

Reprinted from British Tax Review Issue 4, 2018

Sweet & Maxwell
5 Canada Square
Canary Wharf
London
E14 5AQ
(Law Publishers)

To subscribe, please go to
<http://www.sweetandmaxwell.co.uk/catalogue/productdetails.aspx?recordid=338&productid=6614>.

Full text articles from the British Tax Review are also available via subscription to www.westlaw.co.uk, or <https://www.checkpointworld.com>.

SWEET & MAXWELL

Scope and Interpretation of Article 12A: Assessing the Impact of the New Fees for Technical Services Article

Tatiana Falcão*

Bob Michel**

Abstract

One of the most important changes in the update of the UN Model of 2017, released in May 2018, is the introduction of a new Article 12A dedicated to fees for technical services. In this contribution, the authors analyse the policy considerations which underly the new provision and describe past and current tax treaty practice with regard to the allocation of taxing rights on fees for technical services. The authors examine the scope of the new model Article 12A and its interaction and potential overlap with items of income covered under Article 5 and Article 7 (permanent establishment and business profits), Article 12 (royalties) and Article 14 (independent services) of the UN Model. In the final section, the authors analyse how the new provision might play a significant role in the taxation of (certain business models of) the digital economy.

1. Introduction

The UN Committee of Experts on International Cooperation in Tax Matters (UN Committee of Experts) met for the 16th time in May 2018 in New York. Amongst the main orders of the day, was the launch of the new United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model),¹ which was pre-dated to 2017 following the change in the membership of the Committee of Experts.

The new version of the UN Model incorporates several changes brought about by the BEPS programme, in addition to introducing a few changes unique to the UN Model. This article will focus on the introduction of the new Article 12A on fees for technical services. More importantly, it will analyse the impact of this new Article in light of the general structure of the UN Model, and distinguish the services covered in Article 12A from those mentioned in the deemed services permanent establishment (PE) provision (Article 5(3)(b)), in the royalties Article (Article 12)

* Schumann Fellow at Muenster University, former secretariat of the UN Committee of Experts in International Tax Cooperation. The author would like to thank Muenster University and Professor Joachim Englisch for hosting and sponsoring this research. The views expressed in this contribution are the author's personal views.

** Adv. LLM, Editor of the Tax Treaty Case Law Database, IBFD and Technical Coordinator and Editor of the UN Double Taxation Convention (2017 update) at UN ECOSOC, New York (consultant). The views expressed in this contribution are the author's personal views.

¹ Department of Economic & Social Affairs, *United Nations Model Double Taxation Convention between Developed and Developing Countries 2017 Update* (New York: United Nations, 2018), available at: http://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf [Accessed 26 September 2018].

and in the independent personal services Article (Article 14) which, unlike in the OECD Model,² still subsists in the present UN Model.

This article will not delve in to the OECD Model. That is because the new Article 12A is unique to the UN Model. In the context of the OECD Model, fees for technical services are generally regarded as qualifying under Article 7 (business profits) and are taxable in the residence state only, unless the PE threshold is surpassed by the service provider in the source state. The fees could qualify as “royalties” under Article 12 in certain circumstances, for instance in cases where the domestic law interprets income from a particular type of service to be regarded as a royalty.³ Under Article 12 of the OECD Model, royalties are nevertheless taxable but only in the residence *state* of the recipient.

2. A dedicated Article to cover fees for technical services

2.1. Policy considerations

The new Article 12A allows a Contracting State to tax fees for specified technical services paid to a resident of the other Contracting State on a gross basis at a rate negotiated by the Contracting States.⁴

It was pre-existing developing country tax treaty practice that informed the introduction of Article 12A in the UN Model. As further demonstrated below under section 2.2 of this article, numerous developing countries had been engaging in similar practices, either by introducing provisions in their tax treaties dealing with fees for technical services or by adopting domestic legislation to account for the taxation of technical services and requiring that their double tax treaties be interpreted in light of the domestic legislation.⁵

When the UN started discussing the introduction of a dedicated Article 12A to deal with fees for technical services, circa 2013, many countries already included the right to tax fees for technical services within the context of the royalties’ Article. As a result, several treaties involving

² OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing, 2017), available at: http://dx.doi.org/10.1787/mtc_cond-2017-en [Accessed 9 October 2018].

³ According to the Commentary on Article 12 of the OECD Model para.11.4 (reproduced in the Commentary on Article 12 of the UN Model, after para.12), technical assistance is excluded from the scope of definition of royalties, although technical services may, depending on the country, be included within the scope of the royalties Article. According to the Commentary on Article 12 of the UN Model (unnumbered paragraph p.315), given the broad definition of “information, commercial or scientific experience”, some countries tend to regard the provision of brainwork and technical services as constituting a royalty payment to which source taxing rights would apply.

⁴ For more information on this topic, see: United Nations, *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, edited by A. Trepelkov, H. Tonino and D. Halka, 2nd edn (New York: United Nations, 2017), available at: <https://www.un.org/esa/ffd/wp-content/uploads/2017/08/handbook-tax-base-second-edition.pdf> [Accessed 26 September 2018]; T. Falcão, “The U.N. Model’s New Fees for Technical Services Provision” (23 July 2018) 91(4) *Tax Notes International* 367; A.J. Martín Jiménez, “Article 12: Royalties - Global Tax Treaty Commentaries” (last updated: 10 July 2017) in *Global Tax Treaty Commentaries* (IBFD online resources); B.J. Arnold, “The UN Committee of Experts and the UN Model: Recent Developments” (2017) 71(3/4) *Bull. Intl. Taxn.*; and for discussion, see F. Sixdorf and S. Leitsch, “Taxation of Technical Services under the New Article 12A of the UN Model – Improved Taxation or a Step in the Wrong Direction?” (2017) 57(6) *Eur. Taxn.* 234, 234 and following; B.J. Arnold, “The Taxation of Income from Services under Tax Treaties: Cleaning Up the Mess – Expanded Version” (2011) 65(2) *Bull. Intl. Taxn.*

⁵ For example, the Brazilian domestic legislation has long levied a tax on the services rendered in Brazil by a foreign service provider, and on the services rendered abroad, by a Brazilian service provider.

developing countries, from both earlier and later periods, contain a “reformed” royalties clause whose scope is “royalties and fees for technical services”—both amalgamated into Article 12.⁶

According to the Commentaries on Article 12A, until the addition of this Article, income from services derived by a resident of a Contracting State was taxable exclusively by the residence state, unless the enterprise carried on business through a PE or fixed base in the source state.

Because fees for technical services are usually deductible against a country’s tax base, the payment of fees for technical services may result in the erosion of a source country’s tax base, to the extent it is prevented from taxing such fees. Base erosion and profit shifting was therefore a major consideration in the introduction of this Article and has clearly been an issue of concern to many developing countries, as demonstrated by the wide array of countries which have entered into Article 12A-like clauses even before the revision of the UN Model was concluded.

