Issues in International Taxation

Issues Related to Article 14 of the OECD Model Tax Convention

TAXATION



No. 7

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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FOREWORD

This publication, the seventh in the series “Issues in International Taxation”, includes the report entitled “Issues Related to Article 14 of the Model Tax Convention”, which the Committee on Fiscal Affairs adopted, and decided to make available to the public, on 27 January 2000.

Article 14 of the OECD Model Tax Convention deals with the taxation of professional services and other activities of an independent character. The report deals with a number of problems relating to the interpretation and application of Article 14. It recommends the elimination of that Article 14 from the Model Tax Convention and identifies a number of consequential changes to the Model. Those changes will be included in the next update to the Model.

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ISSUES RELATED TO ARTICLE 14 OF THE MODEL TAX CONVENTION

Introduction

1. In 1996, the Committee set up a working group to examine a number of problems of interpretation and application of Article 14 of the OECD Model Tax Convention. This publication contains the report of that working group, which was approved by the Committee on 27 January 2000.[1] The main recommendation of this report is that Article 14 be eliminated from the Model Tax Convention. Section I of this report presents the recommendation to eliminate Article 14. Sections II to V contain the analysis of the relationship between Articles 7 and 14 on which that recommendation is based. The Annex includes a description of the changes to the Model Tax Convention that will result from the elimination of Article 14.

I. The elimination of Article 14

2. Having examined the various problems of application and interpretation raised by Article 14, the Committee found that all these issues raised the more fundamental question of whether it was appropriate to maintain that article in the Model Tax Convention.

3. In order to reach a conclusion on that question, the Committee examined the relationship between Articles 7 and 14. The following questions, which are discussed in sections II to IV below, were found to be especially relevant:

- Which activities fall within Article 14 as opposed to Article 7? Is the distinction between these activities satisfactory and easy to apply?
- Which entities fall within Article 14 as opposed to Article 7?

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1 . At the time of adopting the report, Italy and Portugal indicated that they reserved the right to continue to include Article 14 concerning the taxation of independent personal services in their conventions.

- What are the practical differences concerning taxation under Article 7 and 14? In particular, are there differences between the concepts of permanent establishment and fixed base?
- If Article 14 were eliminated, would there need to be changes to Article 7?

4. As the paragraphs below will indicate, the Committee concluded that, with respect to these various aspects of Articles 7 and 14, there was either no practical difference between the two Articles or, where such differences existed, there did not appear to be any valid policy justification for them. Having concluded that any practical differences between Articles 7 and 14 did not appear to be justified, the Committee considered two approaches: trying to eliminate these differences by making Article 14 a mirror image of Article 7 or merely deleting Article 14. The Committee concluded that the elimination of Article 14 from the Model Tax Convention would be the more logical approach.

5. Deleting Article 14 from the Model requires a number of changes to the provisions of the Model and to the Commentary thereon, as would have required any attempt to solve the issues whilst retaining Article 14 in the Model Tax Convention. These changes are presented in the Annex.

II. Which activities fall within Article 14?

6. If there are no differences in result whether Article 7 or 14 applies, there is no need to distinguish the activities that fall within the first Article from those that fall within the second. Where, however, there are such differences (e.g. if the rule of paragraph 3 of Article 5 could apply or if, as a result of bilateral negotiations, a 183 day rule were included in Article 14 but not in Article 7), such a need arises.

7. It is, however, far from clear which activities fall within Article 14. To a large extent, the uncertainty results from the fact that, whilst the 1963 Draft Double Taxation Convention referred to “professional services or other independent activities of a similar character”, the current Model refers to “professional services or other activities of an independent character”, a broader formulation.

8. For instance, it has been suggested that the activities of subcontractors in the construction industry, which would otherwise come under Article 7, may be caught by this broader formulation. That has led to a suggestion that the new formulation should be replaced by “other similar activities” or “similar services” to avoid that result, therefore partly reversing the change made in the 1977 Model.

9. A number of Member countries indicated that, in practice, they only applied Article 14 to professional services, thereby ignoring *de facto* the reference to "other activities of an independent character". The Committee could not readily define that phrase, noting that, if read literally, it could potentially apply to any activity falling under Article 7. Whilst paragraph 1 of the Commentary on Article 14 states that the Article excludes "industrial and commercial activities", it has been suggested that the strict wording of the paragraph and the priority given to Article 14 over Article 7 by paragraph 7 of the latter Article support a different conclusion. It was also noted that the reference to "services or other activities" in paragraph 1 suggests that there is also a discrepancy between the text of the Article, which covers services and other activities, and its title, which only refers to personal services.

10. The Committee considered whether the wording of paragraph 1 of the Article should be amended so as to read as it did in the 1963 Draft Double Taxation Convention. This, however, would have required the clarification of what activities are of a "similar character" to professional services. Whilst the Committee felt that it would be difficult to determine what are activities of a "similar character", it expressed the view that these would not include the activities of building subcontractors.

11. The fact that the 1977 change does not appear to have led to practical difficulties in determining which activities fall under Article 14 must be attributed to the fact that the rules of Articles 7 and 14 are similar and that Article 14 has generally been considered to be applicable only to individuals, so as to minimise the importance of the distinction between activities that fall within Article 7 and those that fall under Article 14. It must be recognised, however, that the 1977 change could eventually create practical difficulties, especially in cases where the provisions of paragraphs 3 to 6 of Article 5 would be relevant. Also, as stated below, it is questionable whether it is appropriate to restrict the application of Article 14 to individuals. All these difficulties justify the decision to eliminate Article 14.

12. The Committee also examined the relationship between Articles 14 and 15. On the basis of the second sentence of paragraph 1 of the Commentary on Article 14 and of the title of Article 14, which refers to "independent" services as opposed to the phrase "dependent services" found in the title of Article 15, it is clear that the activities covered by Article 14 exclude those carried on in an employment relationship. It is, however, sometimes difficult to distinguish between particular activities carried out in an employment relationship and those carried out in an independent capacity (e.g. university professors and teachers being asked to perform research or give a few lectures in another country). The elimination of Article 14 will not solve that issue as the distinction is also relevant for the purposes of Articles 7 and 15. Whilst paragraph 2 of Article 3 would require that such cases be solved on the basis of the domestic law of the state that applies the Convention, it is recognised that this could result in conflicts of qualification, which

would then need to be resolved using, where appropriate, the mutual agreement procedure (see also section III of the report on the Application of the Model Tax Convention to Partnerships).

III. Which entities fall within Article 14?

13. The personal scope of application of Article 14 is also unclear. The main issue is whether the Article applies to individuals only or whether it is also applicable to legal persons. Another issue is to what extent it applies to partnerships.

14. It has sometimes been argued that the use of the pronoun "his", in paragraph 1 of Article 14, indicates that the Article was intended to apply to individuals only. The Committee, however, found the argument to be far from convincing as paragraph 1 of Article 4, which clearly applies to both individuals and legal persons, also uses the pronoun "his" when referring to the various criteria for full liability to tax.

15. Whilst the Commentary on Article 14 does not directly deal with this issue, the Commentary on the United Nations Model notes that the Experts Group generally agreed that a payment for services made to an individual would fall under Article 14 whilst "payments made to an enterprise in respect of the furnishing by that enterprise of the activities of employees or other personnel are subject to Article 5" [i.e. would fall under Article 7 because of the definition of permanent establishment under Article 5]. That statement, however, can be explained by the fact that the United Nations Model includes a 183 day rule applicable to services in both Articles but that only the provision in Article 5 is drafted in a way that makes it readily applicable to a legal person. Also, the Commentary of the United Nations Model expressly allows parties that believe that the relationship between Articles 5 and 14 needs to be clarified to do so in the course of negotiations, thereby recognising the potential uncertainty.

16. In an observation included in the Commentary on Article 14 (cf. paragraph 4.1 of that Commentary), Mexico has officially stated its position that Article 14 also applies to legal persons. This view is shared by other countries, such as Turkey, which have interpreted Article 14 as applying to legal persons.

17. The Committee noted that it was now more frequent for professionals to incorporate than it was when Article 14 was drafted. Since it could not see any justification for imposing different rules to services depending on whether they were

provided by an individual (Article 14) or a legal person (Article 7),[2] or to have different Articles if the rules were the same, it considered this as another reason to eliminate Article 14.

