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DIFFERENCES BETWEEN METHODS OF ELIMINATION OF DOUBLE TAXATION ESTABLISHED IN UN AND OECD MODEL TAX CONVENTIONS

Abstract

The United Nations Model Double Taxation Convention between developed and developing countries is part of an ongoing international effort to eliminate double taxation. These efforts were initiated by the League of Nations and continued within the framework of the Organization for European Economic Cooperation (OEEC) (now known as the Organization for Economic Co-operation and Development (OECD)) and regional forums, as well as the United Nations. In general, these efforts have found their concrete expression in a number of model bilateral tax conventions or their drafts.

The United Nations Model Convention and the OECD Model Convention on Income and Property have had a profound impact on international treaty practice and contain a significant number of common provisions.

In general, the United Nations Model Convention favors the retention of wider tax rights for the so-called "source country", i.e. the country of investment, compared to the investor's "country of residence", according to the tax treaty. Although this issue has long been of particular importance to developing countries, some developed countries are also trying to include this provision in their bilateral international agreements.

Keywords: *The United Nations (UN) Model Convention, OECD model tax convention, elimination of double taxation, tax policy, tax legislation*

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BMT və OECD model vergi konvensiyalarında müəyyən edilmiş ikiqat vergitutmanın aradan qaldırılması üsulları arasında fərqlər

Xülasə

İnkişaf etmiş və inkişaf etməkdə olan ölkələr arasında Birləşmiş Millətlər Təşkilatının İkiqat Vergitutma üzrə Model Konvensiyası ikiqat vergitutmanın aradan qaldırılması üçün davam edən beynəlxalq səylərin bir hissəsidir. Bu səylər Millətlər Liqasının təşəbbüsü ilə irəli sürülüb və Avropa İqtisadi Əməkdaşlıq Təşkilatı (OEEC) (hazırda İqtisadi Əməkdaşlıq və İnkişaf Təşkilatı (OECD) kimi tanınır) və regional forumlar, eləcə də Birləşmiş Millətlər Təşkilatının Millətlər. Ümumiyyətlə, bu səylər bir sıra model ikitərəfli vergi konvensiyalarında və ya onların layihələrində öz konkret ifadəsini tapmışdır.

Birləşmiş Millətlər Təşkilatının Model Konvensiyası və OECD-nin Gəlir və Mülkiyyət üzrə Model Konvensiyası beynəlxalq müqavilə praktikasına dərin təsir göstərmiş və xeyli sayda ümumi müddəaları ehtiva edir.

Ümumiyyətlə, Birləşmiş Millətlər Təşkilatının Model Konvensiyası qondarma "mənbə ölkə" üçün daha geniş vergi hüquqlarının saxlanmasının tərəfdarıdır, yəni. vergi müqaviləsinə əsasən investorun "yaşayış ölkəsi" ilə müqayisədə investisiya ölkəsi. Bu məsələ uzun müddət inkişaf etməkdə olan ölkələr üçün xüsusi əhəmiyyət kəsb etsə də, bəzi inkişaf etmiş ölkələr də bu müddəanı öz ikitərəfli beynəlxalq müqavilələrinə daxil etməyə çalışırlar.

Açar sözlər: *Birləşmiş Millətlər Təşkilatının (BMT) Model Konvensiyası, İƏİT model vergi konvensiyası, ikiqat vergitutmanın aradan qaldırılması, vergi siyasəti, vergi qanunvericiliyi*

Introduction

The United Nations Model Convention itself reflects a trade-off between the source principle and the subsistence principle, although this convention gives more weight to the source principle than in the OECD Model.

The OECD model agreement envisages various methods for avoiding double taxation, listed below:

- The problem of double taxation that may arise when a person's income and wealth inside and outside the country is required to be taxed by both states is solved by residence. Accordingly, if a person resides in both Contracting States, it must first be determined in which Contracting State he resides.
- If the person's income and wealth outside the country of residence will be taxed by both countries; The problem of double taxation that would arise when one of the states applying the residence and source principles waives the right to tax is solved. Who will be exempted from the right of taxation is determined by the tax agreement to be concluded. In order to avoid the problem in this direction, the method of regulated exemption or credit is used in the OECD model. Similarly, in many tax agreements made on the basis of the OECD model, it is noteworthy that the resident state applies both methods to avoid double taxation.
- The OECD model does not provide a solution to the problem of double taxation that will arise if the income or wealth of a person with a permanent place of work in one country is taxed by both states (1).