As further demonstrated in this article, the introduction of a dedicated Article on fees for technical services has the effect of allowing a source state to tax such fees, even when the service provider does not have a substantial presence in the country by surpassing the PE or the fixed base threshold of Articles 5 (including the “service PE” of Article 5(3)(b)), 7 or 14. This is the main distinguishing feature when comparing Article 12A to Article 5(3)(b), Article 7 and Article 14, because, even if the fees for technical services are also for consultancy or independent personal services, Article 12A will confer on the source state the right to apply a tax until the minimum threshold to define presence in the source state under Articles 5(3)(b), 14 or 7 is met.

This position is also currently being discussed in the context of the taxation of digital businesses, a topic which gave rise to an additional impulse for the inclusion of the fees for technical services Article in the UN Model, as further argued in section 4 of this article (below).

Since the taxation of fees for certain technical services is a tax withheld on a gross basis, from a policy perspective, the introduction of a specific Article to tax such fees provides an incentive for the enterprise engaged in business in the source state to incorporate or to take on a PE status in order to qualify for net income taxation with respect to the technical services provided in or to that state.⁷

⁶See in this respect, for example, Agreement between the Government of the Republic of Latvia and the Government of the Socialist Republic of Viet Nam for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 19 October 2017; Agreement between the Government of the Republic of Cyprus and the Government of the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion, signed on 18 November 2016.

With respect to taxes on income, Agreement between the Kingdom of Morocco and the Republic of Rwanda for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 19 October 2016; Agreement between the Government of the Republic of Estonia and the Government of the Socialist Republic of Viet Nam for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 26 September 2015 (Estonia–Viet Nam 2015); Agreement between the Government of the Republic of Korea and the Government of the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 18 May 2015; and Convention between the Government of Ireland and the Government of the Islamic Republic of Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 16 April 2015.

⁷China–Kenya Income Tax Treaty (2017) Art.13, IBFD Tax Treaty Database. Para.2 of Art.13 provides: “However, fees for technical services arising in a Contracting State may also be taxed in the Contracting State in which they arise and subject to the laws of that State, but if the beneficial owner of the fees is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the fees.”

Attention should be drawn to the fact that under the terms of Article 12A, a source state will be entitled to withhold taxes even if the service is not provided in the first state. Fees paid to a foreign service provider will be subject to the withholding tax provided they are not: 1. paid to a PE or fixed base located in the source state; or 2. borne by a PE or fixed base located in the residence state.

2.2. Past and current treaty practice

The earliest inception of a dedicated fees from technical services Article comes from the United Kingdom–Gambia Tax Treaty (1980, currently in force).⁸ The Article covered fees in consideration for services of a technical or consultancy nature and allowed a gross withholding tax of 15 per cent to be levied in the state where the fees arose. Interestingly, the Article provides that the recipient of the fees can elect to have tax charged on a net basis.⁹ For both states, the inclusion of the Article in a tax treaty seems to have been a one-off.

In Pakistan and India, the inclusion of fees for technical services has been part of settled tax treaty policy since the 1990s.¹⁰ Originally, most Pakistani and Indian treaties covered fees for technical services under the royalties Article.¹¹ In recent treaties, dedicated provisions on fees for technical services are clearly on the rise.¹² Like the UN Model, these provisions generally cover “managerial, technical or consultancy services”. In Indian treaties, the withholding tax

⁸Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of The Gambia; for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, signed on 20 May 1980 Art.14.

⁹United Kingdom–Gambia Tax Treaty (1980), above fn.8, Art.14(5).

¹⁰About 40% of Pakistan’s 66 tax treaties currently in force cover fees for technical services. The same is true in about 75% of the 98 Indian tax treaties currently in force.

¹¹For recent examples, see Convention between Ireland and Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 16 April 2015; and the revised Agreement between India and Cyprus for the Avoidance of Double Taxation and the Prevention of Fiscal evasion (DTAA) with respect to taxes on income, signed on 18 November 2016.

¹²For Pakistan, see for instance, Agreement between The Government of the Hong Kong special administrative region of the People’s Republic of China and The Government of the Islamic Republic of Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 17 February 2017 (Hong Kong–Pakistan (2017)); Convention between The Islamic Republic of Pakistan and the Kingdom of Spain for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 2 June 2010 (Pakistan–Spain (2010)); and Convention between Japan and the Islamic Republic of Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 23 January 2008. For India, see for instance, Convention between the Government of the Republic of India and the Government of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, signed on 24 August 1982 as amended on 10 May 2016; Agreement between the Government of Malaysia and the Government of the Republic of India for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 6 May 2012; and Convention between the Council of Ministers of Serbia and Montenegro and the Government of the Republic of India for the avoidance of double taxation with respect to taxes on income and on capital, signed on 8 February 2006.

rate is usefully set at 10 per cent. In Pakistani treaties the rate varies from 10 per cent¹³ to 12.5 per cent¹⁴ and in some cases even 15 per cent.¹⁵

Malaysia, Vietnam and Indonesia are the only other countries to have in the past successfully pursued a policy of including fees for technical services in some of their tax treaties.¹⁶ In most of these treaties, fees for technical services are dealt with under the royalties Article, although in recent years, these countries seem to have come to adopt a policy of including a dedicated provision.¹⁷ Unlike the Indian and Pakistani treaties, the withholding tax rates are often lower than 10 per cent.¹⁸

Whereas for decades only a handful of Asian countries pursued the policy of including fees for technical services in their tax treaties, the work of the UN Committee leading up to the adoption of the new Article 12A in the 2017 version of the Model coincides with, or has served as a catalyst for, a more widespread global interest in the pursuance of an independent fees for technical services Article, particularly in developing countries. In the last three years, Cambodia has started to include fees for technical services in its treaties¹⁹ and for the first time the provision

¹³ See, for example, Pakistan–Serbia (2010) the Convention between the Government of the Republic of Serbia and the Government of the Islamic Republic of Pakistan for the Avoidance of Double Taxation with respect to Taxes on Income, signed on 21 May 2010; and India–Mauritius (1982, as amended in 2016), above fn.12.

¹⁴ See, for example, Pakistan–Hong Kong (2017), above fn.12.

¹⁵ See, for example, convention between Brunei and the Islamic Republic of Pakistan for the avoidance of double taxation with respect to taxes on income, signed on 6 October 2009; and Convention between the Government of the Republic of Belarus and The Government of the Islamic Republic of Pakistan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 23 July 2004.

¹⁶ About 25% of Malaysian tax treaties deal with fees for technical services. For Vietnam and Indonesia, the inclusion rate is 16% and 8%, respectively.

