

# Chapter XI

## Salient Features of the ASEAN Model Tax Treaty

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### 1. Introduction: ASEAN and the ASEAN Free Trade Area

Indonesia, Malaysia, the Philippines, Thailand, and Singapore formed the Association of South-East Asian Nations (ASEAN) on 8 August 1967. Brunei joined ASEAN on 7 January 1984, one week after gaining its independence from the United Kingdom. Vietnam was admitted on 28 July 1995. The admission of Laos and Myanmar took place on 23 July 1997. Finally, the admission ceremony for the Kingdom of Cambodia was held on 30 April 1999.

One of ASEAN's most significant accomplishments is the ASEAN Free Trade Area (AFTA).<sup>1401</sup> There are other ASEAN cooperative arrangements addressing: industry, dispute resolution, information technology and e-commerce, intellectual property rights, customs, minerals, energy, finance and banking, agriculture, transportation and communications, tourism, human resources development, the Asean University Network, and technology transfer.

AFTA has contributed much to the level of commitment, and sense of common purpose, among the ASEAN members. Contrary to expectations, AFTA made most of its planned tariff reductions ahead of schedule. Recently, ASEAN received a significant boost when China said it will join AFTA, which will make AFTA the largest trading bloc in the world. Observers often compare recent ASEAN developments with EU economic integration; however, there are obvious differences as well as similarities.

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<sup>1401</sup> The AFTA was established under three documents signed at the 4th ASEAN heads of government meeting in 1992: the Singapore Declaration, a Framework Agreement on Enhancing ASEAN Economic Cooperation, and an Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area. Besides reducing tariffs on all manufactured products, capital goods, processed agricultural products (not services or agricultural goods), the AFTA eliminates non-tariff barriers and quantitative restrictions. See Tiwari, S., "Legal Implications of the Asean Free Trade Area," *Singapore Journal of Legal Studies*, 1994, 218-233.

At the end of the 1980s, ASEAN was taking important steps toward economic integration. These steps led to the creation of AFTA in 1992. The Manila meeting of December 1987 considered economic integration, and facilitating international trade and investment, including investment protection treaties.<sup>1402</sup> Taxation matters were, as is customary in investment protection treaties, excluded.<sup>1403</sup> The same year, however, the ASEAN Working Group on Tax Matters signed a model convention for the avoidance of double taxation (ASEAN model). This article reviews the salient features of the model.

In the Framework Agreement on the ASEAN Investment Area, the member states agreed to expand the number of tax treaties between ASEAN members.<sup>1404</sup> The ASEAN members also agreed to "examine the possibility of an ASEAN double taxation agreement."<sup>1405</sup> ASEAN was already monitoring the double taxation agreements between its members.<sup>1406</sup>

Presently, the ASEAN members have not concluded bilateral tax treaties with all the other members. The newest members, Cambodia, Laos, Myanmar, and Vietnam, have concluded the least number of treaties. The table on the next page represents the tax treaties that are currently in force or signed between ASEAN member states. The number of tax treaties concluded between ASEAN members is less than half of the possible maximum. There is a substantial variation between members. For example, Thailand and Malaysia have concluded the most intra-ASEAN tax treaties; and less developed members, including Cambodia, Laos, and Myanmar, have concluded the least number of treaties.

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<sup>1402</sup> Agreement for the Promotion and Protection of Investments, Manila, 15 December 1987.

<sup>1403</sup> Article 5 of the Agreement for the Promotion and Protection of Investments, Manila, 15 December 1987.

<sup>1404</sup> Point (a) iii of Schedule I to the Framework Agreement (Cooperation and Facilitation Program).

<sup>1405</sup> Point (b) iv of Schedule I to the Framework Agreement (Cooperation and Facilitation Program).

<sup>1406</sup> See the reports of the 12th and 13th meetings of the Cooperation Committee in Finance and Banking (respectively in March 1984 and January 1985). On the need for tax cooperation in the Asia-Pacific region, see Vann, R.J., "A Model Tax Treaty For The Asian-Pacific Region?," *Bulletin I.F.D.* 1991, (part I), p. 99-111. (Part II), p. 151-163.