18. The application of Article 14 to partnerships presents other problems. Countries that treat partnerships as fiscally transparent would generally recognise that Article 14 applies to the individuals who are partners in that partnership.[3] This, however, raises the question as to whether the partners must then personally perform services in the source country to be taxable therein on their share of the partnership's income attributable to a fixed base of the partnership located in that country. This issue is discussed below.

19. In the case of countries that treat partnerships as non-fiscally transparent, the result would likely be different since, in that case, the problem of the application of Article 14 to legal persons, which is discussed above, would arise.

20. Mixed partnerships, where some partners are individuals and others are legal persons, would create a particular problem if Article 14 were found to apply only to individuals. In that case, either the partners who are legal persons would be covered by Article 7 whilst the partners who are individuals would be covered by Article 14 or, alternatively, Article 14 would not apply to any partner of a partnership where at least one partner were a legal person. Neither approach would be satisfactory.

IV. What are the practical differences concerning taxation under Articles 7 and 14?

21. At the outset, the Committee agreed that if there were significant practical differences between the rules of Article 7 and Article 14, there would not appear to be a valid justification for the resulting different treatment of large professional partnerships and incorporated professionals. Such a different treatment would not appear to be

2. One example of a possible exploitation of the perceived differences between Articles 7 and 14 would be that of an individual who is in business on his own account as an architect or surveyor and who decides to undertake a contract in another country through a one-man company in order to fall under Article 7 and take advantage of the exclusion provided for under paragraph 3 of Article 5 (see paragraphs 31 to 33).

3. Sweden, however, adopts a different approach since it treats most foreign partnerships as legal persons for Swedish tax purposes, with the result that fiscally transparent foreign partnerships and their partners are not entitled to the benefits of tax treaties with respect to the partnership's income.

adapted to modern ways of providing cross-border professional services, where a number of professionals, in particular engineers, provide their services through companies.

22. For the purpose of determining whether there were significant practical differences between the rules of Articles 7 and 14, the Committee analysed the following various questions:

- Are there differences between the concepts of "permanent establishment" and "fixed base"?
- Does Article 14 restrict source taxation to income from services performed personally by the taxpayer?
- Are the specific rules of paragraphs 2-7 of Article 7 applicable to Article 14?
- Are there differences in the source taxation rights granted under Articles 7 and 14?
- Does the distinction between Articles 7 and 14 have any impact on domestic law distinctions?

a) Are there differences between the concepts of "permanent establishment" and "fixed base"?

23. Whilst Article 7 refers to the concept of "permanent establishment", which is defined in Article 5, Article 14 refers to the undefined concept of "fixed base". The Committee examined whether there were any practical differences between the two concepts and, if yes, whether this was intended. It concluded that, except where the provisions of paragraphs 3 to 6 of Article 5 applied, there were no practical differences between the two concepts.

24. The Committee noted that it had sometimes been suggested in the literature that a permanent establishment might require a greater degree of permanence than a fixed base. Also, it noted that the definition of "permanent establishment" requires that a business be actually carried on in a fixed place of business whilst there is no such requirement with respect to a fixed base, which needs only be regularly available.

25. To the extent that the concept of permanent establishment is narrower than that of fixed base, it might be argued that eliminating Article 14 would increase the threshold for taxation, which could in turn raise concerns, for instance, with respect to Articles 10, 11 and 12. One example that was discussed in that respect is that of an office opened to provide services, but which, because of subsequent events, is never used for

that purpose. Whilst the office would not fall within the definition of permanent establishment as long as no business was carried on therein, it could arguably constitute a fixed base.

26. The Committee, however, felt that such lower threshold, assuming that it existed, would not be a significant practical issue. In the above example, there would be no income from services to tax and the provisions of paragraphs 4 of Article 10 and 11 and paragraph 3 of Article 12 would not be applicable as these paragraphs require that independent personal services be performed from the fixed base.

27. The Committee also noted that it would be difficult to see any difference between the phrases "fixed place of business" and "fixed base". As a matter of fact, it could be argued that a "base" from which activities are performed is somewhat narrower than a "place of business" and that the "regularly available" requirement found in Article 14 but not in Article 7 might in fact restrict the scope of Article 14 so as to impose, in some cases, a higher taxation threshold than in Article 7. For instance, one could argue that there are cases where income is attributable to a fixed place that is sometimes, but not regularly, available for performing the services and that this income therefore escapes source taxation under Article 14.

28. Notwithstanding any such theoretical differences, the Committee could not, in practice, find examples of fixed bases that would not be permanent establishments or vice-versa. The examples of "fixed bases" found in paragraph 4 of the Commentary on Article 14, i.e. a physician's consulting room or the office of a lawyer or architect, would, for instance, equally constitute permanent establishments.

29. In reaching that conclusion, however, the Committee distinguished the case of the rules of paragraphs 3 to 6 of Article 5. Whilst the Commentary on Article 14 "imports" the principles of Article 7, it does not refer at all to Article 5. This would support the conclusion, based on a strict reading of Articles 5 and 14, that the rules of these paragraphs have no application to fixed bases. Whilst it could be argued that the reference, in the Commentary on Article 14, to the rules of Article 7 concerning "allocation of profits between head office and permanent establishment" might constitute an indirect reference to Article 5, this would seem to be a tenuous link.

30. In trying to decide whether the principles of Article 5 should apply to fixed bases, the most relevant rules to examine are those of paragraphs 3, 5 and 6 of that Article.

1) Paragraph 3: construction site

31. The question of whether the rule of paragraph 3 of Article 5, which provides that a construction site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months, should apply to a fixed base, has practical significance especially with respect to services rendered by engineers and architects.

32. On the one hand, most Member countries indicated that, in practice, they would consider that engineers or architects who maintain an office on a particular construction site that lasts more than twelve months would be considered to have a fixed base. On the other hand, they did not rule out that a fixed base could exist even if the construction site lasted for a shorter period.

33. This approach appears consistent with the conclusion that the construction site rule of paragraph 3 of Article 5 is not applicable to fixed bases since that rule is drafted as an exclusion from the permanent establishment concept rather than as a rule that creates a deemed permanent establishment. It raises, however, the issue of whether it is appropriate to have different treatment of various activities conducted on the same construction site. Eliminating Article 14 will mean that activities of supervising engineers on a construction site will become subject to the general taxation threshold applicable to other non-residents performing activities on a construction site, a result that the Committee considers appropriate.

2) Paragraphs 5 and 6: dependent and independent agent rules

34. A similar issue is whether the so-called dependent and independent agents rules of paragraphs 5 and 6 of Article 5 should be applicable to fixed bases.

35. In some cases, the independent agent rule of paragraph 6 has been applied to determine that a fixed base did not exist. U.S. Revenue ruling 75-131, which has been followed by a number of similar rulings,[4] referred to the pre-1977 Commentary on Article 14, which stated that Article 14 was based on the same principles of Article 7, to conclude that the "independent agent" rule of Article 5 applied so that a U.S. corporation that acted as an agent for a French concert player did not constitute a fixed base of the artiste. Also, in a 1992 decision, the Dutch Hoge Raad held that a photo model resident in the Netherlands did not have a fixed base through her commission agent in France and in Germany.

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4. See for instance Revenue rulings 78-12-038, 78-12-045, 78-38-063 and-82-49-047.

36. There does not appear to have been cases, however, where paragraph 5 would have been applied to deem a fixed base to exist. Because the application of paragraph 5, unlike that of paragraph 6, would result in additional source taxation, it would be a more serious test.

37. Again, the Committee found no justification for not applying the rules of paragraphs 5 and 6 to the activities covered by Article 14, and therefore finds it appropriate to make these rules applicable to such income through the elimination of Article 14.

b) Does Article 14 restrict source taxation to income from services performed personally by the taxpayer?

