Article 5: Alternative Wording where the Double Taxation Treaty does not refer to “Fixed Base”

Where the relevant Double Taxation Treaty does not contain provisions relating to a fixed base and the Amending Agreement so specifies, the amendment made by Article 3 shall take effect with the exclusion of all reference to a fixed base.

Article 6: Consequential Amendments

The relevant Double Taxation Treaty shall be further amended as a consequence of the insertion of the Article on the Taxation of Automated Digital Services as follows (but only in so far as the relevant Double Taxation Treaty contains the Articles referred to in the following paragraphs):

- (a) In the Article of the relevant Double Taxation Treaty relating to Elimination of Double Taxation by Exemption,¹⁷ the number of the Article inserted by this Protocol shall be added to the numerical list of Articles in paragraphs (2) and (4);
- (b) In the Article of the relevant Double Taxation Treaty relating to Non-Discrimination,¹⁸ the wording “or paragraph 7 of Article [19]” and “fees for technical services” shall be inserted into the paragraph relating to deductions²⁰;
- (c) In the Article of the relevant Double Taxation Treaty relating to Entitlement to Benefits,²¹ the number of the Article inserted by this Protocol shall be added to the numerical list of Articles in the definition of “equivalent beneficiary”²².

Article 7: Signature and Notifications

- (v) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.
- (vi) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Third Protocol

¹⁷ The equivalent of Article 23A of the UN Model.

¹⁸ The equivalent of Article 24 of the UN Model.

¹⁹ The number of the Article inserted by this Protocol.

²⁰ The equivalent of Article 24(4) of the UN Model; the additional wording shall be inserted in the equivalent positions to that paragraph in the UN Model.

²¹ The equivalent of Article 29 of the UN Model.

²² The equivalent of Article 29(7)(e)(1)(B)(1) of the UN Model.

to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]

2. Details of the relevant Double Taxation Treaty: [E.g., “The Convention between the Government of State A and Government of the Republic of B for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains signed on the 14th July 1955 [*Fn to citation in UN Treaty Series or other official series of published treaties*].”]
3. Article number to be assigned to the new Article on the Taxation of Fees for Technical Services as inserted by the amendment made by Article 3 of the Protocol: [E.g., “The Article inserted by the amendment made by the Third Protocol shall be numbered 12A”].
4. Whether or not the alternative wording in Article 4 of the Third Protocol is to apply: [E.g., “The alternative wording in Article 4 of the Third Protocol shall / shall not apply to the amendments made by this Agreement”]
5. Article numbers to be inserted into the amendment made by Article 3, paragraph 2: [E.g., “The Article numbers to be inserted in the wording of the amendment made by Article 3(2) of the Third Protocol shall be Article numbers 14 and 8, 16 and 17 respectively”].
6. Percentage to be inserted into the amendment made by Article 3, paragraph 2: [E.g., “The percentage to be inserted in the amendment made by Article 3 of the Third Protocol shall be 3%”].
7. Article numbers to be inserted into the amendment made by Article 3, paragraph 4: [E.g., “The Article numbers to be inserted in the wording of the amendment made by Article 3(2) of the Third Protocol shall be Article numbers 7 and 14”].
8. Whether the relevant Double Taxation Treaty includes references to a fixed base: [E.g.: “For the purposes of Article 5 of the Third Protocol the Double Taxation Convention does / does not refer to ‘fixed base’”].
9. The date of taking effect in State A: [E.g., “This Agreement and the amendments to the Double Taxation Treaty that it makes shall come into effect and be implemented under the law of State A on the 1st January 2024.”]

Fourth Protocol to the Fast Track Instrument: Income from Automated Digital Services

Desiring to give effect to the changes to the UN Model in respect to the taxation of income from automated digital services within the scope of their Double Taxation Treaties

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties that have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following articles of this Protocol.

Article 3: Amendment of the Relevant Double Taxation Treaty in respect of the Taxation of Automated Digital Services

The relevant Double Taxation Treaty shall be amended by the insertion of the following wording in accordance with the Amending Agreement:

“Article []²³

INCOME FROM AUTOMATED DIGITAL SERVICES

1. Income from automated digital services arising in a Contracting State, underlying payments for which are made to a resident of the other Contracting State, may be taxed in that other State.

²³ Number to be agreed between the parties and included in the Amending Agreement.

2. However, subject to the provisions of Article [24] and notwithstanding the provisions of Article [25], income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the tax so charged shall not exceed ___²⁶ per cent [*the percentage is to be established through bilateral negotiations*] of the gross amount of the payments underlying the income from automated digital services.

3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises, to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article [27] and notwithstanding the provisions of Article [28], the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be 30 per cent of the amount resulting from applying the profitability ratio of that beneficial owner’s automated digital services business segment to the gross annual revenue from automated digital services derived from the Contracting State where such income arises. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits. However, where the beneficial owner belongs to a multinational enterprise group, the profitability ratio to be applied shall be that of the business segment of the group relating to the income covered by this Article, or of the group as a whole in case segmental accounts are not maintained by the group, provided such profitability ratio of the multinational enterprise group is higher than the aforesaid profitability ratio of the beneficial owner. Where the segmental profitability ratio or, as the case may be, the overall profitability ratio of the multinational enterprise group to which the beneficial owner belongs is not available to the Contracting State in which the income from automated digital services arises, the provisions of this paragraph shall not apply; in such a case, the provisions of paragraph 2 shall apply.

4. For the purposes of paragraph 3, “multinational enterprise group” means any “group” that includes two or more enterprises, the tax residence for which is in different jurisdictions. Further, for the purposes of paragraph 3, the term “group” means a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated

²⁴ Number to be agreed between the parties and included in the Amending Agreement.

²⁵ Number to be agreed between the parties and included in the Amending Agreement.

²⁶ Percentage to be agreed between the parties and included in the Amending Agreement.

²⁷ Number to be agreed between the parties and included in the Amending Agreement.

²⁸ Number to be agreed between the parties and included in the Amending Agreement.

Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public stock exchange.

5. The term “automated digital services” as used in this Article means any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.

6. The term “automated digital services” includes especially:

- (a) online advertising services;
- (b) supply of user data;
- (c) online search engines;
- (d) online intermediation platform services;
- (e) social media platforms;
- (f) digital content services;
- (g) online gaming;
- (h) cloud computing services; and
- (i) standardized online teaching services.

7. The provisions of this Article shall not apply if the payments underlying the income from automated digital services qualify as “royalties” or “fees for technical services” under Article [29] or Article [30] as the case may be.

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

- (a) such permanent establishment or fixed base, or
- (b) business activities referred to in subparagraph (c) of paragraph 1 of Article [31].

²⁹ Number to be agreed between the parties and included in the Amending Agreement.

³⁰ Number to be agreed between the parties and included in the Amending Agreement.

³¹ Number to be agreed between the parties and included in the Amending Agreement.

In such cases the provisions of Article [32] or Article [33], as the case may be, shall apply.

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

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

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

Article 4: Alternative Wording: Threshold for the taxation of income from automated digital services³⁴

Where the parties to an Amending Agreement so provide, the following wording shall apply in place of the wording in paragraph 2 of Article 3 above:

³² Number to be agreed between the parties and included in the Amending Agreement.

³³ Number to be agreed between the parties and included in the Amending Agreement.

³⁴ This reflects the provisions of paragraph 26 of the Commentary to Article 12B of the UN Model.

“2. However, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, income from automated digital services arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the income is a resident of the other Contracting State, the income from automated digital services arising in a Contracting State may be taxed in the Contracting State in which it arises only if:

(a) the worldwide revenue derived by the beneficial owner of the income during the fiscal year concerned is an amount exceeding [³⁵]; and

(b) the revenue from automated digital services derived by the beneficial owner from the Contracting State during the fiscal year concerned is an amount exceeding [³⁶];

and the tax so charged shall not exceed [³⁷] per cent of the gross amount of the income from automated digital services arising in the first-mentioned State.”

Article 5: Alternative Wording: Carve out for Routine Profits³⁸

Where the parties to an Amending Agreement so provide, the following wording shall apply in place of the wording in paragraph 3 of Article 3 above:

“3. The provisions of paragraph 2 shall not apply if the beneficial owner of the income from automated digital services, being a resident of a Contracting State, requests the other Contracting State where such income arises to subject its qualified profits from automated digital services for the fiscal year concerned to taxation at the tax rate provided for in the domestic laws of that State. If the beneficial owner so requests, subject to the provisions of Article 8 and notwithstanding the provisions of Article 14, the taxation by that Contracting State shall be carried out accordingly. For the purposes of this paragraph, the qualified profits shall be [³⁹] per cent of the amount resulting from applying to the gross annual revenue from automated digital services derived from the Contracting State where such income arises:

(a) the automated digital services business segment profitability ratio of the beneficial owner where segmental accounts are maintained;

(b) the overall profitability ratio of the beneficial owner where segmental accounts are not maintained;

³⁵ Numerical threshold to be agreed between the parties and included in the Amending Agreement.

³⁶ Numerical threshold to be agreed between the parties and included in the Amending Agreement.

³⁷ Percentage to be agreed between the parties and included in the Amending Agreement.

³⁸ This reflects the provisions of paragraph 48 of the Commentary to Article 12B of the UN Model.

³⁹ Percentage to be agreed between the parties and included in the Amending Agreement.

deducted by [⁴⁰] per cent deemed return on routine functions for providing the automated digital services.

Article 6: Alternative Wording: fees for technical services and fixed base

Where the relevant Double Taxation Treaty does not contain provisions relating to either

- (a) Fees for technical services; or
- (b) A fixed base

and the Amending Agreement so specifies, the amendment made by Article 3 shall take effect with the exclusion of all reference to fees for technical services or to a fixed base or both.

Article 7: Consequential Amendments

The relevant Double Taxation Treaty shall be further amended as a consequence of the insertion of the Article on the Taxation of Automated Digital Services as follows (but only in so far as the relevant Double Taxation Treaty contains the Articles referred to in the following paragraphs):

- (d) In the Article of the relevant Double Taxation Treaty relating to Elimination of Double Taxation by Exemption,⁴¹ the number of the Article inserted by this Protocol shall be added to the numerical list of Articles in paragraphs (2) and (4);
- (e) In the Article of the relevant Double Taxation Treaty relating to Non-Discrimination,⁴² the wording “or paragraph 11 of Article [⁴³]” and “payments underlying income from automated digital services” shall be inserted into the paragraph relating to deductions⁴⁴;
- (f) In the Article of the relevant Double Taxation Treaty relating to Entitlement to Benefits,⁴⁵ the number of the Article inserted by this Protocol shall be added to the numerical list of Articles in the definition of “equivalent beneficiary”⁴⁶.

⁴⁰ Percentage to be agreed between the parties and included in the Amending Agreement.

⁴¹ The equivalent of Article 23A of the UN Model.

⁴² The equivalent of Article 24 of the UN Model.

⁴³ The number of the Article inserted by this Protocol.

⁴⁴ The equivalent of Article 24(4) of the UN Model; the additional wording shall be inserted in the equivalent positions to that paragraph in the UN Model.

⁴⁵ The equivalent of Article 29 of the UN Model.

⁴⁶ The equivalent of Article 29(7)(e)(1)(B)(1) of the UN Model.

Article 8: Signature and Notifications

- (i) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.
- (ii) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Fourth Protocol to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]
2. Details of the relevant Double Taxation Treaty: [E.g., “The Convention between the Government of State A and Government of the Republic of B for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains signed on the 14th July 1955 [*Fn to citation in UN Treaty Series or other official series of published treaties*].”]
3. Article number to be assigned to the new Article on the Taxation of Income from Automated Digital Services as inserted by the amendment made by Article 3 of the Protocol: [E. g., “The Article inserted by the amendment made by the Fourth Protocol shall be numbered 12B”].
4. Whether or not the alternative wording in Article 4 of the Fourth Protocol is to apply (and the financial levels of the threshold in sub-paragraphs 2(a) and (b)): [E.g., “The

alternative wording in Article 4 of the Fourth Protocol shall / shall not apply to the amendments made by this Agreement [and the financial thresholds in sub-paragraphs (a) and (b) shall be US\$100 million and US\$10 million respectively]”]

5. Whether or not the alternative wording in Article 5 of the Fourth Protocol is to apply (and the percentages to be included in paragraph 3): [E.g. “The alternative wording in Article 5 of the Fourth Protocol shall / shall not apply to the amendments made by this Agreement [and the percentages to be inserted in paragraph 3 shall be 25% and 10% respectively]”]
6. Article numbers to be inserted into the amendment made by Article 3, paragraphs 2, 3 and 8: [E.g., “The Article numbers to be inserted in the wording of the amendment made by Article 3(2) of the Fourth Protocol shall be Article numbers 14 and 8, 16 and 17 respectively”].
7. Percentage to be inserted into the amendment made by Article 3, paragraph 2: [E.g., “The percentage to be inserted in the wording of the amendment made by Article 3(2) of the Fourth Protocol shall be 3%]
8. Article numbers to be inserted into the amendment made by Article 3, paragraph 7: [E.g., “The Article numbers to be inserted in the wording of the amendment made by Article 3(7) of the Fourth Protocol shall be Article numbers 12 and 12A”].
9. Whether the relevant Double Taxation Treaty contains provisions relating to (a) fees for technical services; or (b) fixed base; or both: [E.g., “For the purposes of Article 6 of the Fourth Protocol the Double Taxation Treaty (a) does / does not refer to ‘fees for technical services’, and (b) does / does not refer to ‘fixed base’.”]
10. The date of taking effect in State A: [E.g., “This Agreement and the amendments to the Double Taxation Treaty that it makes shall come into effect and be implemented under the law of State A on the 1st January 2024.”]
11. The date of taking effect in State B: [E.g., “This Agreement and the amendments to the Double Taxation Treaty that it makes shall come into effect and be implemented under the law of the Republic of B on the 1st July 2024.”]
12. The language version (or versions) of the amendments (and if a language other than an official UN language is adopted, then the text of the amendments or modifications in that language should be appended): [E.g., “The language version of the amendments made by this Agreement are English and Ruritanian – the Ruritanian text of the amendments is appended”].]

Fifth Protocol to the Multilateral Fast Track Instrument: Arbitration

Desiring to give effect to the changes to the UN Model to include provision for the arbitration of disputes under the mutual agreement procedure provided for in their Double Taxation Treaties.

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties who have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following articles of this Protocol.

Article 3: Inclusion of Provision for Arbitration of Disputes Within the Relevant Double Taxation Treaty

In the Article of the relevant Double Taxation Treaty relating to Mutual Agreement Procedure, the following paragraph shall be included at the end of the Article:

“^[47]. Where,

- (a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and
- (b) the competent authorities are unable to reach an agreement to resolve

⁴⁷ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

that case pursuant to paragraph 2 within three years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if either competent authority so requests. The person who has presented the case shall be notified of the request. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.”

Article 4: Alternative Wording: Voluntary Arbitration

Where the parties to an Amending Agreement so provide, the following wording shall apply in place of the wording in Article 3 above:

“⁴⁸. If the competent authorities are unable to resolve by mutual agreement a case pursuant to paragraph 2, the case, may, if both competent authorities and the person who has presented the case pursuant to paragraph 1 agree, be submitted for arbitration, provided any person directly affected by the case agrees in writing to be bound by the decision of the arbitration board. If the competent authorities are unable to resolve by mutual agreement a difficulty or a doubt pursuant to paragraph 3, the difficulty or doubt may also, if both competent authorities agree, be submitted for arbitration. The decision of the arbitration board in a particular case shall be binding on the Contracting States with respect to that case. Where a general difficulty of interpretation or application is submitted to arbitration, the decision of the arbitration board shall be binding on the Contracting States as long as the competent authorities do not agree to modify or rescind the decision. The competent authorities shall by mutual agreement settle the procedures for such an arbitration board.”

⁴⁸ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

Article 5: Signature and Notifications

(i) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.

(ii) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Fifth Protocol to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]
2. Details of the relevant Double Taxation Treaty: [E.g., “The Convention between the Government of State A and Government of the Republic of B for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains signed on the 14th July 1955 [*Fn to citation in UN Treaty Series or other official series of published treaties*].”]
3. Whether or not the alternative wording in Article 4 of the Fifth Protocol is to apply: [E.g., “The alternative wording in Article 4 of the Fifth Protocol shall / shall not apply to the amendments made by this Agreement”]
4. The date of taking effect in State A: [E.g., “This Agreement and the amendments to the Double Taxation Treaty that it makes shall come into effect and be implemented under the law of State A on the 1st January 2024.”]

Sixth Protocol to the Multilateral Fast Track Instrument:

Subject to Tax Rule

Desiring to give effect to the changes to the UN Model to include a Subject to Tax Rule in their Double Taxation Treaties.

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties who have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following articles of this Protocol.

Article 3: Inclusion of a Subject to Tax Rule in the Relevant Double Taxation Treaty

In the Article of the relevant Double Taxation Treaty relating to the Scope of the Convention the following paragraph shall be included at the end of the Article:

“⁴⁹. (a) This Convention shall not affect the taxation by a Contracting State of any income arising in that State and derived by a resident of the other Contracting State if that income is subject to a low level of taxation in that other State within the meaning of subparagraph (b).

(b) Income is subject to a low level of taxation in that other State if:

(i) it is subject to a statutory tax rate of [⁵⁰] per cent or less; or

⁴⁹ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

⁵⁰ Percentage to be agreed between the parties and included in the Amending Agreement.

(ii) it is subject to a statutory tax rate higher than the rate set out in subdivision (i) but the beneficial owner of the income is entitled to a special exemption, exclusion or reduction that is linked directly to the income or the entity receiving it so that the amount of tax paid in that other State with respect to such income is less than the amount of tax that would be imposed if the tax rate set out in (i) were applied to such income without regard to such exemption, exclusion or reduction.

(c) Subparagraph (a) will not apply to income that:

(i) [⁵¹].”

Article 4: Signature and Notifications

(i) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.

(ii) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Sixth Protocol to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]

⁵¹ Exceptions to the operation of the Subject to Tax Rule are to be agreed between the parties to an Amending Agreement and set out in that Agreement.

2. Details of the relevant Double Taxation Treaty: [E.g., “The Convention between the Government of State A and Government of the Republic of B for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains signed on the 14th July 1955 [*Fn to citation in UN Treaty Series or other official series of published treaties*].”]
3. Percentage to be inserted into the amendment made by Article 3: [E.g., “The percentage to be inserted in the wording of the amendment made by Article 3 of the Sixth Protocol shall be 15%].
4. The specified exceptions to be inserted into sub-paragraph (c) of the Subject to Tax Rule: [E.g., “The exceptions contained in sub-paragraph (c) shall be:
 - i. income derived by a recognised pension fund;
 - ii. income derived by an entity established for exclusively charitable purposes;
 - iii. income derived by a collective investment vehicle;
 - iv. income earned through exempt foreign branches and permanent establishments;
 - v. [such other exceptions as the parties to the Amending Agreement agree to include].”]⁵²
5. The date of taking effect in State A: [E.g., “This Agreement and the amendments to the Double Taxation Treaty that it makes shall come into effect and be implemented under the law of State A on the 1st January 2024.”]
6. The date of taking effect in State B: [E.g., “This Agreement and the amendments to the Double Taxation Treaty that it makes shall come into effect and be implemented under the law of the Republic of B on the 1st July 2024.”]
7. The language version (or versions) of the amendments (and if a language other than an official UN language is adopted, then the text of the amendments or modifications in that language should be appended): [E.g., “The language versions of the amendments made by this Agreement are English and Ruritanian – the Ruritanian text of the amendments is appended”.]

⁵² Note: the terminology used in this list of exceptions should match the terminology in the relevant tax treaty. It may be necessary to include additional definitions for the purpose of these exceptions, in which case the Amending Agreement should add words: “For the purposes of the amendment made by the Sixth Protocol to the Fast Track Instrument the term “[e.g., collective investment vehicle]” shall mean”.

IN WITNESS WHEREOF, the undersigned, being duly authorised thereto, have signed this Amending Agreement.

Done at [], the day of , in []
in two copies.

Seventh Protocol to the Multilateral Fast Track Instrument: Capital Gains Deriving from the Value of Immoveable Property

Desiring to give effect to the changes to the UN Model to include a provision for the taxation of gains deriving from the value of immoveable property in their Double Taxation Treaties.

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties who have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following articles of this Protocol.

