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## Working Party No. 1 on Double Taxation

# FINAL REPORT OF THE AD HOC GROUP OF EXPERTS ON INTERNATIONAL CO-OPERATION IN TAX MATTERS ON THE WORK OF ITS EIGHTH MEETING

*The attached note is submitted to the Working Party FOR INFORMATION at its meeting on 24-26 February 1998.*

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# FINAL REPORT OF THE AD HOC GROUP OF EXPERTS ON INTERNATIONAL CO-OPERATION IN TAX MATTERS ON THE WORK OF ITS EIGHTH MEETING

## I. TAX HAVENS, WITH SPECIAL REFERENCE TO EXCHANGES OF INFORMATION

The subject of tax havens was introduced by the Secretariat, which noted that tax havens are threats to the tax systems of both developed and developing countries. Tax havens compromise the principle of tax neutrality because they cause tax considerations to inappropriately affect investment choices. Techniques were described that have been adopted by many countries as defenses against tax haven activities, including controlled foreign corporation and foreign investment funds legislation. Bank secrecy and confidentiality rules in tax havens make it difficult for other countries to uncover tax fraud and other illicit activities, and some tax havens, not wishing to be viewed as having complicity in illicit activities, have agreed to exchange some tax information.

The Group of Experts generally agreed that the tax haven issue should not be viewed as developed countries against developing countries because developing, as well as developed, countries are injured by tax haven activity. An observer noted that the tax haven problem is worse now than it was five years ago and will probably get still worse because Internet commerce and electronic banking make it ever easier to move funds into tax havens, which, among other things, has made the use of tax havens feasible for people with only modest wealth.

The discussion of the topic began with an effort to define the concept of tax haven. One member suggested that, very broadly, any aspect of a country’s laws or practices that is subversive of other countries' tax regimes could be considered a tax haven characteristic. Several speakers pointed to two basic features of tax havens: minimal or no tax on at least some types of income and lack of effective access to, and exchange of, tax information. A member and an observer elaborated further on these elements, as follows:

1. Low or zero effective tax rate.
2. An unwillingness to make information available.
3. A lack of transparency.
4. No requirement that real business activity be carried on.
5. In the case of a haven regime within a country with an otherwise acceptable tax system, a separation of the special regime from the domestic economy (a "ring fence”).

The presence of more than one of these characteristics is a good indicator of a tax haven.

### A. Low or No Tax

Several members of the Group suggested that it is the effective rate of tax, not the nominal rate, that determines whether a country has the low-or-no-tax characteristic of a tax haven. A country with high nominal income tax rates may nevertheless be a tax haven with respect to some investments if it has special exemptions or allowances that reduce the effective rate of tax on income from particular types of investments, although some believe that it is not appropriate to label a country a tax haven merely because it has different tax regimes for different types of income. Moreover, the crucial factor is the practical application of the law, not the nominal terms of the law. In some countries, unpublished rulings are given that substantially erode the tax base, tax rates are varied by private negotiation, or the law may simply not

be enforced as written. Such a lack of transparency - a policy of applying the law differently in practice from how it is stated in publicly available documents - is one of the most troublesome tax haven practices.

However, several members suggested that a country's failure to tax all income of all locally-organized entities should not in all cases be considered a tax haven characteristic. For example, a country should not be considered a tax haven merely because it grants tax holidays or other concessions as means of attracting foreign investments to finance real economic activities within the country. Also, a country is not a tax haven merely because its overall policy on taxing business income is to impose tax at a low rate on a broad tax base. Moreover, exemptions and other reliefs given only as means of avoiding double taxation should not mark a country as a tax haven.

In response, it was suggested that the distinguishing characteristic of a low-or-no-tax haven is that the tax haven facilitates the avoidance of taxation worldwide on income from sources in other countries. Under this view, the characteristic of a tax haven is the ability to shift funds to that country's tax jurisdiction without shifting economic to the country.