38. An issue that has attracted some attention is whether the application of source taxation under Article 14 is restricted to the person who provides the services or whether it applies also to anyone who derives income from these services. The following example illustrates the problem. A, B and C, three lawyers who are residents of State A, form a partnership. The partnership opens an office in State B, where only D, a new partner resident of State B, will provide services. It is agreed that the partnership's income will be divided equally among the four partners so that each partner will derive a share of the income from services rendered in State A as well as in State B. The issue, in that case, is whether Article 14 allows State B to tax that part of the income related to the services rendered therein that accrues to the partners resident in State A, even though these partners have not, themselves, rendered any services in State B.

39. The first approach is to consider that Article 14, like Article 7, applies to any person who derives income from the services performed through a fixed base so that partners A, B and C are taxable in State B. Under that approach, it is argued that since paragraph 1 of Article 14 refers to "income derived by a resident ... in respect of ... services" rather than to "income derived by a resident... in respect of... his services", the paragraph may be applied to someone who is not performing the services referred to in the paragraph but who derives income from these services. That approach reduces the differences between Article 14 and Article 7 but would indirectly seem to support the view that Article 14 also applies to companies.

40. The second approach is to consider that Article 14 only allows State B to tax income attributable to a fixed base that is used by a non-resident to provide his personal services so that A, B and C are not taxable in State B as long as they do not personally provide any services therein. Under that approach, the words "for the purpose of performing his activities" are interpreted so that the office in State B is not considered to

be a fixed base regularly available to A, B, C for the purposes of performing their activities, since they do not perform any activities in that office.

41. The second approach narrows considerably the scope of source taxation under Article 14. It would seem to create tax avoidance opportunities since it would allow all the profits related to professional services rendered through a fixed base, as long as they are allocated to non-resident partners, to escape source taxation. Similarly, that approach would prevent the State where the fixed base is located from taxing any of the partnership's profits attributable to that fixed base if the partnership's activities in that State were exclusively carried out by employees.

42. The second approach, clearly, would produce a result that would be at odds with that under Article 7, particularly when taking into account the implications of paragraph 5 of Article 5 (the "agency permanent establishment" rule) in the legal context of a partnership.

43. It has been argued, however, that the second approach solves the important administrative difficulties that would result from the first approach, which would require each of the partners of a partnership that has offices in many countries to comply with the tax requirements of all these countries (e.g. possibly having to file a great number of tax returns). This might explain why that approach has sometimes been applied.[5] For example, in a 1993 Revenue ruling, the Internal Revenue Service of the U.S. adopted the second approach and decided that the German resident partners in a German partnership that had an office in the U.S. would not be liable to U.S. tax on their distributive share attributable to the U.S. office as they did not perform any services in the United States. That approach, however, has now been expressly rejected by the United States in its most recent tax treaties. It should also be noted that specific legislation has been adopted in the United States to provide for regulations that would alleviate some of the administrative difficulties described above.[6]

44. The Committee concluded that the first approach was the correct one. It considered that the second approach, apart from producing an inappropriate result, was

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5. It has also been suggested that the second approach provides a better result with respect to the application of personal allowances and progressive rates. This, however, is a consideration that generally supports residence as opposed to source taxation. It should also be noted that, as regards taxation by the country of residence of the partner, a system of foreign tax credit or exemption with progression will reduce the difficulties that the first approach may create in that respect.

6. See section 1141(a) of the United States Taxpayer Relief Act of 1997.

based on a deficient interpretation of Article 14. According to the Committee, when applying Article 14 to the income allocated to each partner, the activities of the partnership must be attributed to the partners to the same extent as is the fixed base of the partnership, so that it may be said that each partner "has a fixed base ... for the purpose of performing his activities". This is consistent with the views expressed in the report on the Application of the Model Tax Convention to Partnerships. Clearly, eliminating Article 14 will make sure that the second approach is no longer argued.

45. The Committee noted, however, that the administrative difficulties described in paragraph 43 above in relation to Article 14 would also exist under Article 7. For that reason, the Committee favours a more general solution to these difficulties.[7] It considers, for instance, that the legislative approach adopted in the United States is a useful way of addressing this issue. The Committee also discussed to what extent these administrative difficulties constitute a practical, as opposed to a theoretical, problem.

46. It was suggested in that respect that taxpayers can avoid the administrative difficulties noted above by providing in their partnership agreement that the income arising in a particular country will only, or primarily, be allocated to the partners who are residents in that country ("special allocation" rules).

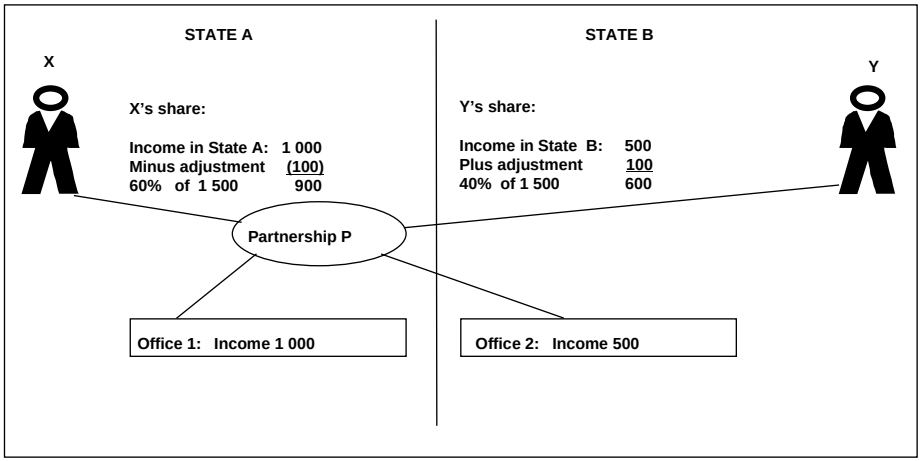
47. It seems, however, that countries adopt different positions as regards the extent to which such special allocation rules can be recognised for tax purposes. Some countries feel bound to follow the provisions of the partnership agreement as regards both the amount and the nature or source of the part of the partnership's income that is allocated to a partner. Other countries consider that a partner's share of the partnership's income includes the same pro rata share of all items of income earned by the partnership regardless of any contractual arrangement purporting to allocate these items of income on the basis of their nature or source. There are also intermediary positions as some countries may agree to recognise such special allocation rules for tax purposes as long as they have economic substance or subject to general or specific anti-avoidance rules allowing them to disregard any income allocation that is primarily tax-motivated. A country may also condition its acceptance of special allocation rules to a requirement that these rules not allow for top-up payments to a partner in the event that the type or source of income allocated to him produces a lower share of income.

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7. As noted above (see note 3), Sweden treats most foreign partnerships as taxpayers for Swedish tax purposes, thereby avoiding these administrative difficulties in the case of foreign partnerships. The Committee, however, concluded that the general adoption of that approach would create more difficulties than it would solve with respect to the application of tax conventions to partnerships' income.

48. This is another example of the many differences that exist in the tax treatment of partnerships under the domestic laws of Member countries. As the provisions of the Model Tax Convention do not restrict the application of domestic law with respect to this particular issue, it is recognised that conflicts may arise in that respect. The following example illustrates such a conflict.

Example: *Partnership P has been established in State A. Partner X is a resident of State A, a credit country that recognises special allocations for tax purposes. Partner Y is a resident of State B, an exemption country that does not recognise special allocations. Partnership P maintains office 1 in State A which generates income of 1 000 in year 01; it also maintains office 2 in state B which generates income of 500 in the same year. The partnership's agreement provides that, subject to an "equalisation" adjustment, partner X is entitled to the income realised by the partnership in State A and partner Y to the income realised in State B. The "equalisation" adjustment is the amount required to be added or subtracted to such income in order to ensure that X and Y's shares of the overall profit of the partnership equal 60% and 40% respectively.*



49. In that example, State B will consider, on the basis of its domestic law, that Partner X derives 300 (60% of 500) from a fixed base situated on its territory and that Partner Y, who is taxed as a resident, derives 200 (40% of 500) from its territory and is entitled to an exemption for the 400 (40% of 1 000) that he derives from State A.

50. State A, which recognises special allocations, will consider that Partner X derives all of his income (900) from State A. It will also consider that only the adjustment amount (i.e. 100) constitutes income of Partner Y derived from a fixed base situated on its territory.

