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Committee of Experts on International
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Agenda Item 3 (a) (viii)*
Article 23

Article 23 A and 23 B of the UN Model –
Conflicts of qualification and interpretation

As agreed at the Ninth Annual Session of the Committee of Experts on International Cooperation in Tax Matters, this paper was prepared by Claudine Devillet for consideration and discussion at the Tenth Annual Session.

I. Introduction

1. During the seventh session of the Committee, the central issue was the 2011 update of the United Nations Model Convention (UN Model). In this respect, it was agreed that issues that could not be addressed in the course of that session would be excluded from the 2011 update and included in a catalogue of items for future discussion and possible inclusion in later updates. This was the case for the issue of conflicts of qualification. Conflicts of qualification are dealt with under paragraphs 30.32.7 of the Commentary on Articles 23A and 23B of the OECD Model Convention (OECD Model). Due to diverging views and lack of time, in quoting the Commentary on Articles 23A and 23B of the OECD Model, these paragraphs have been omitted as not being applicable to the interpretation of the UN Model.

2. During the seventh session of the Committee, a note (E/C.18/2011/CRP.2/Add.3) had been prepared by Claudine Devillet on the possible inclusion of paragraph 4 of Article 23A of the OECD Model on conflicts of interpretation in Article 23A of the UN Model. Due to diverging views, it was decided to address the matter in the Commentary and not to include paragraph 4 in the Article itself. The issue is addressed in paragraph 19 which reads as follows:

* E/C.18/2014/1

III.

projects. The activities of Subcontractor SA on

23A and 23B provided for under paragraphs 32.1 to 32.5 allows the resolution of mismatches and disputes resulting from conflicts of qualification.

V. Proposals

17. In case of divergences of qualification under the domestic laws of the Contracting States, the tax treaty may fail to eliminate double taxation or may create non-taxation. In these situations, each Contracting State applying the treaty provisions properly in accordance with its domestic law characterizes. In order to eliminate double taxation or non-taxation in these situations, the Committee recommended to agree to incorporate paragraphs 32.1 to 32.7 of the Commentary on Articles 23A and 23B of the OECD Model in the Commentary on Article 23 of the UN Model.

18. In case of divergences of interpretation of the treaty provisions between the Contracting states, the tax treaty may fail to eliminate double taxation or may create non-taxation. The mutual agreement procedure organised under Article 25 may eliminate double taxation by redressing actions resulting in taxation not in accordance with the tax treaty. Where a tax treaty does not contain a provision similar to paragraph 4 of Article 23A of the OECD Model, a Contracting State that applies the exemption method must exempt an item of income that it considers taxable in the other State in accordance with the treaty even if that item of income is not taxed in the source State whatever reason (e.g. because the other State considers that it may not tax the item of income under the tax treaty). Article 23A of the UN Model should provide a rule under which the residence state shall not exempt an item of income or of capital where a divergence of interpretation would result in non-taxation. The Committee is therefore recommended to include in Article 23A of the UN Model the alternative provision proposed under paragraph 19 of the UN Commentary on Article 23:

“4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10, 11 or 12 to such income; in the latter case, the first-mentioned State shall allow the deduction of tax provided for by paragraph 2.”

19. Paragraph 4 would also apply where the source State interprets the facts of a case or the provisions of the Convention in such a way that an item of income falls under the provisions of paragraph 2 of Article 10, 11 or 12, which provides for limited taxation in the source State while the residence State adopts a different interpretation and considers that such income falls under a provision of the Convention that provides for unlimited taxation in the source State. The last sentence of paragraph 4, which is not found in the OECD Model, has been added for the sake of certainty in order to make explicit that in such case the residence State will apply paragraph 2 of Article 23A and give a credit for the tax levied in the source State.

20. Where the source State applies the provisions of paragraph 2 of Article 10, 11 or 12 to an item of income, some countries may prefer not to deny the application of the provisions of paragraph 1 despite the fact that the source State must limit its tax on such income. The Commentary on paragraph 4 would allow those countries to limit the scope of paragraph 4 to cases where the source State applies the provisions of the Convention to exempt an item of

income or capital from tax and to delete the ~~top~~ paragraph 4 dealing with Articles 10, 11 and 12.

Proposed Changes to the UN Model

Paragraph 4 of Article 23 A

“4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the ot

double taxation be granted by the State of residence notwithstanding the conflict of qualification resulting from these differences in domestic law.

32.4 This point may be illustrated by the following example. A business is carried

to paragraph 2 of Article 23 A. This should be the case even if the State of residence has interpreted the facts of the case or the provisions of the Convention in such a way that would result in the State of source having an unlimited right to tax the income under the convention, which would mean that the State of residence should normally exempt that income under the provisions of paragraph 1. Applying the credit method in that case is more efficient than trying to determine, pursuant to the mutual agreement procedure how the treaty requires that double taxation be relieved. The last part of paragraph 4, which is not found in the OECD Model, has been added for the sake of clarity in order to make that point explicit. In paragraph 2, some States may require a credit for taxes payable in the other Contracting State to be granted subject to the provisions of its domestic law regarding the allocation of a credit for foreign taxes but without affecting the general principle provided in such paragraph. Such wording would generally allow the application of the credit resulting from paragraph 4. However, where the reference to its domestic law is not so limited, the Contracting States should verify during the negotiations that no inconsistency between the domestic law and the treaty rules exist that could prevent the granting of the credit (e.g. the domestic law of the State of residence may not provide for a credit for foreign taxes where an item of income is taxed under its domestic law as a business profit attributable to a permanent establishment and not as a royalty).

16.6 Where the State of source applies the provisions of paragraph 2 of Article 10, 11 or 12 to an income, some States may prefer not to deny the application of the provisions of paragraph 1 despite the fact that the State of source must limit its tax on such income. Those States may limit the scope of paragraph 4 to cases where the State of source applies the provisions of the Convention to exempt an income or capital from tax and delete the part dealing with Articles 10, 11 and 12.

16.7 The quoted paragraph 56.3 of the OECD Commentary clarifies that paragraph 1 does not impose an obligation on the State of residence to give exemption in cases of conflicts of qualification and that paragraph 4 is therefore required to avoid double non-taxation in those cases. The State of residence could, however, have an obligation to give exemption under paragraph 1 in cases of conflict of qualification if that State did not agree with the interpretation given in the quoted paragraphs 32.6 and 32.7 of the OECD Commentary to the phrase "in accordance with the provisions of the Convention" in Article 23 or if the wording of paragraph 1 in the relevant bilateral Convention was different from that used in the Model Tax Convention and does not allow such interpretation. In such situations, paragraph 4 also ensures that the State of residence is not obliged to exempt the relevant income.

Paragraph 19 of the Commentary on Article 23 of the UN Model is deleted.