¹⁷ See, for instance, Agreement between the Government of the Republic of Kazakhstan and the Government of the Socialist Republic of Vietnam for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 31 October 2011 (Kazakhstan–Vietnam (2011)); Agreement between the Government of the Republic of Azerbaijan and the Government of the Socialist Republic of Viet Nam for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, signed on 19 May 2014 (Azerbaijan–Vietnam (2014)); Agreement between the Government of Malaysia and the Government of the Slovak Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 25 May 2015; and Agreement between the Government of the Hong Kong special administrative region of the People’s Republic of China and the Government of Malaysia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 25 April 2012 (Hong Kong–Malaysia (2012)).

¹⁸ For an example of a treaty with a 10% rate, see Azerbaijan–Vietnam (2014), above fn.17. For 8%, see Agreement between the Government of the Islamic Republic of Iran and the Government of the Socialist Republic of Viet Nam for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 14 October 2014; and Agreement between the Government of Malaysia and the Government of the State of Qatar for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 3 July 2008. For 7.5%, see Estonia–Vietnam Tax Treaty (2015), above fn.6; and Agreement between the Government of the Socialist Republic of Vietnam and the Government of the State of Israel for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, signed on 4 August 2009 (Vietnam–Israel (2009)). For 7%, see Agreement between the Federal Republic of Germany and Malaysia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 23 February 2010. For 5%, see Malaysia–Slovak Republic (2015), above fn.17; Hong Kong–Malaysia (2012), above fn.17.

¹⁹ See, for instance, Agreement Between The Royal Government Of Cambodia And The Government Of The Kingdom Of Thailand For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 7 September 2017 (Cambodia–Thailand (2017, not yet in force)); and Agreement Between The Government Of The People’s Republic Of China And The Royal Government Of Cambodia For The Avoidance

has also been incorporated in a number of treaties signed by countries in South America (that is, Brazil,²⁰ Chile²¹ and Uruguay²²) and in Africa (that is, Morocco²³ and Ghana²⁴). Most of these recent treaties adopt a withholding tax rate of 10 per cent.

In absolute numbers of signed tax treaties the results might seem negligible, but the analysis reveals a rising interest in the provision and confirms the important role of the UN Committee of Experts in disseminating international tax policies tailored to the needs of developing countries.

3. Income covered under Article 12A: conceptualising technical services

3.1. A plethora of “services” under the UN Model

The term “services” appears on several occasions in the UN Model, even though there is no single rule or definition to qualify what the term means in each circumstance.²⁵ Under the presumed “services PE” rule in Article 5(3)(b), the Model refers to “the furnishing of services, including consultancy services”. The new Article 12A references technical services, which used to be (potentially) included within the royalties Article, but which will now (possibly) be distinguished from the royalties Article on account of the addition of new Article 12A. Article 12 on royalties might still cover technical services and technical assistance if the bilateral tax treaty so determines and if the countries do not adhere to new Article 12A. Finally, Article 14 on independent personal services references “professional services”.

The following sections will explore how each of these terms are currently conceptualised in the new version of the UN Model and will determine how they are to interrelate with each other going forward. Despite there being an apparent overlap in the scope of the services covered by each Article, the conflicts will be resolved through the application of the allocation rules, to the extent some Articles pre-empt others.

3.2. “Fees for technical services” (Article 12A)

According to new Article 12A, fees for technical services are defined to mean payments for services “of a managerial, technical or consultancy nature”.²⁶ The Commentaries denote that, given the ordinary meaning of the terms managerial, technical and consultancy, the fundamental concept underlying the definition is that the services must involve the application by the service

Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 13 October 2016 (Cambodia–China (P.R.C.) (2016)).

²⁰ See, for example, Brazil–Singapore Income Tax Treaty (2018, not yet in force), and Brazil–Switzerland Income Tax Treaty (2018, not yet in force).

²¹ See, for instance, Chile–Uruguay (2016, not yet in force).

²² See, for instance, Convention between the Government of the United Arab Emirates and the Oriental Republic of Uruguay for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, signed on 10 October 2014 (U.A.E.–Uruguay (2014)).

²³ See, for instance, Morocco–Zambia (2017, not yet in force) and Morocco–Rwanda (2016, not yet in force).

²⁴ See, for instance, Ghana–Ireland (2018, not yet in force); Agreement between the Government of the Republic of Singapore and the Government of the Republic of Ghana for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income 31 March 2017 (not yet ratified) (Singapore–Ghana (2017, not yet in force)) and Czech Republic–Ghana (2017, not yet in force).

²⁵ UN Model, above fn.1, Commentary on Article 12A, para.83.

²⁶ UN Model, above fn.1, Art.12A para.3.

provider of “specialized knowledge, skill and expertise” for the benefit of a client,²⁷ other than a transfer of information covered by the royalties Article or a professional service referred to in Article 14(2).

The terms “management”, “technical” and “consultancy” do not have precise meanings in the Model and may overlap. Therefore, services of a technical nature may also constitute services of a consultancy nature, for example, and management services may also constitute consultancy services.²⁸

According to the Commentaries, the “ordinary meaning of the term ‘technical’ involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Therefore, fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering and dentistry”²⁹ would be qualified as fees for technical services as long as they involve a level of specialisation.

Furthermore, the usual meaning of the term “‘consultancy’ involves the provision of advice or services of a specialized nature”.³⁰ Likewise, “the ordinary meaning of the term ‘management’ involves the application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization”.³¹

The definition of “fees for technical services” provided in paragraph 3 of Article 12A is believed to be exhaustive, and does not allow reference to the domestic law of a Contracting State, among other things, in order to reduce uncertainty in the interpretation of the Article.

As a result, the Commentaries on Article 12A propose both a narrower and a broader application of this Article. The narrow application involves the amendment of the royalties Article to permit taxation of certain “fees for included services”, an approach that is found in a number of tax treaties between developed and developing countries.³² This narrower approach covers only fees for services directly related to the enjoyment of property, for which a royalty is paid under the terms of Article 12. In treaty practice, fees for technical services have sometimes been included in the scope of the royalties Article without restricting the application to services directly related to the enjoyment of property. Such has been the case in many early Indian treaties for example.³³ In any case, both these options clearly exclude the need to introduce an Article 12A.

The broad application involves extending the application of Article 12A to all fees for services (technical and other services) provided in a Contracting State, and outside that state to a person

²⁷ UN Model, above fn.1, Commentary on Article 12A, para.65.

²⁸ UN Model, above fn.1, Commentary on Article 12A, para.67.

²⁹ UN Model, above fn.1, Commentary on Article 12A, para.64.

³⁰ UN Model, above fn.1, Commentary on Article 12A, para.66.

³¹ UN Model, above fn.1, Commentary on Article 12A, para.63.

³² UN Model, above fn.1, Commentary on Article 12A, para.24.