51. As a result, Partner X will be taxed on 900 in State A and State A will consider that that income arises from its territory. He will also be taxed on 300 in State B, which that country will consider as arising on its territory. The result will be double taxation on 300 of income because of the different allocation rules and the resulting conflict concerning the source of the income of Partner X. By contrast, Partner Y will only be taxed on 200 in State B and 100 in State A, the amount that State A considers as attributable to a fixed base located on its territory; there will therefore be double non taxation of 300 in his case.

52. The Committee concluded that this is an example of a conflict of source. It noted that some conventions solve this type of conflict by providing that income which may be taxed in a State in accordance with the Convention shall be deemed to arise from sources situated in that State for purposes of the application of the provisions of the Convention dealing with the elimination of double taxation. It also noted that the conclusions put forward in Part III of the report on the Application of the Model Tax Convention to Partnerships may also be relevant to the extent that a conflict of source could also constitute a conflict of qualification.

53. The Committee also discussed the treatment of "salary" or similar payments which may be paid to a partner to supplement income attributed to him under special allocation rules (e.g. in the case of a partner who is asked to work in a new office established in an emerging market economy). Under the domestic law of some countries, such payments would be considered as employment income of the partner rather than as a share of the partnership income, thereby reducing the amount of income attributable to non-resident partners. The fact that other countries would take the opposite view could result in conflicts of qualification. Again, the principles put forward in Part III of the report on the Application of the Model Tax Convention to Partnerships would help avoiding situations where such conflicts would result in double taxation or double non-taxation.

54. Another possibility is that of an office of a partnership located in a particular country which would be offered "guaranteed" fees by other offices of the same partnership in order to artificially increase the income attributable to that office for purposes of the application of special allocation rules. The Committee concluded that such arrangements might be problematic in light of paragraph 2 of Article 7, which, under the Commentary thereon, is implicitly applicable in determining the income attributable to a fixed base.

c) Are the specific rules of paragraphs 2-7 of Article 7 rules applicable to Article 14?

55. Whilst paragraph 3 of the Commentary on Article 14 indicates that the provisions of Article 7 and the Commentary thereon could be used as guidance for interpreting and applying Article 14, it has been suggested that there is no clear authority in the text of Article 14 for such conclusion. Also, whilst the Commentary on Article 14 expressly confirms the application to Article 14 of the provisions of paragraphs 2 and 3 of Article 7, it does not mention paragraphs 4 to 7 of that Article.

56. The Committee found that Member countries have generally considered that paragraphs 2-6 of Article 7 are applicable, so far as they may be relevant in a particular case, to the income currently treated under Article 14. It concluded that the elimination of Article 14 made it unnecessary to clarify that position. It was unclear, however, to what extent the priority rule of paragraph 7 of Article 7 can apply to Article 14**.**

d) Are there differences in the source taxation rights granted under Articles 7 and 14?

57. Whilst Article 7 provides for the source taxation of "profits" attributable to a permanent establishment, Article 14 allows the source State to tax the "income" attributable to a fixed base.

58. On the one hand, it is clear that the concept of profits corresponds to the "net" income, i.e. after the deduction of relevant expenses, a result that is confirmed by paragraph 3 of Article 7. On the other hand, the concept of income, which is used in Article 14, can be interpreted more broadly so as to allow taxation on either a gross or net basis. This interpretation is confirmed by the fact that the phrase "income derived", which is found in Article 14, is also found in other Articles, such as Articles 6 (Income from Immovable Property) and 17 (Artistes and Sportsmen), where it has been interpreted to allow taxation of gross payments.[8] Arguably, a further confirmation of that interpretation is the fact that paragraph 3 of Article 24 (Non-discrimination), which has a direct effect on the deduction of expenses related to a permanent establishment, is not applicable to fixed bases.

59. Paragraph 3 of the Commentary on Article 14, however, clearly states that the expenses incurred for the purposes of a fixed base should be allowed as a deduction in

8. See, for instance, the last sentence of paragraph 4 of the Commentary on Article 6 as well as paragraph 10 of the Commentary on Article 17.

determining the income attributable to a fixed base in the same way as is provided by paragraph 3 of Article 7. Most Member countries confirmed that, in practice, their country would allow the deduction of expenses in taxing the income attributable to a fixed base and agreed that there would be no policy justification for allowing tax to be levied differently under Articles 7 and 14. They did, however, recognise the difficulty created by the use, in Article 14, of the phrase "income derived". Again, any uncertainty in that respect will be removed through the elimination of Article 14.

e) Does the distinction between Articles 7 and 14 have any impact on domestic law distinctions?

60. The Committee discussed the extent to which any differences between Articles 7 and 14 might have an impact where, under domestic laws, there exist separate rules for the taxation of professional services and other business profits (e.g. where cash accounting applies to professional services but not to other activities).

61. It was noted that whilst Member countries may have such separate rules in their domestic laws, the application of these rules would not be influenced by the distinction between Article 7 and 14 as the distinctions made by tax treaties would generally not matter for the application of distinctions made under domestic laws, except maybe for the application of foreign tax credit provisions.

62. On that basis, the Committee concluded that the elimination of Article 14 will not prevent countries from continuing to apply any distinction between professional services and other business profits that might exist under their domestic tax laws.

V. Does the elimination of Article 14 require changes to Article 7?

63. By eliminating Article 14, the income previously covered by that Article will fall under Article 7. The Committee found it important to confirm that result to prevent arguments that either Article 21 or Article 15, for example, could apply to that income. The Committee agreed that, apart from changes resulting directly from the elimination of the Article, changes to the Commentary on Articles 5 and 7 and to some of the Articles in the Model themselves would be useful, in particular to make sure that the concept of enterprise applied to the provision of professional services.

ANNEX

CHANGES TO THE MODEL TAX CONVENTION RESULTING FROM THE DECISION TO ELIMINATE ARTICLE 14

The following are the changes to the Model Tax Convention resulting from the decision to eliminate Article 14. Changes to the existing text of the Model Tax Convention and the Commentary are indicated by ~~strikethrough~~ for deletions and ***bold italics*** for additions.

Changes to the Articles

Article 3

1. In paragraph 1 of Article 3, renumber existing subparagraphs c) to f) as subparagraphs d) to g) and add the following new subparagraphs c) and h):

> ***c) the term "enterprise" applies to the carrying on of any business;***
>
> ***h) the term "business" includes the performance of professional services and of other activities of an independent character."***

Article 6

2. Replace paragraph 4 of Article 6 by the following:

> "4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise ~~and to income from immovable property used for the performance of independent personal services~~."

Article 10

3. Replace paragraph 4 of Article 10 by the following:

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

4. Replace paragraph 5 of Article 10 by the following:

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

Article 11

5. Replace paragraph 4 of Article 11 by the following:

"4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein~~, or performs in that other State independent personal services from a fixed base situated therein,~~ and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment ~~or fixed base~~. In such case the provisions of Article 7 ~~or Article 14 , as the case may be,~~ shall apply."

6. Replace paragraph 5 of Article 11 by the following:

"5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is

a resident of a Contracting State or not, has in a Contracting State a permanent establishment ~~or a fixed base~~ in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment ~~or fixed base~~, then such interest shall be deemed to arise in the State in which the permanent establishment ~~or fixed base~~ is situated."

Article 12

7. Replace paragraph 3 of Article 12 by the following:

"3. The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein~~, or performs in that other State independent personal services from a fixed base situated therein~~, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment ~~or fixed base~~. In such case the provisions of Article 7 ~~or Article 14, as the case may be,~~ shall apply."

Article 13

8. Replace paragraph 2 of Article 13 by the following:

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

Article 14

9. Delete Article 14. The remaining Articles of the Model will not be renumbered. Article 14 and its title will therefore be shown in brackets with the word "Deleted".

Article 15

10. Replace the title of Article 15 by the following:

"***INCOME FROM EMPLOYMENT*** ~~DEPENDENT PERSONAL SERVICES~~"

11. Replace subparagraph 2(c) of Article 15 by the following:

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

Article 17

12. Replace paragraph 1 of Article 17 by the following:

"1. Notwithstanding the provisions of Articles ~~14~~ ***7*** and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State."

13. Replace paragraph 2 of Article 17 by the following:

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

Article 21

14. Replace paragraph 2 of Article 21 by the following:

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

Article 22

15. Replace paragraph 2 of Article 22 by the following:

> "2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State ~~or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services~~, may be taxed in that other State."

