International

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Update on the United Nations Tax Work

The United Nations (UN) work on tax related issues is of increasing importance especially with regard to developing countries. The author provides an overview of recent developments on the UN Model tax treaty and other areas of tax cooperation being undertaken by the organization.

1. Introduction

As noted in previous articles in this journal,[1] the United Nations (UN), as the successor body to the League of Nations, has a long lineage in dealing with international double taxation. The UN tax work has most recently focussed on (i) the *United Nations Model Double Taxation Convention between Developed and Developing Countries* (the UN Model) and (ii) the *United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (the Manual). The current (2001) version of the UN Model is now being revised with a view to a new version being completed by the end of 2011. The Manual, which gives some extra background to the UN Model and its practical application, was revised in 2003, and is also being further revised.[2]

The UN tax work was discussed in the two previous articles[3] and in particular it was noted that the place of tax work in the UN system can only be properly understood in the context of the 2002 "Monterrey Consensus" on Financing for Development. Because of the obvious linkages between tax cooperation, including the development and maintenance of the UN Model, and the sustained development of country economies, a very small Secretariat for the Tax Matters Committee is stationed in New York – in the Financing for Development Office of the UN Department of Economic and Social Affairs. The Financing for Development Office was created in direct response to the Monterrey Consensus.

A major follow-up conference on Financing for Development was held in Doha, Qatar from 29 November to 2 December 2008 to review the progress on financing for development since Monterrey, and the outcome document, the "Doha Declaration", gave further recognition to the need for international cooperation in tax matters to mobilize domestic resources, while ensuring that developing countries have sufficient input into international tax norms affecting them.

The greater recognition of the role of tax systems in promoting development, including the need to better equip developing countries in combating tax evasion, is a common focus in this area, and a key aspect of the mandate of the UN Committee of Experts on International Cooperation in Tax Matters (the Committee), the work of which is supported by the UN Secretariat.

The Committee itself is composed of 25 Members nominated by governments but selected by the Secretary-General of the UN and acting in their personal capacity. The selection is made to reflect not just the individual expertise of candidates, but also an adequate equitable geographical distribution, representing different tax systems, and bearing in mind the special developing country focus of the UN tax work. The term of office for the current iteration of the Committee (chosen in 2009) is four years, finishing at the end of June 2013.

The Committee is now composed of experts from 15 developing countries, i.e. Brazil, Morocco, South Africa, Nigeria, Ghana, Senegal, India, Pakistan, China, Malaysia, South Korea, Egypt, Barbados, Chile, Mexico, as well as experts from 10 developed countries, i.e. Germany, Belgium, Italy, Spain, New Zealand, Norway, Switzerland, Bulgaria, the United States and Japan.[4] In any case, the experts act on their own behalf, rather than as representatives of their countries.

The role of *non*-Members of the Committee in the UN Tax work should not be underestimated, however. The Annual Session of the Committee, which is always held in Geneva (18-22 October in 2010), is attended by many representatives of "observer" governments as well as those from intergovernmental organizations, academia, business and non-governmental organizations. Those representatives can participate freely in discussions and some are represented in the subcommittees and working groups of the Committee which do so much of the substantive work. It remains vital for the success of the Committee's work that it finds wide acceptance across the wider UN membership as a whole, and that it takes into account the relevant views of other "stakeholders" in the UN tax work, so this opportunity for wider participation in the Committee's work is ultimately central to the quality, relevance and acceptance of that work.

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This article is based on his presentation at the Asian Development Bank Institute's Regional Tax Forum, 3-6 November 2009, Tokyo, Japan. The views expressed are personal to the author and do not necessarily represent those of the UN or the UN Tax Committee.

1. Lennard, M., "The Purpose and Current Status of the United Nations Tax Work", 14 *Asia-Pacific Tax Bulletin* 1 (2008), and Lennard, M., "The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments", 15 *Asia-Pacific Tax Bulletin* 1 (2009).
2. The 2001 version of the UN Model and the 2003 version of the Manual are freely available on the UN tax website: http://www.un.org/esa/ffd/tax/index.htm.
3. See note 1.
4. Note that for UN purposes, Mexico and South Korea are classified as developing countries.