³³ See in this respect, Agreement Between The Government Of The Republic Of Latvia And The Government Of The Republic Of India For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 28 December 2013; Agreement Between The Government Of The Republic Of Macedonia And The Government Of The Republic Of India For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 17 December 2013; and Agreement Between The Government Of The Republic Of India And The Government Of The Republic Of Fiji For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 30 January 2014.

closely related to the payer of the fees.³⁴ This approach is recommended for those countries concerned with the definition of fees for technical services. By removing the word “technical”, source taxing rights would apply to all fees derived by a source state, for services.³⁵ Under this option, the conceptual approach embodied by the different elements of the definition in Article 12A(2) is of little relevance. This approach has, to some extent, been adopted by Ghana in a number of its recent treaties.³⁶

Under the main version of Article 12A, the term “services” should be understood to have a broad meaning in accordance with ordinary usage, and to relate to activities carried out in a wide variety of ways, since the manner in which the services are provided does not alter their character for the purposes of Article 12A.³⁷ To that end, the extension found in certain treaties of the definition of “technical services” to also encompass “the provision of services of technical or other personnel”³⁸ or “the provision by the enterprise of the services of technical or other personnel”³⁹ seems merely explanatory, if not redundant.

Payments made: 1. to an employee of the person making the payment; 2. for teaching in or by an educational institution; and 3. by an individual for services for the personal use of an individual, are excluded from the scope of the Article, and therefore cannot be taxed by the source state.⁴⁰ For this reason, there is no overlap between Article 12A and Articles 15, 18 and 19 dealing with income from employment, pensions and government services, respectively.

The fees for technical services Article does not exclude profits from international transport, and income from entertainment and sports. However, Article 12A(2) expressly provides that this type of income does not fall into the scope of Article 12A if it is covered under Article 8 (“international shipping and air transport”) or Article 17 (“artists and sportspersons”).⁴¹ An example could be advertisement and endorsement fees paid to a sportsperson outside an employment agreement, which are deemed not to be directly or indirectly connected with the person’s sportive activities and thus fall outside the scope of Article 17. Unless attributable to a fixed base or a PE in the source state, the fees for these “specialized” services are taxed pursuant to Article 12A(2).

In current treaty practice, additional carve-outs have been included by reference to the function of the nature of the services provided. For instance, in many treaties signed by Pakistan “consideration for any construction, assembly or installation project, or supervisory activities in

³⁴ Except for the services excluded in Article 12A para.3(a)–(c).

³⁵ See UN Model, above fn.1, Commentary on Article 12A, para.26 for the language of the alternative Article provision.

³⁶ See, for instance, Singapore–Ghana (2017, not yet in force), above fn.24, Art.13 on “service fees”, and Convention Between The Swiss Confederation And The Republic Of Ghana For The Avoidance Of Double Taxation With Respect To Taxes On Income, On Capital And On Capital Gains, signed on 23 July 2008 Art.12 “services fees and royalties”. In both treaties, the term “technical” is omitted in the relevant Article yet the services caught by the Article are still defined as “services of a ‘managerial, technical or consultancy nature’”.

³⁷ UN Model, above fn.1, Commentary on Article 12A, para.84.

³⁸ See, for instance, Agreement Between The Government Of The Republic Of India And The Government Of The Republic Of Kenya For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 11 July 2016 Art.13(3) and Estonia–Viet Nam (2015), above fn.6, Art.12(3)(b).

³⁹ See, for instance, Cambodia–Thailand (2017, not yet in force), above fn.19, Art.13(3) and Convention Between The Swiss Confederation And The Islamic Republic Of Pakistan For The Avoidance Of Double Taxation With Respect To Taxes On Income, signed on 21 March 2017 (not yet in force) (Switzerland–Pakistan (2017)) Art.13(3).

⁴⁰ UN Model, above fn.1, Art.12, para.3(a)–(c).

⁴¹ UN Model, above fn.1, Commentary on Article 12A, para.73.

connection therewith undertaken by the recipient” is expressly excluded from the scope of the technical services Article.⁴² In the Agreement between the Government of the Republic of Singapore and the Government of the Republic of Ghana for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income of the 31 March 2017 (Ghana–Singapore (2017)) “consideration...for supervisory activities in connection with installation incidental to the sale of machinery or parts thereof” is also excluded.⁴³ As a consequence, these payments are covered under the general Article on business profits. Finally, in U.A.E.–Uruguay Tax Treaty (2014), fees for technical services “related to the exploration, extraction or exploitation of hydrocarbons paid by governmental institutions of one of the Contracting States to governmental institutions of the other Contracting State” are taxed at a withholding rate of zero per cent.⁴⁴

3.3. “Fees for technical services” (Article 12A) versus “royalties” and services related to the royalties Article (Article 12)

3.3.1. Royalties, technical services and everything in between

According to Article 12(3) of the UN Model, the term royalties means

“payments of any kind received as consideration for the use of, or right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience”.

Except for the inclusion of the expression “the use of, or the right to use, industrial, commercial or scientific equipment”, this definition coincides with the royalty definition employed in the OECD Model.

The crux of the matter can be found in the last few words of paragraph 3 of Article 12 of the UN Model, which authorise countries to regard the “information concerning industrial, commercial or scientific experience” as a payment of royalties, and hence to potentially levy a withholding tax on such payments. Many countries have taken this language to mean that “technical assistance”, that is, technical services “connected with the use of information” are within the scope of the royalties Article and have explicitly referenced technical services in Article 12.⁴⁵

⁴² See, for instance, Switzerland–Pakistan (2017), above fn.39, Art.13(3) and Pakistan–Spain (2010), above fn.12, Art.13(3).

⁴³ Singapore–Ghana (2017, not yet in force), above fn.24, Art.13, para.3.

⁴⁴ See U.A.E.–Uruguay (2014), above fn.22, Art.12(2)(a).

⁴⁵ For instance, until 2010, Portugal and Spain reserved the right with regard to OECD Model (2008) Art.12 to tax at source as royalties income arising from technical assistance in connection with the use of, or right to use, rights or information of the type referred to in para.2 of the Article. (See OECD, *Model Tax Convention on Income and on Capital: Condensed Version* (OECD, July 2008), Commentary on Article 12, para.44.) Spanish tax treaties have also tended to include “technical assistance” in the definition of royalties (see Convention between the Kingdom of Spain and the Argentine Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, signed on 11 March 2013 Art.12(3)). For details on the interpretation of this clause and the position of the Spanish courts, see Martín Jiménez, above fn.4, s.5.1.8.4.3. Brazil is another example of a country that has tried in the past to include technical services and assistance within the scope of the royalties Article.

Other countries have assimilated income from “included services”, that is, “services ancillary and subsidiary to the application and enjoyment of the right, property or information” into royalties in their treaties.⁴⁶ It is noteworthy that both these developments are contrary to the Model Commentaries which provide that (pure) technical assistance and other related services are outside the scope of royalties.⁴⁷ This has led some OECD countries to negotiate a “negative” most-favoured-nation (MFN) clause in the treaty, foreseeing that if the other country agrees to treat technical assistance and other related services outside the scope of Article 12 (that is, under Articles 7 or 14), such treatment will also be applicable with respect to that OECD country.⁴⁸

This issue has been in contention under the UN Model for many years because the definition of royalties contained in the (previous and current) Commentaries on Article 12 makes it difficult to distinguish between payments derived strictly for the use of one’s intellectual property and other payments made in remuneration for the provision of services, including technical services and technical assistance.