Changes to the Commentary

Commentary on Article 1

16. Replace paragraph 4 of the Commentary on Article 1 by the following:

> "4. Moreover, different rules of the Convention may be applied in the Contracting States to income derived by a partner from the partnership, depending on the approach of such States. In States where partnerships are treated as companies, distributions of profits to the partners may be considered to be dividends (paragraph 3 of Article 10), whilst for other States all profits of a partnership, whether distributed or not, are considered as business profits of the partners (Article 7). In many States, business profits of partnerships include, for tax purposes, all or some special remuneration paid by a partnership to its partners (such as rents, interest, royalties, remuneration for services), whilst in other States such payments are not dealt with as business profits (Article 7) but under other headings (in the above-mentioned examples: Articles 6, 11, 12~~, 14~~ and 15, respectively).

Commentary on Article 3

17. Replace paragraph 4 of the Commentary on Article 3 by the following:

> "4. The question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No ***exhaustive*** definition of the term "enterprise" has therefore been attempted in this Article. ***However, it is provided that the term "enterprise" applies to the carrying on of any business. Since the term "business" is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional services or other***

activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term "enterprise" from their bilateral conventions."

18. Add the following heading and paragraph 10.1 to the Commentary on Article 3:

"***THE TERM "BUSINESS"***

10.1 The Convention does not contain an exhaustive definition of the term "business", which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Sub-paragraph h), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in 2000 at the same time as Article 14, which dealt with Independent Personal Services, was deleted from the Convention. This addition, which ensures that the term "business" includes the performance of the activities which were previously covered by Article 14, was intended to prevent that the term "business" be interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition."

Commentary on Article 5

19. Add the following paragraph 1.1 to the Commentary on Article 5:

"***1.1 Before 2000, income from professional services and other activities of an independent character was dealt under a separate Article, i.e. Article 14. The provisions of that Article were similar to those applicable to business profits but it used the concept of fixed base rather than that of permanent establishment since it had originally been thought that the latter concept should be reserved to commercial and industrial activities. The elimination of Article 14 in 2000 reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. The elimination of Article 14 therefore meant that the definition of permanent establishment became applicable to what previously constituted a fixed base.***"

Commentary on Article 6

20. Replace paragraphs 3 and 4 of the Commentary on Article 6 by the following:

"3. Paragraph 3 indicates that the general rule applies irrespective of the form of exploitation of the immovable property. Paragraph 4 makes it clear that the provisions of paragraphs 1 and 3 apply also to income from immovable property of industrial, commercial and other enterprises ~~and to income from immovable property used for the performance of independent personal services~~.

4. It should be noted in this connection that the right to tax of the State of source has priority over the right to tax of the other State and applies also where, in the case of an enterprise ~~or of non-industrial and non-commercial activities,~~ income is only indirectly derived from immovable property. This does not prevent income from immovable property, when derived through a permanent establishment, from being treated as income of an enterprise, but secures that income from immovable property will be taxed in the State in which the property is situated also in the case where such property is not part of a permanent establishment situated in that State. It should further be noted that the provisions of the Article do not prejudge the application of domestic law as regards the manner."

Commentary on Article 7

21. Add the following new paragraph 2.1 to the Commentary on Article 7:

"***2.1 Before 2000, income from professional services and other activities of an independent character was dealt under a separate Article, i.e. Article 14. The provisions of that Article were similar to those applicable to business profits but it used the concept of fixed base rather than that of permanent establishment since it had originally been thought that the latter concept should be reserved to commercial and industrial activities. However, it was not always clear which activities fell within Article 14 as opposed to Article 7. The elimination of Article 14 in 2000 reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. The effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits. This was confirmed by the addition of a definition of the term "business" which expressly provides that this term includes professional services or other activities of an independent character.***"

22. Replace paragraph 35 of the Commentary on Article 7 by the following:

"35. It has seemed desirable, however, to lay down a rule of interpretation in order to clarify the field of application of this Article in relation to the other Articles dealing with a specific category of income. In conformity with the practice generally adhered to in existing bilateral conventions, paragraph 7 gives first preference to the special Articles on dividends, interest etc. It follows from the rule that this Article will be applicable to ~~industrial and commercial~~ ***business*** income which does not belong to categories of income covered by the special Articles, and, in addition, to dividends, interest etc. which under paragraph 4 of Articles 10 and 11, paragraph 3 of Article 12 and paragraph 2 of Article 21, fall within this Article (cf. paragraphs 12 to 18 of the Commentary on Article 12 which discusses the principles governing whether, in the particular case of computer software, payments should be classified as ~~commercial~~ income within Articles 7 ~~or 14~~ or as a capital gains matter within Article 13 on the one hand or as royalties within Article 12 on the other). It is understood that the items of income covered by the special Articles may, subject to the provisions of the Convention, be taxed either separately, or as ~~industrial and commercial~~ ***business*** profits, in conformity with the tax laws of the Contracting States."

Commentary on Article 10

23. Delete paragraph 32 and replace paragraphs 2 and 34 of the Commentary on Article 10 by the following:

"2. The profits of a business carried on by a partnership are the partners' profits derived from their own exertions; for them they are ~~industrial or commercial~~ ***business*** profits. So the partner is ordinarily taxed personally on his share of the partnership capital and partnership profits.

32. ~~The rules set out above also apply where the beneficiary of the dividends has in the other Contracting State, for the purpose of performing any of the kinds of independent personal services mentioned in Article 14, a fixed base with which the holding in respect of which the dividends are paid is effectively connected.~~

34. Paragraph 5 rules out the extra-territorial taxation of dividends, i.e. the practice by which States tax dividends distributed by a non-resident company solely because the corporate profits from which the distributions are made originated in their territory (for example, realised through a permanent establishment situated therein). There is, of course, no question of extra-territorial taxation when the country of source of the corporate profits taxes the dividends because they are paid to a shareholder who is a resident of that State or to a permanent establishment ~~or fixed base~~ situated in that State."

Commentary on Article 11

24. Delete paragraph 25 and replace paragraph 30 of the Commentary on Article 11 by the following:

"25. ~~The rules set out above also apply where the beneficiary of the interest has in the other Contracting State, for the purpose of performing any of the kinds of independent personal services mentioned in Article 14, a fixed base with which the debt-claim in respect of which the interest is paid is effectively connected.~~

30. Moreover, in the case—not settled in paragraph 5—where whichever of the two Contracting States is that of the payer's residence and the third State in which is situated the permanent establishment for the account of which the loan is effected and by which the interest is borne, together claim the right to tax the interest at the source, there would be nothing to prevent those two States together with, where appropriate, the State of the beneficiary's residence from concerting measures to avoid the double taxation that would result from such claims. The proper remedy, it must be said again, would be the establishment between these different States of bilateral conventions, or a multilateral convention, containing a provision similar to that in paragraph 5. Another solution would be for two Contracting States to word the second sentence of paragraph 5 in the following way:

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

C*ommentary on Article 12*

25. Delete paragraph 21 and replace paragraphs 10, 11, 14 and 16 of the Commentary on Article 12 by the following:

"1. In principle, royalties in respect of licences to use patents and similar property and similar payments are income to the recipient from a letting. The letting may be granted in connection with an ~~industrial or commercial~~ enterprise (e.g. the use of literary copyright granted by a publisher~~) or an independent profession (e.g.~~ ***or the*** use of a patent granted by the inventor) or quite independently of any activity of the grantor (e.g. ***the*** use of a patent granted by the inventor's heirs).

10. Rents in respect of cinematograph films are also treated as royalties, whether such films are exhibited in cinemas or on the television. It may, however, be agreed through bilateral negotiations that rents in respect of cinematograph films shall be treated as ~~industrial and commercial~~ ***business*** profits and, in consequence, subjected to the provisions of Articles 7 and 9.