Some members of the Group believed that even this conception of tax haven is too broad because it would classify as tax havens all countries with territorial tax systems and some exemptions intended only as relief from double taxation might be considered tax haven provisions by this view.

However, the Group reached consensus that lack of transparency is an invidious tax haven characteristic.

Several members of the Group noted that although the use of tax incentives to attract investment into a country should not be considered a tax haven characteristic, tax competition among countries for investment is often unhealthy, and this competition might usefully be considered by the Group on another occasion.

**B. Information Exchange**

The Group quickly reached consensus that lack of access to tax information was a tax haven characteristic. This lack of access may derive, for example, from bank secrecy laws, other laws protecting the confidentiality of financial information, or laws facilitating the issuance of bearer shares and bonds.

It was also agreed that the best way to provide access to tax information is through tax treaties with provisions for information exchanges or separate international agreements on information exchanges. These provisions should deal explicitly with any bank secrecy laws of either country. It was suggested that countries with extensive experience in information exchanges should provide tools to help countries with less experience initiate exchange programs. An additional approach is to urge countries to abandon laws and practices that are harmful to the tax systems of other countries.

It was pointed out that some countries have had some success in obtaining information on transactions in tax havens by indirect means. For example, if a country's laws require resident individuals and corporations to disclose to the tax administration all records and documents in their possession, including material kept outside the country, these laws may sometimes be used to obtain records on tax haven transactions. Also, a tax administrator's power to compel the production of documents may be extended to a foreign parent corporation of a domestic subsidiary corporation. Moreover, a taxpayer, particularly if accused of a tax crime, could be ordered by a court to waive secrecy rights under the laws of a tax haven country. If the taxpayer deals with banks having branches in the taxing country and in

various other countries, the tax administrator may be able to compel the bank to produce records on transactions of branches in other countries, including tax havens. Finally, courts in non-haven countries may refuse to accept the defense that a disclosure of tax information would violate the criminal laws of a tax haven.

Some members of the Group from developing countries observed that although techniques such as these may be effective for large developed countries with great economic power and highly developed legal systems, they may be less practical for smaller countries, particularly developing countries.

## II. INNOVATIVE FINANCIAL INSTRUMENTS

The subject of derivatives and other financial instruments was introduced by the Secretariat. It was pointed out that all financial instruments consist of or are constructed from three basic building-blocks: financial assets (stocks and bonds); options; and forward contracts . Options come in two forms: options to buy (call options) and options to sell (puts). A person may be either the holder of an option (the person entitled to buy or sell) or the writer of the option (the person required to honor the holder's right to buy or sell). Because the obligation is not reciprocal, the holder usually pays a premium to the writer when the option is issued. A forward is an agreement whereby one person agrees to buy designated property at a specified future date for a specified price and the other person agrees to sell. Because the obligations under a forward contract are mutual, no money changes hands when a forward is made if the contract price is the market forward price at that time. A futures contract is a type of forward that is traded on an organized exchange and subject to the rules of the exchange, which usually require that the contract be marked to market by an interim settlement each day. Options and forwards are called derivatives because their values fluctuate with the values of the underlying property, but they do not directly represent an ownership in that property.

Most countries are now in the process of developing their domestic rules for financial assets and derivatives. In doing so, it is important that the rules for various types of instruments be as consistent with each other as is possible. Because an option or forward contract economically duplicates (or is the opposite of) all or a portion of the ownership of the underlying property, it is possible, by combining derivatives or financial assets and derivatives, to achieve the economic equivalent of ownership of the property or any desired portion of the ownership. Thus, if the rules for the three types of building blocks are not fully consistent, taxpayers using derivatives for legitimate business reasons (principally, to manage risk) may find these uses upset by asymmetrical tax treatments, and other taxpayers will exploit these discontinuities to the detriment of tax revenues. Unfortunately, complete consistency is not practicably achievable because derivatives blur the lines between capital gains and other income, realized and other gains, dividends and interest, and various other categories commonly used in tax laws. Thus, a tax law could completely eliminate the asymmetries and arbitrage opportunities that derivatives facilitate only by eliminating all of these categories and simply imposing tax on net accretions to wealth, an approach that is only theoretical and not practicable. The objective thus must be to achieve consistency to the extent practicably achievable, recognizing that derivatives threaten all categorizations in a tax law affecting financial transactions and holdings.