The OECD model was designed taking into account economic relations between developed countries. Therefore, if the OECD model is based on an agreement between a developing country and a developed country, developing countries can make significant concessions due to the heavy provisions in the model. For this reason, developing countries like Azerbaijan have made reservations regarding various items in the OECD model.

Considering that the OECD model is insufficient in terms of agreements between developing and developed countries, an alternative model (Double Taxation Convention Model between Developing and Developing Countries) was developed by the United Nations. In this model, the taxing of the source state is emphasized in order to soften the strict attitude of the OECD model to the residency principle. The United Nations (UN) model, which has the same systematic structure as the OECD model, differs from the OECD model in the following points:

- Acceptance of taxing power to be shared between the resident and source states in favor of the source state
- Expanding the concept of permanent representation to increase the tax powers of the source country;
- Distribution of the power of taxation from the income obtained from entrepreneurial activity;
- Recognition of the tax authority of the source state in connection with sea trade and air transport;
- The upper limit of the tax to be charged by the source state is variable, excluding income elements included in the scope of property income of securities;
- When royalty is taxed, the taxing authority belongs not only to the resident state, but also to the source state (Denisayev, 2005: 33).

One of the most important issues in the preparation of model tax conventions is to achieve a certain balance during the distribution of income between the countries of residence and source while eliminating double taxation. The mentioned issue is directly related to the extent to which the source country will give up its taxation rights. That is, if the country fully waives its right to tax, then the country of residence has the opportunity to fully tax the income of the investor. Or, on the contrary, if the source country reserves its rights arising from the taxation authority to a certain extent, then the country of residence should either not tax the income taxed in the source country, or allow a credit (deduction) in the amount of taxes paid in the source country during taxation in its own country (Khodov, 2003: 215).

Differences in definitions and permanent representation

Differences in definitions (Article 3).

The OECD model tax convention contains concepts of enterprise and business that are not found in the UN convention. The purpose of including these concepts in the convention is to make sure that all the income covered by the mentioned article regarding the removal of Article 14 (Independent personal services) from the OECD Convention falls under the combined scope of Article 5 (Permanent establishment) and Article 7 (Profits from business activities). is to provide. Unlike the OECD, the UN Tax Committee has decided to retain Article 14. However, the UN tax convention provides alternative articles for countries that follow the OECD approach. Obviously, an alternative approach is to include the concepts in question in the convention (Pepelyayev, 2015: 84).

Permanent representation (Article 5)

In general, Article 5 of the UN Model Tax Convention gives more taxing rights to the source country by imposing the issue of economic nexus.

Construction sites

The UN model convention provides for a 6-month test period for construction sites. However, in the OECD convention, this period is 12 months.

Taxation of services

Article 5 of the UN tax convention highlights the difference between the UN and OECD approaches by covering the so-called “permanent establishment of services”: The term permanent establishment also covers the following: the provision of services by the enterprise by employees or other individuals engaged for these purposes provision, including the provision of consultancy services, provided that activities of this nature (for the same or a related project) in a Contracting State continue for more than a total of 6 months in any 12-month period (Aliyev, 2012: 635).

The OECD tax convention does not have specific conditions for services and the supply of services is treated in the same way as the supply of goods. In other words, in order to justify taxation in the country of origin, an economic presence of the same nature as the supply of goods in the country is required: a stable physical presence in the country over a certain period of time is required. According to paragraph 42.11 of the Commentary to Article 5, the provision of services will be treated in the same way as any other business activity, subject to certain exceptions (such as those covered by Articles 8 and 17), so that the same conditions for permanent establishment apply to all business activities. , including the provision of independent services. It may be asked why Article 8 (sea and air transport) and Article 17 (artists and athletes) are exceptions? There is an analogy between the activities of artists who perform the full economic cycle of activity in the country with a limited and mobile presence and are paid high incomes and some other service providers. A similar approach is appropriate for other service providers who are paid high fees (Sadigov, 2008: 299).

Delivery.

Another difference between the OECD and UN tax conventions is that Article 5(4) of the UN Tax Convention does not refer to the activity of delivery when enumerating preparatory and ancillary activities. In other words, according to the UN tax convention, supply alone is an activity that creates a sufficient economic connection with the source country, and in this respect, the convention allows taxation in the source country, unlike the OECD convention. The UN's approach is based on the fact that having a stock of goods that allows for immediate delivery can be considered a permanent establishment and the income from this activity can be taxed in the source country because it provides a permanent link with the source country by supporting sales and thereby profit generation.