Article 3: Inclusion of a Provision on Gains Deriving from the Value of Immoveable in the Relevant Double Taxation Treaty

In the Article of the relevant Double Taxation Treaty relating to Capital Gains the following paragraphs shall be included in addition to or in place of any existing paragraphs relating to the disposal of shares and other interests:

“^[53]. Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or

⁵³ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

[⁵⁴]. Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests, such as interests in a partnership or trust, which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least [⁵⁵] per cent of the capital of that company or entity.”

Article 4: Signature and Notifications

(i) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.

(ii) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Seventh Protocol to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]

⁵⁴ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

⁵⁵ Percentage to be agreed between the parties and included in the Amending Agreement.

Eighth Protocol to the Multilateral Fast Track Instrument: Services Permanent Establishments

Desiring to give effect to the changes to the UN Model to include a provision relating to permanent establishments arising from the provision of services in their Double Taxation Treaties.

The signatories to this Protocol intend that this Protocol shall have the effect as follows:

Article 1: Purpose of this Protocol

Where two Parties to the Instrument have signed this Protocol, they may give effect to the amendments contained in this Protocol by concluding an Amending Agreement in accordance with the Schedule to this Protocol.

Article 2: The Effect of the Conclusion of an Amending Agreement

The Double Taxation Treaty between the Parties who have concluded an Amending Agreement and that is identified in that Amending Agreement (“the relevant Double Taxation Treaty”) shall be amended in accordance with the following articles of this Protocol.

Article 3: Inclusion of a Provision on Services Permanent Establishments in the Relevant Double Taxation Treaty

In the Article of the relevant Double Taxation Treaty defining Permanent Establishments the following paragraphs shall be included in addition to or in place of any existing paragraphs relating to construction sites or the provision of services:

“⁵⁶. The term “permanent establishment” also encompasses:

⁵⁶ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

(a) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than [⁵⁷] months;

(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 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.”

Article 4: Inclusion of a Provision on Services Permanent Establishments in the Relevant Double Taxation Treaty – Alternative Wording⁵⁸

Where the parties to an Amending Agreement so provide, the following wording shall apply in place of the wording in Article 3 above:

“⁵⁹]. The term “permanent establishment” also encompasses:

(a) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than [⁶⁰] months;

(b) The furnishing of services by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal year concerned;

(c) For an individual, the performing of services in a Contracting State by that individual, but only if the individual’s stay in that State is for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal year concerned.”

⁵⁷ The number of months is to be included in the Amending Agreement.

⁵⁸ This alternative wording reflects the provisions of paragraph 39 et seq of the Commentary to Article 3 of the UN Model.

⁵⁹ Number to be inserted according to the consecutive numbering of the paragraphs of this Article.

⁶⁰ The number of months is to be included in the Amending Agreement.

Article 5: Signature and Notifications

(i) The Depository shall maintain a list of signatories of this Protocol. Any Party to the Fast Track Instrument may sign this Protocol.

(ii) The parties to an Amending Agreement concluded in accordance with this Protocol shall notify each other of the conclusion of all procedures necessary to bring the Amending Agreement and the amendments and modifications in this Protocol into force in the territory of that Party. They shall also notify the Depository accordingly.

THIS PROTOCOL shall be open for signature by Parties to the Instrument from the [] day of [].

Schedule: Contents of the Amending Agreement

An Amending Agreement concluded pursuant to this Protocol shall include all of the following contents:

1. Introductory text declaring the purpose and effect of the Agreement [E.g., “The parties to this Amending Agreement have agreed that the Double Taxation Treaty in force between them and identified in this Agreement shall, from the dates set out below, have effect and be implemented as amended by the amendments set out in the Eighth Protocol to the Fast Track Instrument, in accordance with the terms of this Amending Agreement, notwithstanding anything to the contrary in that Double Taxation Treaty as it stands at the date of this Agreement”.]
2. Details of the relevant Double Taxation Treaty: [E.g., “The Convention between the Government of State A and Government of the Republic of B for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains signed on the 14th July 1955 [*Fn to citation in UN Treaty Series or other official series of published treaties*].”]
3. Number of months to be inserted into the amendment made by Article 3: [E.g., “The number of months to be inserted in the wording of the amendment made by Article 3 of the Eighth Protocol shall be six [6]”].
4. Whether or not the alternative wording in Article 4 of the Protocol is to apply in place of the wording in Article 3: [E.g. “The alternative wording in Article 4 of the Eighth Protocol shall apply in place of the wording in Article 3”].

ANNEX 3

**REVISED DRAFT
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UNITED NATIONS SUBCOMMITTEE ON TAXATION ISSUES RELATED TO THE DIGITALIZED AND GLOBALIZED ECONOMY

WORKSTREAM B

REFORM PROPOSAL WITH RESPECT TO THE TAXATION OF BUSINESS PROFITS FROM SERVICES UNDER THE UNITED NATIONS MODEL CONVENTION

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1. INTRODUCTION

- 1.1 This paper discusses a proposal for reforming the provisions of the United Nations Model Convention with respect to the taxation of business profits from cross-border services. The paper is part of the ongoing work (referred to as Workstream B) of the Subcommittee on Taxation Issues Related to the Digitalized and Globalized Economy (the Subcommittee) and the United Nations Committee of Experts on International Cooperation in Tax Matters (the Committee). Workstream B was originally focused on a review of the use of the concept of physical presence as a condition for the taxation of income by source countries under the United Nations Model Convention, with a view to its function and relevance.
- 1.2 The Subcommittee met several times during the last half of 2022 and the first half of 2023 to discuss the domestic tax and tax treaty issues that arise with respect to the use of tests based on physical presence. My paper discussing the use of physical presence tests in the United Nations Model Convention was discussed extensively at a meeting of the Subcommittee on January 4, 2023, and, after extensive revisions, the paper E/C.18/2023/CRP.1 Annex D was presented to the Committee at the 26th Session in

March 2023. The Committee agreed that the work on Workstream B should continue and the Subcommittee was tasked to propose how to take the work on Workstream B forward.

- 1.3 The Subcommittee met on May 23, 2023, and requested that a further paper be prepared focusing primarily on the threshold requirements for taxing business profits under the provisions of the United Nations Model Convention and identifying practical options for clarifying or reforming those threshold requirements. That paper analyzed the different threshold requirements for taxing business profits, their underlying principles, advantages and disadvantages, and ancillary consequences. In addition, the paper proposed a wide range of options for reforming the threshold requirements, including an option to simplify the provisions of the United Nations Model Convention dealing with the taxation of business profits by combining Articles 5(3)(b), 12A, and 14 into a new provision with expanded taxing rights for source countries. The paper was discussed in detail at a meeting of the Subcommittee held in Amsterdam from August 7 to 9, 2023, and the Subcommittee asked that a follow-up paper be prepared providing more detailed analysis of the possibility of combining Articles 5(3)(b), 12A and 14 into a single provision. The Subcommittee also decided that, if the proposal to combine Articles 5(3)(b), 12A and 14 turned out to be unacceptable for some reason, more limited changes to the provisions of the United Nations Model Convention dealing with business services should be considered.
- 1.4 This paper discusses the proposal to combine Articles 5(3)(b), 12A and 14 into a new provision dealing with cross-border business services. It provides draft wording for the proposed new provision and analyzes the implications of the new provision with respect to the allocation of taxing rights under the United Nations Model Convention. It also briefly discusses the consequential amendments to the other provisions of the Model if the new provision is adopted. In addition, an attachment to this paper discusses a variety of possible amendments to the provisions of the United Nations Model Convention dealing with business services that might be adopted if the primary proposal to combine Articles 5(3)(b), 12A and 14 is rejected.
- 1.5 Although this paper describes proposed changes to the United Nations Model Convention and analyzes their consequences, it does not make any recommendations.

2. AN OVERVIEW OF THE EXISTING PROVISIONS OF THE UNITED NATIONS MODEL CONVENTION DEALING WITH BUSINESS SERVICES

2.1 A surprisingly wide range of threshold requirements for the taxation of profits from services is used in the provisions of the United Nations Model Convention, as listed below:

- a fixed place of business, except for preparatory or auxiliary activities – Article 5(1);
- a building site, construction, assembly or installation project, including supervisory activities, lasting more than 6 months, except for preparatory or auxiliary activities – Article 5(3)(a);
- furnishing services through employees or other personnel for more than 183 days in any 12-month period, except for preparatory or auxiliary activities – Article 5(3)(b);
- a person acting in a state on behalf of a principal resident in the other state and habitually concluding contracts binding on that principal or habitually playing the principal role leading to the conclusion of such contracts, except for preparatory or auxiliary activities and independent agents acting in the ordinary course of their business – Article 5(5)(a) and (7);
- a person acting in a state on behalf of a principal resident in the other state and who habitually maintains a stock of goods or merchandise in the state from which the person regularly delivers goods or merchandise on behalf of the enterprise – Article 5(5)(b);
- collecting insurance premiums or insuring risks in a state by an insurance enterprise of the other state, except for an independent agent acting in the ordinary course of business – Article 5(6);
- international shipping activities (more than casual shipping activities in a country, i.e., a scheduled visit to a port in a country to pick up passengers or goods) – Article 8 (alternative B);
- dividends, interest, royalties, fees for technical services, income from automated digital services, and other income not covered by Articles 6 - 20 – no threshold requirement – Articles 10, 11, 12, 12A, 12B, and 21. The only condition for taxation by a country of these amounts is that a resident of the country (or a with a PE or fixed base in the country) pays the specified amount to a resident of the other country.¹

¹ The recipient must also be the beneficial owner of the income represented by the payment.

- A fixed base in a country – Article 14(1)(a); income from professional or other independent services performed in a country through a fixed base that is regularly available to the taxpayer is taxable by that country.² Although the meaning of the term “fixed base” is the same as the meaning of a fixed place of business for purposes of the definition of a PE under Article 5, the exception for preparatory or auxiliary activities in Article 5(4) does not apply for purposes of the concept of a fixed base.
- physical presence in a country for 183 days or more – Article 14(1)(b); income from professional and other independent services performed in a country is taxable by that country. For this purpose, all that is necessary is that the service provider “stay” in the country for 183 days or more in any 12-month period. It is not necessary for the service provider to work in the country for a minimum number of days, although only the income from the independent services provided in the country is subject to tax under Article 14(1)(b).
- entertainment and sports activities – Article 17; the only threshold requirement under Article 17 is the performance of personal activities as an entertainer or sports person in a country. The activities are not required to be performed for any minimum period of time.

2.2 The temporal requirements in these provisions dealing with business services also vary widely:

- from 6 months for a fixed place of business PE or fixed base,
- “habitually” or “habitually” and “regularly” for a dependent agency PE,
- more than 183 working days for a services PE,
- 183 days or more of presence under Article 14(1)(b),
- any time for entertainment or athletic services under Article 17, and
- no minimum period at all under Article 12A.

2.3 Some service businesses are subject to very low or no threshold requirements. For example, royalties from the leasing of tangible property (Article 12), fees for technical services (Article 12A) and payments for automated digital services (Article 12B) are not

² Article 14 was eliminated from the OECD Model Convention in 2000, with the result that since 2000, income from professional and other independent services arising in a country is taxable in that country under that Model in accordance with Article 7 only where the services are performed through a PE in the country.

subject to any threshold requirement. Other service businesses, such as insurance, entertainment or sports activities and international shipping, are subject to very low threshold requirements – the performance of the specified activities in a country irrespective of how long the activities are carried on in that country or the amount of income or revenue derived by the taxpayer from such activities.

- 2.4 Other service businesses are subject to much higher thresholds. For example, professional and other independent services arising in a country are taxable under Article 14(1)(a) only if they are provided through a fixed base in a country or if the service provider is present in the country for 183 days or more in any 12-month period; income from other services arising in a country is taxable only if the services are provided through a fixed place of business.

3. THE PROPOSAL TO REPLACE ARTICLES 5(3)(b), 12A AND 14 WITH A NEW ARTICLE DEALING WITH FEES FOR SERVICES

3.1 Description of the Proposal

- 3.1.1 In simple terms, the proposal involves replacing Article 5(3)(b), Article 12A, and Article 14 of the United Nations Model Convention with a new provision which would allow a contracting state to impose tax on the gross amount of payments made by residents of that state (or non-residents with a permanent establishment (PE) in that state that bears those payments, referred to in this paper for convenience simply as non-residents with a PE) to service providers resident in the other state. A draft version of the new provision is provided in section 3.3 below to focus the discussion of the issues. The design of the new provision is based closely on existing Article 12A dealing with fees for technical services.
- 3.1.2 Under the new provision, a contracting state would be entitled to tax fees or payments for services arising in that state. However, where the recipient of the fees is a resident of the other contracting state and the beneficial owner of the fees, the tax would be limited to a percentage of the gross amount of the fees, with the percentage to be determined through the negotiations of the treaty partners (as is customary under the provisions of the United Nations Model Convention with respect to rates of tax). Fees for services would be considered to arise in a contracting state if the fees are paid by a resident of that

state or are borne by a non-resident with a PE in that state. However, where the payer has a PE in the state where the service provider is resident and the fees for services are borne by that PE, the fees would be deemed not to arise in the state where the payer is resident, and that state would not be permitted to impose tax on those fees under the new provision.

- 3.1.3 The term “fees for services” would be defined broadly to include any payment for any type of service but would not include payments to an employee by an employer, payments for teaching in and by educational institutions, and payments by individuals to other individuals for services for their personal use. These payments are excluded from the definition of “fees for technical services” under Article 12A(3). As discussed further below, these payments seem to be equally appropriate for exclusion from the application of the new provision. However, they are not excluded from Article 5(3)(b) or Article 14; therefore, it is worthwhile considering whether these exemptions should be retained in the new article. Other payments for services could also be excluded from the definition of the fees for services subject to the new article. In addition, a de minimis exemption could be added for fees for business services that do not exceed a monetary amount, as discussed below.
- 3.1.4 The new provision would not apply where the service provider has a PE in the other state and the payments for services are effectively connected with the PE. In this situation, such fees for services would be taxable on a net basis by the state in which the PE is located in accordance with Article 7. This “throwback” rule is similar to the throwback rules in Articles 10, 11, 12A, 12B, and 21 of the United Nations Model Convention. In addition, a provision similar to Article 12B(4), allowing a service provider to elect net based taxation of fees for services received from the other state even where the service provider does not have a PE in the other state, could be included in the new provision, as discussed below.

3.1.5 Existing Articles 5(3)(b), 12A, and 14 would be deleted from the United Nations Model Convention because they would no longer be necessary. The Commentary on those articles should be retained in some manner because those articles will continue to be included in many bilateral tax treaties for some time.

3.2 The Goals of the Proposal

3.2.1 The fundamental goals of the proposal to combine Articles 5(3)(b), 12A and 14 are to simplify the provisions of the United Nations Model Convention dealing with business services and to expand source country taxing rights with respect to such income. Combining Articles 5(3)(b), 12A and 14 into a single provision would simplify the Model Convention significantly. It would no longer be necessary for taxpayers and tax officials to distinguish between fees for technical services taxable in accordance with Article 12A and other services, or between professional and other independent services taxable in accordance with Article 14 and other services. In addition, income derived from most business services, including income currently dealt with under Article 7, Article 12A and Article 14, would be taxable in accordance with the same rules.

3.2.2 The proposal would expand the taxing rights of source countries. Currently, under Article 5(3)(b), income from services provided by a resident of one contracting state in the other state is taxable by the other state only if the service provider is present and working in the other state for more than 183 days in any 12-month period. Under existing Article 14, a resident of one contracting state providing professional or other independent services in the other state is subject to tax by the other state only if the service provider has a fixed base in the other state that is regularly available to the service provider or is present in the other state for 183 days or more in any 12-month period. In contrast, under the proposal, a service provider resident in one contracting state would be subject to tax on payments for services received from residents of the other state (and non-residents with a PE in that state) irrespective of the nature of those services, subject to certain limited exclusions and possibly subject to a de minimis rule.

3.3 Draft Wording of a New Provision on the Taxation of Fees for Services

3.3.1 The following draft wording of a new article to replace Articles 5(3)(b), 12A and 14 is intended to facilitate a discussion of the issues and an assessment of whether the adoption

of such a new article is desirable. All aspects of the wording of the provision are open for discussion and revision. It is understood that the Subcommittee on the United Nations Model Convention has developed proposals to deal with Article 5(6) dealing with insurance; as a result, the exclusion for fees for insurance in Article xx(3)(e) is intended only to highlight that the treatment of insurance services requires consideration for purposes of the proposal, taking into account the recommendations of the Subcommittee on the United Nations Model Convention.

Article xx FEES FOR SERVICES

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

2. However, subject to the provisions of Articles 8, 12B, 16 and 17, fees for services arising in a Contracting State 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 fees is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent [the percentage is to be established through bilateral negotiations] of the gross amount of the fees.

3. The term “fees for services” as used in this Article means any payment in consideration for any service, unless the payment is made:

(a) to an employee of the person making the payment;

(b) for teaching in an educational institution or for teaching by an educational institution;

(c) by an individual for services for the personal use of an individual;

(d) for services, including supervisory services, related to a construction, assembly or installation project; or

(e) to an insurance enterprise for insurance.

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

(a) such permanent establishment, or

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

In such cases the provisions of Article 7 shall apply.

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

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

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

3.3.2 The logical place for Article xx to be inserted in the United Nations Model Convention is probably as either Article 12A or Article 14. For the purposes of this paper, the proposed article will continue to be referred to as Article xx, however.

3.4 Analysis of Article xx

General Considerations

3.4.1 In general, draft Article xx has the effect of extending a country's right to tax to almost all cross-border services without any requirement for the services to be performed in the country. Until Article 12A was added to the United Nations Model Convention in 2017, income from services derived by a resident of one contracting state in the other state was subject to tax by the other state only if the services were furnished, rendered or performed in that state. Moreover, the service provider was required to provide services in the other state for more than 183 days in any 12-month period under Article 5(3)(b) or to stay in the other state for 183 days or more in any 12-month period under Article 14(1)(b). These high threshold requirements for a country to tax income from services performed by residents of the other contracting state place arguably inappropriate limits on a country's right to tax.

3.4.2 The digitalization of the economy has enabled service providers resident in one state to provide substantial business services in other states without establishing any taxable presence in those countries. Over the past two decades, physical presence has increasingly been questioned as an appropriate basis for the allocation of taxing rights pursuant to bilateral tax treaties. An alternative basis for the taxation of income from services is to allocate taxing rights to the country in which the services are used or consumed rather than the country in which the services are performed. The country in which services are used or consumed is generally the country where the person paying for the services is resident or has a PE, and where that person is carrying on business, the fees paid for services to non-resident service providers will usually be deductible in

computing that person's income for purposes of that country's tax. The reduction of a country's tax base by the deduction of fees for services paid to non-resident service providers can be seen as sufficient justification for that country to impose tax on the fees derived by the non-resident service provider. This base reduction or erosion is recognized in the Commentary on Article 12A as a justification for a country to tax fees for technical services paid to non-residents. It can also be seen as a justification for Article 16, which allows the taxation of directors' fees and the remuneration of top-level managerial officials by a country in which the company paying such fees and remuneration is resident. Another precedent for the taxation of payments that reduce or erode a country's tax base is existing Article 12 of the United Nations Model Convention, which allows the taxation of rent paid by a resident of one contracting state to a resident of the other state for the use of commercial, industrial or scientific equipment.

- 3.4.3 By combining Article 5(3)(b), Article 12A and Article 14 in a single provision dealing with services in general, the United Nations Model Convention could be simplified significantly. It would no longer be necessary to distinguish between fees for technical services and other business services or between professional and other independent services and other business services. In addition, the difficulties caused by the concept of a fixed base would be eliminated completely; it would also be unnecessary to count days during which a service provider is furnishing services or is present in a country for some purpose other than working. This simplification can be achieved without introducing new complexity, other than the imposition of an obligation on resident payers (and non-resident payers with a PE in the country) paying for services provided by non-resident service providers to withhold tax at the agreed rate. Even this withholding obligation might be simplified for some residents because they would no longer have to determine whether their payments are for technical services, professional or other independent services, or other services. Almost all payments for business services would be subject to withholding.
- 3.4.4 No definition of the term "services" is provided in Article xx. The term is not defined in the existing provisions of either the United Nations Model Convention or the OECD Model Convention that use the term, and the lack of a definition does not appear to have caused any problems. According to paragraph 84 of the Commentary on Article 12A, "the term 'services' should be understood to have a broad meaning in accordance with

ordinary usage to generally include activities carried on by one person for the benefit of another person in consideration for a fee.” A similar statement could be included in the Commentary on draft Article xx.