According to the Secretariat, those who have studied the matter have generally agreed that income from cross-border derivative transactions can feasibly be taxed only on a residence basis and that withholding taxes at source on payments under such derivatives are not practical, if even theoretically appropriate. Derivatives transactions often exploit thin margins between prices available in different markets. For example, it may be possible for a person to borrow money at a variable rate, enter into an interest rate swap to exchange the variable rate obligation for a fixed rate obligation, and wind up with an

interest obligation at a rate marginally lower than could have been obtained by borrowing directly at a fixed rate. However, the difference is usually very small. Even a small withholding tax (e.g., 5 percent of the taxpayer's payments under the swap agreement) is likely to be larger than the margin exploited by the transaction. If so, the result of the withholding tax is that the transaction will not occur, and no withholding tax will be collected.

A representative of the OECD spoke of that organization's work on financial instruments. He noted that although the concept of derivatives is very old, the use of derivatives has grown greatly in recent years because of the globalization of financial markets and because of the financial risks (principally, currency and interest risks) that businesses increasingly encounter in international commerce. He further noted that a withholding tax on cross-border payments under derivatives simply causes derivatives transactions subject to the tax not to occur. Usually, the result is that the transactions move offshore and residents devise ways of participating in the offshore markets without incurring the withholding tax (e.g., through the use of offshore subsidiaries). Other observers confirmed that the experience of several countries has been that withholding taxes generally cannot be imposed at source on derivatives transactions.

Several members of the Group agreed that payments under cross-border derivatives transactions should not, as a general rule, be subject to withholding taxes. However, some members from developing countries noted that income tax treaties made by developing countries, following the United Nations Model, are generally based on the premise that the countries of source and residence should share tax jurisdiction over income from cross-border transactions; these members questioned whether this policy should not also be followed for derivatives transactions. In response, it was suggested that while such a sharing is appropriate where the income economically derives from the source country, the country from which a cross-border derivatives payment emanates is not usually the economic source of any income other than that reported on a residence basis by the payor. For example, if a business in country *A* enters into a swap with an investment bank in country *B*, the bank makes no investment in country *A*, but instead earns its income under the swap from activities and capital located in country *B*; payments by the country *A* business to the bank thus do not include any income of the bank from country *A* sources. If country *A* taxes all income of the country *A* business on a residence basis, it taxes all income from the transaction that originates in that country. One member of the Group made an analogy to cross-border sales of physical goods, where, if the seller carries on no activities in the buyer's country, no portion of the seller's income on the sale is considered to be from sources in the buyer's country. It was also noted that 1995 additions to the Commentaries to the OECD Model Double Taxation Convention clarify that because an interest swap is not a debt claim, payments under the swap are not subject to the interest article of the Convention.

The OECD representative noted that source taxation of derivatives is, however, appropriate in some circumstances. For example, if a derivatives transaction is made at arm's length, but at a price differing from the market price, a payment is made from one party to the other to compensate for this divergence; this payment may have the economic effect of a loan, the implicit interest on which may appropriately be taxed as such. Also, when derivatives contracts are made between related persons, the pricing may not be at arm's length, and withholding taxes on the excess payments may be appropriate. UK legislation on derivatives contains three anti-abuse rules directed at these and other transactions, including a rule that a derivatives transaction with a tax haven country is presumed not to be at arm's length. The United States also has rules to ensure that derivatives transactions do not inappropriately avoid withholding and other taxes. A 1995 addition to the Commentaries to Article 21 of the OECD Model suggests a provision that might be added to the article to ensure that the article does not inappropriately exempt income from derivatives contracts not at arm's length.