Reserve storage.

According to Article 5 of the UN tax convention, unlike the OECD convention, cases where the agent keeps a reserve create a dependent agent situation even when the contract is not concluded on behalf of the principal. The basics of such an approach are the same as in delivery. It is considered that the availability of resources and their delivery by the agent form sufficient economic ties with the country of origin to provide grounds for granting taxing rights to that country.

Insurance.

Article 5 of the UN model tax convention reflects some of the characteristics of the insurance industry that are relevant to both the ILO and the ILO. If the insurance agent is independent, he is not subject to tax in the country of source according to Article 5.7. If the UN model convention did not have a separate paragraph 5.6 relating to insurance, such income would not be taxable under Article 5(a) as insurance agents do not normally have the right to contract where the agent is not independent. The presence of a special paragraph related to insurance in the Convention, when the insurance company collects insurance premiums through a person located in another country or carries out insurance of risks located in another country, it is considered that there is a permanent representation, except for the independent agents provided for in Article 5.7. The special paragraph does not apply to reinsurance activities that involve the transfer of risks from one insurer to another, as it is considered that in this case there is insufficient economic connection with the source country (Bagirov, 2006: 7).

Differences in taxation of business profits, sea and air transport income.

Business profit (Income from Entrepreneurial activity) is subject to a limited "attraction rule" in the UN model tax convention. This is one of the main characteristics that distinguish the UN convention from the OECD convention. According to Article 7.1, the profits of an enterprise of a contracting state must be taxed in that country, if the activity of that enterprise does not constitute a permanent establishment in another state. If an enterprise carries on business in another State through a permanent establishment, that part of its profits may be taxed in that other State which is attributable to (a) the permanent establishment, (b) the sale of goods identical or similar to those sold by the permanent establishment situated in the other State (c) related to activities similar or identical to activities carried out by a permanent representation located in another state.

Sea and air transport (Article 8)

"Alternative A", reflected in Article 8 of the UN model tax convention, is identical to the OECD model convention. Thus, the profit from the operation of sea or air vessels in international transportation is supposed to be taxed in the country where the management is carried out. However, in “Alternative B”, income from international maritime transport is allowed to be taxed to a limited extent in the source country (Model, 2017:125).

Income from the operation of sea vessels in international transportation is taxed at the place of effective management, if its activity in another country is not permanent (more than occasional). If the activity is permanent, it may be taxed in that other country. Profits subject to tax in the other country will be determined by means of a reasonable allocation of the aggregate profits derived from the operation of seagoing vessels. The tax assessed based on such distribution is then reduced by percent. (The percentage will be determined through bilateral negotiations).

Differences in taxation of passive income

Dividends (Article 10), Interest (Article 11), Royalties (Article 12)

The UN model tax convention does not specify the maximum tax rate for taxation of dividends to the source country. These rates are supposed to be determined as a result of negotiations between the states that are parties to the agreement. As you know, the OECD model tax convention sets a maximum tax rate of 15% for portfolio investments and 5% for direct investments. Conventions concluded on the basis of the UN model convention usually give source countries the right to tax at higher rates, thereby ensuring fairer treatment of net capital importing countries than net capital exporting countries (United, 2017: 58).

Conclusion

In summary, the disparities between the UN and OECD model tax conventions in addressing double taxation are significant and reflect the diverse interests and priorities of the international community. The UN model's emphasis on equitable treatment and the needs of developing nations underscores a commitment to fostering global economic inclusivity. In contrast, the OECD model leans towards protecting the interests of capital-exporting nations, often prioritizing the reduction of tax barriers to facilitate cross-border investment.

The UN model advocates for a broader scope of taxing rights for source countries, aiming to ensure that the benefits of economic activities are more evenly distributed. On the other hand, the OECD model tends to support residence-based taxation, prioritizing the jurisdiction where the taxpayer is based, which may disproportionately favor developed economies with multinational corporations.

While both models seek to eliminate double taxation, the UN model's emphasis on maintaining a balance between developed and developing nations suggests a more cooperative and inclusive approach. The OECD model, by contrast, may be perceived as reflecting the interests of economically powerful nations, potentially contributing to global economic imbalances.

Ultimately, the differences in these models underscore the complex interplay between economic development, global trade dynamics, and the need for fair and effective international taxation. As the landscape evolves, ongoing discussions and revisions to these models will be crucial to ensure that they continue to adapt to the changing realities of the global economy and contribute to a more equitable and sustainable international tax framework.

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