- 3.4.5 Article 5(3)(b) applies to services furnished by a resident of one contracting state to residents (or non-residents with a PE) in the other state where those services are provided by employees or other personnel. It would not be necessary to include similar wording in proposed Article xx because it would apply to all fees for services paid to a service provider resident in a contracting state regardless of whether the services are provided by employees or other personnel of the service provider, or through other means.
- 3.4.6 The proposal presented in this paper is limited to replacing Articles 5(3)(b), 12A and 14. It does not apply to other provisions of the United Nations Model Convention dealing with services: Article 15 (Income from Employment), Article 12B (Income from Automated Digital Services), Article 16 (Directors’ Fees and Remuneration of Top-Level Managerial Officials) and Article 17 (Artistes and Sportspersons), as well as Article 5(3)(a) and 5(6) dealing with construction and insurance. The reasons for not consolidating these provisions dealing with various types of services with proposed Article xx are discussed in the following paragraphs, although the Subcommittee may not find these reasons convincing and may prefer to consolidate some or all of these other provisions.
- 3.4.7 Article 15 is not included in Article xx because Article 15 deals with employment income rather than business profits. Different considerations apply with respect to employees because they are paid by their employers, not by the consumers of the services provided by their employers. Employment situations would be comparable only where an employer resident in one contracting state paid remuneration to an employee resident in the other state. This situation is dealt with in the proposal to add proposed Article 15(4) to the United Nations Model Convention as part of Workstream C. As a result, payments to employees by their employers are explicitly excluded from the definition of “fees for services.” For similar reasons, Article xx is subject to Article 17, which deals with both employees and independent contractors earning income as artistes and sportspersons; as a result, any income from entertainment and sports activities would continue to be taxable exclusively under Article 17.

3.4.8 Article 12B is not included in proposed Article xx dealing with fees for services, although an argument can be made that automated digital services should be included, with the result that fees for automated digital services would be taxable in accordance with Article xx and Article 12B would be eliminated. Currently, Article 12A dealing with fees for technical services and Article 12B dealing with income from automated digital services are compatible and coordinated. Article 12A does not apply to routine standardized services, regardless of whether they are digital or not; however, it does potentially apply to customized digital services. Conversely, Article 12B applies to automated digital services but does not apply to customized digital services. If Article 12A is replaced by proposed Article xx, there would be potential overlap between the new provision and Article 12B: Article xx would apply to all fees for services, including automated digital services, and so would Article 12B. This potential overlap can be resolved by providing that Article xx is subject to Article 12B or by excluding payments covered by Article 12B from the new provision. If Article xx is subject to Article 12B, then Article 12B would apply to any income from automated digital services covered by Article 12B and Article xx would potentially apply to any income from automated digital services not covered by Article 12B. In addition, Article 12B contains special provisions in Article 12B(3) and (4) that allow a taxpayer to request a state to impose tax on its net profits. If Article 12B were deleted and income from automated digital services were included in proposed Article xx, it would be necessary, or at least appropriate, to include the possibility for taxpayers to request net-basis taxation. However, doing so would raise the issue whether such net-basis taxation should be extended to all fees for services covered by the new provision. Therefore, it may be preferable to leave Article 12B as it is and make Article xx subject to Article 12B.

Relationship Between Article xx and Other Provisions

3.4.9 Proposed Article xx should be explicitly subject to Articles 8, 12B, 16 and 17, for the same reasons that Article 12A is subject to those provisions (other than Article 12B). See paragraphs 49 to 51 of the Commentary on Article 12A. The effect of making Article xx subject to other provisions is to ensure that any income to which those provisions apply is not subject to Article xx.

3.4.10 It is not necessary to make Article xx subject to Article 15 because the definition of fees for services excludes payments to employees by their employers. If, instead, Article xx

were to be subject to Article 15, Article xx would apply to any payments by an employer resident in one contracting state to an employee resident in the other state for employment services that are not covered by Article 15 (for example, payments by an employer resident in State A to an employee resident in State B for employment services provided outside State A). This would conflict with the proposal to add Article 15(4) to the United Nations Model Convention as part of Workstream C.

- 3.4.11 For the reasons explained above in paragraph 3.4.8, where Article xx is subject to Article 12B, any income from automated digital services would be covered by Article 12B rather than Article xx. Article 12A is not subject to Article 12B because there is no overlap between those two provisions. In contrast, there could be substantial overlap with respect to the application of Articles xx and 12B.
- 3.4.12 Article xx(2) would apply in priority to Article 7 as a result of Article 7(6). Thus, fees for services covered by Article xx would be taxable in accordance with Article xx (without the need for any PE) rather than Article 7. However, where a service provider resident in one state provides services effectively connected with a PE in the other state, Article xx(4) provides that the fees are taxable in accordance with Article 7 in priority to Article xx. In effect, fees for business services paid by residents or non-residents with a PE in a state are taxable by that state under Article xx at an agreed rate on the gross amount of the fees, or under Article 7 if the fees are effectively connected with the service provider's PE in that state. However, this result does not apply where the fees for services are excluded from Article xx. In this situation, Article 7 is the only relevant provision, so that if the service provider does not have a PE in the other state the fees for services would be taxable exclusively by the state in which the service provider is resident.
- 3.4.13 The potential taxation under proposed Article xx of fees for construction and insurance services, which result in the service provider having a deemed PE in a country under Article 5 in certain circumstances, raises issues that require careful consideration. As noted in paragraph 3.4.12, if construction or insurance services (or any other business services) are not explicitly excluded from Article xx, then, as a result of Article 7(6), Article xx will apply to allow the state in which the payer for the services is resident (or a non-resident with a PE in the country) to tax those fees at the agreed rate on the gross amount. However, if the service provider provides the services through a PE in the state where the payer is resident or has a PE, then that state would be entitled to tax on a net

basis in accordance with Article 7. If construction and insurance services are explicitly excluded from the definition of “fees for services” in Article xx(3), Article 7 would apply to all construction and insurance services, with the result that payments for such services where the payer does not have a PE in the state would not be taxable by that state at all.

- 3.4.14 The taxation of income from construction services does not present the same type of challenge as income from other services since construction services usually take place at a fixed place in a country and creates a PE if the activities last for more than 6 months. For construction services that do not last for more than 6 months, the issue is whether the fees should be taxable by the country in which the payer is resident (which may not necessarily be the state in which the construction takes place) or taxable only by the state in which the service provider is resident. The draft version of Article xx in section 3.3 above explicitly excludes construction services, but does so only to ensure that the issue is clearly visible (not as a recommendation as to the appropriate treatment of construction services). If the decision is taken to explicitly exclude construction services from Article xx, it might be appropriate to reduce the 6-month time threshold for construction activities in Article 5(3)(a).
- 3.4.15 The treatment of fees for insurance for purposes of Article xx raises the possibility of eliminating Article 5(6) entirely.³ Article 5(6) applies to insuring risks or collecting premiums in one contracting state by an insurance enterprise resident in the other state; Article xx could be extended to cover payments by a resident of one contracting state to an insurance enterprise of the other state for insurance, which would include the activities of insuring risks and collecting premiums. However, Article xx would cover a broader range of payments for insurance than are covered in Article 5(6) (for example, payments for the insurance of risks outside the country in which the payer is resident where the premiums for such risks are collected outside that country). The tax base reduction or erosion rationale underlying Article xx would not apply to some payments by resident individuals to non-resident insurers for personal insurance. The exclusion from Article xx of fees for services paid by an individual for the personal use of an individual would apply to payments by an individual for personal insurance coverage for the individual or

³ The comments about insurance in this paper were prepared without any knowledge of the proposals dealing with insurance being developed by the Subcommittee on the Update of the United Nations Model Tax Convention. Obviously, those comments may need to be revised or deleted in light of that Subcommittee’s recommendations and relevant Committee decisions.

another individual. Article 5(6) would probably have to be retained in order not to deprive states of their existing taxing rights with respect to such personal insurance. If Article 5(6) is retained, then all payments to a non-resident insurance enterprise should probably be explicitly excluded from Article xx.

The Rate of Tax

3.4.16 The rate of tax imposed on fees for services under Article xx is limited to a percentage of the gross amount of the fees for services, which must be established by negotiations of the parties. The negotiated rate should reflect the fact that the tax is imposed on the gross amount of the fees and the costs incurred in providing some services can be substantial. In effect, the rate of tax agreed by the parties to the treaty should be considered as a proxy for the tax that would be payable on the service provider's net income. However, since the costs incurred in providing different types of services vary significantly, applying a single rate of tax to all fees for services would likely be inappropriately high for some services and inappropriately low for other services. As a result, consideration might be given to including an alternative provision in the Commentary to allow states to impose tax on different types of services at different rates depending on the costs incurred by the service provider in rendering the services. However, such a provision might add unwanted additional complexity to the new provision. In addition, a provision allowing a service provider to request a state to impose tax in accordance with Article xx on the net amount of income from services might also be useful in avoiding excessive taxation of fees for services where service providers have small profit margins.

Elimination of Double Taxation

3.4.17 Where a contracting state imposes tax in accordance with Article xx on fees for services paid to residents of the other state, the other state is required by the provisions of Article 23 to relieve double taxation by exempting the income or providing a credit against its tax for the tax paid to the first state in accordance with Article xx. This relief must be provided even where the services are performed in the state where the service provider is resident because Article xx applies irrespective of where the services are performed.

Exclusions

- 3.4.18 The amounts excluded from the definition of “fees for technical services” under Article 12A(3) have also been excluded from the definition of “fees for services” in proposed Article xx(3). In addition, two additional types of fees for services have been excluded from the definition of fees for services: payments for construction services and payments for insurance. Other possible exclusions – fees for services paid by governments and governmental bodies and a de minimis exclusion – are discussed below in paragraphs 3.4.21 and 3.4.22. Fees for international shipping and air transport, directors’ fees and remuneration of top-level managerial officials of a resident company, and payments for entertainment or sports services under Article 8, Article 16, and Article 17, respectively, are not excluded from the definition of fees for services because the application of Article xx is explicitly subject to the provisions of those articles. However, fees for services outside the scope of those articles (for example, fees derived by a director of a company in the capacity of a consultant and fees for personal activities of entertainers or athletes outside the country where the payer is resident) would be subject to Article xx.
- 3.4.19 The exclusion of remuneration paid by an employer to an employee is explained above in paragraph 3.4.10. The exclusion for teaching in and by educational institutions is explained in paragraphs 70 and 71 of the Commentary on Article 12A.
- 3.4.20 The exclusion of payments by an individual for services for the personal use of an individual (whether the payer or some other individual) may be justified by several considerations. First, typically such payments are not deductible by the payer for tax purposes and do not reduce or erode the tax base of the country in which the payer is resident. Second, the imposition of tax on all such payments might make it difficult for the tax authorities to collect the tax effectively and efficiently since many individuals may be reluctant to comply with their withholding obligations. See generally paragraph 72 of the Commentary on Article 12A.
- 3.4.21 Other exclusions could be added to Article xx to narrow its scope. For example, payments for services made by governments and government agencies could be excluded. Although payments to government employees would be excluded by Article xx(3)(a), that exclusion would not apply to payments by governments to independent contractors such as consultants. If such an exclusion were added to Article xx(3), the importance of the

distinction between employees and independent contractors would be eliminated, at least with respect to payments for services by governments.

- 3.4.22 Another possibility would be to add a de minimis exclusion so that Article xx would not apply to payments for services made by a resident to a particular non-resident service provider unless those payments exceed or may reasonably be expected to exceed a specified monetary amount for a particular fiscal period. A de minimis exclusion based on a non-resident service provider's total revenue derived from services provided to residents of a particular country is not feasible since the resident payers in the country would not know at the time that they make payments for services whether or not they are required to withhold. Such an overall de minimis rule could operate by requiring withholding on all payments and then allowing the non-resident service provider to apply for a refund after the end of the year if the de minimis rule is not exceeded. However, such a refund process might impose an onerous administrative burden on the tax authorities of some developing countries.

Throwback Rule

- 3.4.23 The throwback rule in Article xx(4) is similar to the throwback rules in Articles 10(4), 11(4), 12(4), 12A(4) and 12B(8). Where a service provider resident in one contracting state has a PE in the other contracting state and the fees for services received by the service provider are effectively connected with the PE, the fee will be taxable by the state in which the PE is located in accordance with Article 7 rather than with Article xx. The throwback rule also applies to any fees for services that are effectively connected with business activities that are the same as or similar to those effected through the PE in accordance with Article 7(1)(c) (the limited force-of-attraction rule).
- 3.4.24 The primary effects of the throwback rule are to remove the limitation on the rate of tax imposed on payments for services in Article xx(2) but, in effect, to require the payments for services to be taxed by the state in which the fees arise on a net basis, allowing a deduction for any costs incurred by the service provider in furnishing the services.

Special Relationship Rule

- 3.4.25 Article xx(7) applies where there is a special relationship between the payer of fees for services and the beneficial owner of the fees and the amount of the fees exceeds the

amount that the parties would have agreed to if they had been dealing at arm's length. Where Article xx(7) applies, Article xx applies only to the arm's length amount of the fees and the excess is taxable according to the laws of the contracting states and the other provisions of the treaty. Article xx(7) is similar to the special relationship rules in Articles 11, 12, 12A and 12B.

Consequential Amendments

3.4.26 If Articles 5(3)(b), Article 12A and Article 14 are deleted from the United Nations Model Convention and replaced by new Article xx, several consequential amendments to the other provisions of the Model Convention would be necessary. For example, Article 5(3)(a) would become Article 5(3) and all the references to “fixed base” would be eliminated. In addition, many changes to the Commentary would be required. At this stage, it is premature to make a complete list of the necessary consequential amendments to the Model Convention and the Commentary.

ATTACHMENT

ALTERNATIVE REFORM PROPOSALS

1. Introduction

- 1.1 If the Committee decides not to pursue the proposal to combine Articles 5(3)(b), 12A and 14, it may wish to consider the more limited proposals for reform, that are described and analyzed briefly in this attachment. These alternative reform proposals consist of a range of possible changes to the threshold requirements for taxing business services under the provisions of the United Nations Model Convention and Commentary. The alternative reforms are intended to be dealt with separately rather than as a package. The Committee may choose to approve further work on some of the reforms, but not others.
- 1.2 Each reform proposal is described briefly in section 3 of this attachment but not analyzed exhaustively. For any reform proposals that the Committee wishes to investigate further, follow-up work would include a detailed analysis of each proposal and the preparation of draft wording for any required amendments to the provisions of the United Nations Model Convention and Commentary.

2. The Goals of the Alternative Reform Proposals

- 2.1 The fundamental goals of the alternative reforms in this attachment are similar to and consistent with the goals of the primary reform proposal to combine Articles 5(3)(b), 12A and 14 described in the main body of the paper; however, the goals of these alternative proposals are more limited than those of the primary proposal. First, like the primary proposal, the alternative reforms are intended to simplify the interpretation and application of the provisions of the United Nations Model Convention and Commentary dealing with business services. This simplification would be achieved by reducing or eliminating any unnecessary or inappropriate inconsistencies among the existing threshold requirements for taxing business profits from services and by clarifying the interpretation and application of those requirements. Second, also like the primary proposal, the alternative proposals are intended to expand the taxing rights of source countries with respect to business profits from services, although not as significantly as the primary proposal.

3. The Alternative Reform Proposals

- 3.1 Explain the rationale for each threshold requirement for taxing business profits under the provisions of the United Nations Model Convention, possibly in the Commentary on Article 7.

The underlying rationale for the application of different threshold requirements to different types of businesses or business profits is relevant for the interpretation of those requirements in accordance with the interpretive provisions of the Vienna Convention on the Law of Treaties.⁴ The most appropriate place to articulate the underlying rationale of the various threshold requirements in the United Nations Commentary is not obvious. The article-by-article format of the Commentary does not facilitate an explanation of the reasons for the use of different thresholds in different articles. Perhaps the best place for such an explanation would be in a separate section of the United Nations Commentary on Article 7.

- 3.2 Revise the time aspects of the various threshold requirements in the provisions of the United Nations Model Convention to make them more consistent.

One desirable goal of reforming the threshold requirements for taxing business profits under the United Nations Model Convention is to reduce or eliminate any unnecessary or inappropriate inconsistencies among the existing threshold requirements. For example, the time aspects of the minimum threshold requirements could be revised to make them consistent. All time periods should be expressed in terms of a number of days, rather than months,⁵ and in the consistent form of either “__ days or more in any 12-month period” or “more than __ days in any 12-month period.”

- 3.3 The threshold requirement for the taxation of business services under Article 5(3)(b) could be reduced to a period of, say, 90 or 120 days, or alternatively, a number of days to be negotiated by the contracting states.

⁴ Articles 31 and 32.

⁵ Measuring time in terms of months raises more difficult issues of interpretation than using days. For example, presence in a country or working in a country for any part of a day can reasonably be counted as one day, but counting presence in a country or working in a country for any part of a month as a full month seems unreasonable.

The existing threshold in Article 5(3)(b) – more than 183 days of furnishing services in a country – is inappropriately high and inconsistent with other threshold requirements for services in the United Nations Model Convention. A period of 90 or 120 days working in a country represents a total period of presence in the country, counting weekends, of approximately 116 or 154 days, respectively. The alternative possibility of leaving the number of days to be agreed by the parties would be consistent with the approach taken in other articles of the United Nations Model Convention that allow countries to agree on the maximum rates of tax on certain payments. Either of these possible reforms could be adopted without any serious consequences for the operation of other provisions of the United Nations Model Convention.

- 3.4 The existing threshold in Article 5(3)(b), more than 183 working days, could be converted into a pure physical presence test.

This change would simplify the application of the threshold since a service provider is either present in a country or not, making it unnecessary for the tax authorities to ascertain whether a service provider is working or not on any days that the service provider is present in the country. Converting Article 5(3)(b) into a pure physical presence test would also make it consistent with Article 14(1)(b). However, if Article 5(3)(b) continues to be based on a minimum number of working days, then consistency would suggest that Article 14(1)(b) should be converted into a similar threshold based on the same number of working days.

- 3.5 Where an enterprise resident in one contracting state furnishes services in the other state through multiple employees or other personnel, the number of such persons working in the other state would appear to be a relevant factor in assessing whether the enterprise's involvement in the economy of the other state is sufficient to justify the taxation by that state of the enterprise's business profits from the services provided in that state.

Under the existing version of Article 5(3)(b), any day during which an enterprise has multiple employees or other personnel working in the other country counts as only one day. The threshold requirement could be revised to take into account both the number of employees and other personnel working in a country and the number of days each one works in the country. This change would make the threshold more complicated and more difficult for enterprises to comply with and, as a result, may be considered a low priority

for reform. However, it seems strange that a service provider with one employee working in another state for 184 days would be deemed to have a PE in that state, but a service provider with 500 employees working in a state for 183 days would not have a PE there.

- 3.6 The dependent agency PE rule in Article 5(5) could be revised to provide that a service provider resident in one state would have a PE in the other state if the service provider has employees or other personnel working in the other country for at least a specified number of days.

This type of provision could make Article 5(3)(b) unnecessary. Arguably, Article 5(3)(b) applies only to employees and other personnel providing services to third parties, whereas the proposed revision of Article 5(5) would apply to any employees and other personnel working in the other state irrespective of whether they are providing services to the service provider or to third parties. However, the nature of the services provided by those employees and other personnel to the service provider (concluding contracts or other activities) would be irrelevant. The exception for preparatory and auxiliary activities could continue to apply and only the profits attributable to the PE would continue to be taxable.⁶ The exception for independent agents could be eliminated.

This reform proposal contrasts sharply with the existing dependent agency PE rule and is obviously controversial.

- 3.7 More limited options for reforming the dependent agency PE rule include:

- eliminating the requirement that agents habitually conclude contracts or habitually play the principal role leading to the conclusion of such contracts;
- replacing the term “habitually” with a specific time requirement such as 183 working days or 183 days of presence; whatever number of days is chosen should be consistent with the time requirements in other provisions;
- clarifying the meaning of “habitually” in the Commentary and explicitly including situations where an agent works for an extended period but only a single large contract is concluded. The existing Commentary indicates that “it is not possible to lay down a precise frequency test” because the time requirement depends on the

⁶ Where employees and other personnel work for their principal, no profits result directly from their activities.

nature of the contracts and business of the principal.⁷ However, the OECD Commentary does not explain why a specific time period cannot be provided, as it is in other provisions. “Habitually” is defined in the *Oxford English Dictionary* as meaning “settled practice, usually, customarily.” This suggests that intermittent contracting activities of an agent might not be sufficient to create a PE under Article 5(5). For example, it is doubtful that the provision would apply to an agent who concludes a single large contract or plays the principal role leading to the conclusion of such a contract.