<b>Country</b>	<b>Brunei</b>	<b>Indonesia</b>	<b>Malaysia</b>	<b>Phiippines</b>	<b>Singapore</b>
Brunei	-	No	No	No	No
Indonesia	No	-	Yes	Yes	Yes
Malaysia	No	Yes	Yes	Yes	Yes
Philippines	No	Yes	Yes	Yes	Yes
Singapore	No	Yes	Yes	Yes	Yes
Thailand	No	Yes	Yes	Yes	Yes
Cambodia	No	No	No	No	No
Laos	No	No	No	No	No
Myanmar	No	No	Yes	No	No
Vietnam	No	Yes	Yes	Yes	Yes
<b>Total</b>	0	5	6	5	5

<b>Country</b>	<b>Thailand</b>	<b>Cambodia</b>	<b>Laos</b>	<b>Myanmar</b>	<b>Vietnam</b>
Brunei	No	No	No	No	No
Indonesia	Yes	No	No	No	Yes
Malaysia	Yes	No	No	No	Yes
Philippines	Yes	No	No	Yes	Yes
Singapore	Yes	No	No	No	Yes
Thailand	-	No	Yes	No	Yes
Cambodia	No	-	No	No	No
Laos	Yes	No	-	No	No
Myanmar	No	No	No	-	No
Vietnam	Yes	No	No	No	-
<b>Total</b>	6	0	1	1	5

DTA Maximum 110: All Members = 40 6 Original Members = 33 Last 4 Member = 7

## 2. General Remarks on the ASEAN Model Tax Convention

The ASEAN Model Tax Convention is based on the edition of the OECD model in force at the time that the ASEAN model was drafted,<sup>1407</sup> but the ASEAN model also adopts many of the U.N. model's features. However, the ASEAN model is generally more in favor of developing countries than the well-known U.N. model. The ASEAN model, for example, includes a tax sparing credit, while the U.N. model does not. Also, under the ASEAN model, an agent, that does not have independent status, may be deemed to be a permanent establishment, without even having the authority to conclude contracts, if the agent habitually *secures orders* in the source state. This provision does not exist under the U.N. model.

The ASEAN member countries signed the ASEAN model. ASEAN member countries use it when negotiating tax treaties with each other, and also when they negotiate tax treaties with non-member countries. However, the model is not binding on ASEAN members, and they are to use it for "guidance."<sup>1408</sup> In the following discussion, only ASEAN model provisions that are different from the OECD model are analyzed.

## 3. Permanent Establishment

### 3.1. Building Sites and Consulting Services

The ASEAN model generally follows the UN model provisions on PEs. A building site, construction, assembly, or installation project, or related supervisory activities, constitutes a PE, but only when the site, project, or activities continue for more than six months.

An enterprise furnishing services, including consultancy services, through employees or other personnel engaged by the enterprise for that purpose, constitutes a PE providing that the activities continue (for the same or a connected project) in the source state for a period or periods aggregating more than 6 months within any 12-month period.<sup>1409</sup>

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<sup>1407</sup> The ASEAN model was drafted in 1987, at which time the 1977 version of the OECD model was the most recent version.

<sup>1408</sup> ASEAN document available at [www.aseansec/asc/r8889/asc88i.htm](http://www.aseansec/asc/r8889/asc88i.htm).

<sup>1409</sup> Article 5(3)(b) of the U.N. model.

### 3.2. Farms and Plantations

Article 5(2) of the ASEAN model provides a nonexhaustive list of PEs combed from all the model tax agreements. Both the OECD and the U.N. models list the following as PEs: a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, and any other place where natural resources are extracted.