The confusion is particularly acute when it comes to the employment of mixed contracts. In business practice, contracts with both a royalty and a services component are commonplace. A franchise contract, for example, usually entails the licensing of intellectual property but often also involves the transfer of knowledge, experience and technical assistance. A franchisor might also agree to provide additional business consultancy services to the franchisee. The Commentaries prescribe that the appropriate course to take is to break down, based on the contract or by means of reasonable apportionment, the whole amount of the payment and apply the relevant tax treaty treatment to each part. If one part constitutes the principal purpose of the contract and the other parts are only ancillary, then the treatment applicable to the principle part should apply to the whole amount of the payment.⁴⁹

Under the OECD Model, the characterisation of the different components as, respectively, royalties, related services and technical services is of little relevance since none of these items of income trigger taxation in the source state. For those treaties where there is a provision for source state taxation, it is only the royalty component which is taxed in the source state—technical services in most cases are not. This potential conflict has led some states to include a “negative”

See, for example, Agreement between the Government of the Republic of Turkey and the Government of the Federative Republic of Brazil for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 16 December 2010.

⁴⁶ See, for instance, Convention Between The Government Of The United States Of America And The Government Of The Republic Of India For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income, signed on 12 September 1989 Art.12(4).

⁴⁷ See OECD Model (2017), above fn.2, Commentary on Article 12, para.11.4, as reiterated in UN Model (2017), above fn.1, Commentary on Article 12.

⁴⁸ See, for example, Convention between the Governments of the United Mexican States and the Federative Republic of Brazil for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 25 September 2003. Para.6 of the Protocol to Mexico–Brazil (2003) provides that “it is understood that the provisions of paragraph 3 of Article 12 shall apply in respect of payments of any kind received as a consideration for the rendering of technical services and technical assistance”. The paragraph also contains a most-favoured-nation (MFN) clause which provides that if Brazil agrees on a later date with any other country to deal with fees for technical services under Art.7 or Art.14, such treatment shall also apply in relation to Mexico. It is believed that this has not yet occurred.

⁴⁹ See OECD Model (2017), above fn.2, Commentary on Article 12, para.11.6, as reiterated in UN Model (2017), above fn.1, Commentary on Article 12.

definition for “fees for technical services”, as in the qualification of income that cannot be considered to constitute a royalty payment.⁵⁰

The formal introduction of a positive definition for fees for technical services in a dedicated Article in line with Article 12A of the UN Model (2017) risks creating additional tension in interpreting the provision, especially when taking into account historic and current treaty practice. Under current practice, technical services could be deemed to have at least three different treaty interpretations, depending on context: 1. technical services within the meaning of Article 12 (a royalty payment); 2. technical services within the meaning of Article 12A—*independent technical services*, subject to limitations; and 3. payment for services of a non-technical nature, which can be within or outside the meaning of the royalties Article.

In order to avoid having to distinguish between the royalties Article and the fees for technical services Article, in what seems to be an extremely nuanced classification, the UN Model recommends that countries introducing the fees for technical services Article should adopt the same rate of tax both in Article 12 and in Article 12A, for administrative simplicity and to avoid conflict of interpretation between the clauses.⁵¹ Unfortunately, this recommendation is often ignored in treaty practice: a significant number of treaties contain a withholding tax rate for fees for technical services that is either higher⁵² or lower⁵³ than the rate for royalties.

3.3.2. Impact of the introduction of Article 12A

Under the strict construct of the UN Model (2017), the distinction between royalties and technical services is clear. Royalties involve the use of or right to use (intellectual) property (including know-how). Whereas technical services do not concern the transfer of use of a property right, even if a property right might incidentally be within the scope of the technical service commissioned by the client. The key feature to be examined, is whether there was a transfer of use or right of use of property, in relation to which a royalty is due in remuneration. If not, as a general rule, Article 7 applies.

⁵⁰ See, for instance, Convention between the Republic of Panama and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 6 October 2010. See also, Protocol, para.IX Ad Article 7: “Payments received as a consideration for technical services, including studies or surveys of a scientific, geological or technical nature, or for consultancy or supervisory services shall be deemed to be payments to which the provisions of Article 7 apply.” Similar examples can be found in Agreement between the Swiss Federal Council and the Government of the Socialist Republic of Vietnam for the avoidance of double taxation with respect to taxes on income and on capital, signed on 6 May 1996.

⁵¹ See UN Model (2017), above fn.1, Commentary on Article 12A paras 45 and 99.

⁵² See, for example, Hong Kong–Pakistan (2017), above fn.12 (royalties: 10%/fees for technical services: 12.5%); Convention between the Portuguese Republic and the Democratic Republic of Sao Tome and Principe for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 13 July 2015 (royalties: 10%/fees for technical services: 15%); Kazakhstan–Vietnam (2011), above fn.17 (royalties: 10%/fees for technical services: 15%); Hong Kong–Malaysia (2012), above fn.17 (royalties: 8%/fees for technical services: 5%); Vietnam–Israel (2009), above fn.18 (royalties: 5%/fees for technical services: 7.5%).

⁵³ See, for example, Brazil–Singapore (2018, not yet in force) (royalties (trademarks): 15%/fees for technical services 10%); Latvia–Vietnam (2017, not yet in force) (royalties: 10%/fees for technical services: 7.5%); Agreement Between The Grand Duchy Of Luxembourg And The Republic Of Indonesia For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income And On Capital, signed on 14 January 1993 (royalties 12.5%/fees for technical services: 10%).

The issue, particularly in transactions involving a developing and a developed country, has always been whether to broaden or restrict the scope of the definition of royalties to also cover technical services, or to introduce a narrower definition or interpretation where technical services are not subject to source taxation unless the enterprise has a PE in that country, in which case taxes would be imposed on the net income element of the payments attributable to that PE. The latter is, incidentally, the OECD approach.⁵⁴

Countries, in particular developing countries, that consider technical services to be within the scope of Article 12, interpret the term “information concerning industrial, commercial or scientific experience” to mean specialised knowledge, having intrinsic property value relating to industrial, commercial, or managerial processes, and hence subject to remuneration via a royalty.

The introduction of an Article 12A type clause into a tax treaty has the effect of not only partially resolving this conflict but also reducing the scope of application of Article 12 for those countries that believe that Article 12 should have had a broader meaning. In other words, it avoids diluting the conceptual clarity of the royalties concept which has historically been conceived as applying to passive income from intangible property.⁵⁵

The key to determine whether income falls under Article 12 or under Article 12A in a treaty containing both provisions is to verify: 1. whether the income is paid in relation to the assignment of any property rights (use or right of use)—if it is, the income falls under Article 12; and 2. whether the person providing the service for which the income is paid is personally engaged in the provision of such service (either individually or through their personnel)—if that is the case, the income could fall under Articles 12A, 7 or 14, according to the treaty context.