An observer noted that double taxation can result if a financial instrument is classified differently by two countries (e.g., if one country treats a swap as including an embedded loan and another finds no embedded loan). It was noted that the OECD has recognized the problems of inconsistent classification and is working on developing solutions to these problems.

Several members noted that the time was not ripe for the Group to be making recommendations on this subject and that the purpose of the discussion of the subject at this meeting should be considered to be to exchange of information. It was suggested that all countries are still on the learning curve on this subject.

## III. TRANSFER PRICING

The subject of transfer pricing was introduced by the Secretariat. It was noted that, at the international level, transfer pricing has become a matter of concern to all countries, but efforts by tax administrations in this area have steadily evolved over the decades. The United States, which subsequently took a leading role in the development of transfer pricing rules, did not often question reported transfer prices in international transactions until the 1960s. After four years of deliberation, extensive transfer pricing regulations were issued by the United States in 1968, which confirmed the arm's length principle as the basic guide and elaborated on the application of that principle. In 1979, the OECD issued transfer pricing guidelines, which were generally consistent with the US regulations but put forward additional considerations. During the late 1980s and early 1990s, the US Treasury undertook an extensive revision of its transfer pricing regulations, which culminated in the issuance of new regulations in 1993 and 1994. The latter stages of the development of the new regulations was contemporaneous with the OECD's revision its transfer pricing guidelines, which led to the issuance of new Guidelines in 1995 and the supplementation of the Guidelines 1996.

Transfer pricing distortions often arise from the desire to minimize taxes, but other factors can also be the source of the distortions. For example, political factors within a large corporation may cause income to be shifted artificially to favored divisions, and some multinational corporations have shifted income away from foreign subsidiaries and to the parent corporation, principally to enhance the ability of the parent's management to control the funds.

The Group recognized that transfer pricing is a multilateral problem and that an international consensus is needed in dealing with it. The Group acknowledged that the arm's length standard is the base on which that consensus must rest. However, it noted that the arm's length principle is not easy to apply, and that nearly all of the detailed elaboration in the US regulations and the OECD Guidelines is an effort to meet the difficulties of applying this standard. One member of the Group suggested that these difficulties were especially great for developing countries because, given the limited markets in many types of goods and services, comparable prices often were not available. For example, in dealing with oil companies, world prices for oil can be used for transfers of oil, but comparables can generally not be found to test payments for services made by local corporations to their foreign parents and other affiliates. Members from developing countries suggested that all countries encounter these problems. However, an observer from a developing country noted that developing countries have special difficulty in gathering the administrative resources necessary to audit transfer prices.

It was suggested that because cross-border payments always involve at least two countries, cooperation and exchanges of information among countries was a key to managing transfer pricing problems.

Some developing countries have experimented with alternatives to the arm's length principle. A few countries have rules presuming a certain level of net income from particular activities. Other countries have enacted assets taxes, which are premised on the idea that net income can reasonably be expected to be at least a certain percentage of the taxpayer's investment and that a tax imposed on net asset values can reasonably approximate the effects of the income tax (e.g., one third of the expected return on net assets if the income tax rate is 33 percent). The income tax may be allowed as a credit against assets tax, in which case the assets tax effectively functions as an alternative minimum tax. A member of the Group suggested that in some situations, especially those of companies with losses, these substitute mechanisms could result in excessive taxation and that it was better that countries, rather than resorting to these substitutes, developed their abilities to apply the arm's length principle.