The ASEAN model adds to the list of PEs "a farm or plantation" (subparagraph f) and "timber or other forest producers" (subparagraph g). This practice is followed by most ASEAN members including Indonesia,<sup>1410</sup> Malaysia,<sup>1411</sup> the Philippines,<sup>1412</sup> Singapore,<sup>1413</sup> and Thailand.<sup>1414</sup>

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<sup>1410</sup> Double taxation agreements (including signing dates) with: Australia (22 April 1992), Belgium (16 September 1997), Canada (1979 protocol signed 1 April 1998), Egypt (13 May 1998), France (14 September 1979), Japan (3 March 1982), Jordan (12 November 1996), Kuwait (23 April 1997), Luxembourg (14 January 1993), Malaysia (12 September 1991), Mauritius (10 December 1996), Mongolia (2 July 1996), Netherlands (protocols signed 23 August 1993), Philippines (18 June 1981), Poland (6 October 1992), Singapore (8 May 1990), Sudan (10 February 1998), Sweden (28 February 1989), Switzerland (29 August 1988), Syria (7 June 1997), Taiwan (1 March 1995), Thailand (25 March 1981), Ukraine (11 April 1996), United Arab Emirates (30 November 1995), United States (protocol signed 24 July 1996), Uzbekistan (27 August 1996), Venezuela (27 February 1997), and Vietnam (22 December 1997).

<sup>1411</sup> Double taxation agreements (including signing dates) with: Australia (protocol signed 2 August 1999, agricultural, pastoral, or forestry property), Austria (20 September 1989), Bangladesh (19 April 1983), Belgium (protocol signed 25 July 1979), Canada (15 October 1976), China (23 November 1985), Czechoslovakia (8 March 1996), Denmark (4 December 1970), Egypt (14 April 1997), Fiji (19 December 1995), Finland (28 March 1984), France (protocol signed 31 January 1991), Germany (8 April 1977), Hungary (22 May 1989), India (25 October 1976), Italy (28 January 1984), Jordan (8 August 1994), Korea (R.O.K.) (20 April 1982), Malta (3 October 1995), Mauritius (23 August 1992), Mongolia (27 July 1995), Myanmar (9 March 1998), Netherlands (protocol signed 4 December 1996), New Zealand (19 March 1976), Norway (23 December 1970), Pakistan (29 May 1982), Papua New Guinea (20 May 1993), Philippines (27 April 1982), Poland (16 September 1977), Romania (26 November 1982), Singapore (26 December 1968), Sri Lanka (16 September 1997), Sudan (7 October 1993), Sweden (21 November 1970), Switzerland (30 December 1974), Taiwan (23 July 1996), Thailand (29 March 1982), Turkey (27 September 1994), United Arab Emirates (28 November 1995), United Kingdom (10 December 1996), Uzbekistan (6 October 1997), Vietnam (7 September 1995), and Zimbabwe (28 April 1994).

<sup>1412</sup> Double taxation agreements (including signing dates) with Australia (11 May 1979, agricultural, pastoral, or forest property) and Romania (18 May 1994).

<sup>1413</sup> Double taxation agreements (including signing dates) with: Belgium (protocol signed 10 December 1996), Canada (6 March 1976), France (9 September 1974),

The effect of these additions is clear: farms, plantations, and forest producers are PEs. This is not completely unexpected because many ASEAN members have important agricultural and forestry industries. However, why is the income diverted from the article on income from immovable property, and placed under the business profits article?<sup>1415</sup>

Both the U.N. and the OECD models take the position that income from agriculture and forestry should be treated as income from immovable property. Strangely, this position also appears to be the case under the ASEAN model, because article 6 of the ASEAN model does not deviate from the OECD and the U.N. models, and therefore applies to income from agriculture and forestry.

To assume, however, that articles 6 and 7 may be applied at the same time would be contrary to the generally accepted rule that article 6 is *lex specialis* compared to the general rule of article 7. In other words, article 7 should be applied subject to the provisions of article 6.<sup>1416</sup>

As Vogel points out "such an inclusion [in the PE article] makes sense only if the DTC in question classifies income from the farming of land as business income rather than as income from immovable property."<sup>1417</sup> After all, article 7(7) of the OECD model clearly states that "Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not

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Germany (19 February 1972), India (24 January 1994), Israel (27 September 1971), Netherlands (19 February 1971), New Zealand (21 August 1973), Papua New Guinea (19 October 1991, agricultural, pastoral, or forestry property), Sri Lanka (29 May 1979), Sweden (protocol signed 28 September 1983), Switzerland (25 November 1975), Taiwan R.O.C. (30 December 1981), and United Arab Emirates (1 December 1995).