Now that the new Membership has completed its October 2009 Annual Session, it is opportune to examine the results of that Annual Session and the direction the Committee has set for itself in relationship to the UN Model, the Manual and other aspects of tax cooperation.

2. Organizational Issues

When the Committee met for its first Annual Session with the new Membership in October 2009 in Geneva, Armando Lara Yaffar of Mexico was chosen by the Members as Chairperson of the Committee. First, Second and Third Vice-Chairpersons were also elected in that meeting. Tizhong Liao of China was chosen as First Vice-Chairperson, Anita Kapur of India as Second Vice-Chairperson, and Henry Louie of the United States as Third Vice-Chairperson. Liselott Kana of Chile was chosen as Rapporteur for the Fifth Annual Session.

The new Chairperson noted the importance of having the Committee prioritize tasks, so as to accomplish its broad mandate in the most effective and efficient way possible. He indicated that the Committee had in its discussions regarded the most urgent issue before it to be the revision of the UN Model, which the Committee had targeted to be completed by 2011. Second was the preparation of a Practical Manual on Transfer Pricing for Developing Countries. There were other issues that the Committee regarded as very important to meeting its Mandate, as reflected in the formation of nine subcommittees, as follows:

– UN Model Tax Convention Update;
– Tax Treatment of Services;
– Exchange of Information;
– Dispute Resolution;
– Transfer Pricing – Practical Issues;
– Revision of the Manual for Negotiation of Tax Treaties;
– Art. 14 of the UN Model;
– Capacity Building; and
– Capital Gains.

3. The UN Model

As noted in the previous articles published,[5] both the UN and OECD Model Tax Conventions are designed to encourage investment by preventing double taxation of profits. It follows that most of the real issues in tax treaty negotiations revolve around whether, in respect of *particular* income profits or gains, the source country will relinquish its taxing rights.

The main differences between the two Models are as to the extent of this relinquishment of taxation rights by the source country, the host country of investment. It is still basically true that the OECD is more of a "residence country" model (therefore reducing source country taxing rights and being generally preferable to capital-exporting countries) and the UN Model is a more "source country" oriented model, generally preferable to host countries of investment, which developing countries tend to be. With that background, relevant outcomes from the 2009 Annual Session as to the proposed 2011 revision of the UN Model were as follows:

Definition of permanent establishment

At the 2008 Annual Session the Committee had decided that in view of the differing views about whether Art. 14 (Independent Personal Services) should be deleted from the UN Model, it was appropriate to maintain Art. 14 in the UN Model, but to provide an alternative for those countries which would like to delete Art. 14 and therefore have situations currently addressed by it dealt with instead by Arts. 5 (Permanent Establishment) and 7 (Business Profits).

The agreed outcome at the 2009 Annual Session was that the Commentary to Art. 5 would include a possible form of wording for those wishing to delete Art. 14. That relevant wording provided for Art. 5(3) to read, in this alternative, as follows:

> The term "permanent establishment" also encompasses:
> (*a*) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
> (*b*) the furnishing of services by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or connected project) within a Contracting State for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal period concerned;
> (*c*) for an individual, the performing of services in a Contracting State by that individual, but only if the individual's stay in that State is for a period or periods aggregating more than 183 days within any twelve month period commencing or ending in the fiscal year concerned.

While this proposal was agreed by the Committee, it was recognized that in treating Art. 14(1)(b) as only applying to individuals, so that Art. 5(3) (c) as finalized above is explicitly confined to individuals, this drafting reflected a view expressed in Para. 9 of the Commentary on Art. 14 to the effect that Art. 14 deals only with individuals. Some countries do not hold to that view, and this will be noted in appropriate form in the Commentary to Art. 5, alongside this alternative provision. It was recognized that, in this and other aspects of the UN Model, changes to other Articles in future could, of course, necessitate consequential amendments for the 2011 update.

Taxation of services, including royalties, and technical fees issues

With Art. 14 to be retained in the 2011 version of the UN Model, but with a recognition that there were some issues with its current drafting, a subcommittee had been set up in 2008 with the task of examining in more detail those issues and possible solutions.