Over the last five year, several countries, beginning with the United States, have developed procedures for advance pricing agreements (APAs). These procedures have been received by the business community with some hesitation. An observer noted that, in his country, businesses have been afraid that information disclosed in the course of obtaining APAs would be used by the tax administration in auditing the businesses for prior years. This fear has been somewhat alleviated by assurances that the information would be so used only in cases of blatant abuse. It was observed that the APA procedure is time consuming, and the costs of formulating APAs are substantial for both the tax administration and taxpayers. Moreover, an effective APA program can only be administered by a trained and specialized staff. However, these costs and staffing requirements are usually substantially less than the costs of an audit after the fact, particularly if the audit leads to litigation.

The members of the Group generally agreed that lack of expertise and resources was a major problem in the transfer pricing area for developing, and some smaller developed, countries. One possible solution to this dilemma was the creation of one or more multilateral organizations that would assist in auditing companies jointly on behalf of the member countries. This proposal was not considered by the Group.

One member of the Group suggested that a multinational arbitration framework was needed to aid developing countries in resolving transfer pricing issues and that the United Nations should assist developing countries in organizing such a framework. It was noted, however, that an arbitration forum would not solve what may be the major problem for developing countries - garnering the resources needed to develop transfer pricing cases - and that without a solution to this threshold problem, developing countries that brought arbitration cases would be overwhelmed by the preparation of the companies and would lose the cases. It was also noted that over the last decade, arbitration clauses had been included in some income tax treaties, which generally apply only if the competent authorities do not agree within a reasonable period of time and only if arbitration is consented to by both tax administrations and the taxpayer, moreover, the members states of the European Union have concluded among themselves a multilateral arbitration convention, which became effective at the beginning of 1996. However, no arbitration proceedings have yet been brought under these procedures. In the view of several members of the Group, further ventures into arbitration should probably await the experience under existing arbitration procedures.

Several members of the Group expressed a need for training and other assistance to aid developing countries in gaining practical expertise in transfer pricing issues. Several speakers described efforts of the United Nations, the OECD, the International Monetary Fund, the US Internal Revenue Service, and other organizations to meet this need. A desire was expressed for the Group to extend its

efforts in this area. The Secretariat has prepared a report on technical assistance that will be considered by the Group later in the meeting.

## IV. UPDATING OF UNITED NATIONS MODEL

Discussion of the subject of the updating of the United Nations Model Double Taxation Convention was begun by a representative of the International Bureau of Fiscal Documentation, who described a study of the Model in practice. There are 27 provisions of the Model that are not found in the OECD Model or differ from the corresponding provisions of the OECD Model. The study covered 26 of them, examining whether each of the provisions was included in each of the 811 income tax treaties that have been concluded since the United Nations Model was published in 1980, of which 697 were made by developing countries with developed countries or other developing countries and 114 were between OECD countries.

The study found that six of the 26 UN provisions were included in more than 40 percent of the treaties made by developing countries:

| *Article* | *Description* | *Percentage of inclusion* |
|---|---|---|
| 5(3)(a) | Construction supervisory activities may be PE | 59 |
| 5(3)(a) | Construction site less than 12 months | 69 |
| 12(3) | Tapes for radio or television broadcasting | 88 |
| 13(4) | Gains on shares of real property holding companies | 44 |
| 13(5) | Major shareholdings in other companies | 46 |
| 21(3) | Source taxation of other income | 44 |

Several of the provisions were included in less than 10 percent of these treaties:

| *Article* | *Description* | *Percentage of inclusion* |
|---|---|---|
| 7(5) | Omission of rule that no profits attributable to purchase | 6 |
| 14(1)(c) | Source tax on services income exceeding specified amount | 6 |
| 16(2) | Source tax on salaries of top level managerial officials | 9 |
| 20(2) | Equal treatment of students | 8 |
| 25(4) | Implementation of mutual agreement | 6 |
| 26(1) | Disclosure of secret information | 7 |
| 26(1) | Implementation of information exchanges | 9 |