3.8 Depending on whether any changes are made to Article 5(5), consequential changes to Article 5(5)(b) may be necessary. If Article 5(5)(b) is retained in its current form, consideration should be given to revising the Commentary on Article 5 to provide guidance as to the meaning of the terms “habitually” and “regularly” in the context of Article 5(5)(b).

3.9 The exemption for preparatory or auxiliary activities in Article 5(4) could be eliminated.

The exemption for preparatory or auxiliary activities is problematic in several respects. The justification for the exemption is unclear. Presumably, where a PE exists, but only for the purpose of carrying out preparatory or auxiliary activities, this would be reflected in the determination of the profits attributable to the PE.⁸ As a result, the arguments that the exemption facilitates cross-border trade and investment and applies only to non-profitable activities don’t seem convincing. In addition, it is unclear why the exemption is limited to fixed places of business and dependent agents. Reasonable arguments can be made in support of the elimination of the exemption from Article 5, as suggested in paragraph 19 of the Commentary on Article 5. However, such a change would be very

⁷ Paragraph 23 of the United Nations Commentary on Article 5, quoting paragraph 98 of the OECD Commentary.

⁸ Paragraph 58 of the Commentary on Article 5 of the United Nations Model Convention, quoting paragraph 58 of the Commentary on Article 5 of the OECD Model Convention indicates that preparatory or auxiliary activities are so remote from the realization of profits that it is difficult to allocate any profits to a fixed place of business used only for preparatory or auxiliary activities. However, this justification is flawed because it mixes two separate questions – the existence of a PE and the attribution of profits to the PE. Just because little or no profits are attributable to a PE does not necessarily mean there is no PE. In this regard, it must be remembered that the existence of a PE has other consequences, as described in section 7, in addition to the taxation of the profits of an enterprise attributable to a PE.

controversial and would likely generate substantial opposition from some countries and taxpayers.

- 3.10 Assuming that the exemption for preparatory or auxiliary activities in Article 5(4) is not eliminated, the scope of the exemption could be narrowed as suggested in the existing Commentary on Article 5.

The existing Commentary also acknowledges that some countries consider the activities listed in Article 5(4)(a) to (c) to be inherently preparatory or auxiliary, and an alternative version of Article 5(4) is included in the Commentary for these countries to include in their treaties.

The determination of whether activities are preparatory or auxiliary is a difficult one that must be made on the facts of each case.⁹ According to the Commentary, the test for determining whether an activity is preparatory or auxiliary is whether the activity in question “forms an essential and significant part of the activity of the enterprise as a whole.”¹⁰ This test is not particularly helpful in providing guidance for the interpretation of Article 5(4) since almost any aspect of the business of an enterprise can be considered to be essential. As a result, consideration could be given to developing more useful guidance for determining whether activities are preparatory or auxiliary. However, this is likely to be a challenging task and may not be worth the effort. Consideration might also be given to deleting the exception for auxiliary activities, thereby limiting Article 5(4) to preparatory activities, which are more easily identified because they usually occur before the essential and significant activities carried on through a PE begin. According to the existing Commentary,¹¹ auxiliary activities are activities that support, without being part of, the essential and significant activities of an enterprise. It is difficult to determine whether activities are part of the essential and significant activities of an enterprise or merely auxiliary to those activities. Eliminating the exception for auxiliary activities would make the exception more certain, reducing the potential for disputes and opportunities for tax planning to take improper advantage of the exception.

⁹ Paragraph 58 of the United Nations Commentary on Article 5, quoting paragraph 59 of the OECD Commentary.

¹⁰ Ibid.

¹¹ Paragraph 58 of the United Nations Commentary on Article 5, quoting paragraph 60 of the OECD Commentary on Article 5.

- 3.11 The threshold requirements in Article 5(3)(b) and 14(1)(b) could be revised to make them consistent.

The threshold in Article 14(1)(b) is based solely on a taxpayer's days of presence in a country. Such a threshold provides certainty but is easily avoided and may be difficult for some countries to apply effectively. In addition, the pure physical presence test in Article 14(1)(b) is unrelated to the earning of income. As a result, it is difficult to explain or justify the difference between the 183 working days test in Article 5(3)(b) and the 183 days of presence test in Article 14(1)(b). One obvious option for reform would be to make the thresholds in these two provisions more consistent by changing the threshold in Article 14(1)(b) to a working days threshold or by changing the threshold in Article 5(3)(b) into a pure physical presence threshold.

In paragraph 3.3 above, it was suggested that the 183 working days threshold in Article 5(3)(b) could be reduced to 90 or 120 working days or could be left to a number of days to be agreed between the parties. If such a change is made to Article 5(3)(b), it would make sense to make a similar change to Article 14(1)(b).

The possibility of adding a monetary threshold for both Article 14 and Article 5(3)(b) could also be considered. Although a monetary threshold was originally included in Article 14(1)(c), that threshold was eliminated because very few countries chose to include that provision in their tax treaties. It may be appropriate at this time to reconsider adding a monetary limit to both Article 5(3)(b) and 14.¹²

- 3.12 The meaning of the term “fixed base” in Article 14(1)(a) could be clarified in the Commentary.

Many details about the meaning of the term “fixed base” are not spelled out, either in Article 14 or in the Commentary. The Commentary on Article 14 does not provide a full discussion of the issues of interpretation and application arising with respect to the concept of a fixed base that is comparable to the Commentary on the meaning of a fixed place of business in Article 5(1). The Commentary on Article 14 is very cryptic, indicating only that Articles 7 and 14 are based on the same principles but “it has not

¹² See Muhammad Ashfaq Ahmed, “UN MTC Article 14: The Mistaken Retention.”

been thought appropriate to try to define [the term fixed base].”¹³ This approach, which suggests that “fixed base” and “fixed place of business” have the same meaning but avoids saying so explicitly, is unsatisfactory. Therefore, even if it is still thought to be inappropriate to try to define a fixed base, the Commentary on Article 14 should be revised to clarify whether the meaning of fixed base is the same as the meaning of a fixed place of business, in which case, the relevant parts of the Commentary on Article 5(1) should be equally applicable to Article 14(1)(a). However, if the meaning of fixed base is different from the meaning of a fixed place of business, the differences in meaning should be identified and explained.

- 3.13 The meaning of the term “regularly available” in Article 14(1)(a) could be clarified in the Commentary.

Irrespective of whether the meaning of the term “fixed base” is clarified, as suggested in paragraph 4.3.12, the meaning of the term “regularly available” is unclear and could be clarified. This term is not used in connection with a fixed place of business in Article 5(1). It may have a meaning similar to the requirement that a fixed place of business must be at the disposal of the taxpayer for purposes of Article 5(1). If this is the case, then the Commentary on Article 14 could be revised to include the explanation of the concept of a place being “at the disposal” of a taxpayer in the Commentary on Article 5(1) as the meaning of “regularly available.” If a place being regularly available to a taxpayer does not mean that the place is at the taxpayer’s disposal, then it is perhaps even more important for the meaning of the term “regularly available” to be clarified.

- 3.14 Article 17 could be extended to other high-value services performed by a resident of one state in the other state.

Article 17 applies to personal activities exercised by a person as an entertainer or sportsperson regardless of the duration of those activities or the amount of income derived from the services. The rationale for Article 17 is that some entertainers and athletes can earn large sums from brief performances in a country. In principle, the rationale underlying Article 17 applies to any high-value services that do not require the presence of the service provider in a country for an extended period or a fixed place of

¹³ Paragraph 10, quoting paragraph 4 of the Commentary on Article 14 of the 1977 OECD Model Convention.

business. The primary difficulty with such an option for reform would be to define the additional high-value services to be covered by Article 17. Some of those high-value services would likely be technical services that are already taxable by countries without any threshold requirement under Article 12A. Moreover, expanding Article 17 to cover other high-value services would not respond to the issue of service providers resident in one country rendering high-value services to customers in the other country without the need for the services to be physically performed in that other country.

- 3.15 If the reform option described in paragraph 3.14 is rejected, Article 17 could be improved somewhat by expanding its scope to include income derived by celebrities who, like entertainers and athletes, can derive large amounts from brief public appearances.

Defining the celebrities to be covered would be a challenge but is not substantially different from defining entertainment and sports activities.

- 3.16 A de minimis monetary threshold could be added to Article 17 to exclude entertainers and athletes (and celebrities, if the reform option in paragraph 3.15 is adopted) who derive relatively small fees from performances in a country.

Although a de minimis threshold must deal with the problems of different currencies and inflation. Assuming that any monetary limit should operate on a reciprocal basis for both states, the problem of the contracting states having different currencies, which may fluctuate from time to time, can be dealt with by stipulating the amount in the currency of one of the contracting states and then requiring the other state to use the equivalent of that amount in its currency for any particular amount. Reciprocal amounts may not be appropriate in treaties between developed and developing countries because of significantly different standards of living. The effect of inflation on monetary thresholds can be dealt with, if necessary, by indexing the amount to some objective measure of inflation.

Such a de minimis threshold would encourage cross-border entertainment and sports activities without the loss of substantial tax revenues. At the very least, the possibility for the contracting states to include a de minimis threshold in their treaty could be raised in the Commentary on Article 17.

ANNEX 4

REVISED DRAFT

September 21, 2023

**UNITED NATIONS SUBCOMMITTEE ON TAXATION ISSUES
RELATED TO THE DIGITALIZED AND GLOBALIZED
ECONOMY**

WORKSTREAM C

**THE TAXATION OF NONRESIDENT REMOTE WORKING
EMPLOYEES OF RESIDENT EMPLOYERS UNDER THE
PROVISIONS OF THE UNITED NATIONS MODEL CONVENTION**

Brian J. Arnold

1. INTRODUCTION

1.1 At the meeting of the Subcommittee on the Taxation Issues Related to the Digitalized and Globalized Economy held in Amsterdam on August 7 – 9, 2023, a paper on the taxation of remote working employees was discussed. That paper discussed five issues with respect to the taxation of remote working employees:

- issues arising under Article 15 of the United Nations Model Convention;
- issues arising under Articles 16 and 19 of the United Nations Model Convention with respect to directors and top-level managerial officials resident in one contracting state of a company resident in the other state and government employees of one contracting state working remotely in the other state;
- the problem that arises where employees resident in one contracting state work for an employer resident in the other contracting state;

- the circumstances in which remote working employees of an employer resident in one contracting state might create a PE or fixed base for their employers as a result of their working in the other contracting state; and
- the problems of taxing so-called “digital nomads” (individuals who can work from anywhere and move periodically from one country to another).

1.2 At the meeting, the Subcommittee decided that the treatment of employees resident in one contracting state and working remotely for an employer resident in the other contracting state was the most important issue to take forward at this stage. In particular, the Subcommittee decided to pursue further work on the possibility of modifying Article 15 of the United Nations Model Convention to remove a limitation on the right of the contracting state to tax employment income where an employer resident in that state employs an employee resident in the other state who works in that other state or in a third state. For convenience, the removal of this limitation on the taxing rights of a country is usually referred to in this paper as granting additional taxing rights to a country.

1.3 This paper describes the possible addition of a new paragraph to Article 15 of the United Nations Model Convention to provide the contracting state in which an employer is resident with an additional taxing right, namely, to impose tax on the employment income derived by an employee resident in the other contracting state from employment exercised in that state. To eliminate double taxation, where the new taxing right applies, Article 23B would be revised to require the state in which the employer is resident to provide a credit against its tax payable on the employee’s employment income earned in the other state for the tax imposed by that state on that income.

1.4 The paper begins with a description of the problem under the existing provisions of the United Nations Model Convention that the proposed provisions would be designed to deal with. The paper then discusses a proposed solution to this problem. It provides the draft text of proposed paragraph 4, which would be added to Article 15, and explains how the proposed provision would operate. It also provides the draft text of proposed paragraph 3, to be added to Article 23B to ensure that the proposed new taxing right does not result in the double taxation of an employee’s employment income. The paper then summarizes the

arguments for and against the proposed provisions in order to allow a robust assessment of the proposals, but does not make any recommendation. The paper does not provide draft Commentary to accompany the proposed amendments; however, such Commentary could be prepared based on the justification and explanation of the proposed amendments contained in this paper, taking into account any comments made by the Committee and observers at the Committee's 27th Session.

2. THE PROBLEM: RESIDENT EMPLOYEES OF NONRESIDENT EMPLOYERS WORKING REMOTELY

- 2.1 Under the first sentence of Article 15(1) of the United Nations Model Convention, the contracting state in which an employee is resident is granted the exclusive right to tax any income from employment derived by the resident employee. If, however, the income is derived by an employee resident in one contracting state from employment exercised in the other contracting state, under the second sentence of Article 15(1), that other state is entitled to tax that income. The combination of the second sentence in Article 15(1) and the provisions of Article 15(2) effectively result in the contracting state in which the employment is exercised having a right to tax the employee's employment income derived in that state where:
- 1) the employee is present in the other state for more than 183 days in any 12-month period;
 - 2) the remuneration is paid by an employer who is not resident in the state where the employee is resident; or
 - 3) the remuneration is not borne by a PE or fixed base of the employer in the state where the employee is resident.
- 2.2 It is irrelevant for purposes of Article 15(1) in which state the employee's employer is resident except that, as a result of Article 15(2)(b), if the employer is a resident of the same state in which the employee exercises employment, the state where the employment is exercised is entitled to tax the income without any threshold requirement and without any limitation as to the rate or manner of tax.

- 2.3 Where an employee who is a resident of State A and employed by an employer resident in State B exercises employment duties in a third state (State C), the provisions of Article 15(1) of the treaty between State A and State B grant State A exclusive taxing rights over the employment income derived by its resident employee. If there is a treaty between State A and State C, Article 15 of that treaty may allow State C to tax the employee's income from employment to the extent that the income is derived from employment exercised in State C.
- 2.4 In other circumstances, the contracting state in which an employee is resident is given exclusive taxing rights under Article 15 of the United Nations Model Convention with respect to income from employment derived by that employee from employment exercised in the other state. The exclusive taxing rights given to the contracting state in which an employee is resident under Article 15 apply in relatively narrow circumstances: only where an employee resident in one contracting state works for an employer that is not resident in that state and does not have a PE or fixed base in that state, the employee works in that other state, and is present in that state for 183 days or less in any 12-month period. Nevertheless, the allocation of exclusive taxing rights to the residence country in these circumstances is questionable in terms of the principles underlying Article 15, described in section 3 below. To the extent that employment income is earned from employment exercised in a country, it is arguable that the country should be entitled to tax such income. Although it might be appropriate to impose a threshold for the taxation of a nonresident employee's employment income earned in a country in which the employee is not resident – such as a minimum period of employment in the country or a minimum amount of income earned in the country – no similar threshold is imposed under Article 15 for situations in which a contracting state is entitled to tax employment income derived in that state by a resident of the other contracting state. As a result, it is arguably inappropriate to deny a country the right to tax employment income that arises in that country.¹ Although it may

¹ Such exclusive taxing rights may be appropriate in the context of Article 15 of the OECD Model Convention because of its general preference for the allocation of taxing rights to residence countries. It may also be appropriate in the context of Article 15(3) of both the United Nations and OECD Model Conventions with respect to employees working on ships or aircraft operated in international traffic. However, the Commentary on both Model Conventions provides alternative provisions to allow both the state where the employee is resident and the state of residence of the enterprise operating the ships

be difficult for a country to collect tax imposed on the employment income derived in the country by nonresident employees who are employed in the country only for short periods, this is not a good reason to deny the country the right to tax such income. It would be preferable to work on mechanisms, such as exchange of information, that would improve the ability of these countries to collect taxes on such employment income efficiently.

- 2.5 In effect, the contracting state in which the employer is resident and has an employee who is resident in the other contracting state has no right to tax the employee's income except to the extent that the employment is exercised in the employer's state of residence. As a result of the limitations imposed on the taxing rights of the state in which an employee's employer is resident, Article 15 may result in the reduction or erosion of that state's tax base. The following simple example illustrates this result.
- 2.6 Assume that an individual, X, is a resident of State A and is employed by a company resident in State B. Assume also that State A and State B have entered into a tax treaty with an article identical to Article 15 of the United Nations Model Convention. Assume further that X's employment duties are exercised entirely in State A, where X is resident.
- 2.7 On these simple facts, X's income from employment is taxable exclusively by State A by virtue of the first sentence of Article 15(1). State B is prohibited from taxing X's income because X is not a resident of State B and none of X's employment is exercised in State B. However, X's employer, resident in State B, will usually be entitled to deduct the salary, wages and other remuneration paid to X for purposes of computing the employer's tax payable in State B. The deduction will reduce the tax payable by the employer to State B; however, State B is prevented by Article 15 of the treaty from taxing the employment income derived by X (even if that income from employment is taxable under State B's domestic law). The resulting asymmetry – the deductibility of the employment income against State B's tax base without any offsetting right to tax that employment income

or aircraft to tax the employment income earned by crew members, with the state of residence of the enterprise having the primary right to tax. See paragraph 2 of the Commentary on Article 15 of the United Nations Model Convention, quoting paragraphs 9.6 to 9.9 of the Commentary on Article 15 of the OECD Model Convention.

derived by the nonresident employee – is a concern for several countries, which may be exacerbated by the growing trend to remote working.

- 2.8 The most extreme example of this asymmetry would be a situation in which the applicable tax rates in the two contracting states are very different. For example, assume that State B, where the employer is resident, imposes corporate tax on the employer at a rate of 40 percent but State A, where the employee is resident, imposes a very low tax rate (or no tax at all) on the employee's employment income derived in State A. Assume further that the employee is paid a salary of 100,000. In this situation, State B's tax base would be reduced by 40 percent of the deductible employment income (40,000) but State B would not be entitled to tax the employee's salary at all because of Article 15 of the treaty. In addition, there would be little or no tax imposed by State A on X's employment income.
- 2.9 Where employers resident in one contracting state have many nonresident employees who work exclusively or almost exclusively in other countries in which they are resident, the extent of the reduction of the tax base of the employer's state of residence resulting from the deductibility of the remuneration paid to such remote working employees may be a serious concern. Some countries might attempt to exploit this aspect of their tax treaties by enacting special low-tax regimes to attract highly paid employees to shift their residence.
- 2.10 To offset the reduction in their tax bases in this manner, states in which employers are resident have no option other than terminating their tax treaties. Under the provisions of their tax treaties (assuming they are based on the provisions of the United Nations or OECD Model Conventions), they cannot deny the deduction of the amounts paid by resident employers to their employees resident in other contracting states; nor can they impose tax on the employment income of the nonresident employees of resident employers, as explained in the preceding paragraphs.
- 2.11 Denying the deduction of remuneration paid to employees resident in other contracting states would be prevented by Article 24(4) of a country's tax treaties since it discriminates against resident employers paying nonresident employees compared to resident employers paying resident employees. Even where an applicable tax treaty does not contain a provision equivalent to Article 24(4), denying the deduction of remuneration paid to

nonresident employees is unjustified and unfair to resident employers because the salary, wages and other remuneration paid by them to remote working nonresident employees are legitimate expenses incurred by employers to earn income subject to tax; they should be deductible in the same manner as such amounts paid by resident employers to resident employees.

3. OPTION FOR REFORM: IMPOSING TAX ON THE EMPLOYMENT INCOME OF REMOTE WORKING NONRESIDENT EMPLOYEES OF RESIDENT EMPLOYERS

3.1 The problem discussed in section 2 above can be solved by giving the contracting state in which an employer is resident a limited right to impose tax on the employment income derived by nonresident employees of resident employers irrespective of the fact that the employment income is not exercised in that country. This proposal may be novel, but it deserves serious consideration as a reasonable response to the problem. For a country to implement this proposal, it would likely need both: (1) to amend its domestic law to allow the imposition of tax on the employment income of nonresident employees of resident employers; and (2) to modify the provisions of its existing tax treaties to allow it to impose tax on nonresident employees of resident employers.

3.2 Countries have authority to amend their domestic tax law to impose tax on the employment income of nonresident employees of resident employers and to set out the conditions for the imposition of such tax, the rate of tax, any exceptions, measures for the collection of the tax, and provisions for the relief of double taxation. Countries choosing to impose such a tax on nonresident employees would likely implement a requirement for resident employers to withhold an amount from a nonresident employee's salary, wages and other remuneration to facilitate the efficient collection of tax on such amounts. This withholding tax could be imposed as a final tax or as an interim payment on account of the nonresident's final tax liability, which would be determined by filing a tax return and paying any additional tax owing or claiming a refund for any overpayment of tax. Withholding obligations imposed on resident employers to withhold tax from remuneration paid to nonresident employees are discussed below in paragraphs 3.29 – 3.33.