11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 alludes to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how which do not differ intrinsically. One such definition, given by the "Association des Bureaux pour la Protection de la Propriété Industrielle" (ANBPPI), states that "know-how is all the undivulged technical information, whether capable of being patented or not, that is necessary for the industrial reproduction of a product or process, directly and under the same conditions; inasmuch as it is derived from experience, know-how represents what a manufacturer cannot know from mere examination of the product and mere knowledge of the progress of technique." In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof. This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party. Thus, payments obtained as consideration for after-sales service, for services rendered by a seller to the purchaser under a guarantee, for pure technical assistance, or for an opinion given by an engineer, an advocate or an accountant, do not constitute royalties within the meaning of paragraph 2. Such payments generally fall under Article 7 ~~or Article 14~~. In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then it seems

possible to apply to the whole amount of the consideration the treatment applicable to the principal part.

14. In other cases, the acquisition of the software will generally be for the personal or business use of the purchaser. The payment will then fall to be dealt with as ***business profits*** ~~commercial income~~ in accordance with Articles ~~7 or 14~~. It is of no relevance that the software is protected by copyright or that there may be restrictions on the use to which the purchaser can put it**.**.

16. Each case will depend on its particular facts but in general such payments are likely to be ***business profits*** ~~commercial income~~ within Article 7 ~~or 14~~ or a capital gains matter within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated in full or in part, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.

~~21. The rules set out above also apply where the beneficiary of the royalties has in the other Contracting State, for the purpose of performing any of the kinds of independent personal services mentioned in Article 14, a fixed base with which the right or property in respect of which the royalties are paid is effectively connected.~~"

Commentary on Article 13

26. Replace paragraphs 9, 22, 24, 25 and 27 of the Commentary on Article 13 by the following:

"9. Where capital appreciation and revaluation of business assets are taxed, the same principle should, as a rule, apply as in the case of the alienation of such assets. It has not been found necessary to mention such cases expressly in the Article or to lay down special rules. The provisions of the Article as well as those of Articles 6, 7 and 21, seem to be sufficient. As a rule, the right to tax is conferred by the above-mentioned provisions on the State of which the alienator is a resident, except that in the cases of immovable property or of movable property forming part of the business property of a permanent establishment ~~or pertaining to a fixed base~~, the prior right to tax belongs to the State where such property is situated. Special attention must be drawn, however, to the cases dealt with in paragraphs 13 to 17 below.

22. Paragraph 1 states that gains from the alienation of immovable property may be taxed in the State in which it is situated. This rule corresponds to the provisions of Article 6 and of paragraph 1 of Article 22. It applies also to immovable property forming part of the assets of an enterprise. ~~or used for performing independent personal services.~~ For the definition of immovable property paragraph 1 refers to Article 6. Paragraph 1 of Article 13 deals only with gains which a resident of a Contracting State derives from the alienation of immovable property situated in the other Contracting State. It does not, therefore, apply to gains derived from the alienation of immovable property situated in the Contracting State of which the alienator is a resident in the meaning of Article 4 or situated in a third State; the provisions of paragraph 1 of Article 21 shall apply to such gains.

24. Paragraph 2 deals with movable property forming part of the business property of a permanent establishment of an enterprise ~~or pertaining to a fixed base used for performing independent personal services~~. The term "movable property" means all property other than immovable property which is dealt with in paragraph 1. It includes also incorporeal property, such as goodwill, licences, etc. Gains from the alienation of such assets may be taxed in the State in which the permanent establishment ~~or fixed base~~ is situated, which corresponds to the rules for business profits ~~and for income from independent personal services~~ (Articles 7 ~~and 14~~).

25. The paragraph makes clear that its rules apply when movable property of a permanent establishment ~~or fixed base~~ is alienated as well as when the permanent establishment as such (alone or with the whole enterprise) ~~or the fixed base as such~~ is alienated. If the whole enterprise is alienated, then the rule applies to such gains which are deemed to result from the alienation of movable property forming part of the business property of the permanent establishment. The rules of Article 7 should then apply *mutatis mutandis* without express reference thereto. For the transfer of an asset from a permanent establishment in one State to a permanent establishment (or the head office) in another State, cf. paragraph 10 above.

27. Certain States consider that all capital gains arising from sources in their territory should be subject to their taxes according to their domestic laws, if the alienator has a permanent establishment within their territory. Paragraph 2 is not based on such a conception which is sometimes referred to as "the force of attraction of the permanent establishment". The paragraph merely provides that gains from the alienation of movable property forming part of the business property of a permanent establishment ~~or of movable property pertaining to a fixed base used for performing independent personal services~~ may be taxed in the State where the permanent establishment ~~or the fixed base~~ is situated. The gains from the alienation of all other movable property are taxable only in the State of residence of the alienator as provided in paragraph 4. The foregoing explanations accord with those in the Commentary on Article 7."

Commentary on Article 14

27. Replace the whole of the Commentary on Article 14 by the following:

"***[COMMENTARY ON ARTICLE 14***
CONCERNING THE TAXATION OF INDEPENDENT PERSONAL SERVICES]

[Article 14 was deleted from the Model Tax Convention on 27 January 2000. That decision reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. In addition, it was not always clear which activities fell within Article 14 as opposed to Article 7. The effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits.]"

~~1. The Article is concerned with what are commonly known as professional services and with other activities of an independent character. This excludes industrial and commercial activities and also professional services performed in employment, e.g. a physician serving as a medical officer in a factory. It should, however, be observed that the Article does not concern independent activities of artistes and sportsmen, these being covered by Article 17.~~

~~2. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. Difficulties of interpretation which might arise in special cases may be solved by mutual agreement between the competent authorities of the Contracting States concerned.~~

~~3. The provisions of the Article are similar to those for business profits and rest in fact on the same principles as those of Article 7. The provisions of Article 7 and the Commentary thereon could therefore be used as guidance for interpreting and applying Article 14. Thus the principles laid down in Article 7 for instance as regards allocation of profits between head office and permanent establishment could be applied also in apportioning income between the State of residence of a person performing independent personal services and the State where such services are performed from a fixed base. Equally, expenses incurred for the purposes of a fixed base, including executive and general expenses, should be allowed as deductions in determining the income attributable to a fixed base in the same way as such expenses incurred for the purposes of a permanent establishment (cf. paragraph 3 of Article 7).~~

Also in other respects Article 7 and the Commentary thereon could be of assistance for the interpretation of Article 14, e.g. in determining whether computer software payments should be classified as commercial income within Articles 7 or 14 or as royalties within Article 12.

4. Even if Articles 7 and 14 are based on the same principles, it was thought that the concept of permanent establishment should be reserved for commercial and industrial activities. The term "fixed base" has therefore been used. It has not been thought appropriate to try to define it, but it would cover, for instance, a physician's consulting room or the office of an architect or a lawyer. A person performing independent personal services would probably not as a rule have premises of this kind in any other State than of his residence. But if there is in another State a centre of activity of a fixed or a permanent character, then that State should be entitled to tax the person's activities**:**

Observation on the Commentary

4.1 *Mexico* considers that this Article is applicable to companies that perform professional services.

Reservations on the Article

5. *Turkey* reserves the right to tax persons performing professional services or other activities of an independent character if they are present in this country for a period or periods exceeding in the aggregate 183 days in the calendar year, even if they do not have a fixed base available to them for the purpose of performing such services or activities.

6. *Portugal* and *Spain* reserve their position on paragraph 1.

7. *Denmark, Mexico* and *Norway* reserve the right to tax individuals performing professional services or other activities of an independent character if they are present on their respective territory for a period or periods exceeding in the aggregate 183 days in any twelve month period.

8. *Denmark, Ireland, Norway* and the *United Kingdom* reserve the right to insert in a special article provisions regarding income derived from independent personal services relating to offshore hydrocarbon exploration and exploitation and related activities.

~~9. *Greece*, the *Czech Republic* and *New Zealand* reserve the right to tax individuals performing professional services or other activities of an independent character if they are present on their respective territory for a period or periods exceeding in the aggregate 183 days in any twelve month period, even if they do not have a fixed base available to them for the purpose of performing such services or activities.~~

~~10. *Greece* reserves the right to insert special provisions regarding income derived from independent personal services relating to offshore activities.~~

Commentary on Article 15

28. Replace the heading of the Commentary on Article 15 and add a footnote to it as follows:

"COMMENTARY ON ARTICLE 15
CONCERNING THE TAXATION OF *INCOME FROM EMPLOYMENT*[1]
~~DEPENDENT PERSONAL SERVICES~~

1. Before 2000, the title of Article 15 referred to "Dependent Personal Services" by contrast to the title of Article 14, which referred to "Independent Personal Services". As a result of the elimination of the latter Article, the title of Article 15 was changed to refer to "Employment", a term that is more commonly used to describe the activities to which the Article applies. This change was not intended to affect the scope of the Article in any way."

