



COMMENTARY

UN Committee of Experts on International Cooperation in Tax – 20th Session

Update of the UN Model Double Taxation Convention between Developed and Developing Countries – Proposed changes to the Commentary on Article 5 (Permanent Establishment)

E/C.18/2020/CRP.10

1. General Comments

We note the paper contains the proposed changes to the Commentary on Article 5 (Permanent Establishment) of the Model Double Taxation Convention between Developed and Developing Countries. The proposed changes deal with a number of modifications that were made to the OECD Commentary on Article 5 in 2017 but which, due to time constraints, the former membership of the Committee did not have the opportunity to consider when preparing the 2017 version of the UN Model.

We welcome the opportunity to comment on the proposed changes to the Commentaries on Article 5. However, prior to making the specific comments, we would like to note that Article 5 of the ATAF Model Tax Convention is significantly the same as that of the UN Model Tax Convention; hence there would be very minimal different views. Nevertheless, set out below are some of the specific issues we have above as important for both the provisions for the Article and the Commentary to the same.

2. Specific Comments

2.1. Paragraph 13

We welcome the commentary on Subparagraph (f) paragraph 2 to Article 5, which provides that ... *the expression “any other place of extraction of natural resources” should be interpreted broadly. Some*

have argued that, for this purpose, a fishing vessel could be treated as a place of extraction or exploitation of natural resources since “fish” constitute a natural resource. In their analysis, although it is true that all places or apparatus designated as “permanent establishments” in subparagraphs (a) to (e) in paragraph 2 have a certain degree of permanence or constitute “immovable property”, fishing vessels can be considered as a place used for extraction of natural resources, which may not necessarily mean only minerals embedded in the earth. In this view, fishing vessels can be compared to the movable drilling platform that is used in offshore drilling operations for gaining access to oil or gas. We further note the differing views over the matter and the decision to leave the issue for bilateral negotiations between Contracting States.

We have noted that many African countries have expressed the need for special provisions to address explorations and exploitation of all natural resources. Thus, the Commentaries to Article 5 should consider providing specific provisions for Source States to consider when entering into the bilateral negotiations. Additionally, more guidance on interpretation of such provisions should be provided. Therefore, Commentary 23 should provide the specific provisions for consideration by States.

2.2. Paragraph 68

We note that the Committee discussed the significance of the reference to contracts *“that are routinely concluded without material modification by the enterprise”*, as explained in Paragraph 68 of the Commentary. We consider this as an important issue which needs to be re-evaluated as it may conflict with the initial policy objective of the new Article 5(5). If this phrase is included, enterprises may still artificially avoid Permanent Establishment (P/E) status in the source state by holding that the conditions have not been met as the contracts were materially modified by another part of the enterprise. We thus, hold the view that the Article 5(5) of the UN Model and Commentaries to the same should delete this phrase in order to broaden the Article and to effectively limit the opportunities for avoidance of P/E status.



COMMENTARY

UN Committee of Experts on International Cooperation in Tax – 20th Session Update on the Handbook on Selected Issues for Taxation of the Extractive Industries by Developing Countries

Chapter XX": Tax Incentives – E/C.18/2020/CRP.21

1. Summary

The Chapter provides a general framework on the design and use of tax incentives with a specific analysis of their use in the extractive sector in developing countries. The draft Chapter is submitted for review and approval

2. What is a tax incentive?

The Chapter attempts to define what qualifies as a “tax incentive”.

- Agree that the more restricted definition of a tax incentive set out below is appropriate to use for this Chapter.

“the net difference between the burden imposed under the default (or “counter-factual”) regime and the burden that is predicted to be borne by the taxpayer under the incentive regime, across the lifetime of the project.”

3. International initiatives on harmful tax incentives

While we agree that countries should consider the international initiatives listed in the Box 2 we think it is important to note that many African countries and we believe other developing countries have serious concerns about the EU approach to blacklisting particularly around forcing small economies to

implement the BEPS minimum standards. We think this is an issue that the paper should acknowledge and possibly give further consideration.

- We agree with the list of best practices set out in paragraph 14.
- Table 1 Costs and Benefits lists among the costs – the potential for corruption or abuse in the granting and administration of tax incentives. It would seem this will be extremely difficult to measure. It might be useful to provide some guidance on this issue.
- Paragraph 44. – We note and agree with the comment that *“Withholding tax incentives relating to deductible expenses, for example, whilst easier to administer, may lead to more tax base erosion, which may need to be countered with closer scrutiny of such deductions in the source country”*. However whilst transfer pricing and thin capitalisation rules might provide some base protection there are often very difficult and time consuming to apply and we think this point needs to be noted in the text as it would seem not granting withholding tax incentives might be a better base protection option.

Paragraph 57 states *“Despite the strong justification for retaining withholding taxes, developing countries should consider the potential impact on investment. For example, during the early stages of an extractives project, internal debt may be the only source of funding, in which case withholding tax will increase the overall of cost of the project. This cost may be passed onto the resident company in the form of a higher interest rate, thereby reducing its taxable income”*.

- We agree that withholding taxes may increase the cost of capital and may be passed on in a higher interest rate thorough for example grossing up clauses. However, we have concerns about the statement *during the early stages of an extractives project, internal debt may be the only source of funding*. In our experience in these early stages third party lenders are less likely to lend and will require greater equity investments. Internal debt should be within scope of a country’s transfer pricing legislation and therefore tested on the basis that it is a third party investor under the arm’s length principle.
- Paragraph 65 and 66 discuss customs duty reductions and exemption. We think there is a base erosion practice that should be include here. African countries often report that these exemptions lead to taxpayers overvaluing imported plant and machinery and claiming inflated capital allowances on that value. The exemptions facilitate this tax avoidance strategy.



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UN Committee of Experts on International Cooperation in Tax – 20th Session
Update on the Handbook on Selected Issues for Taxation of the Extractive Industries by
Developing Countries

Chapter XX^{''}: Tax Issues related to the Digitalisation of the Economy – E/C.18/2019/CRP.12
(as referred to in E/C.18/2020/CRP.25)

Question A to the Committee on Paragraphs 17 & 18 and the principles governing the
allocation of taxing rights

1. General Comments

We note that the questions relate to the three proposals which were then merged into the Inclusive Framework Unified Approach and the Subcommittee need to reconsider the question in that context.

Question B

We consider it is accurate to say that taxation at source of passive income is consistent with the supply-side notion of value creation. We agree that for example in the case of royalties the IP relating to that royalty such as a trademark are being exploited in the source jurisdiction and the income from that exploitation therefore arise in the source jurisdiction.

Question C

We have some concerns about indicating that changes to the UN Model Tax Convention should be based on the interaction of supply and demand rather than merely the “supply side” approach as we

would not wish to risk making changes that might be unfavourable to many smaller export-reliant developing countries.

Question D – Complexity of approaches by the Inclusive Framework

As this note is based on the position pre the adopted of the Unified Approach by the Inclusive framework we are unclear as to whether the paper is now asking for our view on the Unified Approach proposals for approaches to determining the routine vs non-routine profits and presumably how the residual profit is calculated to be Amount A for allocation to market jurisdictions. If that is the case then we do not think the current proposals for determining the routine vs non-routine profit is too complex as it is a formulaic approach. As is the calculation of the amount of residual profit allocated to Amount A.

However we do have some concerns over the complexities in the current approach to identify the Amount A paying entities and the jurisdiction where relief for Amount A should be given.