3.3 The following paragraphs examine the possibility of amending the United Nations Model Convention to allow a contracting state to tax employment income paid by an employer

resident in that state to an employee resident in the other contracting state even where the employment income is derived from employment exercised in the employee's state of residence or in a third state. For discussion purposes, the paper provides draft wording of a new paragraph 4 that could be added to Article 15 and identifies the consequential amendments to the United Nations Model Convention that would be necessary. It is premature at this stage for the preparation of draft Commentary for the proposed new provision, but draft Commentary could be prepared if the Subcommittee decides that further work is required with respect to the proposal.

Proposed Amendment to Article 15

- 3.4 As noted in section 2 above, the current version of Article 15 of the United Nations Model Convention prevents a contracting state from taxing the employment income of a resident of the other contracting state (irrespective of where the employer is resident), except to the extent that the employment is exercised in the first state. As a result, Article 15 must be amended to allow a contracting state in which an employer is resident to impose tax on the employment income of an employee resident and working in the other contracting state or in a third state in order to give the state where the employer is resident a right to tax the employee's income.
- 3.5 Such an amendment should be designed to allow the contracting state in which the employer is resident to tax the employment income that is paid to the nonresident employee and deductible by the employer, irrespective of whether the employment is exercised in the other contracting state. Employment income paid by a resident employer to a nonresident employee that is not deductible for income tax purposes in the employer's country of residence (for example, nonresident employees of non-taxable entities such as charities, not-for-profit entities, etc.) could be excluded from the scope of this new provision because there is no reduction of the country's tax base. Note, however, that the taxation of government employees is governed by Article 19 and would not be affected by the amendment, as discussed below.
- 3.6 As a result of the amendment proposed in paragraph 3.5, employment income derived by an employee resident and working in one contracting state but employed by an employer

resident in the other contracting state would be taxable by both contracting states: the country in which the employee is resident and exercising employment and also the state where the employer is resident. The fundamental principle that the country in which employment is exercised has the first right to tax the income should apply, with the result that the state in which the employer is resident (assuming that it is granted a right to tax the income) would have an obligation to relieve double taxation by allowing a credit for the tax imposed by the country in which the employee is resident on the employment income earned in that country. It would be necessary to amend Article 23 to implement this double taxation relief. It is important to note that the country in which the employee is resident would not be required to provide any double taxation relief for tax imposed by the country in which the employer is resident on the employment income derived in the employee's country of residence. The necessary double taxation relief, including the proposed amendment of Article 23, is discussed in paragraphs 3.8 and 3.14 to 3.24.

- 3.7 As explained further below, where the state in which an employee is resident and working (State A) imposes tax on an employee's employment income earned in State A at a rate that is equal to or higher than the tax imposed on that income by the state in which the employer is resident (State B), State B would be obligated by an applicable treaty to give a credit for the tax imposed on that income by State A, and State B's tax would be completely offset. As a result, State A has no legitimate complaint about additional taxing rights given to State B in these circumstances, since State A's tax would take precedence over any tax imposed by State B. In other words, the tax levied by the state in which an employer is resident operates as a top-up tax; it applies only to the extent that the tax imposed by the state in which the employee is resident is less than the tax imposed on the employment income by the state in which the employer is resident.

Double Taxation Relief

- 3.8 Where an employee resident and employed in one contracting state by an employer resident in the other contracting state exercises some duties of employment in the other contracting state (for example, the employee attends meetings or training sessions at the employer's place of business in its country of residence), the relief from double taxation will be quite complicated, as set out in the following steps:

- 1) The country in which the employee is resident would tax the employee's worldwide income, including any employment income earned in that country and in the country in which the employer is resident.
- 2) To the extent that an employee resident in one contracting state exercises employment in the other contracting state (where the employer is resident), the other state may be entitled to tax that income in accordance with the second sentence of Article 15(1); the other state's right to tax that employment income (but not the employee's other income) would take precedence over the right to tax of the state in which the employee is resident.
- 3) The state in which the employee is resident would have an obligation to give a foreign tax credit under Article 23B for the tax imposed by the other contracting state under step 2 against the tax imposed by the state in which the employee is resident on the employment income as a result of the residence of the employee in step 1.
- 4) Under the amendment to Article 15(4), the state in which the employer is resident would have the right to tax the employment income derived by the nonresident employee to the extent of the employment income earned in that employee's country of residence or in a third state. This tax is in addition to the tax imposed by the state in which the employer is resident on the employment income earned in that state under step 2.
- 5) The state in which the employer is resident would have an obligation to allow a foreign tax credit for the tax imposed by the employee's country of residence on the employment income earned in that country (and subjected to tax by that country) under step 1.

Possible Amendment to Article 15 with Respect to Remote Working Employees

3.9 Article 15 of the United Nations Model Convention could be amended by adding new paragraph Article 15(4), shown in bold italics below.

Article 15

DEPENDENT PERSONAL SERVICES

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Remuneration derived by a resident of a Contracting State in respect of an employment, as a member of the regular complement of a ship or aircraft, that is exercised aboard a ship or aircraft operated in international traffic, other than aboard a ship or aircraft operated solely within the other Contracting State, shall be taxable only in the first-mentioned State.

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

Impact on Existing Taxing Rights Under Article 15

3.10 Draft Article 15(4) would have no effect on the existing taxing rights of either of the contracting states under Article 15. In other words, draft Article 15(4) does not limit the taxing rights of either of the contracting states; instead, it provides an additional taxing right for the contracting state where an employer is resident (or more accurately, it removes a limitation on that state's taxing rights). Draft Article 15(4) deprives the contracting state

in which an employee is resident of the exclusive right to tax employment income of its resident employees, as described in paragraph 2.4 above.

- 3.11 Draft Article 15(4) would not have any effect on the operation of Article 15 except where an employee resident in one contracting state (State A) is employed by a resident of the other contracting state (State B). It would not impose any limitation on State A's existing taxing rights under Article 15 of the United Nations Model Convention. Moreover, draft Article 15(4) would have no effect on State B's existing taxing rights under Article 15 with respect to income derived by an employee resident in State A from employment exercised in State B. Instead, draft Article 15(4) allows the contracting state where an employer is resident (State B) to impose tax on the employment income derived by employees resident in State A from employment exercised in State A or in a third state, as long as the remuneration paid by the employer is deductible in computing the employer's income for purposes of taxation by State B. This additional taxing right is accompanied by a corresponding obligation imposed on State B under Article 23B(3) of the United Nations Model Convention to grant a foreign tax credit for the taxes paid by an employee to State A on the employment income taxable by State B under proposed Article 15(4).
- 3.12 Draft Article 15(4) applies both to employment income derived by an employee resident in a contracting state from employment exercised in that state and to employment income earned in a third state. For example, assume that an employee is a resident of State A and works exclusively in State C for an employer resident in State B. Draft Article 15(4) applies in this situation to overcome the effect of the first sentence of Article 15(1) that income from employment is taxable exclusively by the state in which the employee is resident. Thus, State B would be entitled under Article 15(4) of the treaty between State A and State B to tax the employment income earned by a resident of State A in State C. Where there is a tax treaty between State B and State C, that treaty would not apply to the employment income earned by a resident of State A in State C since the employee is not a resident of State C; as a result, nothing in the State B-State C treaty would prevent State B from taxing a resident of State A on employment income earned in State C.

- 3.13 Draft Article 15(4) does not provide any taxing rights to a third state in which an employer resident in a contracting state has a PE that bears the remuneration of an employee resident in the other contracting state. Extending Article 15(4) to a third state where a PE is located would complicate Article 15(4) unnecessarily. To the extent that an employee resident in one contracting state exercises employment in a third state where the employer has a PE that bears the employee's remuneration, the third state would be entitled to tax that employment income assuming there is a treaty between the PE state and the state where the employee is resident. Consideration should be given to adding words to draft Article 15(4) to deny taxing rights to the state where an employer is resident to the extent that the employer has a PE in a third state that bears the employee's remuneration.
- 3.14 As explained in paragraph 3.7, where the tax imposed on an employee's income from employment exercised in the employee's country of residence by that country equals or exceeds the tax payable to the country in which the employer is resident on that same income under Article 15(4), the country in which the employer is resident will not collect any tax on the employee's income. As a result, some members of the Subcommittee have suggested that the country in which the employer is resident should be given a limited right to tax (for example, 10 percent of gross amount of the remuneration paid to an employee resident in the other country). This suggestion would make Article 15 operate in the same manner as Article 11 and 12 with respect to interest and royalties. It would involve a significant change in the allocation of taxing rights with respect to employment income, with countries where employment is exercised being required to give up taxing rights to countries where the employers are resident. Such a change seems likely to result in reduced tax revenues for developing countries.
- 3.15 The operation of the foreign tax credit where draft Article 15(4) applies is illustrated in the following example:

Assume that X is a resident of State A and is employed by an employer resident in State B. The applicable tax rates in State A and State B are 20 percent and 30 percent, respectively. In 20xx, X performs the duties of employment 80 percent in State A and 20 percent in State B. X receives salary and other remuneration totaling 100,000 in 20xx, all

of which is deductible by X's employer for purposes of its tax payable to State B. On these facts, the taxes payable and the foreign tax credits allowed in State A and State B would be as follows:

- State B would be entitled to tax X's employment income of 20,000 derived from the employment exercised in State B; State B's tax would be 30 percent of 20,000² or 6,000.
- State A would be entitled to tax X's entire worldwide income of 100,000, including X's income from State B, as a resident of State A; State A's tax (before any foreign tax credit) would be 20 percent of 100,000 or 20,000.
- State A would be required to give X a foreign tax credit for the tax paid to State B on the employment income derived in State B; this credit would be limited to the amount of State A's tax on the employment income derived by X from State B or 4,000 (20 percent of 20,000 (rather than the full amount of State B's tax, which is 6,000)); as a result, State A's tax payable by X would be reduced from 20,000 to 16,000.
- Under draft Article 15(4), State B would be entitled to tax X's employment income of 80,000 to offset the deduction of X's remuneration by the employer in computing the employer's tax liability to State B; this tax (before any foreign tax credit) would be 30 percent of 80,000 or 24,000; State B is not entitled to tax X's total employment income because it has already imposed tax on X's employment income of 20,000 derived from State B (see the first bullet point above). In effect, State B should tax only X's employment income not already taxed by State B (80,000). Under proposed Article 23B(3), State B would be required to give X a foreign tax credit for X's tax paid to State A (16,000), which is the amount of State B's tax of 30 percent of X's employment income (80,000) derived outside State B; as a result, the tax paid to State B at this stage would be $24,000 - 16,000 = 8,000$.
- The total amount of tax paid by X on employment income of 100,000 can be broken down into three parts:

² The calculation of the amount of income subject to tax would depend on the rules for computing income under State B's domestic law.

- 6,000 paid to State B on employment income of 20,000 earned in State B;
- 16,000 paid to State A on employment income of 80,000 earned in State A (State A's tax of 20 percent of X's total income of 100,000 (20,000) less a foreign tax credit of 4,000 for the tax paid to State B); and
- 8,000 paid to State B on employment income earned by X in State A (representing the difference between the tax rates imposed by State A (20 percent) and State B (30 percent) times the 80,000 of employment income earned outside State B).

3.16 The result in this example can be justified on the basis that State A has not given up any of its taxing rights with respect to its resident employees under Article 15. Even in the absence of draft Article 15(4), State A would have imposed tax of 16,000 on X's employment income of 100,000 (20 percent of 100,000 less a foreign tax credit for State B tax of 4,000). State B retains its right to tax X's income derived from employment exercised in State B (30 percent of 20,000 or 6,000), which takes priority over State A's right to tax that amount as X's country of residence. State B acquires a new right to tax the employment income of nonresident employees paid by employers resident in State B under draft Article 15(4); thus, State B has the right to impose additional tax of 8,000 (30 percent of 80,000 less a foreign tax credit for tax paid to State A of 16,000). The total tax paid on X's employment income (30,000) represents the higher of the applicable tax rates of State A and State B.

3.17 Where an employee who is resident in one contracting state and is employed by an employer resident in the other state works in a third state, the operation of the relief from double taxation would be similar to the relief provided where the employee works in the contracting state of which the employee is a resident. In this situation, the contracting state in which the employer is resident would be entitled under proposed Article 15(4) to tax the employee's employment income earned in a third state but would be obligated under proposed Article 23B(3) to give a foreign tax credit for the tax imposed by the employee's state of residence on the employment income earned in the third state.

- 3.18 The double taxation relief described in paragraph 3.16 where employment income is earned in a third state can be illustrated using the same basic facts as in the example in paragraph 3.15 above:

Assume that X is a resident of State A and is employed by an employer resident in State B. The applicable tax rates in State A and State B are 20 percent and 30 percent, respectively. In 20xx, X performs the duties of employment 80 percent in a third state (State C) and 20 percent in State B. X receives salary and other remuneration totaling 100,000 in 20xx, all of which is deductible by X's employer for purposes of its tax payable to State B. Assume that State C does not impose tax on X's employment income derived from State C. On these facts, the taxes payable and the foreign tax credits allowed in State A and State B would be as follows:

- State B would be entitled to tax X's employment income of 20,000 derived from the employment exercised in State B; State B's tax would be 30 percent of 20,000³ or 6,000.
- State A would be entitled to tax X's entire worldwide income of 100,000, including X's income from State B and State C, as a resident of State A; State A's tax (before any foreign tax credit) would be 20 percent of 100,000 or 20,000.
- State A would be required to give X a foreign tax credit for the tax paid to State B on the employment income derived in State B; this credit would be limited to the amount of State A's tax on the employment income derived by X from State B or 4,000 (20 percent of 20,000 (rather than the full amount of State B's tax, which is 6,000)); as a result, State A's tax payable by X would be reduced from 20,000 to 16,000.
- Under draft Article 15(4), State B would be entitled to tax X's employment income of 80,000 earned in State C to offset the deduction of X's remuneration by the employer in computing the employer's tax liability to State B; this tax (before any foreign tax credit) would be 30 percent of 80,000 or 24,000. State B is not entitled to tax X's total employment income because it has already imposed tax on X's employment income of

³ The calculation of the amount of income subject to tax would depend on the rules for computing income under State B's domestic law.

20,000 derived from State B (see the first bullet point above); in effect, State B should tax only X's employment income not already taxed by State B or 80,000. Under proposed Article 23B(3), State B would be required to give X a foreign tax credit for X's tax paid to State A on X's income earned in State C (20 percent of 80,000 = 16,000); as a result, the tax paid to State B at this stage would be 24,000 – 16,000 = 8,000.

- The total amount of tax paid by X on employment income of 100,000 can be broken down into three parts:
 - 6,000 paid to State B on employment income of 20,000 earned in State B;
 - 16,000 paid to State A on employment income of 80,000 earned in State C; and
 - 8,000 paid to State B on employment income earned by X in State C (representing the difference between the tax rates imposed by State A (20 percent) and State B (30 percent) times the 80,000 of employment income earned outside State B).

3.19 The result in this example can be justified on the basis that State A has not given up any of its taxing rights with respect to its resident employee under Article 15. Even in the absence of draft Article 15(4), State A would have imposed tax of 16,000 on X's employment income of 100,000 (20 percent of 100,000 less a foreign tax credit for State B tax of 4,000). State B retains its right to tax X's employment income derived in State B (30 percent of 20,000 or 6,000), which takes priority over State A's right to tax that amount as X's country of residence. State B acquires a new right to tax the employment income of nonresident employees paid by employers resident in State B under draft Article 15(4) whether the income is earned from employment exercised in the other contracting state or a third state; thus, State B has the right to impose additional tax of 8,000 (30 percent of 80,000 less a foreign tax credit for tax paid to State A of 16,000). The total tax paid on X's employment income (30,000) represents the higher of the applicable tax rates of State A and State B.

3.20 In the example, where the state in which the employer is resident imposes tax on an employee resident in the other state in accordance with Article 15(4), the state in which the employer is resident is required to provide a foreign tax credit for the tax paid by the employee to the state in which the employee is resident even though the employment

income is earned outside that country and outside the state in which the employer is resident (i.e., the income is earned in a third state). It would be possible in this situation to allocate the primary taxing right to the state in which the employer is resident and, as a result, require the state in which the employee is resident to provide a credit for the tax paid to the state in which the employer is resident where that tax is imposed on income earned in a third state. However, this possibility is difficult to justify, for two reasons. First, it is inconsistent with the basic principle underlying proposed Article 15(4) that the state in which the employee is resident is not deprived of any of its existing taxing rights under Article 15. If the state in which the employee is resident were required to give a credit for the tax imposed by the state in which the employer is resident on employment income earned in a third state, the effect would be that the state in which the employee is resident would be required to give up its existing taxing rights over employment income earned by its resident employees in third states. More generally, the claim of the state in which an employee is resident to tax income earned in a third state – which claim is based on the residence of the employee – appears to be preferable to the claim to tax of the state in which the employer is resident – which is based on base erosion. Second, giving priority to the state in which the employer is resident would also introduce additional complexity into the provisions for the relief of double taxation, which are already complex. These two considerations weigh heavily against granting priority to the state in which the employer is resident to tax employment income earned in third states.

- 3.21 The example in paragraph 3.18 assumes that the income from employment earned by the employee in State C, a third state, is not subject to tax by that state. There may be situations in which the third state imposes tax on the employment income derived by an employee resident in another state. This could be the case where there is no tax treaty between State C and State A or where there is a treaty between State A and State C and the employee is present in State C for 183 days or more or the employee's remuneration is borne by a PE or fixed base in State C of the employer resident in State B. Where there is no treaty between State A and State C and where State C imposes tax on the employment income earned by a resident of State A from employment exercised in State C, it would be a matter of the domestic law of State A whether it would provide any relief for State C's tax. If State A does not provide such relief, then State B would be required to provide relief only for

State A's tax on X's employment income earned in State C after State A's tax is reduced by the foreign tax credit for the tax paid by X to State C.

3.22 Where there is a tax treaty between State A and State C, the possibility also exists that State C may impose tax on the employment income earned in State C by an employee resident in State A who is employed by an employer resident in State B. State C would be entitled to tax where the employer, resident in State B, has a PE or fixed base in State C which bears the employee's remuneration, or where the employee, resident in State A, is present in State C for more than 183 days in any 12-month period. If State C imposes tax in these circumstances, State A would be required to give a tax credit for the tax paid to State C on the employee's employment income earned in State C. However, State B would not be required to provide any relief for the tax paid to State C and, because the credit provided by State A for the tax paid to State C will reduce the tax paid to State A, the tax payable to State B on the employee's income earned in State C under Article 15(4) will be increased accordingly.

3.23 The result described in paragraph 3.22 can be illustrated in the following example, which uses facts similar to those used in the example in paragraph 3.18:

Assume that X is a resident of State A and is employed by an employer resident in State B. The applicable tax rates in State A and State B are 20 percent and 30 percent, respectively. In 20xx, X performs the duties of employment 80 percent in a third state (State C) and 20 percent in State B. X is present in State C for more than 183 days during the year (or X's remuneration is borne by a PE or fixed base that X's employer has in State C) and State C imposes tax at a rate of 40 percent on X's employment income of 80,000 earned in State C (32,000). X receives salary and other remuneration totaling 100,000 in 20xx, all of which is deductible by X's employer for purposes of its tax payable to State B. Assume that State A, State B and State C have entered into tax treaties with each other with provisions identical with those of the United Nations Model Convention, except that the treaty between State A and State B contains Article 15(4) and Article 23B(3). On these facts, the taxes payable and the foreign tax credits allowed in State A and State B would be as follows:

- State B would be entitled to tax X's employment income of 20,000 derived from the employment exercised in State B; State B's tax would be 30 percent of 20,000⁴ or 6,000.
- State C would be entitled to tax X's employment income of 80,000 derived from X's employment exercised in State C under the State A-State C treaty because X is present in State C for more than 183 days (or X's employment income is borne by the employer's PE or fixed base in State C); State C's tax would be 40 percent of 80,000 = 32,000.
- State A would be entitled to tax X's entire worldwide income of 100,000, including X's income from State B and State C, as a resident of State A; State A's tax (before any foreign tax credit) would be 20 percent of 100,000 or 20,000.
- State A would be required to give X a foreign tax credit for the tax paid to State C on the employment income derived in State C; this credit would be limited to the amount of State A's tax on the employment income derived by X from State C or 16,000 (20 percent of 80,000 (rather than the full amount of State C's tax, which is 32,000)); as a result, State A's tax payable by X on the income earned in State C would be reduced from 16,000 to zero.⁵
- State A would be required to give X a foreign tax credit for the tax paid to State B on the employment income derived in State B; this credit would be limited to the amount of State A's tax on the employment income derived by X from State B or 4,000 (20 percent of 20,000 (rather than the full amount of State B's tax, which is 6,000)); as a result, State A's tax payable by X would be reduced from 4,000 to zero.
- Under draft Article 15(4), State B would be entitled to tax X's employment income of 80,000 earned in State C to offset the deduction of X's remuneration by the employer in computing the employer's tax liability to State B; this tax (before any foreign tax credit) would be 30 percent of 80,000 or 24,000. State B is not entitled to tax X's total employment income because it has already imposed tax on X's employment income of

⁴ The calculation of the amount of income subject to tax would depend on the rules for computing income under State B's domestic law.