Some difficulties identified by the Subcommittee regarding the current Art. 14 were as follows:

5. See note 1.

- Coverage of activities other than furnishing of professional services. The main problem in this regard is that the current Art. 14 includes in its wording the phrase "other activities of an independent character" which is neither defined in the UN Model nor explained by the Commentaries;
- Uncertainties over scope. The issue of personal scope has been extensively discussed in the context of the Tax Committee work on definition of permanent establishment over the past few years, and addressed in the papers available on the UN tax website noted above. One example was that while some countries consider that Art. 14 can be applied only to individuals, others apply the Article to both individuals and companies;
- Difficulties in applying Art. 14 due to divergent interpretations of the term "fixed base". The current Commentaries point out that the term fixed base is analogous to permanent establishment. However, some participants in the UN tax work have indicated that they make some distinctions between the two terms; and
- Deduction of expenses by a fixed base. The UN Commentaries refer to the OECD Commentaries and point out that deduction of expenses by a fixed base must be allowed under Art. 14. However, such a possibility is not explicitly mentioned in the text of Art. 14 – which in some countries creates problems of interpretation.

Bearing in mind the areas of difficulty just noted, it was proposed that the discussion on proposals to improve Art. 14 could usefully focus on issues such as:
- coverage of activities other than furnishing of professional services;
- uncertainties over the scope of Art. 14 with regard to residents (individuals and companies);
- difficulties in applying Art. 14 due to diverging interpretations of the term "fixed base"; and
- deduction of expenses by a fixed base.

The Subcommittee on Services will also examine the issue of taxation of fees for technical services, an issue of special interest to some developing countries.

Attribution of profits under Article 7 of the UN Model

As a result of discussions at the 2008 Annual Session of the Committee, a short paper had been commissioned outlining recent developments at the OECD with respect to Art. 7 of the OECD Model Tax Convention (OECD Model) and the potential impact on the UN Model. It was noted that the OECD has done a significant amount of work in this area, i.e. it has incorporated a revised commentary on Art. 7 in its 2008 OECD Model update and it is expected that a new Art. 7 will be incorporated in the 2010 update, based on the proposals in the OECD's 2008 Final Report, "The Attribution of Profits to Permanent Establishments".[6]

The view was expressed that the proposed new Art. 7 of the OECD Model will introduce significant changes conflicting with Art. 7 of the UN Model, however, in requiring permanent establishments to be treated as fictional or notional separate legal entities – with assets, capital and liabilities allocated between branches and head offices largely on the basis of "significant people functions". In particular, deductions would be provided for notional payments of royalties and interests and profit margins allowed for services provided by head offices for branches. The proposed new Article in the OECD Model is not expected, however, to allow for the levying of withholding tax on such notional payments. The new Art. 7 in the OECD Model was therefore seen by some as potentially changing the balance between source and resident taxation contrary to their interests of many developing countries.

Some participants expressed support for the OECD revision to the Commentaries on Art. 7 of the OECD Model and to Art. 7 itself, expressing the view that all the OECD changes did was to take more seriously the principles that were already present in Art. 7. These participants did not agree that the changes shifted the balance of source and residence taxation in treaties, and felt that the OECD work would give greater certainty to the attribution of profits.

Ultimately it was decided that whatever approach was right for the OECD Model, the Committee should not adopt the approach to Art. 7 outlined in the OECD's 2008 Report as relevant to the UN Model. This was because it was in direct conflict with Art. 7(3) of the existing UN Model, which generally disallows deductions for amounts "paid" (otherwise than towards reimbursement of actual expenses) by a permanent establishment to its head office. That rule was seen as continuing to be appropriate in the context of the UN Model, whatever changes were made to the OECD Model and Commentaries.

It was agreed that minimal drafting changes to the Art. 7 Commentary should be included in the next UN Model update. That update would include a short statement as to why the UN Model approach varies from the new OECD approach.

Dispute resolution

The UN Model does not have a specific arbitration provision for tax disputes, whereas the OECD Model now has an optional provision. While the dispute resolution discussion in the Committee addresses how to improve the Mutual Agreement Procedure also, a key issue remains that of the possible pros and cons of arbitration for developing countries, including issues of cost, developing country "friendliness" and the likelihood or otherwise of arbitrators coming from developing countries or at least being sufficiently aware of developing country realities.