29. Replace paragraphs 3, 7.1, 17 and 21 of the Commentary on Article 15 by the following:

"3. Paragraph 2 contains, however, a general exception to the rule in paragraph 1. This exception covers all individuals rendering ~~dependent personal~~ services ***in the course of an employment*** (sales representatives, construction workers, engineers, etc.), to the extent that their remuneration does not fall under the provisions of other Articles, such as those applying to government services or artistes and sportsmen.

7.1 Under the third condition, if the employer has in the State in which the employment is exercised a permanent establishment, ~~(or a fixed base if he performs professional services or other activities of an independent character)~~, the exemption is given only on condition that the remuneration is not borne by a permanent establishment ~~or a fixed base~~ which he has in that State.

17. *Ireland*, *Norway* and the *United Kingdom* reserve the right to insert in a special article provisions regarding income derived from ***employment*** ~~dependent personal~~ relating to offshore hydrocarbon exploration and exploitation and related activities.

21. *Greece* reserves the right to insert special provisions regarding income from ***employment*** ~~dependent personal~~ relating to offshore activities."

Commentary on Article 17

30. Replace paragraphs 1, 2, 9, 11 and 15.1 of the Commentary on Article 17 by the following:

"1. Paragraph 1 provides that artistes and sportsmen who are residents of a Contracting State may be taxed in the other Contracting State in which their personal activities as such are performed, whether these are ***of a business or employment nature*** ~~an independent or of a dependent nature~~. This provision is an exception to the rules in Article ~~14~~ ***7*** and to that in paragraph 2 of Article 15, respectively.

2. This provision makes it possible to avoid the practical difficulties which often arise in taxing artistes and sportsmen performing abroad. Moreover, too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of paragraph 1 to ~~independent~~ ***business*** activities. To achieve this it would be sufficient to amend the text of the Article so that an exception is made only to the provisions of Article ***7*** ~~14~~. In such a case, artistes and sportsmen performing ~~for a salary or wages~~ ***in the course of an employment*** would automatically come within Article 15 and thus be entitled to the exemptions provided for in paragraph 2 of that Article.

9. Besides fees for their actual appearances, artistes and sportsmen often receive income in the form of royalties or of sponsorship or advertising fees. In general, other Articles would apply whenever there was no direct link between the income and a public exhibition by the performer in the country concerned. Royalties for intellectual property rights will normally be covered by Article 12 rather than Article 17 (cf. paragraph 18 of the Commentary on Article 12), but in general advertising and sponsorship fees will fall outside the scope of Article 12. Article 17 will apply to advertising or sponsorship income, etc. which is related directly or indirectly to performances or appearances in a given State. Similar income which could not be attributed to such performances or appearances would fall under the standard rules of Article ~~14~~ ***7*** or Article 15, as appropriate. Payments received in the event of the cancellation of a performance are also outside the scope of Article 17, and fall under Articles 7~~, 14~~ or 15, as the case may be.

11. Paragraph 1 of the Article deals with income derived by individual artistes and sportsmen from their personal activities. Paragraph 2 deals with situations where income from their activities accrues to other persons. If the income of an entertainer or sportsman accrues to another person, and the State of source does not have the statutory right to look through the person receiving the income to tax it as income of the performer, paragraph 2 provides that the portion of the income which cannot be taxed in the hands of the performer may be taxed in the hands of the person receiving the remuneration. If the person receiving the income ***carries on business activities*** ~~is an enterprise~~, tax may be applied by the source country even if the income is not attributable to a permanent establishment there. ~~If the person receiving the income is an individual, the income may be taxed even in the absence of a fixed base~~. But it will not always be so. There are three main situations of this kind~~.~~***:***

a) The first is the management company which receives income for the appearance of e.g. a group of sportsmen (which is not itself constituted as a legal entity).

b) The second is the team, troupe, orchestra, etc. which is constituted as a legal entity. Income for performances may be paid to the entity. Individual members of the team, orchestra, etc. will be liable to tax under paragraph 1, in the State in which a performance is given, on any remuneration (or income accruing for their benefit) as a counterpart to the performance; however, if the members are paid a fixed periodic remuneration and it would be difficult to allocate a portion of that income to particular performances, Member countries may decide, unilaterally or bilaterally, not to tax it. The profit element accruing from a performance to the legal entity would be liable to tax under paragraph 2.

c) The third situation involves certain tax avoidance devices in cases where remuneration for the performance of an artiste or sportsman is not paid to the artiste or sportsman himself but to another person, e.g. a so-called artiste company, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the artiste or sportsman nor as profits of the enterprise, in the absence of a permanent establishment. Some countries "look through" such arrangements under their domestic law and deem the income to be derived by the artiste or sportsman; where this is so, paragraph 1 enables them to tax income resulting from activities in their territory. Other countries cannot do this. Where a performance takes place in such a country, paragraph 2 permits it to impose a tax on the profits diverted from the income of the artiste or sportsman to the enterprise. It may be, however, that the domestic laws of some States do not enable them to apply such a provision. Such States are free to agree to other solutions or to leave paragraph 2 out of their bilateral conventions.

15.1 *France* considers that the statement in the first sentence of paragraph 13, which is at variance with the wording prior to the 1995 revision, is incorrect, because it does not conform with reality to characterise *a priori* as ~~industrial or commercial~~ ***business*** the public activities at issue — and in particular cultural activities — that do not ordinarily have a profit motive. In addition, this statement is not consistent with the second sentence of the same paragraph or with paragraph 14, which explicitly provides the right to apply a special exemption regime to the public activities in question: if applied generally to ~~industrial or commercial~~ ***business*** activities, such a regime would be unjustified, because it would then be contrary to fiscal neutrality and tax equality."

Commentary on Article 18

31. Replace paragraphs 9, 11, 12 and 35 of the Commentary on Article 18 by the following:

"9. The provision is confined to the tax treatment of contributions to pension schemes by or on behalf of individuals who exercise employments within the meaning of Article 15 away from their home State. It does not deal with contributions by individuals who ***perform business activities covered by Article 7*** ~~who render independent personal services within the meaning of Article 14~~. However, Member countries may wish, in bilateral negotiations, to agree on a provision covering individuals rendering services within both Article ~~14~~ ***7*** and Article 15.

11. The following is the suggested text of the provision that could be included in bilateral conventions to deal with the problem identified above:

"*a*) Contributions borne by an individual who renders ~~dependent personal~~ services ***in the course of an employment*** in a Contracting State to a pension scheme established in and recognised for tax purposes in the other Contracting State shall be deducted, in the first-mentioned State, in determining the individual's taxable income, and treated in that State, in the same way and subject to the same conditions and limitations as contributions made to a pension scheme that is recognised for tax purposes in that first-mentioned State, provided that:

(i) pension scheme, immediately before he began to exercise employment in that State; and

(*ii*) the pension scheme is accepted by the competent authority of that State as generally corresponding to a pension scheme recognised as such for tax purposes by that State.

b) For the purposes of sub-paragraph *a*):

(*i*) the term "a pension scheme" means an arrangement in which the individual participates in order to secure retirement benefits payable in respect of the employment dependent personal services referred to in sub-paragraph a); and

(ii) a pension scheme is recognised for tax purposes in a State if the contributions to the scheme would qualify for tax relief in that State."

12. Sub-paragraph *a*) of the suggested provision lays down the characteristics of both the employee and the contributions to which the provision applies. It also provides the principle that contributions borne by an individual rendering ~~dependent personal~~ services ***in the course of an employment*** within the meaning of Article 15 in one Contracting State (the host State) to a defined pension scheme in the other Contracting State (the home State) are to be relieved from tax in the host State, subject to the same conditions and limitations as relief for contributions to domestic pension schemes of the host State.