⁵ This result assumes that the State A's foreign tax credit is computed separately for employment income earned in each foreign country.

20,000 derived from State B (see the first bullet point above); in effect, State B should tax only X's employment income not already taxed by State B or 80,000. Under proposed Article 23B(3), State B would be required to give X a foreign tax credit for X's tax paid to State A on X's income earned in State C, which would be zero since State A's tax has been completely eliminated by the foreign tax credit allowed for X's tax paid to State C; as a result, the tax paid to State B at this stage would be $24,000 - 0 = 24,000$.

- The total amount of tax paid by X on employment income of 100,000 is 62,000, which can be broken down into four parts:
 - 6,000 paid to State B on employment income of 20,000 earned in State B;
 - 32,000 paid to State C on employment income of 80,000 earned in State C; and
 - 24,000 paid to State B on employment income earned by X in State C; and
 - Zero tax paid to State A.

3.24 The result in this example is serious unrelieved double taxation, which cannot be justified. The appropriate result in this situation would be for State B to provide relief for State C's tax of 32,000 on X's employment income earned in State C, subject to a limit of 24,000, which is the amount of State B tax on X's employment income earned in State C. Thus, State B's tax on X's employment income earned in State C would be reduced to zero but State B's tax on X's employment income earned in State B would not be affected. This result is consistent with the underlying principle that the tax imposed by the country in which employment is exercised takes precedence over the tax imposed by the country in which the taxpayer or employer is resident. Although this type of relief is not required under the tax treaties between the three countries, countries that impose tax under proposed Article 15(4) should be encouraged to provide this type of relief in their domestic law. Guidance to this effect could be provided in the Commentary to accompany Article 15(4) and Article 23B(3).

3.25 If there is a treaty between State B and State C, the provisions of that treaty would not prevent State B from taxing employment income earned in State C by an employee resident

in State A. As a result, unless State B provides relief under its domestic law, an employee resident in State A working in State C for an employer resident in State B would be subject to double taxation on any employment income earned in State C. Such situations are unlikely to arise frequently and can be avoided through straightforward tax planning.

Possible Amendment of Article 23B

3.26 As shown in the above examples, the adoption of a provision similar to draft Article 15(4) would require changes to Article 23B of the United Nations Model Convention in order to ensure the elimination of double taxation. The necessary changes are shown in the text of Article 23B below in bold italics.

CREDIT METHOD

1. Where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State or because the capital is also capital owned by a resident of that State), the first-mentioned State shall allow:

(a) as a deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State;

(b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where, in accordance with any provision of this Convention, income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

3. Where an employee is a resident of a Contracting State and derives income from employment by an employer who is a resident of the other Contracting State, which may be taxed in the other Contracting State in accordance with paragraph (4) of Article 15 of this Convention, the other Contracting State shall allow as a deduction from the tax on that income of that employee an amount equal to the

income tax paid in the Contracting State of which the employee is a resident on the income from employment derived by the employee from that State.

Such deduction shall not, however, exceed that part of the income tax, as computed before the deduction is given, which is attributable to the income which may be taxed in the State of which the employee is a resident.

- 3.27 Alternatively, it has been suggested that Article 23B(3) could be drafted more simply as follows:

3. A Contracting State that may tax income from employment in accordance with paragraph 4 of Article 15 shall allow as a deduction from the tax on that income an amount equal to the income tax paid in the other Contracting State in accordance with the provisions of Article 15 (other than paragraph 4).⁶

Such deduction shall not, however, exceed that part of the income tax, as computed before the deduction is given, which is attributable to the income which may be taxed in the State of which the employee is a resident.

- 3.28 Draft Article 23B(3) is intended to require a contracting state that is entitled to tax the income from employment of an employee resident in the other contracting state under draft Article 15(4) to allow a foreign tax credit against its tax on that income for the tax imposed by the other contracting state on that income. Draft Article 23B(3) applies only with respect to tax imposed on income from employment in accordance with Article 15(4). As a result, it does not overlap with the foreign tax credit allowed under Article 23B(1) by the contracting state in which an employee is resident for the tax paid to the other contracting state with respect to employment income derived by the employee in the other contracting state where the employer is resident or in a third state. The second sentence of draft Article 23B(3) ensures that the foreign tax credit does not exceed the amount of tax imposed by the state where the employer is resident on the employment income earned in the state in which the employee is resident or in a third state. The state where the employer is resident is not obligated to provide a credit for all of the tax imposed by the other state on all of the employee's income from employment. For example, if the employee earns income from employment exercised in the state in which the employer is resident or in a third state that

⁶ Like the other paragraphs of Article 23, the provision should possibly refer to the resident entitled to the credit.

is subject to tax by the state in which the employee is resident, the state where the employer is resident is not obligated to provide a foreign tax credit for such tax.

- 3.29 Proposed Article 23B(3) does not provide relief for the double taxation that occurs where employment income is taxed in a third state, as discussed in paragraphs 3.21 to 3.24. This problem could be described in the Commentary and countries could be encouraged to provide such relief unilaterally in their domestic law. In addition, where there is a tax treaty between the third state in which employment is exercised and the state in which the employer is resident, an alternative provision to provide relief from such double taxation could be provided in the Commentary for countries that wish to deal with the problem in their tax treaties.

Collection of Tax

- 3.30 If a contracting state in which an employer is resident and pays salary, wages or other remuneration to an employee who is resident and working in the other contracting state or in a third state is granted the right to impose tax on the amounts paid to the employee, as suggested in this paper, the efficient collection of that tax must be considered. Initially, it seems that imposing an obligation on the resident employer to withhold tax from the amount paid to the nonresident employee is a straightforward mechanism for collecting the tax efficiently. However, because of two considerations, the collection of tax imposed under proposed Article 15(4) is not as simple as in the typical situation where a country imposes a withholding obligation on amounts paid by residents to nonresidents.
- 3.31 First, the country in which the employee is resident may also require the employer to withhold tax from the remuneration paid to the employee or, alternatively, to require the employee to pay instalments of tax based on the employee's estimated income for the year. As a result, there is a risk that the amount of tax withheld with respect to an employee's remuneration would be excessive because both countries require withholding at source from the remuneration. This duplication of withholding is clearly inappropriate. It can reasonably be avoided if the withholding obligation imposed on the employer by the country in which the employer is resident is reduced to reflect the amount of tax withheld with respect to the tax imposed by the employee's country of residence or with respect to

the tax instalments paid by the employee on account of that tax. Such an adjustment to the amount to be withheld should be administratively feasible because the employer would have all the necessary information to make the appropriate adjustment or could easily obtain the information from the employee.

3.32 Second, the withholding is even more complicated where an employee works for part of the year in the country in which the employee is resident and also in the country in which the employee's employer is resident. As discussed in the example in paragraph 3.15 above, in this situation, both the tax liability and the withholding obligations should be determined in 3 stages:

- the country in which the employer is resident is entitled to tax the employee's employment income to the extent it is derived from employment exercised in that country;
- the country in which the employee is resident is entitled to tax the employee's entire income from employment, but must give a credit for the tax imposed by the country in which the employer is resident in stage 1; and
- the country in which the employer is resident is entitled under proposed Article 15(4) to tax the employee's employment income derived in the employee's country of residence or in a third country but must give a credit for the tax imposed by the country in which the employee is resident.

3.33 The withholding would be complicated further where an employee exercises employment in a third state.

3.34 As indicated in paragraphs 3.31 and 3.32, the imposition of tax by the two contracting states (or even three states) in these 3 stages raises the risk of excessive withholding by the employer, which would be unfair for the employee. However, the employer should have access to all the necessary information to adjust the amount of the withholding tax to ensure both that the taxes imposed on the employee's employment income are effectively collected and that the employee is not subject to unreasonably excessive withholding. This assumes, of course, that the countries' domestic tax laws allow the employer (and the employee where the employee is required to pay instalments of tax) to adjust the amount

of withholding to reflect amounts withheld on account of the other country's tax liability. This result should apply irrespective of whether one or both contracting states taxes the employment income on a net or gross basis.

Comparison of the Amendment Adding Article 15(4) with Articles 16 and 19

- 3.35 It may be useful to briefly compare the proposed revision to Article 15(4) with Articles 16 and 19 since those articles appear to be intended, at least in part, to address tax base reduction or erosion issues. Article 15 is explicitly subject to the provisions of Articles 16 and 19 so that the provisions of those articles take precedence over Article 15 in any situation where both Article 15 and either Article 16 or Article 19 apply. The priority given to Article 16 and Article 19 would also apply to the taxation of employment income under Article 15(4) by the contracting state in which the employer is resident.
- 3.36 Under Article 16, fees paid to directors and remuneration paid to top-level managerial officials of a company resident in one contracting state are taxable by that state even where the directors or managerial officials are resident in the other contracting state and irrespective of where the directors or managerial officials perform their services. The contracting state in which a director or managerial official of a company resident in the other contracting state is resident is also entitled to tax the fees earned by such a director or the employment income earned by such a managerial official. However, in contrast to Article 15, in these situations the state in which the director or managerial official is resident has only a secondary right to tax and must provide a credit for the tax imposed by the state in which the company paying the fees or remuneration is resident.
- 3.37 The suggested change to Article 15 – adding Article 15(4) to allow states in which an employer is resident to impose tax on the income of nonresident employees of resident employers even where the employment income is earned outside that state – does not require the state where the employee is resident to give a foreign tax credit for the tax imposed by the state in which the employer is resident. Instead, under the suggested changes, unlike Article 16, the tax imposed by the state of residence of the employee would continue to take precedence over the tax imposed by the state in which the employer is resident. The tax imposed by the state of residence of the employer would be imposed only

to the extent that it exceeds the tax on that income imposed by the state of residence of the employee.

- 3.38 Under Article 19(1)(a), salary, wages and other remuneration paid to the employees of a government of one contracting state are taxable exclusively by that state irrespective of whether the employee is a resident of the other contracting state and irrespective of where the services are performed (except in the limited circumstances prescribed in Article 19(1)(b), in which case only the state in which the employee is resident is entitled to tax the employment income). In contrast to Article 15, Article 19(1)(a) provides for the allocation of exclusive taxing rights over remuneration paid to government employees to the government of the state that pays the employees; the contracting state in which a government employee is resident (unless, of course, the government employee is resident in that state) is prevented from taxing employment income derived by its residents from the government of the other contracting state. In contrast, Article 15 provides for exclusive taxing rights for the state in which an employee is resident only where the employee is employed by an employer that is not a resident of the same state and does not have a PE or fixed base in that state and the employee does not spend more than 183 days in that state. The suggested addition of Article 15(4) would have the effect of giving a new taxing right to the contracting state where the employer is resident without depriving the other contracting state where the employee is resident of any of its existing taxing rights. In addition, the additional taxing rights given to the employer's state of residence would be accompanied by a corresponding obligation to eliminate any double taxation by giving a foreign tax credit for any tax imposed by the employee's state of residence on the employment income derived from that state. In effect, the tax imposed by the employee's state of residence would take precedence over the tax imposed by the employer's state of residence, as is the case with respect to employment income in general.

Summary of the Arguments for and Against Adding Proposed Article 15(4) to the United Nations Model Convention

- 3.39 The detailed analysis of the proposed amendments to Article 15 and Article 23B of the United Nations Model Convention presented in section 3 make a reasonable case for making those amendments to give a contracting state in which an employer is resident an

additional right to tax the employment income of the employer's employees resident and working in the other contracting state. In the following paragraphs, the arguments for and the arguments against adding such a provision are summarized briefly.

3.40 The arguments for adding a provision to the United Nations Model Convention along the lines of proposed Article 15(4) in paragraph 3.9 above, to allow the contracting state in which an employer is resident to tax the employment income derived by the nonresident employees of the employer from working outside the country in which the employer is resident, are:

- The deduction claimed by a resident employer for remuneration paid to a nonresident employee working outside the employer's country of residence reduces or erodes the tax base of the country in which the employer is resident.
- Allowing the country in which an employer is resident to tax the remuneration paid to a nonresident employee would not affect the existing taxing rights of the contracting state in which an employee is resident under Article 15 of the United Nations Model Convention. Proposed Article 15(4) would allow the country in which the employer is resident to impose a top-up tax equal to the difference, if any, between its tax on the remuneration paid to a nonresident employee with respect to employment exercised in the other state and the other state's tax on that income. This new taxing right for the country in which the employer is resident does not deprive the country in which the employee is resident of any of its existing taxing rights under Article 15 of the United Nations Model Convention.
- Under the existing version of Article 15, the country in which an employee is resident has exclusive taxing rights over the employee's employment income, except where the employee works in the other contracting state for an employer resident in that state or for a nonresident employer with a PE or fixed base in that state (that bears the employee's remuneration) or where the employee is present in that state for more than 183 days in any 12-month period. The allocation of exclusive taxing rights to the residence state in this manner is arguably inappropriate and inconsistent with other provisions of the United Nations Model Convention, which provide for taxing rights to be shared by the country in which the taxpayer is resident and the country in which the

income arises. The country in which an employee is resident for purposes of Article 15 has no legitimate interest in preventing the country in which the employee's employer is resident from taxing the employee's income from employment as long as the tax imposed by the country of residence of the employee takes precedence over the tax imposed by the country in which the employer is resident (i.e., the country of residence of the employer must provide a foreign tax credit against its tax for the tax imposed by the country of residence of the employee).

- Proposed Article 23B(3) ensures that the tax imposed by the country in which an employee is resident takes precedence over any tax imposed by the country in which the employer is resident and that double taxation of the employee's employment income earned in either of the contracting states is eliminated. Although proposed Article 23B(3) does not eliminate the possibility of double taxation where a third state imposes tax on an employee's employment income derived in that third state, this situation is unlikely to arise frequently and countries where employers are resident can be encouraged to provide relief from this type of double taxation by providing relief in their domestic law.
- Proposed Article 15(4) does not impose any minimum threshold as a condition for taxation by the country in which the employer is resident. This lack of any minimum threshold is consistent with the lack of any minimum threshold for tax imposed by the country in which an employee works for an employer resident in that country or for a nonresident employer with a PE or fixed base in that country. Moreover, if a minimum threshold for tax imposed by a country on the employment income paid to nonresident employees of a resident employer is considered to be appropriate, such a threshold – based either on the number of days of presence or employment in the other country or the amount of remuneration paid – could easily be added to proposed Article 15(4).
- Any tax imposed in accordance with proposed Article 15(4) by the country in which an employer is resident can be effectively collected through withholding at source by resident employers.

3.41 The arguments against adding a provision along the lines of Article 15(4) to the United Nations Model Convention are summarized briefly below:

- An argument frequently raised by developed countries is that any income from services, including both employment income and income from independent services, should be taxable by a country only if the taxpayer is a resident of that country or if the income is derived from services performed in that country by employees or independent contractors who are present in that country.⁷ Although this argument may be appropriate in the context of the OECD Model Convention, it is inconsistent with several provisions of the United Nations Model Convention, including Articles 12A, 12B, 16 and 19.
- Adding proposed Article 15(4) to the United Nations Model Convention to allow a country in which an employer is resident to impose tax on remuneration paid to its nonresident employees working remotely may affect the ability of countries to encourage individuals resident in other countries to shift their residence through the use of tax incentives. However, proposed Article 15(4) would not adversely affect the ability of countries to use tax incentives to encourage independent contractors to shift their residence.
- Adding Article 15(4) to the United Nations Model Convention will exacerbate the preferential treatment of independent contractors compared to employees under the Convention.
- The withholding obligations and the foreign tax credit calculations imposed on resident employers in order to comply with domestic taxes imposed on their nonresident employees working remotely, in accordance with Article 15(4), may be unduly complex.
- Where an employer resident in one contracting state has employees in the other contracting state, especially a developing country, that earn low salaries, any top-up tax imposed by the state in which the employer is resident may result in excessive taxation on such nonresident employees. Countries imposing tax in accordance with draft Article 15(4) should take the possibility of such excessive taxation into account in

⁷ See paragraph 139 of the Commentary on Article 5 of the OECD Model Convention.

designing any tax on nonresident employees, perhaps by imposing tax only on employees earning remuneration in excess of a monetary amount.

ANNEX 5

**REVISED DRAFT
SEPTEMBER 6, 2023**

UNITED NATIONS SUBCOMMITTEE ON THE TAXATION ISSUES RELATED TO THE DIGITALISED AND GLOBALISED ECONOMY

WORKSTREAM C

THE TAXATION OF REMOTE WORKING EMPLOYEES UNDER THE PROVISIONS OF THE UNITED NATIONS MODEL CONVENTION: OPTIONS FOR REFORM

Brian J. Arnold

1. INTRODUCTION

- 1.1 This paper deals with the tax issues caused by so-called remote workers under the provisions of the United Nations Model Convention; it is intended to contribute to the work on this topic (referred to as Workstream C) by the Subcommittee on Taxation Issues Related to the Digitalized and Globalized Economy (the Subcommittee) and the United Nations Committee of Experts on International Cooperation in Tax Matters (the Committee).
- 1.2 The Subcommittee met several times during the last half of 2022 and the first half of 2023 to discuss the domestic tax and tax treaty issues with respect to the increasing trend of remote working, enabled by new technology and accelerated by the Covid-19 pandemic. Those discussions focused on whether the treatment of remote workers under the existing provisions of the United Nations Model Convention was appropriate and whether, and how, those provisions might be modified to better accommodate remote working. The Subcommittee also considered whether it would be useful to provide countries, especially

developing countries, with some type of guidance with respect to the treatment of remote workers under their domestic law and tax treaties.

- 1.3 UNDESA engaged me to prepare a paper examining the treatment of remote workers under the existing provisions of the United Nations Model Convention, including the identification of the various circumstances in which remote working might be considered to arise, the potential challenges or issues presented by remote working under the existing provisions of the United Nations Model Convention, and a brief list of possible reform measures. That paper, which was presented to the Committee at its 26th session at the end of March 2023, took a broad and comprehensive approach to the application of the provisions of the United Nations Model Convention to various types of remote working, including both employees and independent contractors, in order to identify any possible issues to be addressed in the provisions of the Model Convention.
- 1.4 At its 26th session, the Committee decided, as a preliminary matter, that Workstream C on remote workers should continue as a stand-alone project and not be folded into Workstream B dealing with the use of physical presence and other tests in the United Nations Model Convention. However, there was no clear consensus on the direction or focus of the work, and it was left to the Subcommittee to propose how to take the work forward.
- 1.5 On May 23, 2023, the Subcommittee met to discuss a draft outline for a follow-up paper with respect to the treatment of remote workers under the United Nations Model Convention, focusing on the treatment of remote working employees and identifying practical options for clarifying the treatment of such employees and their employers.
- 1.6 In accordance with the Subcommittee's approval of the outline, this follow-up paper was prepared to provide, in general, practical and workable options for the Subcommittee and the Committee for taking concrete action with respect to Workstream C and, more specifically:
 - a) to provide guidance for developing countries with respect to the taxation of remote workers in order for those countries to exercise their existing taxing rights effectively;

- b) to explore the possibility of providing additional taxing rights under the United Nations Model Convention for countries in which employers of nonresident employees are resident;
 - c) to provide guidance, possibly in the Commentary on Articles 5 and 14 of the United Nations Model Convention, with respect to the circumstances in which remote workers might create a permanent establishment (PE) or fixed base for their employer in the country in which the remote working employees work; and
 - d) to clarify the taxation of so-called digital nomads – highly skilled individuals who can work from anywhere and move periodically from one country to another without creating a taxable presence in any country.
- 1.7 The paper does not deal with non-tax issues (such as immigration or social security) involving remote workers, or VAT issues. It focuses principally on the tax consequences for remote working employees and their employers under the provisions of the United Nations Model Convention and on aspects of domestic law closely related to those treaty provisions. Some issues, such as the tax residence of remote working employees and their employers, are not dealt with extensively but are merely noted as relevant factors in determining whether and how remote working employees and their employers are taxable by countries in accordance with the United Nations Model Convention. Similarly, the paper does not deal in detail with the issues that may arise with respect to the calculation of the income derived by remote workers that is taxable by the country in which they work or the profits attributable to a PE or fixed base of an employer as a result of the activities of remote working employees.
- 1.8 The paper begins with brief descriptions of the meaning of “remote working” for the purposes of the paper and the remote working employees who are the central focus of the paper. It then discusses the fundamental principles underlying Article 15 and other relevant provisions of the United Nations Model Convention to which any modifications of Article 15 should conform. The following sections provide a detailed analysis and options for reform with respect to the treatment of:

- employees resident in one contracting state and working remotely in the other contracting state;
- directors and top-level managerial officials employed by a company resident in one contracting state but working in the other contracting state;
- employees of the government of one contracting state working in the other contracting state;
- the circumstances in which remote working employees of an employer resident in one contracting state might create a PE or fixed base for their employers as a result of their working in the other contracting state; and
- digital nomads.