It was noted that the Subcommittee dealing with this issue will address the topic with the goal of accelerating

6. OECD (2008) available at http://www.oecd.org/dataoecd/20/36/41031455.pdf.

and facilitating final agreement of disputes covered by tax treaties under the Mutual Agreement Procedure. The work of the Subcommittee will cover two aspects:

- the different possible ways to improve the Mutual Agreement Procedure; and
- the possibilities offered by arbitration, including the questions that such a mechanism raises (e.g. as to possible constitutional barriers and interaction with domestic legal remedies) and the different types of arbitration available.

The Subcommittee will present to the 2010 Annual Session of the Committee a report for further consideration and guidance. This dispute resolution work has in the past been slow in the UN context, but the formation of the new Subcommittee should move things forward much more quickly.

4. Other Tax Cooperation Issues

Tax competition in corporate tax: Tax incentives that have worked and not worked in attracting foreign direct investment

There has been discussion in the Committee over the last two years on the extent to which tax incentives have or have not been successful for developing countries. During discussions, many of the participants highlighted the "political" aspect of offering tax incentives, a practice that is frequently detached from the tax administration. The negotiation often happens at a level which does not involve input from tax authorities and escapes tax budgetary considerations. While an incentive is usually granted under the expectation that the foreign investor will bring more investments into the country, experience has shown that may not happen in practice.

Tax sparing was cited as an example of a practice that is generally not supported by developed countries now and is less commonly sought by developing countries. The view was put that by refusing to agree to tax sparing in tax treaties, the developed country is in fact capturing for itself the benefit granted by the developing country's reduced taxes to encourage investment and, ultimately, development.

Most of the participants supported the elaboration of a paper on tax incentives, concluding that it will need to reflect the variety of experiences of different countries. Many of the representatives contributed their own home country experiences. Some countries had chosen to end tax incentives, yet foreign direct investment had increased markedly, possibly demonstrating that tax incentives were not the main reason for foreign investment, at least in their cases. Others noted developments in regional groupings to exchange tax incentive information and experiences as a way of improving practices in this area.

The Committee concluded that it would be useful to explore how different regions in the world could coordinate on tax incentive issues and share experiences. It was agreed that there was a need for further discussion of the topic at Committee level. The Members decided that the UN Secretariat would prepare a paper on this issue which would portray the literature on the subject and identify other issues that could be looked at by the Committee. The paper will be submitted to the Committee for discussion at the 2010 Annual Session.

The proposed UN Code of Conduct on cooperation in combating international tax evasion and avoidance

The Committee had in past years decided to develop a Code of Conduct on cooperation in combating international tax evasion. A draft was discussed in the 2008 meeting and a Technical Working Document on a Proposed Code was released for the Doha Follow-Up Conference on Financing for Development at the end of that year.

Since then the Subcommittee on Exchange of Information had worked on further developing the draft Code. There had not been unanimity as to the approach to be taken. A goal was nevertheless suggested for the Committee of agreeing on a draft Code at the 2009 Annual Session – a goal which was ultimately met. It was noted that the Committee itself would not itself adopt the Code. Instead it would be recommended to the UN's Economic and Social Council (ECOSOC) for adoption in appropriate form.

The Code would, if adopted at state level, constitute a commitment to:

- effectively exchange information in both criminal and civil tax matters;
- ensure there are no restrictions on information exchange caused by application of the dual criminality principle or a domestic tax interest requirement;
- have appropriate confidentiality rules for information exchanged and safeguards and limitations that apply to taxpayer information; and
- ensure that reliable information is available, in particular, bank account, ownership, identity and relevant accounting information, with powers in place to obtain and provide such information in response to a specific request.

There was discussion about what level of cooperation should be sought in such a document. Some considered that the Code should mandate "automatic" exchange of information to make a strong statement against tax evasion, and to assist developing countries – which might have trouble achieving the level of knowledge needed to make a request for exchange of information, such as bank account details. Others noted the potential burden of an overuse of automatic exchange, including the logistical issues in achieving effective automatic exchange of information.