Because a royalty payment entails the employment of formulae, licences or know-how, a service provider will not generally be personally employed in the provision of the service. Although both the provision of technical services, on the one hand, and the provision of know-how or the licensing of intangibles, on the other hand, may require specialised knowledge, only the provision of technical services will require personal involvement in providing such service. Whether the technical service is classified under Article 12A or as general business profits or income from independent personal services under Articles 7 or 14 will therefore be a subsequent matter of treaty interpretation.

Countries adopting a narrower interpretation of Article 12 should annex a protocol to the treaty making it clear that payments for technical services should be deemed to be profits of an enterprise to which Article 7 applies.

⁵⁴ See UN Model (2017), above fn.1, Commentary on Article 12, paras 14–16.

⁵⁵ This is particularly true in the UN Model, where the royalties Article has always defended a withholding tax in the source state, unlike ordinary business profits. Finding an historical explanation as to why there is a royalties Article in the OECD Model is far more difficult, as shown by R. Vann (see R. Vann, “The History of Royalties in Tax Treaties 1921-1961: Why?” in *Comparative Perspectives on Revenue Law: Essays in Honour of John Tiley*, edited by J. Avery Jones, P. Harris and D. Oliver (CUP, 2008)).

3.4. “Fees for technical services” (Article 12A) versus “independent personal services” (Article 14)

Article 14 refers to independent personal services of a professional nature. According to Article 14(2):

“The term ‘professional services’ includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.”⁵⁶

Although the nature of the services provided in Articles 12A and 14 might at times be the same, Article 14 only allows a source state to tax if: 1. the individual has a fixed base regularly available to them for the performance of their activities and the income is attributable to that fixed base; or 2. the individual is present in the country for a period or periods aggregating at least 183 days in any 12 month period, even if there is no fixed base.⁵⁷

Between 1980 and 1999, a third rule, Article 14(1)(c) of the UN Model, 1980, concerning the amount of remuneration was in operation.⁵⁸ Under that rule, a source state would have taxing rights if the remuneration exceeded a certain threshold to be agreed bilaterally between the parties, regardless of the existence of a fixed base. This third alternative rule was removed after it was recognised that the monetary ceiling would become meaningless after a period due to the operation of inflation. Also, the composition of the Committee of Experts in 1999 confirmed that this third rule was not widely implemented in a bilateral context, it having only appeared in 6 per cent of the existing double taxation conventions finalised between 1980 and 1997.

Article 14(1)(c) no longer exists, but some developing country members continued using this Article to support the view that taxation by the source country should not be restricted by the existence of a fixed base, or by the length of stay.⁵⁹ In the view of these members, source of income should have been the only criterion from the start.

It is to be conceded that Article 12A does not cover all services of an independent nature. Article 12A relates to services of a technical nature, and therefore it may, at times, be more restricted in scope than Article 14. However, Article 12A may also come to encompass other services not foreseen in Article 14. For example, services performed by other professionals, not mentioned in Article 14(2), such as pharmacists, scientists and academics may also constitute

⁵⁶ UN Model (2017), above fn.1, Art.14 para.2. See in this respect, D.P. Sengupta, “Article 14: Independent Personal Services - Global Tax Treaty Commentaries” (last updated: 1 September 2016) in *Global Tax Treaty Commentaries* (IBFD online resources).

⁵⁷ UN Model (2017), above fn.1, Art.14 para.1.

⁵⁸ See UN Model (1980) Art.14(1)(c) which provided that income from independent personal services could also be taxed in the source state: “If the remuneration for his activities in the other Contracting State is paid by a resident of that Contracting State or is borne by a permanent establishment or a fixed base situated in that Contracting State and exceeds in the fiscal year... (the amount is to be established through bilateral negotiations).”

⁵⁹ For examples of recent treaties still incorporating this provision, see Convention between the Government of Malta and the Government of the Hashemite Kingdom of Jordan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 16 April 2009; and Convention between the Government of the Islamic Republic of Pakistan and the Government of Ukraine for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income, signed on 23 December 2008. In both treaties the threshold is fixed at US \$10,000 or its equivalent in a local currency.

technical services if those services involve the provision of specialised knowledge, skills and expertise.⁶⁰

The term “technical” involves the application of specialised knowledge, skill or expertise with respect to a particular art, science, profession or occupation which may or may not be within the scope of Article 14. There may be overlap between the services in Article 12A and Article 14. However, where overlap occurs, the context of the activity, and the rules of preference in the tax treaty will distinguish between them.

Under paragraph 4 of Article 12A, if a resident of a Contracting State performs independent personal services that are technical services in the other Contracting State through a fixed base that is regularly available to the resident and the resident receives fees for technical services that are within the meaning of Article 12A(3), Article 14 will apply to those payments, in priority over Article 12A, and the fees will be taxed on a net basis, only with respect to the income that is attributable to that fixed base.

If, on the other hand, a resident of a Contracting State performs independent personal services that are technical services in the other Contracting State, but those services are not provided through a fixed base or on a continuous basis so as to constitute presence in the source state, the fees received for that service will be qualified under Article 12(2) and will be taxed on a gross basis by the source state.

3.5. *“Fees for technical services” (Article 12A) versus services permanent establishment (Article 5(3)(b))*

Unlike the OECD Model, Article 5 of the UN Model has a specific provision that deems a PE to exist through the furnishing of “services, including consultancy services”. According to the Commentaries on the services PE provision, many developing countries believe that management and consultancy services should be covered in this Article, because the provision of these services in a developing country can generate large profits for the enterprise established in a developed country. Article 5(3)(b) was already included in the (original) UN Model of 1980 and there could be cases where there might be a conflict of scope between this provision and the new Article 12A if the services in question are of a technical and specialised nature.

More importantly, the 2017 version of the UN Model further broadened the scope of Article 5(3)(b) by eliminating the words “for the same or connected project” from the text of the Article. Therefore, under the UN Model (2017), a PE may be constituted regardless of the number of projects taking place in the country.

This also does away with the historical analogy between the “service PE” of Article 5(3)(b) and the “construction PE” of Article 5(3)(a). The latter has been, and is still deemed to exist, based on the duration of a “same or connected” project following the minimum threshold set in the tax treaty, whereas the former now can get to the PE threshold by counting individual days of activity in the source country, irrespective of whether the services provided are related to each other via a project or any other account. With the 2017 modification, it becomes much easier for a service provider to meet the PE threshold, and become entitled to the net payment of taxes connected to that PE.