As explained in the next paragraph, the tax treatment of employees resident in one contracting state and working for an employer resident in the other contracting state is discussed in detail in a separate paper.

1.9 This paper was initially prepared for a meeting of the Subcommittee in Amsterdam from August 7 – 9, 2023. At that meeting, it was decided that the part of the paper dealing with the possibility of providing a new taxing right under Article 15 of the United Nations Model Convention for the contracting state in which an employer is resident where that employer has an employee who is resident in the other contracting state and is employed in that state or a third state, should be expanded and included in a separate paper. As a result of that decision, a new paper, “The Taxation of Nonresident Remote Working Employees of Resident Employers Under the Provisions of the United Nations Model Convention,” dated September 6, 2023, was prepared, discussing in more detail the tax treatment of employers resident in one contracting state with employees resident and working in the other state. As a result, this paper deals only with the issues mentioned in paragraph 1.8.

2. WHO ARE REMOTE WORKERS?

- 2.1 Remote workers are referred to variously as “digital nomads,” “teleworkers” or “telecommuting workers,” “remote workers,” “hybrid workers,” and “distance workers.”¹ For purposes of this paper, the neutral term “remote worker” is used to refer to remote working employees. Although individuals providing independent personal services may also engage in remote working, the treatment of such independent contractors working remotely under the provisions of the United Nations Model Convention raises different, and more difficult, issues than the treatment of employees, and is not dealt with in this paper except with respect to digital nomads.² In other words, this paper is restricted to the treatment of remote working employees and their employers.
- 2.2 For the purposes of this paper, remote working employees are employees who are working in a country other than the country in which the employee is resident or in which the employee’s employer is resident or has a PE. This cross-border aspect of remote working is a necessary condition for any tax treaty issues to arise. A remote working employee may work at a place of business of their employer, from the employee’s home or from some other place as long as that place of work is located outside the country in which the employee or the employer is resident. Remote working employees may be residents of the country in which their employer is resident or of another country, and they may work in a country other than the country in which they are resident. The work carried out by a remote worker in a country may be short-term or long-term.
- 2.3 Tax issues also arise with respect to purely domestic remote working, but those issues are not dealt with in this paper. In a domestic context, the term “remote working” usually means situations in which employees work from their homes rather than at their employer’s place of business. In some situations, both domestic and international tax issues may arise with respect to an employee who works part of the time in the country in which their

¹ See, for example, the report of the UK Office of Tax Simplification on hybrid and distance working, available at <https://www.gov.uk/government/publications/ots-report-on-hybrid-and-distance-working>.

² The treatment of remote working independent contractors was dealt with in the paper presented to the 26th session of the Committee of Experts as E/C.18/2023/CRP.1, Annex E.

employer is resident and part of the time in another country. International tax and tax treaty issues arise where an employee works outside the country in which the employee is resident.

- 2.4 This paper deals with both the taxation of remote working employees themselves and the tax issues for their employers caused by remote working employees. The activities of remote working employees may create a PE or fixed base for the employer in the country in which the employee is working. Further, where an employer resident in one country has a PE or fixed base in another country and where the employee's activities are connected to the PE or fixed base, the amounts paid to a remote working employee are usually deductible in computing the profits attributable to the PE or fixed base.
- 2.5 Digital nomads are a special subset of remote workers: they are individuals, usually with specialized skills, who can work from almost anywhere with a laptop computer or tablet as long as there is a reliable Wi-Fi connection. These digital nomads may spend years roaming the globe while spending only a few months in any particular country. Alternatively, they may follow a regular pattern of spending a few months in 3 or 4 countries every year. Still others may have a permanent home in one country but spend significant periods of time during the year working in other countries. Digital nomads may be either employees or independent contractors; however, the tax issues with respect to independent contractors are not dealt with in detail. The special problems of taxing digital nomads are discussed in section 6 below.

3. PRINCIPLES FOR THE TAXATION OF THE INCOME OF REMOTE WORKERS UNDER THE PROVISIONS OF THE UNITED NATIONS MODEL CONVENTION

- 3.1 This section identifies the major principles or factors that are relevant in determining whether a country (i.e., the country in which an individual is working) is entitled to tax the income earned in that country by employees resident in the other contracting state, and also whether the country in which an employee is resident is entitled to tax the employee's income from employment derived from another state. These principles may conflict and, as a result, some principles are given more importance in some articles of the United Nations Model Convention and less importance in other articles. No attempt is made here

to suggest how these principles should be balanced with respect to any particular article of the United Nations Model Convention, and the principles are not listed in any particular order. These underlying principles should be used to evaluate the suitability of the existing provisions of the United Nations Model Convention applicable to remote working employees, as well as any proposals to modify those provisions.

3.2 The following discussion of the underlying principles for the taxation of remote workers is limited to the principles that govern the allocation of taxing rights between the contracting states; it does not include the treaty rules that govern how countries can impose tax on the income of remote workers (i.e., net or gross income and limited or unlimited rate of tax).

3.3 The principles underlying the taxation of income from employment derived by an employee resident in one contracting state from employment exercised in the other contracting state under the provisions of the United Nations Model Convention can be summarized briefly as follows:

- The country in which employment is exercised is entitled to tax the income from that employment, and this right takes precedence over the right of the country in which the employee is resident to tax that income.
- In certain circumstances, the right of a country to tax income from employment exercised in that country is limited to situations where an employee is present in the country for more than 183 days in a 12-month period. This physical presence threshold requirement is applicable where the employee's employer is not a resident and does not have a PE or fixed base in the country where the employment is exercised; however, where the employer is a resident of the country or has a PE or fixed base in the country where the employment is exercised, there is no minimum period of time that an employee must be present in that country for it to impose tax on the employment income.
- In some situations involving remote working employees (and in some other circumstances as well), the imposition of tax by a country appears to be justified at least in part by the reduction or erosion of the country's tax base. For example, where an employee resident in one contracting state exercises employment in the other

contracting state for an employer resident in that other state or with a PE or fixed base in that other state (which bears the employee's remuneration), the other state is entitled to tax the employment income irrespective of how long the employee works or is present in that country. However, the employment must be exercised in that country; if the employment is not exercised in that country, it has no right to tax under Article 15. Similarly, under Article 16, the fees and remuneration derived by directors and top-level managerial officials of a company resident in one contracting state who work in the other contracting state are subject to tax on those fees and remuneration by the state in which the company is resident, (and that state's tax takes precedence over the tax imposed by the state in which the director or managerial official is resident or the state in which the director or managerial official works), presumably because such fees and remuneration are deductible by the payer company.

- In certain narrow circumstances, countries' taxing rights under the provisions of the United Nations Model Convention might be limited if those countries cannot collect the tax in a reasonably efficient manner. These enforcement concerns justify denying taxing rights to countries only where it would be very difficult or impossible for the countries to impose and collect taxes on nonresidents, even on the assumption that they have the necessary administrative capacity to impose taxes on nonresidents effectively. For example, a country may encounter serious difficulties enforcing taxation on remote working employees who are employed by nonresident employers and who work in the country temporarily for very short periods.

4. ANALYSIS OF THE TAXATION OF REMOTE WORKING EMPLOYEES UNDER THE PROVISIONS OF THE UNITED NATIONS MODEL CONVENTION

4.1 Introduction – The Various Fact Patterns of Remote Working Employees

- 4.1.1 As discussed in section 2 above, for the purposes of this paper, remote working means an employee who is resident in one country but works in another country or who works for an employer resident in another country. This cross-border remote working arises in a wide variety of different fact patterns, with varying tax consequences under the provisions of bilateral tax treaties based on the United Nations or OECD Model Convention. The tax consequences of these different patterns vary depending on the following major factors:

- the residence of the employee,
- the residence of the employer,
- the legal status of the remote worker as an employee,
- whether the employer has a PE or fixed base in the country in which the employee works,
- the country or countries in which the employee works, and
- the length of time that the employee is physically present in the country where the employee works.

4.1.2 The residence of both an employee and the employee's employer will be determined under Article 4 of the provisions of the United Nations Model Convention, and that will determine whether a particular treaty is applicable to the employee. The determination of residence under Article 4 is well understood and is not discussed further here.

4.1.3 The determination of whether an employer resident in one country has a PE or fixed base in another country is made in accordance with the provisions of Articles 5 and 14 of the United Nations Model Convention, respectively. Although determinations of the existence of a PE or fixed base are difficult, considerable guidance is available in the Commentary on Article 5 (and to a lesser extent, Article 14) of the United Nations Model Convention to assist in making those determinations. As a result, the determination of whether an employer resident in one country has a PE or fixed base in another country is discussed in this paper (in section 5 below) only with respect to whether the activities of remote working employees in a country for an employer resident in another country create a PE or fixed base in the first country for the employer.

4.1.4 The following three sections analyze the tax consequences under the United Nations Model Convention with respect to three situations involving remote working employees:

- first, in sections 4.2 and 4.3, where an employee and the employee's employer are resident in one contracting state but the employee works in the other state or where the employee is resident in one contracting state but works in the other state in which the employer is resident or has a PE or fixed base;

- second, in section 4.4, where a director or top-level managerial official of a company resident in one contracting state works remotely in the other contracting state (Article 16 of the United Nations Model Convention applies in this situation); and
- third, in section 4.5, where employees of the government of one contracting state work remotely in the other contracting state where they are resident or in a third state (Article 19 of the United Nations Model Convention applies in this situation).

4.2 Resident Employees Working Remotely

Situations Involving Resident Employees as Remote Workers

4.2.1 For purposes of analysis, two core fact situations involving the application of Article 15 to resident employees who work remotely are:

- 1) An employee resident in State A works in State B for an employer resident in State A or State B; and
- 2) An employee resident in State A works in State B or a third State (State C) for an employer resident in State A with a PE or fixed base in State B.

4.2.2 The tax consequences under Article 15 of the United Nations Model Convention for employees who are resident in one contracting state (State A) and who work remotely in the other contracting state (State B) are summarized in Table 1.

TABLE 1

EMPLOYEE	EMPLOYER			
	Resident in State A	Resident in State A with PE or Fixed Base in State B	Resident in State A with PE or Fixed Base in State C	Resident in State B
Resident in State A; working in State B	<p style="text-align: center;">Case 1</p> <ul style="list-style-type: none"> • taxable in State A • taxable in State B if employee is present in State B for more than 183 days 	<p style="text-align: center;">Case 2</p> <ul style="list-style-type: none"> • taxable in State A • taxable in State B if salary borne by PE or fixed base or if employee present for more than 183 days 	<p style="text-align: center;">Case 3</p> <ul style="list-style-type: none"> • taxable in State A • taxable in State B if employee present for more than 183 days • not taxable in State C 	<p style="text-align: center;">Case 4</p> <ul style="list-style-type: none"> • taxable in State A • taxable in State B

Summary of the Tax Consequences for Remote Working Employees under Article 15

4.2.3 Under the provisions of Article 15 of the United Nations Model Convention,³ the country in which a remote working employee is resident always has the right to tax the employee's employment income, irrespective of where the employee works or where the employee's employer is resident or carries on business through a PE or fixed base. This result is shown in all 4 cases in Table 1: State A has the right to tax the employee's income from employment in all 4 cases. (The tax result is different for certain government employees who are residents of that country under Article 19(1)(b)).

4.2.4 The country in which an employee is working but not resident (State B in Table 1) is entitled to tax the employee's employment income derived in State B in the following 4 situations:

- the employee's employer is not resident in the country in which the employee is working (State B) and does not have a PE or fixed base in that country (State B), but only if the employee is present in that country (State B) for more than 183 days in any 12-month period (see Article 15(2)(a)). Cases 1 and 3 of Table 1.
- the employee's employer is a resident of the country in which the employee is working (State B) and the employee's salary is paid by or on behalf of the employer; in this case, there is no minimum threshold for the country (State B) to tax the employee's income derived from that country (State B) (other than the performance of duties of employment in that country (State B)) (see Article 15(2)(b)). Case 4 of Table 1.
- the employee's employer has a PE or fixed base in the country in which the employee is working (State B) that bears the employee's salary; in this case, there is no minimum threshold for the country (State B) to tax the employee's income derived from that country (State B) (other than the performance of duties of employment in that country (State B)) (see Article 15(2)(c)). Case 2 of Table 1.

³ The same result applies under Article 15 of the OECD Model Convention.

- the employee's employer has a PE or fixed base in the country in which the employee is working (State B) that does not bear the employee's salary, but only if the employee is present in that country (State B) for more than 183 days in any 12-month period (see Article 15(2)(c)). Case 2 of Table 1.
- 4.2.5 Where the employer has a PE or fixed base in a third country (State C) but the employee does not work in that country, that country does not have any right to tax the employee's employment income under the treaty between State A and State B. (Case 3 of Table 1.) Similarly, where there is a treaty between State A and State C, State C would not have any right to tax the employee's income from employment because none of the employment is exercised in State C.
- 4.2.6 In all the cases referred to in paragraphs 4.2.4 and 4.2.5, where the contracting state in which an employee exercises employment has a right to tax the income from employment under Article 15 of the United Nations Model Convention, there is no limitation on the manner (taxation of the gross income of the employee is permitted) or the rate of tax imposed by that country.
- 4.2.7 The right to tax of the country in which the employee is working (State B) is not affected in situations where the employee is working for an employer resident in a third country or for a PE or fixed base in a third country of the employer, even where the employee's salary is borne by the employer and/or the PE or fixed base. For example, assume an employee resident in State A and working in State B for an employer resident in State A with a PE or fixed base in State C, which bears the employee's salary. (This is the situation in Case 3 of Table 1.) Under Article 15 of the treaty between State A and State B, State B is entitled to tax the employee's employment income earned in State B if the employee is present in State B for more than 183 days. In this case, Article 15(2) does not apply. However, where the employee is not present in State B for more than 183 days, Article 15(2) applies because the conditions in Article 15(2)(b) and (c) are not met. (The employer is not a resident of State B and does not have a PE in State B; the PE is situated in State C, not in State B.) Therefore, the employment income is taxable only in State A. Note that, in this situation, the treaties between State A and State C and between State B and State C are not relevant

because there is no resident of State C. This result applies despite the fact that State A and State C will likely allow a deduction for the employee's salary for the period of employment in State B.

- 4.2.8 To summarize, only countries in which an employee is resident or in which an employee exercises the duties of employment have the right under Article 15 of the UN Model Convention to tax income from the employee's employment. The right to tax of the country in which an employee works has priority over the right to tax of the country in which the employee is resident, and the country in which the employee is resident has an obligation under Article 23 of the United Nations Model Convention to relieve any double taxation. The country in which an employee's employer is resident and the country in which the employer has a PE or fixed base that bears the employee's salary have no right to tax the income from employment of the employee unless the employment is exercised in their country. The possibility of granting the country in which the employee's employer is resident the right to tax the nonresident employee's income from employment exercised in the other country is examined in a separate paper.

4.3 [Issues with Respect to Resident Employees Working Remotely](#)

- 4.3.1 The major tax treaty issues with respect to employees who work in a country other than the country in which they are resident are discussed in the following paragraphs:

Residence

- 4.3.2 If an employee resident in one country works in another country for an extended period of time and has other personal and economic connections with that country, there is risk that the other country will consider the employee to be a resident of that country. As a result, the employee is likely to be resident in both countries, and the tie-breaker rules in Article 4(2) would apply to determine the employee's country of residence for purposes of the applicable tax treaty. Although an employee may encounter some compliance issues with respect to dual-residence situations, the residence provisions of the United Nations Model Convention appear to operate appropriately and do not require any modifications or additional commentary in this regard.

Taxation of Remote Working Employees by the Country in Which They Work

4.3.3 As discussed in section 4.2 above, under Article 15 of the United Nations Model Convention, remote working employees are subject to tax by the country in which they work only where:

- an employee works for an employer resident in the country in which the employee works or for a nonresident employer with a PE or fixed base in that country that bears the employee's remuneration. In these two situations, taxation by the country in which the employment is exercised is clearly justified in accordance with two underlying principles – the employment income arises in that country, and that country's tax base is reduced or eroded by the deduction of the remuneration by the resident employer or in computing the profits attributable to the nonresident employer's PE or fixed base. Moreover, there are no enforcement concerns, since these taxes can be collected effectively through the presence of the resident employer or the PE or fixed base in the country. Consideration could be given to adopting a minimum threshold based on an employee's physical presence or number of working days in a country; however, there does not appear to be a convincing case for the need for such a minimum threshold to be added to Article 15; countries that want to adopt such a threshold can do so in their domestic law.
- the employee is present in a country for more than 183 days. This 183-day physical presence threshold appears to be very generous. An employee who spends more than 183 days in a country, even if all of that time is not spent working, has a substantial connection to the country that justifies that country in taxing the employee's employment income. The only reasonable alternatives to facilitate remote working by employees would be for the country in which the employee works to give up its taxing rights on these remote working employees entirely, or to allow that country to tax only where the employee actually works for more than 183 days in the country (which is equivalent to about 255 total days, assuming a 5-day work week). This would make Article 15(2) similar to Article 5(3)(b). Neither alternative appears to be appropriate. An argument can be made that the 183-day threshold should be reduced to, say, 90

days, which would give countries in which nonresident employees work additional taxing rights; however, this would exacerbate problems for remote workers.

- 4.3.4 In other circumstances, the contracting state in which an employee is resident is given exclusive taxing rights under Article 15 of the United Nations Model Convention with respect to income from employment derived by that employee from employment exercised in the other state. The exclusive taxing rights given to the contracting state in which an employee is resident under Article 15 apply in relatively narrow circumstances: only where an employee resident in one contracting state works for an employer that is not resident in that state and does not have a PE or fixed base in that state that bears the employee's remuneration, the employee works in that other state, and is present in that state for 183 days or less in any 12-month period. Nevertheless, the allocation of exclusive taxing rights to the residence country in these circumstances is questionable in terms of the principles underlying Article 15, described in section 3.
- 4.3.5 To the extent that employment income is earned from employment exercised in a country, that country should be entitled to tax such income. Although it might be appropriate to impose a threshold for the taxation of a nonresident employee's employment income earned in a country in which the employee is not resident – such as a minimum period of employment in the country or a minimum amount of income earned in the country – no similar threshold is imposed under Article 15 for situations in which a contracting state is entitled to tax employment income derived in that state by a resident of the other contracting state. As a result, it is arguably inappropriate to deny a country the right to tax employment income that arises in that country.⁴ Although it may be difficult for a country

⁴ Such exclusive taxing rights may be appropriate in the context of Article 15 of the OECD Model Convention because of its general preference for the allocation of taxing rights to residence countries. It may also be appropriate in the context of Article 15(3) of both the United Nations and OECD Model Conventions with respect to employees working on ships or aircraft operated in international traffic. However, the Commentary on both Model Conventions provides alternative provisions to allow both the state where the employee is resident and the state of residence of the enterprise operating the ships or aircraft to tax the employment income earned by crew members, with the state of residence of the enterprise having the primary right to tax. See paragraph 2 of the Commentary on Article 15 of the United Nations Model Convention, quoting paragraphs 9.6 to 9.9 of the Commentary on Article 15 of the OECD Model Convention.

to collect tax imposed on the employment income derived in the country by nonresident employees who are employed in the country for only short periods, this is not a good reason to deny the country the right to tax such income. It would be preferable to work on mechanisms, such as exchange of information, that would improve the ability of these countries to collect taxes on such employment income efficiently.