The result was to affirm in the Code a minimum level of international cooperation that all jurisdictions, including developing countries would in practice now be able to meet, but to aspire toward a higher level of cooperation as a jurisdiction's circumstances so allowed.

Another issue was the coverage – whether the Code should extend to tax avoidance as well as tax evasion. Some participants felt that to only address tax evasion reduced the relevance of the Code in the real world, where the boundaries between tax evasion and tax avoidance were blurred, and could be seen as making it harder, rather than easier, to combat sophisticated tax avoidance schemes which exploited such "blurred distinctions".

Practical Manual on Transfer Pricing for Developing Countries

In introducing the proposed Practical Manual on Transfer Pricing for Developing Countries, it was noted that the Practical Manual would *not* be intended to substitute for the OECD Transfer Pricing Guidelines. The project is currently being developed in a spirit informed by the scope of the South-South Sharing of Successful Tax Practices (S4TP) project, a project involving the Special Unit on South-South Cooperation of the UN Development Programme, as well as two non-governmental organizations, i.e. New Rules for Global Finance and the Tax Justice Network, and therefore had the special focus of ensuring that lessons learnt by developing countries in this complex area, could be shared for the benefit of other developing countries.

The participants emphasized the need to provide real life examples, rather than theoretical examples that will not help in the "real world" application of transfer pricing guidelines. It was noted that different approaches in this area will apply for different countries, and that some grouping of different countries at a similar stage of their "transfer pricing journey" may be useful in beneficial sharing of experiences.

The need to have a Practical Manual that would assist field officers in applying domestic transfer pricing rules was highlighted, as was the lack of qualified personnel to apply transfer pricing rules and the lack of necessary information, even where the skills existed. Tax administrators reported special difficulty in providing comparables and the treatment of intangible assets.

In acknowledging that the Practical Manual is to be consistent with the OECD Transfer Pricing Guidelines, it was recognized that there are difficulties in practically applying some of those guidelines in developing, and even developed countries, as well as issues of how well the guidelines reflect the practical realities of how methodologies are applied. Issues of internal consistency or otherwise of the OECD Transfer Pricing Guidelines might also have to be considered.

The Committee acknowledged the importance of having a Practical Manual which would be tailor-made for the needs of developing countries, with their input and priorities fully incorporated, but recognizing that transfer pricing capability was a "journey" with different countries at different stages in that journey at different points of time. The formulation of the transfer pricing Practical Manual is to be one of the Committee's main priorities for the year.

Tax and environment issues

The Committee also requested a Secretariat paper on opportunities for tax cooperation to assist in dealing with major environmental issues – with a particular focus on climate change. This was noted by the Secretariat as an emerging issue, as both carbon taxes and emissions trading schemes involved considerable tax issues that may impact on the effectiveness of such responses because of double taxation or uncertainty about taxing events and allocation of taxation rights between countries (e.g. on internationally bought and sold trading rights or carbon-derivatives). It is essential that lack of tax cooperation does not adversely affect responses to climate change in particular, but instead enhances it. It was agreed that although the Committee agenda was already very full, there should be some consideration of opportunities for enhancing cooperation to play its proper part in addressing a major global challenge.

Capacity building

While the work that the OECD and others do in capacity building and technical assistance was acknowledged, the value of a distinct UN role in this area was widely noted, especially with the UN's 192 country membership, and its recognition of the need for greater developing country participation as "norm setters", not just "norm-receivers". A strong Capacity Building Subcommittee has been formed, and first met in January 2010. Further, it was announced at the Annual Session that the International Bureau of Fiscal Documentation (IBFD) and the UN will have a joint regional symposium in Asia in 2010. This will be the first such UN event in some years, and will hopefully be the first of many in various regions.

5. Conclusion

The UN Tax Committee is currently a very strong one in terms of ability, breadth of experience, enthusiasm and commitment. Its work is increasingly focussing on very practical ways in which tax cooperation can assist developing countries to meet the development challenge. This entails a greater emphasis on tax administration issues than in the past, but also a willingness to look at important tax issues such as transfer pricing and tax and climate change issues that preserve, but complement, the vital updating of the UN Model and Manual. The years ahead will no doubt be productive and development-focussed for the UN Tax Committee and the UN tax work more generally.