35. The definition of a pension scheme makes no distinction between pensions paid from State-run occupational pension schemes and similar privately-run schemes. Both are covered by the scope of the provision. Any pensions, such as pensions from general State pension schemes dependent on contribution records whether or not contributors are employees, are excluded from the provision as the individual will not contribute to such schemes in order to receive benefits payable in respect of ~~dependent personal~~ his employment."

Commentary on Article 19

32. Replace paragraph 13 of the Commentary on Article 19 by the following:

"13. *France* considers that the scope of the application of Article 19 should cover:

— remuneration paid by public legal entities of the State or a political subdivision or local authority thereof, because the identity of the payer is less significant than the public nature of the income;

— public remuneration of artistes and sportsmen in conformity with the wording of the Model prior to 1995 (without applying the criterion of ~~industrial or commercial~~ ***business*** activity, seldom relevant in these cases), as long as Article 17 does not contain a provision along the lines suggested in paragraph 14 of the Commentary on Article 17."

Commentary on Article 21

33. Replace paragraphs 4 and 5 of the Commentary on Article 21 by the following:

"4. This paragraph provides for an exception from the provisions of paragraph 1 where the income is associated with the activity of a permanent establishment ~~or fixed base~~ which a resident of a Contracting State has in the other Contracting State. The paragraph includes income from third States. In such a case, a right to tax is given to the Contracting State in which the permanent establishment ~~or the fixed base~~ is situated. Paragraph 2 does not apply to immovable property for which, according to paragraph 4 of Article 6, the State of situs has a primary right to tax (cf. paragraphs 3 and 4 of the Commentary on Article 6). Therefore, immovable property situated in a Contracting State and forming part of the business property of a permanent establishment of an enterprise of that State situated in the other Contracting State shall be taxable only in the first-mentioned State in which the property is situated and of which the recipient of the income is a resident. This is in consistency with the rules laid down in Articles 13 and 22 in respect of immovable property since paragraph 2 of those Articles applies only to movable property of a permanent establishment.

5. The paragraph also covers the case where the beneficiary and the payer of the income are both residents of the same Contracting State, and the income is attributed to a permanent establishment ~~or a fixed base~~, which the beneficiary of the income has in the other Contracting State. In such a case a right to tax is given to the Contracting State in which the permanent establishment ~~or the fixed base~~ is situated. Where double taxation occurs, the State of residence should give relief under the provisions of Article 23 A or 23 B. However, a problem may arise as regards the taxation of dividends and interest in the State of residence as the State of source: the combination of Articles 7 and 23 A prevents that State from levying tax on that income, whereas if it were paid to a resident of the other State, the first State, being the State of source of the dividends or interest, could tax such dividends or interest at the rates provided for in paragraph 2 of Articles 10 and 11. Contracting States which find this position unacceptable may include in their conventions a provision according to which the State of residence would be entitled, as State of source of the dividends or interest, to levy a tax on such income at the rates provided for in paragraph 2 of Articles 10 and 11. The State where the permanent establishment is situated would give a credit for such tax on the lines of the provisions of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B; of course, this credit should not be given in cases where the State in which the permanent establishment is situated does not tax the dividends or interest attributed to the permanent establishment, in accordance with its domestic laws."

Commentary on Article 22

34. Replace paragraph 3 of the Commentary on Article 22 by the following:

"3. The Article, therefore, enumerates first property which may be taxed in the State in which they are situated. To this category belong immovable property referred to in Article 6 which a resident of a Contracting State owns and which is situated in the other Contracting State (paragraph 1), and movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State~~, or pertaining to a fixed base which a resident of a Contracting State has in the other Contracting State for the performance of independent personal services~~ (paragraph 2)."

Commentary on Articles 23A and 23B

35. Replace paragraphs 3, 5, 9 and 10 of the Commentary on Article 23A and 23B by the following:

"3. International juridical double taxation may arise in three cases:

a) where each Contracting State subjects the same person to tax on his worldwide income or capital (concurrent full liability to tax, cf. paragraph 4 below);

b) where a person is a resident of a Contracting State (R)[9] and derives income from, or owns capital in, the other Contracting State (S or E) and both States impose tax on that income or capital (cf. paragraph 5 below);

c) where each Contracting State subjects the same person, not being a resident of either Contracting State to tax on income derived from, or capital owned in, a Contracting State; this may result, for instance, in the case where a non-resident person has a permanent establishment ~~or fixed base~~ in one Contracting State (E) through which he derives income from, or owns capital in, the other Contracting State (S) (concurrent limited tax liability, cf. paragraph 11 below).

5. The conflict in case *b*) may be solved by allocation of the right to tax between the Contracting States. Such allocation may be made by renunciation of the right to tax either by the State of source or situs (S) or of the situation of the permanent

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1. Throughout the Commentary on Articles 23 A and 23 B, the letter "R" stands for the State of residence within the meaning of the Convention, "S" for the State of source or situs, and "E" for the State where a permanent establishment ~~of a fixed base~~ is situated.

establishment ~~or the fixed base~~ (E), or by the State of residence (R), or by a sharing of the right to tax between the two States. The provisions of the Chapters III and IV of the Convention, combined with the provisions of Article 23 A or 23 B, govern such allocation.

9. Where a resident of the Contracting State R derives income from the same State R through a permanent establishment ~~or a fixed base~~ which he has in the other Contracting State E, State E may tax such income (except income from immovable property situated in State R) if it is attributable to the said permanent establishment ~~or fixed base~~ (paragraph 2 of Article 21). In this instance too, State R must give relief under Article 23 A or Article 23 B for income attributable to the permanent establishment ~~or fixed base~~ situated in State E, notwithstanding the fact that the income in question originally arises in State R (cf. paragraph 5 of the Commentary on Article 21). However, where the Contracting States agree to give to State R which applies the exemption method a limited right to tax as the State of source of dividends or interest within the limits fixed in paragraph 2 of the Articles 10 or 11 (cf. paragraph 5 of the Commentary on Article 21), then the two States should also agree upon a credit to be given by State E for the tax levied by State R, along the lines of paragraph 2 of Article 23 A or of paragraph 1 of Article 23 B.

10. Where a resident of State R derives income from a third State through a permanent establishment ~~or a fixed base~~ which he has in State E, such State E may tax such income (except income from immovable property situated in the third State) if it is attributable to such permanent establishment ~~or fixed base~~ (paragraph 2 of Article 21). State R must give relief under Article 23 A or Article 23 B in respect of income attributable to the permanent establishment ~~or fixed base~~ in State E. There is no provision in the Convention for relief to be given by Contracting State E for taxes levied in the third State where the income arises; however, under paragraph 4 of Article 24 any relief provided for in the domestic laws of State E (double taxation conventions excluded) for residents of State E is also to be granted to a permanent establishment in State E of an enterprise of State R (cf. paragraphs 49 to 54 of the Commentary on Article 24)."

Commentary on Article 24

36. Replace paragraphs 7, 21 and 26 of the Commentary on Article 24 by the following:

"7. To take the first of these two cases, if a State accords immunity from taxation to its own public bodies and services, this is justified because such bodies and services are integral parts of the State and at no time can their circumstances be comparable to those of the public bodies and services of the other State. Nevertheless, this

reservation is not intended to apply to State corporations carrying on gainful undertakings. To the extent that these can be regarded as being on the same footing as private ~~industrial and commercial~~ ***business*** undertakings, the provisions of paragraph 1 will apply to them.

21. By the terms of the first sentence of paragraph 3, the taxation of a permanent establishment shall not be less favourably levied in the State concerned than the taxation levied on enterprises of that State carrying on the same activities. The purpose of this provision is to end all discrimination in the treatment of permanent establishments as compared with resident enterprises belonging to the same sector of activities, as regards taxes based on ~~industrial and commercial~~ ***business*** activities, and especially taxes on business profits.

26. As such measures are in furtherance of objectives directly related to the economic activity proper of the State concerned, it is right that the benefit of them should be extended to permanent establishments of enterprises of another State which has a double taxation convention with the first embodying the provisions of Article 24, once they have been accorded the right to engage in ~~industrial or commercial~~ ***business*** activity in that State, either under its legislation or under an international agreement (treaties of commerce, establishment conventions, etc.) concluded between the two States."

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