<sup>1414</sup> Double taxation agreements (including signing dates) with: Australia (31 August 1989, "or forestry"), China (27 October 1986), Czechoslovakia (12 February 1994), Denmark (23 February 1998), Finland (25 April 1985), Hungary (18 May 1989), India (22 March 1985, forestry), Indonesia (25 March 1981), Israel (22 January 1996), Japan (7 April 1990), Laos (20 June 1997), Luxembourg (6 May 1996), Malaysia (29 March 1982, "or other forest produce"), Mauritius (1 October 1997), Nepal (2 February 1998), New Zealand (22 October 1998), Pakistan (14 August 1980), Singapore (15 September 1975), Spain (14 October 1997), Switzerland (12 February 1996), and Uzbekistan (23 April 1999).

<sup>1415</sup> This was the approach under the London and Mexico drafts, but was abandoned in the 1963 OECD model.

<sup>1416</sup> OECD Commentary, article 6, para. 4.

<sup>1417</sup> Vogel, *Double Taxation Conventions*, 3rd ed., Kluwer, 1997, p. 302.

be affected by the provisions of this Article," which excludes the possibility of applying articles 6 and 7 at the same time.

Under the domestic law of the source country, some agricultural income is categorized as business profits rather than income from immovable property. In that event, the question is raised whether the source country would have to prove the existence of a PE to have taxing power, which explains the inclusion of "farm or plantation" in article 5(2), provided of course that article 7 applies to agricultural income instead of the income being subject to article 6.

### 3.3. Agents

The ASEAN, OECD, and U.N. models treat persons, other than independent agents, that act on behalf of an enterprise, as PEs. That may even be the case when a person, who does not have authority to conclude contracts in the name of the enterprise, habitually maintains a stock of goods in the source state from which they regularly deliver goods. The U.N. and ASEAN models converge on this issue.<sup>1418</sup>

In a major deviation from the OECD and U.N. models, the ASEAN model adopts a rule which assimilates a dependent agent with a PE when an agent habitually secures orders in the source state, wholly or almost wholly, for the enterprise itself, or for enterprises which are controlled by it, or have a controlling interest in it.<sup>1419</sup>

The ASEAN provision contains two important elements: first, the securing of orders by a person working on behalf of the enterprise, and second, the extension to related enterprises. The provision probably originated from Thai treaty practice, where it is found in almost every agreement.<sup>1420</sup> The provision is also found in some treaties concluded by Indonesia,<sup>1421</sup> Malaysia,<sup>1422</sup> the Philippines,<sup>1423</sup> and Singapore.<sup>1424</sup>

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<sup>1418</sup> Art. 5 (5)(b) ASEAN and U.N. models.

<sup>1419</sup> Art. 5 (5)(c) ASEAN model.

<sup>1420</sup> Double taxation agreements (including signing dates) with: Austria (8 May 1985), Bangladesh (20 April 1997), Belgium (16 October 1978), Canada (11 April 1984), China (27 October 1986), Czechoslovakia (12 February 1994), Denmark (23 February 1998), Finland (25 April 1985), France (27 December 1974), Germany (10 July 1967), Hungary (18 May 1989), India (22 March 1985), Indonesia (25 March 1981), Israel (22 January 1996), Italy (22 December 1977), Japan (7 April 1990), Korea (26 August 1974), Luxembourg (6 May 1996), Malaysia (29 March 1982), Nepal (2 February 1998), Netherlands (11 September 1975), Norway (9 January 1964),

Introducing the rule into a tax treaty means that sales-representatives, agents, and commercial intermediaries, who do not have the authority to conclude contracts on behalf of the enterprise, may still be deemed dependent agents, provided they work exclusively, or almost exclusively, for that enterprise. Consequently, the profit that is derived from sales in an ASEAN member state through the agent would be taxable in that state even if the agent does not have the authority to conclude contracts on behalf of the enterprise.