⁶⁰ UN Model (2017), above fn.1, Commentary on Article 12A, para.64.

The broadening of the scope of Article 5(3)(b) is justified in the Commentary by the fact that

“if a non-resident provides services in a country for more than 183 days, the non-resident’s involvement in the commercial life of that country clearly justifies the country taxing the income from those services whether the services are provided for one project or multiple projects”.⁶¹

However, a non-resident enterprise furnishing services through 10 employees might be 10 times more efficient (and consequently take less days to provide said services) than the same non-resident enterprise furnishing the same services through one employee, with equal involvement in the source country’s commercial life, and without passing the time threshold. The introduction of Article 12A destitute of a time or a turnover threshold mitigates these concerns to some extent, since the service provider failing to meet the services PE threshold under Article 5(3)(b) will now be subjected to gross based taxation—a potentially worse economic result.

Broadening the scope of Article 5(3)(b) means potentially reducing the scope of application of Article 12A, because if a PE is deemed to exist under paragraph 3(b) of Article 5, the technical services that are effectively connected to such a PE fall outside the scope of Article 12A by application of the “throwback” rule of Article 12A(4)(a). In effect, those fees for technical services will then be taxed in the source country on a net basis.

It should also be noted that the services to be taken into account for the purposes of Article 5(3)(b) must necessarily be performed within the source state in order to give rise to a PE and corresponding taxing rights in the said state whereas for the purposes of Article 12A, the services can also be performed outside the source state. As noted in the Commentary, the only required nexus for Article 12A is the residence of the payer of the fees, not the place of performance.⁶²

Article 5(3)(b) is distinguished from Article 14, in that the former applies to the profits of enterprises, whereas the latter relates to independent personal services. However, some countries consider that Article 14 applies to the profits of enterprises as well.⁶³ Should that be the case, the treaty will have to be interpreted according to context in order to ensure that the correct Article is applied.

The difference with respect to services should not be substantial, because Articles 14(1)(b) and 5(3)(b) contain an identical temporal threshold for the allocation of source state taxing rights. Under both Articles, these taxing rights will be granted if the activities continue in the source state for a period or periods aggregating more than 183 days (six months) in a 12 month period.

⁶¹ UN Model (2017), above fn.1, Commentary on Article 5, para.12.

⁶² See UN Model (2017), above fn.1, Commentary on Article 12A, para.12.

⁶³ That is the policy to some extent in Mexico and Brazil. Whereas certain Mexican treaties refer in Art.14 to income derived by “an individual”, other treaties (like Agreement between the Government of the People’s Republic of China and the Government of the United Mexican States for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 12 September 2005) refer to income derived by “a resident” which by application of Arts 3 and 4 covers any type of person, both individuals and companies. In Brazil, certain treaties expressly refer to “companies” in Art.14. The Convention between the Argentine Republic and the Federative Republic of Brazil for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, signed on 17 May 1980, as amended on 21 July 2017 Art.14(1)(a) provides that: “Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State unless: (a) the payment of such services or activities is borne by a company which is a resident of the other Contracting State or is due by a permanent establishment or fixed base situated in that other State.”

Having said that, some treaties reduce the temporal limit to three months and a few developing countries oppose the six month threshold altogether, claiming that source state taxation could easily be avoided through artificial arrangements in certain circumstances. These countries believe that there should be no temporal threshold in the Article.⁶⁴ This is a point that has been repeatedly put forward by developing countries in discussions on the future direction of the UN Model, and it has now been partially taken through in the 2017 version of the Model by the introduction of Article 12A, albeit only with regard to services of a technical nature.

To recapitulate, one can conclude that Article 12A will only apply if the services provided are: 1. technical in nature; 2. provided as a one off, or for a short period of time; and 3. there is no basis upon which to determine presence that is effectively connected to a fixed base or a PE in the state where the fees arise.

3.6. “Fees for technical services” (Article 12A) and “business profits” (Article 7)

Article 7 of the UN Model (2017) contains two additional rules of referral that have to be considered to determine whether or not Article 12A is applicable.

First of all, as in the OECD Model,⁶⁵ Article 7(6) of the UN Model currently provides that, if items of income are dealt with in other Articles of the UN Model, then the provisions of those Articles shall not be affected by the provisions of Article 7. Since Article 12A is a specific Article in respect of fees for technical services, it takes precedence over Article 7. Therefore, absent a fixed place of business or a PE, Article 7 will not apply.

Secondly, Article 7(1)(c) of the UN Model (2017) adopts a limited force-of-attraction rule which expands the range of income taxable in the source state as business profits. The force of attraction rule extends the profits attributable to a PE to also include profits from “other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment”. This is the basis upon which the “extended” “throwback rule” of Article 12A(4) will operate, by reverting back to the (general) allocation rule of business profits (that is, Article 7) both fees for technical services effectively connected with: 1. a PE or fixed base in the source state; and 2. business activities caught in the force-of-attraction rule of Article 7(1).

4. Digital technical services

Although Article 12A has not been specifically developed and adopted by the UN Committee of Experts to address the recent tax challenges arising from the digitalisation of the economy, it is clear that the new provision can act as a powerful instrument to tackle some of the issues arising under that framework. The adoption of a withholding tax on fees for technical services has been referred to by the OECD as a valid unilateral measure against base erosion in the face of the digitalisation of the economy.⁶⁶ To the extent domestic measures affect the allocation of

⁶⁴ UN Model (2017), above fn.1, Commentary on Article 5, para.10.

⁶⁵ See OECD Model (2017), above fn.2, Art.7(4).

⁶⁶ OECD/G20 Base Erosion and Profit Shifting Project, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS* (Paris: OECD Publishing, 2018), available at: <http://dx.doi.org/10.1787/9789264293083-en> [Accessed 27 September 2018], para.355.

taxing rights, it is elementary for states to make corresponding amendments to the tax treaties of which they are a part, for instance through the introduction of Article 12A.

Article 12A of the UN Model (2017) does not apply to services hired by an individual for personal use, so the Article does not affect digital business models involving the cross-border provision of services to individuals like streaming services or cloud computing. Besides, many of the services provided through an online interface are “generic” in nature and not of the required technical and specialised nature to be caught by Article 12A in the first place.

Generally speaking, Article 12A also does not address the calls for the introduction of a new nexus rule that would allow one to tax digital enterprises based on “significant digital presence”, or “user location”. As previously noted in section 3.5, the nexus criterion used in Article 12A is the location of the payer of the services, therefore it will only reach digital transactions where the payer is located in the source state. This means that the state granting the payer the right to deduct expenses related to the hiring of services is also entitled to impose tax on the payments in the hands of the service provider and thus offset the effect of the deduction. Given that developing countries are often disproportionate importers of technical services, Article 12A’s remedial effect on base erosion is significant.