Some of the UN provisions were found as often or more often in treaties between OECD countries than in treaties with developing countries:

| | | *Percentage of inclusion* | |
|---|---|---|---|
| *Article* | *Description* | *OECD* | *Developing* |
| 12(3) | Tapes for radio or television broadcasting | 89 | 88 |
| 13(4) | Gains on shares of real property holding companies | 58 | 44 |
| 13(5) | Major shareholdings in other companies | 54 | 46 |
| 18 | Social security payments taxable only in payor State | 42 | 30 |

Only the following UN provisions were included significantly more often in treaties of developing countries:

| | | *Percentage of inclusion* | |
|---|---|---|---|
| *Article* | *Description* | *Developing* | *OECD* |
| 15(3)(a) | Construction supervisory activities may be PE | 59 | 34 |
| 5(3)(a) | Construction site less than 12 months | 69 | 25 |
| 5(3)(b) | Services as PE | 31 | 2 |
| 5(4)(a), (b) | Delivery not excluded as PE | 26 | 0 |
| 5(5)(b) | Dependent agents with stock of goods | 34 | 8 |
| 7(1) | Limited force of attraction | 22 | 8 |
| 7(3) | Elaboration on deductions of PE | 28 | 5 |
| 14(1)(b) | Independent services/183 day rule | 38 | 18 |

The members of the Group generally agreed that a revision of the United Nations Model was needed. Because the OECD Model and Commentaries have been revised in many particulars since the issuance of the United Nations Model in 1990, it is necessary that the United Nations Model be revised as mandated by the General Assembly (Programme budget for the biennium 1998-1999 - A/52/6/Rev.1 - Section 10: "Development Support and Management Services", para. 10.24). It was also suggested that the process of updating the Model should be ongoing because revision tends to become more and more difficult as time passes since the last updating. A representative of the OECD explained that the changes to the OECD Model and Commentaries since 1980 have been technical in nature, involving issues of application and interpretation rather than matters of fundamental substance and that because few of these

technical changes involved questions peculiar to developed or developing countries, most of them should be equally useful in the developing country context. He also noted that the OECD has invited non-member countries to comment on the OECD Model and that the comments received from 17 non-member countries are reported in volume II of the 1997 updating of the OECD Model and Commentaries. The members agreed that the Group should consider the OECD changes for inclusion in the United Nations Model.

Some members cautioned that a revised United Nations Model should be issued only if the Group is able to reach consensus on substantially all issues of concern to developing countries that affect the Model and that if the Group only reached consensus on the inclusion of various of the OECD changes, publication of a new document as a United Nations Model would give the false impression of a comprehensive revision agreed to by the Group. These members suggested that the Group should only issue a report to supplement the 1980 Model if it is not able to reach consensus on substantially all of the relevant issues.

An observer suggested that revisions of the United Nations Model should take into account of how technological innovation can have the effect of eroding source taxation by, for example, making it possible to do extensive business with residents of a country without establishing a permanent establishment in the country.

Based upon informal consultations with members of the Steering Committee, the Chairman and the Secretary recommended that the Group proceed with the updating of the Model as follows: During this meeting, the Group would identify the OECD updates that are generally acceptable to the Group and those that require further discussion. The latter, and any other issues that should be considered in a revision of the Model, would be referred by the Secretariat to a focus group consisting of the following five members of the Group: Mr. Benbrik, Mr. Gabay, Mr. Feinberg, Mr. Figueroa, and Mr. Shepherd. Alternate members, to serve if any of the principal members is unable to serve, are Mr. Alder, Mr. Bunders, Mr. Ishaq, and Mr. Skurnik. The focus group would work on the updating project throughout 1998 by correspondence, at least two online conferences, and one meeting to be held in person. The results of this effort would be referred to the Group at least two months before the Ninth Meeting of the Group of Experts, to be held some time between June and October of 1999. After discussion, this proposal was accepted by consensus.