This is a considerable extension of the PE concept. Vogel notes that "the employees of a foreign enterprise or persons acting on behalf of a specific enterprise or group of enterprises would already be deemed to constitute a PE merely by soliciting orders for such enterprise or group of enterprises."<sup>1425</sup> How regular those orders must be to pass the "habitually" requirement is unclear. It is also unclear whether the requirement relates to the amount of orders or to the agent's intended activity. Will, for example, one massive order secured by the agent for the enterprise be sufficient to warrant source taxation?

The requirement that "other enterprises which are controlled by it or have a controlling interest in it" are also to be taken into account in assessing the agent's activities, is an antiavoidance measure, addressing the situation where the group of enterprises, rather than the enterprise that realizes the sales in the source state, employs the agent.

Qureshi noted that "given the wide range of operations of multinational corporations, it would be desirable to modify the provisions of paragraph

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Pakistan (14 August 1980), Philippines (14 July 1982), Poland (8 December 1978), Romania (26 June 1996), Singapore (15 September 1975), South Africa (12 February 1996), Spain (14 October 1997), Sri Lanka (14 December 1988), Sweden (19 October 1988), Switzerland (12 February 1996), United Kingdom (18 February 1981), United States (26 November 1996), and Uzbekistan (23 April 1999).

<sup>1421</sup> Double taxation agreements (including signing dates) with: Kuwait (23 April 1997), Sri Lanka (3 February 1993), and Venezuela (27 February 1997).

<sup>1422</sup> Double taxation agreements (including signing dates) with: Bangladesh (19 April 1983), Norway (23 December 1970), Taiwan (23 July 1996), Thailand (29 March 1982), and United Arab Emirates (28 November 1995).

<sup>1423</sup> Double taxation agreement with Japan signed on 13 February 1980.

<sup>1424</sup> Double taxation agreements (including signing dates) with: Australia (protocol signed 16 October 1989), Bangladesh (19 December 1980), Finland (23 October 1981), India (24 January 1994), Luxembourg (6 March 1993), Pakistan (13 April 1993), Taiwan (30 December 1981), and United Arab Emirates (1 December 1995).

<sup>1425</sup> Vogel, *Double Taxation Conventions*, 3rd ed., Kluwer, 1997, p. 341.

5 of article 5 of the U.N. draft so as to cover the activities of independent agents exclusively or almost exclusively devoted to a group of centrally controlled enterprises."<sup>1426</sup> These remarks relate to the truly independent character of independent agents, but this issue was not addressed by the ASEAN model. The ASEAN model does follow the U.N. model regarding independent agents.

#### **4. Taxation of Business Profits**

The ASEAN model follows the U.N. model regarding the taxation of business profits, and provides for a limited force of attraction rule that is identical to article 7(1) of the U.N. model:

1. The income or profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the income or profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that permanent establishment;

*(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or*

*(c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment. (Change from OECD is in italics.)*

The provision regarding deductibility of expenses of a PE, in particular head office expenses, in the ASEAN model is also identical to U.N. model article 7(3):

However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or,

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<sup>1426</sup> Qureshi, "The tax treaty needs of developing countries," IFA Seminar, 1979, p. 35.

except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

The U.N.'s reluctance to allow the deductibility of these expenses can be traced back to the Manual for Negotiating Tax Treaties between Developed and Developing Countries.<sup>1427</sup> Under title V, seven member countries pointed out that through the allocation of inflated head office expenses and management fees, and misallocation of research marketing expenses, they are losing tax revenue.

There are two possible interpretations of the U.N. model.<sup>1428</sup> First, one could argue that internal services are not excluded and that the price charged for those services may only be based on expenses that were actually paid by the head office for the performance of the services.

In other words, internal services rendered by the head office to the PE may not contain a profit element. For example, if the head office performed a specific legal service using its own in-house lawyer, only the salary of the in-house lawyer, their travel expenses, and administrative expenses, may be taken into account when allocating the cost to the PE. The legal service may not be charged to the PE at market price.