Article 12A could nevertheless play a significant role in the taxation of online advertisement business, which is one of the most prominent businesses in the context of the digital economy.⁶⁷ The business of an online advertisement network essentially consists of the pairing of advertisers (that is, clients that want to advertise their brands online) with publishers (that is, owners of web pages that have advertisement space available). The sale of advertisement services usually occurs offshore without triggering an agency PE in the country of the client. The payments received from the offshore sale of access to an automated online advertisement platform cannot be considered as “fees for technical services” under Article 12A, since granting access to an online platform does not entail specialised technical services.⁶⁸ However, to better accommodate the needs of key account clients (that is, advertisers with big advertisement budgets), the networks typically set up local subsidiaries from which the employees provide tailor-made assistance to optimise the advertisement campaigns and to use the data generated by the network more efficiently.

Legally speaking, the advertisement services (the access to the platform and the tailor-made services) are sold offshore to the client by the parent company, without the latter triggering PE status (fixed PE or agency PE) in the client’s country. The tailoring services provided to the client by the local subsidiary’s employees are remunerated by the parent company at a minimal cost-plus margin (typically 8 per cent). The bulk of the profits from the online advertisement services is only taxable offshore in the country of the platform.

This business model is widespread in the online advertisement business and has been subject to intense scrutiny in those European countries—the client countries—where the online

⁶⁷ Based on the World Economic Forum’s list of “the world’s 20 largest tech giants”, two companies out of the top five are engaged primarily in online advertising. These are Google/Alphabet and Facebook (see, J. Desjardins, *These are the world’s largest tech giants*, World Economic Forum, 16 July 2018, available at: <https://www.weforum.org/agenda/2018/07/visualizing-the-world-s-20-largest-tech-giants> [Accessed 27 September 2018]).

⁶⁸ See, for an analogous example, UN Model (2017), above fn.1, Commentary on Article 12A, para.90.

advertisement business generates large turnovers for offshore online advertisement companies, without subjecting the corresponding profits to significant taxes in the client (or source) state.^{69,70}

The introduction of an Article 12A-type provision in the tax treaties of the states in question could be a first step in the direction of solving this issue to the extent that it would subject the “tailoring of services” to a gross withholding tax in the country where the client of the advertisement service is located. As such, the same services that are first outsourced and purchased at arm’s length from the local subsidiary in the source state are subsequently re-sold to the client as part of the online advertisement services provided and a withholding tax is due on the part of the payments which relates to the “tailoring” of those services.

Alternatively, states could choose to widen the scope of services covered under Article 12A to also include digital services, whether of a specialised or of a more generic nature. This is, as of yet, a rare occurrence. The only known case where this has happened was in the Protocol of 21 July 2017 to the Argentina–Brazil Tax Treaty (1980), which entered into force on 29 July 2018. The Protocol provides that technical services also include “services...resulting from automated structures with clear technological content”.⁷¹ Arguably, this covers most digital services.

5. Conclusion

Article 12A has added to the array of Articles in the UN Model which deal with the taxation of services. Although the scope of the Article seems to be subsidiary to the scope of other more general services Articles, such as the service PE and individual services of a personal basis, a more detailed analysis of each provision seems to indicate that they are, in fact, each within their fields of competence. Some of the services covered may overlap, but they do not necessarily engulf all of the services covered in Article 12A.

The apparent overlap between Articles 12A, 12, 14 and 5(3)(b) can be resolved by analysing whether the context of the particular case is one which would meet the presence requirements contained in Article 14 and Article 5(3)(b). Absent a PE or fixed place of business that would entitle the taxpayer to tax only the income that is attributable to that fixed base or PE on a net

⁶⁹ In France, the *Tribunal Administratif* and the *Cour Administrative d’Appel* rejected the attempts by the French tax authorities to assess the profits derived by Google and Valueclick, respectively, in France. Both companies were selling online advertisement services from Ireland to French clients by means of a French subsidiary providing the “marketing services”/“tailoring services”. (See France: Cour Administrative d’Appel, No.17PA01538 (*Valueclick*), 1 March 2018, Tax Treaty Case Law IBFD, available at: https://online.ibfd.org/kbase/#topic=doc&url=/collections/ttcls/html/cl_fr_2018-03-01_1-summary.html [Accessed 27 September 2018]; and France: Tribunal Administratif, No.1505178/1-I (*Google*), 12 July 2017, Tax Treaty Case Law IBFD, available at: https://online.ibfd.org/kbase/#topic=doc&url=/highlight/collections/ttcls/html/cl_fr_2017-07-12_1-summary.html [Accessed 27 September 2018]).

⁷⁰ In the UK, the same business model came under scrutiny with regard to UK advertisement clients served by Google from its base in Ireland by means of a local subsidiary in the UK. Instead of pursuing taxable presence in the UK through the existence of a PE, HMRC settled the matter with Google, accepting an increase in the transfer price charged by Google UK for the “tailoring services” provided to UK clients on behalf of Google Ireland. See, UK: House of Commons. Committee of Public Accounts, *Corporate tax settlements, Twenty-fifth Report of Session 2015–16* (The Stationery Office, 24 February 2016), HC 788, available at: <https://publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/788/788.pdf> [Accessed 27 September 2018].

⁷¹ See, Argentina–Brazil (1980), Protocol (2017), above fn.63, para.7(b).

basis, the fee is to be taxed at source, on a gross basis, either under the royalties Article or under the more specific fees for technical services Article.

Any conceptual confusion might only really occur when distinguishing between the royalties and the fees for technical services Articles. The Commentaries recommend that countries adopt the same withholding tax rate under both Articles in order to avoid having to distinguish between them. However, as demonstrated by treaty practice, not all countries are following that approach. For those treaties that make the point of distinguishing between Articles 12 and 12A, the issue will be to determine whether or not the payment was made with respect to a property right. If it is, then it is a royalty. If not, then it is a technical service.

From a policy perspective, the introduction of a specific Article to tax fees for technical services provides an incentive for an enterprise engaged in business in the source state to incorporate in a source state in order to qualify for net income taxation with respect to the technical services provided in or to that state. In that sense, it is an efficient tool to curb tax avoidance and evasion.

Article 12A provides an answer to longstanding claims from developing countries. It does not fully answer to those claims because it only asserts gross taxing rights on technical services, and not services in general (although it concedes that some countries might want to choose to do so by eliminating the word “technical” from the Article). However, it is a clear first step towards more assertive source country taxation with the aim of avoiding the erosion of the tax base and the simplification of the administration of taxes at source country level.

The astounding number of treaties which are either in force, or are waiting ratification, that have already included a UN Article 12A-type Article shows that this is a policy sought by many developing countries, and conceded by developed countries. In addition to that, the challenges presented by the digitalisation of the economy might further entice certain developed countries to add Article 12A to their tax treaty wish list. [Ⓔ]

[Ⓔ] Developed countries; Developing countries; Double taxation treaties; Fees; Model laws; Royalties; Supply of services; Tax administration; United Nations