Proceeding article-by-article, the Group discussed the changes made to the text of the articles of the OECD Model and other matters that should be considered in updating the United Nations Model. Some of the OECD article changes were found suitable for inclusion as such in the United Nations Model articles. The Group did not discuss the Commentaries and refers all potential changes to the Commentaries to the focus group, together with all other unresolved issues. Some of the issues identified for future discussion presented below:

Article 9, paragraph 2, requires a country to make an “appropriate adjustment” (a correlative adjustment) to reflect a change in a transfer price made by the other country under article 9, paragraph 1. It was suggested that if the transfer price corrected by the primary adjustment under paragraph 1 was fraudulent, no adjustment should be made. Another observer noted that a correlative adjustment under paragraph 2 could be very costly to a small country and suggested that a small country might consider not including paragraph 2 in its treaties. Several members of the Group responded that they believed paragraph 2 was an essential aspect of article 9. However, a country appropriately could closely examine the primary adjustment under the paragraph 1 before deciding what correlative adjustment is appropriate to reflect the primary adjustment. Moreover, it may be possible in some instances to spread the

correlative adjustment over a period of years. It was further observed that any fraud in connection with the transfer price was against the interests of the country making the primary adjustment, which may assess a penalty on the fraud.

In 1995, the OECD amended article 10, paragraph 2, and article 11, paragraph 2, to change "if the recipient is the beneficial owner of the dividends [interest]" to "if the beneficial owner of the dividends [interest] is a resident of the other Contracting State." The same substitution was made in article 12, paragraph 2 of the draft revised United Nations Model presented for the Group's consideration. The purpose of these changes is to allow the benefits of these articles to a beneficial owner residing in a treaty country, regardless of the residence of any broker or other intermediary collecting the income on behalf of the beneficial owner, and correspondingly to deny treaty benefits when the beneficial owner is not a resident of the treaty country, even if the intermediary collecting the income is a resident. Several members of the Group expressed support for this change, but some members had doubts about its effects on developing countries and countries that tax on a remittance basis and recommended that it be examined by the focus group.

The draft revised United Nations Model proposes a new paragraph 6 to Article 10, dealing with branch taxes. The Group agreed that because this paragraph and the accompanying commentaries had not previously been considered by the Group, it should first be studied by the focus group. However, it was suggested that because not all countries have branch taxes, this paragraph might better be in the commentaries. Also, the focus group should consider whether the draft paragraph, which refers to "profits attributable to the permanent establishment," is broad enough, given that article 7, paragraph 1 of the United Nations Model allows the source country to tax more than the profits attributable to the permanent establishment.

The OECD, in 1992, deleted the words "for the use of, or the right to use, industrial, commercial or scientific equipment” from article 12, paragraph 3 of its Model. The Group agreed that because of the broad substantive effect of this deletion, the issue of whether the same deletion should be made in the United Nations Model should be referred for study by the focus group. It was also suggested that the focus group should consider providing additional guidance in the commentaries on the indistinct dividing line between payments for know-how, which are royalties under article 12, paragraph 3, and payments for technical assistance services, which are not royalties.

It was noted that article 13, paragraph 4 - allowing taxation at source of gains on sales of shares of companies whose assets consist principally of immovable property - was commonly included in treaties, even treaties among OECD countries, although the paragraph is not found in the OECD Model. However, it was suggested that the focus group should consider strengthening the provision by making it applicable to interests in partnerships and trusts holding immovable property. On the other hand, the focus group might consider whether it should apply when the company is in an active business other than managing property (e.g., a hotel company). It was also suggested that paragraph 5 of article 13 - which allows source taxation of gains on dispositions of substantial participations in a company - might be modified to limit source country tax to a rate less than that generally applied in that country.

It was suggested that in article 14, paragraph l(b) - which allows income from independent personal services to be taxed by the source country if the services performer is present in that country for at least 183 days - the 183 day threshold was too long. Although the 183 day rule may be seen as only a backup of the fixed base rule in paragraph l(a), a member of the Group noted that it was often possible for substantial services to be rendered in a country without either a fixed base or 183 days of presence in the country. It was agreed that the issue should be studied by the focus group.

