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This note represents comments by Pragya Saksena, a Member of the Committee of Experts on International Cooperation in Tax Matters, on the note prepared by Claudine Devillet on Conflicts of Qualification and Interpretation, which is for consideration at the annual session as E/C/2014/CRP.10.

Comments on Article 23A(4) of OECD Model

1. The two model conventions, i.e. United Nations Model Convention and the OECD Model tax Convention on Income and Capital, are similar in the sense that both reflect the importance of achieving consistency, wherever possible. However, the focus of the two is different. The UN Model convention favours retention of greater "source country" taxing rights under a tax treaty – taxation rights of the source country of investment stmp msou24m.00snditt041.6(t.00).

* E/C.18/2014/1

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goods and services and to the movement of capital and persons, constitutes a significant component of such a climate.

4. The general objectives of bilateral tax treaties, therefore, include the protection of taxpayers against double taxation with a view to improving the inflow of international trade and investment and the transfer of technology. The double taxation is avoided by following one of the two methods -- (1) exemption method and (2) credit method.

5. The exemption method is based on the concept that the State in which items of income arise or in which items of capital are situated has a better right of taxation, and that the exempting State, therefore, has to give way. Under the exemption method income or capital is excluded from the base. As a rule exemption is generally given irrespective of whether the income or capital concerned is subject to any tax liability in the other contracting state. Nor does it matter whether any tax payable to the other contracting State has actually been paid.

6. In economic respect, the exemption method makes for equally competitive conditions in the State of source among investors from different countries ----- capital import neutrality. On the other hand, the credit method makes for equal treatment in the State of residence of all capital investments, whether made at home or abroad – capital export neutrality. In fiscal respects, too, the credit method trends to favour the State with the higher level of taxation, seeing that lower taxes imposed by the State of source, rather than benefiting the taxpayer, benefit the State of residence. Tax incentives offered by the State of source for reasons of economic policy are 'siphoned off' by the State of residence. That is why developing countries, in particular, see a disadvantage in the application of the credit method.

7. The developing countries consider exemption method to be more appropriate as the exclusive tax jurisdiction over certain income is allotted to the country of source under a treaty and one of the principal defects of the foreign tax credit method in the eyes of the developing countries, is that the benefit of low taxes in developing countries or special tax concessions granted by them in large part inure to the benefit of the treasury of the capital – exporting country rather than to the foreign investor for whom the benefits were designed. Thus, revenue is shifted from the developing country to the capital exporting country.

8. Against this background, including paragraph 4 of Article 23A of OECD Model in the UN Model would not be desirable as it will result in including the avoidance of double non-taxation as a treaty objective in the UN Model whereas that is not the objective of the UN model convention. Although some countries regard double non-taxation as undesirable, very few countries consider its avoidance as a treaty objective. Double non-taxation may be intended or unintended but does not constitute tax evasion. Double non-taxation should be considered a problem only if it is abusive.

9. As mentioned above, there are fundamental differences with respect to tax treaty policy between developed and developing countries. For example:

- The developed countries which follow the OECD Model focus on the avoidance of double taxation as a treaty objective, whereas many developing countries

consider that the main purpose of a tax treaty is to ensure an equitable distribution of taxing rights.

- Developed countries are concerned primarily with the avoidance of double taxation (and now double non-taxation) from a purely fiscal perspective whereas developing countries negotiate treaties for both fiscal and non-fiscal considerations. They negotiate treaty for economic, social or political considerations as well. A number of developing countries grant specific fiscal benefits with a view to promote their development, which may result in unintended double non-taxation.

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- Article 23A(4) is not acceptable to the Courts of some countries and may be unconstitutional in some countries. Therefore, the UN Model should permit each country to retain its fiscal sovereignty and to follow its own domestic law interpretations. The UN Model should not recommend a provision that does not comply with the domestic laws of countries and affects their sovereign taxing rights.

In view of the above, paragraph 4 of Article 23A of the OECD Model should not be included in UN model convention and accordingly, paragraph 19 of the commentary on Article 23 of the UN Model should continue.

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