- 4.3.6 Where an employee resident in one contracting state works for an employer resident in the other state, both the state in which the employee works and the state in which the employee is resident are entitled to tax the employee's employment income derived from the state in which the employment is exercised. Under Article 15, if an employee resident in one contracting state works in the other state where the employee's employer has a place of business (PE or fixed base) and the PE or fixed base bears the employee's remuneration, the state where the employer's place of business is located is entitled to tax the employee's income only to the extent that the employee's employment is exercised in that state. As a result, where an employee works partly at the employer's place of business and partly at home in another country where the employee is resident (which is a situation that arose frequently as a result of Covid-19 and appears to be increasing), the employee's income from employment will be taxable in part by both countries in proportion to the number of days of employment in each country. Detailed record-keeping is necessary to ensure that the country in which the employer is resident imposes tax only on the employee's income from employment in that country, and also to ensure that the country in which the employer is resident provides a foreign tax credit for no more than the proper amount of tax paid by the employee to the other country.
- 4.3.7 Where the number of employees resident in one contracting state and working for employers resident in the other contracting state are relatively equal for both states, adding a provision to the bilateral treaty between the two countries may serve to reduce the compliance burden for employees and employers and for tax administrations. Such a provision could deem the days that an employee works at home in the employee's country of residence rather than at the employer's place of business as days that the employee works at the employer's place of business, as long as those days do not exceed a maximum to be agreed by the countries. Perhaps such a provision could be added to the Commentary on

the United Nations Model Convention as an alternative that some countries might wish to include in some of their bilateral tax treaties.

- 4.3.8 Under Article 15 of the United Nations Model Convention, primary taxing rights are allocated to the country in which the employment is exercised, with secondary taxing rights to the country in which the employee is resident. In contrast, under Articles 16 and 19(1), the primary taxing right is allocated to the contracting state where a company is resident or to the contracting state that is the employee's employer, irrespective of where the employment is exercised. Although Articles 16 and 19(1) appear to be exceptions to the general principle that employment income should be subject to tax in the first instance by the contracting state in which the employment is exercised, it would be possible to change the allocation of the primary taxing right in respect of employment income to the state in which the employer is resident. This would be a major change in the treatment of employment income, which would involve taking taxing rights away from countries where employment is exercised and giving those taxing rights to the country in which the employer is resident.
- 4.3.9 It has also been suggested that a distinction could be made between situations in which employment is exercised in a particular country because of the nature of the work or other considerations and other situations in which the employment is not linked in some way to a particular country. Such a distinction would be difficult to make except on the basis of the facts and circumstances of each case.
- 4.3.10 More generally, theoretically, primary taxing rights with respect to employment income can be allocated to the country:
- in which employment is exercised, which is the general rule in Article 15;
 - in which the employee is resident;
 - in which the employee's employer is resident; and

- in which the employee's employment services are consumed or used by third parties.⁵

Compliance Issues

4.3.11 Remote working employees may incur compliance obligations (for example, the obligation to file tax returns) where they become subject to tax in the country in which they are working. These compliance obligations do not appear to impose an undue burden on such employees, except perhaps where employees work in a country for very brief periods. Countries imposing tax on remote working employees should provide clear guidance for such employees with respect to their tax obligations.

Relief from Double Taxation

4.3.12 Where remote working employees are subject to tax on their income from employment by the country in which they work, the country in which the employee is resident is required to relieve any double taxation. Therefore, double taxation should not be an issue.

The Distinction Between Employees and Independent Contractors

4.3.13 The distinction between the legal status of an individual as an employee or an independent contractor is important for purposes of the United Nations Model Convention because the treatment of these two types of individuals differs considerably. The different treatment of employees and independent contractors extends to employees and independent contractors working remotely. However, both the Subcommittee and the Committee have concluded that, although the issues raised by the distinction are obviously important, the scope and difficulty of the issues require a long-term project. As a result, the distinction is beyond the scope of this paper.

Summary of Options for Reform with Respect to Resident Employees Working Remotely

4.3.14 Based on the preceding analysis, four options for reform deserve serious consideration with respect to the provisions of Article 15 of the United Nations Model Convention dealing

⁵ This possibility would be difficult to apply because in many situations an employee's services are used or consumed by the employer rather than by third parties.

with employees resident in one contracting state who exercise their employment in the other contracting state:

- The 183-day period of presence of a nonresident employee in a contracting state under Article 15(2) is difficult to justify and could be reduced to 60 or 90 days to give expanded taxing rights to countries in which nonresident employees exercise their employment.
- Where an employee resident in one contracting state exercises their employment duties in the other contracting state for a nonresident employer who does not have a PE or fixed base in the other state and the employee is not present in the other state for more than 183 days, the other state is prevented from taxing the employee's income earned in that state. In this situation, the exclusive taxing rights allocated to the country in which the employee is resident is difficult to justify on the basis of the fundamental principles governing the allocation of taxing rights, and could be reconsidered for purposes of Article 15 of the United Nations Model Convention.
- An alternative provision could be added to the Commentary on the United Nations Model Convention to deal with situations where the number of employees resident in one contracting state and working for employers resident in the other contracting state are relatively equal for both states.
- The Commentary on Article 15 could be modified along the lines set out in section 4.3 to add guidance about the treatment of remote working employees. The existing Commentary on Article 15 does not contain any consideration of the taxation of remote working employees under Article 15. In light of the increase in cross-border remote working, the addition of a few paragraphs to the Commentary on Article 15 explaining the tax consequences for remote working employees and their employers, as well as the taxing rights of countries in which employees exercise their employment, would be welcome, especially by tax officials of developing countries. The additional commentary should explain both the situations in which the contracting state where remote working employees exercise their employment is entitled to tax the employment income under Article 15 and the situations in which they are prohibited from taxing

such income. Consideration could also be given to including some brief examples to illustrate the operation of Article 15 with respect to remote working employees.

4.4 Directors and Top-Level Managerial Officials Working Remotely for a Resident Company

4.4.1 Under Article 16 of the United Nations Model Convention, the remuneration of directors and top-level managerial officials of a company resident in one contracting state is taxable by the country in which the company is resident. Thus, where such directors or managerial officials are resident in one contracting state and working for a company resident in the other contracting state, both states have the right to tax the remuneration derived by those directors or managerial officials under Article 16 of the United Nations Model Convention. However, the state in which the directors or top-level managerial officials are resident must provide relief from double taxation under Article 23. Where the services provided by directors or top-level managerial officials are performed in a state other than the state in which the company is resident or the director or managerial official is resident, that state does not have any right under the provisions of the United Nations Model Convention to tax their remuneration.

4.4.2 The allocation of taxing rights under Article 16 is quite different from the allocation under Article 15. Under Article 16, neither the contracting state in which the directors or top-level managerial officials of a company are resident nor the state in which the company is resident is given the exclusive right to tax the remuneration paid to the directors or top-level managerial officials. Both states are entitled to tax the remuneration; the state in which the directors or top-level managerial officials of the company are resident is entitled to tax the income, but is under an obligation to provide relief from double taxation under Article 23 with respect to any tax imposed by the state in which the payer company is resident. In contrast, under Article 15, in certain circumstances described in paragraph 4.3.4 and 4.3.5 above, the contracting state in which an employee is resident is given exclusive taxing rights to tax the employee's income from employment even where the employment is exercised in the other contracting state. The state in which the employer paying the employee's remuneration is resident is not given any right to tax the remuneration unless the employment is exercised in that state. It appears that the justification for Article 16 is

based on concerns about the reduction or erosion of the tax base of the country in which a company paying nonresident directors or top-level managerial officials is resident, since the amounts paid will be deductible by the resident company irrespective of where the services are rendered.

4.5 [Government Employees Working Remotely](#)

4.5.1 Under Article 19(1)(a), salary, wages and other remuneration received by government employees, including nonresident employees working remotely, are taxable exclusively by the government that pays them. As a result, no issue arises with respect to government employees working remotely in a country other than the country that is their employer. Article 19 can be justified on the basis of concern about the reduction or erosion of a government's treasury by the remuneration paid to remote working government employees.

4.5.2 Under Article 19(1)(b), remote working is an issue, since an employee of a government of one contracting state is taxable exclusively by the other state where the services are rendered in the other state and the employee is a resident and a national of the other state (or even if not a national of the other state, did not become a resident of the other state for the purpose of performing the services). The remote working issue under Article 19(1)(b) does not appear to be a serious issue because not many government employees would be covered by that provision.

5. TAX TREATY IMPLICATIONS FOR EMPLOYERS OF REMOTE WORKING EMPLOYEES

5.1 [Tax Treaty Implications for Employers with Remote Working Employees](#)

5.1.1 Under the provisions of the United Nations Model Convention, the activities of an employer's employees working remotely in a country other than the country in which the employer is resident can have important consequences for the taxation of the employer by the country in which the employees are working. Probably the most important consequence is that the actions of remote working employees may cause the employer to have a PE or fixed base in the country or countries in which the employer's employees are working. This risk arises where:

- an employee has an office, including a home office, or other fixed place of business in the country in which the employee is working, and the office or place is at the disposal of the employer and exists for at least 6 months;
- an employee working remotely concludes certain contracts on behalf of the employer or plays the principal role leading to the conclusion of such contracts; or
- an employee furnishes services for the enterprise in the country for more than 183 days in any 12-month period.

If the activities are limited to preparatory or auxiliary activities, they will not result in a PE for the employer regardless of whether they are carried out at a fixed place or involve the conclusion of contracts binding on the employer. However, there is no parallel exemption from the concept of a fixed base under Article 14 for preparatory or auxiliary activities.

5.1.2 Where an employer has an existing PE or fixed base in a country and has an employee working in that country, the tax consequences for the employer depend on whether the employee's remuneration is borne by the PE or fixed base (i.e., is deductible in computing the profits of the PE or fixed base for purposes of the tax imposed by the country in which the PE or fixed base is located). If the employee's remuneration is not borne by the PE or fixed base, the employee will not be subject to tax in that country unless the employee is present in that country for more than 183 days. If the employee's remuneration is borne by the PE or fixed base, the employee's remuneration from working in the country will be subject to tax by that country (irrespective of the time spent in the country by the employee), which may result in withholding obligations for the employer.

5.1.3 Whether an employee's remuneration is borne by a PE or fixed base is a question of fact and does not depend solely on whether a deduction for the remuneration is actually claimed in computing the profits of the PE or fixed base (see paragraph 6.2 of the UN Commentary on Article 15, quoting paragraph 7.1 of the OECD Commentary on Article 15). As a result, there could be some uncertainty for employers as to whether remote working employees are subject to tax in the country in which the employer has a PE or fixed base. It is an open question whether the concept of an employee's remuneration being borne by a PE or fixed base could be made more certain by restricting it to situations where the remuneration is actually deducted by the PE or fixed base, although this possibility could be explored.

5.2 Issues for Employers with Respect to Remote Working Nonresident Employees

5.2.1 The three major problems or issues for employers with respect to remote working employees are examined in the following paragraphs.

Risk of a PE or Fixed Base

5.2.2 There is a risk that a remote working employee or employees may create a PE or fixed base for their employer. This risk increases with the number of remote working employees that an employer has in a country and with the nature of the activities of those employees (i.e., selling, contracting and management activities are more likely to result in a PE).

5.2.3 Whether a remote working employee's home office constitutes a PE for the employer is a difficult issue, and countries take varying positions. The OECD's special guidance on the issue, issued in response to the Covid-19 pandemic, indicates that the intermittent use of a home office does not mean that the office is at the employer's disposal; however, a home office may be a PE "if it is used on a continuous basis for carrying on business of that enterprise and the enterprise has required the individual to use that location to carry on the enterprise's business." (OECD, *Updated Guidance on Tax Treaties and the Impact of the Covid-19 Pandemic*, 21 January 2021).

5.2.4 One way to reduce or eliminate this risk for multinational enterprises would be to change the definition of a PE to provide an additional exemption for the activities of remote working employees. However, it is not clear why a multinational enterprise should not be considered to have a PE or fixed base as a result of these kinds of activities by remote-working employees, and there was little support expressed at the 26th session of the Committee of Experts for such an additional exemption. It might be preferable for countries that wish to reduce the risk of an inadvertent PE or fixed base resulting from the activities of remote working employees to provide an advance ruling procedure or to change their domestic law so that multinationals can obtain the necessary certainty. However, PE determinations in these situations are highly dependent on the facts and may not be suitable for advance rulings. Moreover, it is unclear why countries should be expected to eliminate the risk that remote working employees might create a PE or fixed base where

multinationals have or should have control of their employees and should be able to minimize the risk themselves.

- 5.2.5 Another possibility for reducing the risk of an inadvertent PE created by remote working employees would be to clarify the UN Commentary on Article 5 (and also perhaps on Article 14) that remote working employees would not create a PE or fixed base for their employer except in clearly specified circumstances. Such additional guidance would be helpful for both employers and tax officials and does not present any obvious disadvantages.
- 5.2.6 Although the concept of a fixed base in Article 14 is similar in part to the concept of a PE in Article 5, the two concepts are apparently not exactly the same and there is uncertainty about how the two concepts differ. For example, there are no exceptions to the concept of a fixed base equivalent to the exceptions in Article 5(4) for preparatory or auxiliary activities. Consideration could be given to adding an exception for preparatory or auxiliary activities to the concept of a fixed base or, at least, clarifying whether or not equivalent exceptions can be incorporated into Article 14 through changes to the Commentary on Article 14. However, since the term “fixed base” is not defined in the United Nations Model Convention, such a change would probably require the addition of a complete definition of a fixed base and Commentary, which would be a formidable challenge.

Compliance Burden on Employers

- 5.2.7 Where an employer resident in one country has an employee working in another country, the employer may be subject to a legal obligation to withhold tax and other amounts from the employee’s remuneration under the domestic law of the country in which the employee works. There may also be withholding obligations with respect to social security payments. These withholding requirements are governed solely by a country’s domestic law and are not dealt with in tax treaties.
- 5.2.8 It may often be difficult for countries to enforce withholding at source with respect to employers that are neither resident in the country nor have a PE or fixed base there. Where an employee of a nonresident employer spends fewer than 183 days in another country, the employee will not be subject to tax in that country. The employer may nevertheless be

subject to withholding obligations. These compliance obligations may also apply where the remote worker is an independent contractor rather than an employee, although where an independent contractor is exempt from a country's tax as a result of a tax treaty, the country must either exempt the payer from any withholding obligations or refund any tax that is withheld improperly. As explained above, the characterization of the relationship between a remote worker and the payer as one of employment or independent contractor is difficult and uncertain, with some risk for employers.

Certainty

5.2.9 The third concern of multinational enterprises is a general concern about uncertainty with respect to the tax issues raised by remote working employees. As noted above in paragraph 5.2.5, one possible response to this concern is to review the Commentary with respect to the provisions of the United Nations Model Convention relevant to remote working employees that have implications for employers in order to determine whether those aspects of the Commentary can be clarified.

6. ISSUES WITH RESPECT TO DIGITAL NOMADS

6.1 The potential problems caused by digital nomads – remote workers who move periodically from country to country, as described in paragraph 2.5 – are related to double taxation and double non-taxation. Where such workers are resident in a country (perhaps the country in which they are domiciled or have a dwelling available for their use), they may remain subject to tax by that country. However, that country may have significant difficulties enforcing its tax where a worker has few, if any, assets in the country and chooses not to comply voluntarily. In addition, some countries may have territorial tax systems under which they do not impose tax on any, or only on certain foreign source income earned by their residents, while other countries may tax the foreign source income of their residents on a remittance basis (i.e., foreign source income is not taxable unless or until it is remitted to the residence country).

- 6.2 Thus, there are significant opportunities for digital nomads to avoid paying tax anywhere on the income from their work, or to pay less tax than they would pay if they were resident in and taxable on their total worldwide income in one country.
- 6.3 With respect to the taxation of digital nomads by the country or countries in which they work, under tax treaties based on the United Nations Model Convention, those countries will not be entitled to impose tax on the income earned in their countries unless a digital nomad spends more than 183 days furnishing services in the country under Article 5(3)(b) or stays for more than 183 days in a country under Article 14(1)(b), which seems unlikely. Even where a digital nomad spends more than 183 days working in a country, because of a lack of information, it may be very difficult for that country to enforce any tax liabilities (including any liabilities of the nonresident payer for which the digital nomad is working where the nonresident is deemed to have a PE in the country under Article 5(3)(b)). The tax authorities are unlikely to have any information that the digital nomad is working in the country; even where they do have such information and assess tax, the digital nomad may already have left the country, making any tax liability difficult to enforce.⁶ In all these situations, digital nomads may not be subject to tax in any country.
- 6.4 It is unlikely, but conceivable, that a digital nomad could be subject to double taxation. However, assuming that a digital nomad does not become resident in a country in which the nomad works, each country in which the nomad works is likely to impose tax only on the nomad's income earned in that country. Thus, double taxation of nomad workers is much less likely than the double non-taxation of such workers, and no action with respect to the provisions of the United Nations Model Convention is required to deal with the risk of double taxation.

Reform Options to Deal with Digital Nomads

- 6.5 Options for modifying the United Nations Model Convention or its Commentary to deal with digital nomads are limited. The first problem is insufficient information about the presence of digital nomads working in a country. Digital nomads are likely to spend time

⁶ Article 27 of the United Nations Model Convention provides for the contracting states to give assistance to one another in the collection of their taxes.

in countries on tourist visas; even if such visas prohibit the visa holder from working in the country such a prohibition is difficult to enforce, especially if the nomad is working for clients who are not resident in that country. Indeed, many countries may welcome extended stays in their countries by high-income service providers and may not wish to assert any taxing rights with respect to such persons working from their countries. It is difficult to see how the exchange-of-information provisions in tax treaties could be used to improve this situation because no country would have the necessary information about a digital nomad to share with other countries. Second, even if a country identifies the presence of a digital nomad, it will encounter serious problems imposing tax on the income earned by the nomad. The nomad is unlikely to voluntarily comply with the country's tax laws, including a demand to file a tax return, and is likely to simply leave the country to find a more hospitable location. Moreover, the provisions in bilateral tax treaties requiring treaty partners to provide assistance in collection of tax would be of little assistance in this regard.

- 6.6 Because of the difficulties of taxing digital nomads effectively, even drastic options, such as allowing the country of which a digital nomad is a citizen or in which the nomad is domiciled to continue to tax the nomad as a resident after the nomad has ceased to be a resident of the country, seem unlikely to be successful.
- 6.7 It may be possible to explore the possibility of using withholding at source on amounts paid by residents of one state to digital nomads in other states. Such withholding taxes are consistent with other provisions of the United Nations Model Convention that allow one contracting state to impose withholding tax on certain payments to residents of the other state. However, digital nomads will rarely, if ever, be residents of the other state. The withholding obligation could be imposed only on payments for services to nonresidents who do not disclose their country of residence to the resident payer. The costs of compliance imposed on resident payers to determine detailed facts about the digital service provider must be balanced against the tax revenue likely to be raised from such withholding taxes on payments to digital nomads.
- 6.8 It seems premature to take any action at this time to impose tax on the income of digital nomads. However, the possibility of requiring residents to withhold tax from payments for

services provided by digital nomads deserves further study to determine whether it is a feasible option.

7. CONCLUSION: SUMMARY OF REFORM OPTIONS

7.1 The options for reform that are discussed in detail in this paper are listed in paragraph 7.2, along with the sections of the paper dealing with each option. Other reform options mentioned in the paper but not analyzed in detail are listed in paragraph 7.3.

7.2 The reform options discussed in this paper that could be given further consideration by the Subcommittee are:

- provide guidance in the Commentary on Article 15 of the United Nations Model Convention with respect to the treatment of employees who work remotely (paragraph 4.3.11);
- provide guidance in the Commentary on Article 5, or separately, with respect to the risk that remote working employees may create a PE or fixed base for their employers (section 5); and
- continue working on the development of practical solutions for the effective taxation of digital nomads (section 6).

7.3 Other reform options mentioned, but not discussed extensively in the paper, that might be considered by the Subcommittee are:

- reduce the time threshold of 183 days in Article 15(2)(a) to lesser number of days, say, 60 or 90 days;
- eliminate the exclusive taxing rights under Article 15 for countries in which employees are resident by allowing countries in which employees work to tax the income from such work without any minimum threshold; and
- add an alternative provision to the Commentary on Article 15 to make it easier for employees resident in one contracting state to work remotely in the other contracting state where the flows of cross-border employees between the two states are equal or almost equal.