A member of the Group suggested that paragraph 2 of article 16 - allowing salaries of top-level managers to be taxed in the country of which the company is resident - should be examined by the focus group.

Several speakers suggested that the focus group consider whether article 18, relating to pensions and social security benefits, should be modified to reflect privatized social security systems adopted by several countries.

In paragraph 3 of article 19, the OECD has added a reference to article 17. The effect of this change is that remuneration of sportsmen and entertainers performing services for a contracting State in the other State are taxable at source under article 17, rather than being taxable only in the employer State under article 19, paragraph l(a). It was agreed that the focus group should consider whether this change should be made in the United Nations Model.

The OECD Commentaries on article 21 (Other Income) have been amended to suggest an additional provision to limit the application of the article to derivative transactions not at arm's length. The Group agreed that the focus group should consider this amendment, taking due note of the differences between the OECD and UN Models in the basic provisions of article 21.

In the 1980 United Nations Model, the final sentence of article 24, paragraph 4 is in brackets, indicating that the sentence should be omitted in a treaty that does not contain an article on capital taxes (article 22). It was agreed that the brackets were included in error because article 24 applies to all taxes, including capital taxes, even if capital taxes are not otherwise covered by the treaty.

Several members of the Group noted that some treaties contained provisions for collection assistance in article 26, even though neither the United Nations Model nor the OECD Model contains such a provision. The Group agreed that the focus group, in its consideration of article 26, should examine whether the United Nations Model or the commentaries should include provisions for collection assistance.

## V. TECHNICAL TRAINING

The Secretariat presented a proposal for a series of training seminars in international taxation for tax administrators in developing and transitional economy countries. It was noted that with the growth of international commerce and investment, the tax administrations of all countries are faced with increasing challenges in assessing and collecting the taxes due them from international transactions. For developing and transitional economy countries, this challenge is further complicated by limitations on their resources for developing practical expertise in international taxation, particularly such complex and quickly developing areas as transfer pricing and financial innovation. The Secretariat therefore proposed that the United Nations arrange a series of Interregional Workshops to improve the practical technical skills of tax administrators of developing and transitional economy countries in international taxation, including practical methods and strategies for combating tax evasion. The Workshops would be taught by case studies and lectures presented by experts in international taxation and finance, including eminent tax administrators and university professors. The Workshops would also provide an opportunity for participating tax administrators to share experiences and points of view on matters having a vital bearing on the tax systems of their countries. The Secretariat proposed a series of five workshops to be held in five locations dispersed among the regions of the world. Each Workshop would continue for 10 working days, and each would be attended by about 50 representatives of 15 to 20 developing countries in the

region. It is proposed that although funding for the Workshops has not yet been obtained, the costs would be shared by the United Nations, UNDP, and the host countries.

The Group received the proposal with enthusiastic approval. Several members indicated that they would urge their countries to serve as hosts of one of the Workshops or to provide assistance in other ways. The members also suggested that financial support should be sought from other organizations.

Members of the Group and observers made several suggestions for maximizing the effectiveness of the Workshops. It was suggested that because all tax administrations lose personnel to the private sector, the Workshops should be structured to train the Workshop participants to train other members of their tax administrations in the matters covered in the Workshops. Several members suggested that the Workshops should be planned in careful coordination with the training efforts of other organizations in order to target the limited resources available for the Workshops toward subjects and countries that are not covered by other training programs. Also, it was suggested that the Workshops would be more successful if each Workshop were focused on one or a small number of topics and that it may not be desirable to mix in a single Workshop participants from countries with tax administrations in widely differing stages of development. Also, those attending a Workshop could be expected to participate actively in the discussion, rather than merely listening to lectures, only if the number of participants in each Workshop was not greater than 25.

The Secretary thanked the members and observers for their suggestions and noted that the United Nations welcomed participation and assistance from other organizations.