A second possible interpretation is that *all* internal services were meant to be excluded under the U.N. exception. Only services that the head office obtains from third parties, for the PE's business purposes, may be allocated to the PE at the actual amount that was expended.

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<sup>1427</sup> "Tax Treaties Between Developed and Developing Countries, Sixth Report," 1976, Prepared by the United Nations Department of Economic and Social Affairs (Part II).

<sup>1428</sup> Van der Bruggen, E., "About the Deductibility of Head Office Expenses: A Commentary on Art. 7 (3) of the OECD Model, the UN Model and Alternative Provisions Adopted in Tax Treaty Practice," *Intertax*, 2002, p. 270-284.

I believe the first interpretation should be followed, bearing in mind that article 7(2) is closely related to the application of article 7(3) and, therefore, article 7(3) should be interpreted in a manner consistent with what the result would have been for independent enterprises. Disallowing all consideration for intra-group services, whatever their price level, is manifestly not what would have happened between independent enterprises.<sup>1429</sup> It is also a result that is not consistent with article 24(3) (nondiscrimination).

Moreover, allowing the deduction for the internal service, but without a profit margin, satisfies the intent of the drafters of the U.N. model, namely to avoid base erosion where possible. For example, if the head office charged a large management fee to its PE for base erosion purposes, the greater part of the fee would not be deductible because it exceeds the actual costs of supplying the service including the salary of managers and administration expenses.

## 5. Shipping and Air Transport

Article 8 of the ASEAN model deviates significantly from the other model tax conventions. Income derived by an enterprise of a contracting state from the operation of *aircraft* in international traffic may only be taxed in the residence state.<sup>1430</sup> The place of effective management of the enterprise is irrelevant under the ASEAN model, the only relevant factor is the residence of the enterprise operating the aircraft.

Income derived from international *shipping* may be taxed in the source state but the tax imposed must be reduced by 50 percent. This practice has been adopted by some ASEAN members including Indonesia,<sup>1431</sup> Malaysia,<sup>1432</sup> Singapore,<sup>1433</sup> and Thailand.<sup>1434</sup> The Philippines, however,

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<sup>1429</sup> See for example the OECD guidelines on transfer pricing, part V.

<sup>1430</sup> This provision may be compared with article 8(1) of the U.S. model, but the latter applies to both ships and aircraft.

<sup>1431</sup> Double taxation agreements (including signing dates) with: Austria (24 July 1986), Hungary (19 October 1989), Malaysia (12 September 1991), Philippines (18 June 1981), Romania (3 July 1996), Singapore (8 May 1990), Sri Lanka (3 February 1993), Switzerland (29 August 1988), and Thailand (25 March 1981).

<sup>1432</sup> Double taxation agreements (including signing dates) with: Austria (20 September 1989), Bangladesh (19 April 1983), China (23 November 1985), Denmark (4 December 1970), Hungary (22 May 1989), India (25 October 1976), Myanmar (9 March 1998), Norway (23 December 1970), Philippines (27 April 1982), Singapore

usually refers to the gross revenue derived from sources in the state, and generally levies a tax of 1.5 percent on the gross transport revenue.<sup>1435</sup>

The ASEAN model therefore provides a simpler solution than the U.N. model. The U.N. model offers two alternatives. Alternative A is identical to the OECD model article; while alternative B requires a rather difficult

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(26 December 1968), Sri Lanka (16 September 1997), Sweden (21 November 1970), and Thailand (29 March 1982).

<sup>1433</sup> Double taxation agreements (including signing dates) with: Bangladesh (19 December 1980), Czechoslovakia (21 November 1997), Finland (23 October 1981), Hungary (17 April 1997), Luxembourg (6 March 1993), Mauritius (19 August 1995), Mexico (9 November 1994), Pakistan (13 April 1993), Poland (23 April 1993), Sri Lanka (29 May 1979), Sweden (protocol signed 28 September 1983), Switzerland (25 November 1975), Taiwan (R.O.C.) (30 December 1981, "not to exceed 2 percent"), and Turkey (9 July 1999).

<sup>1434</sup> Double taxation agreements (including signing dates) with: Australia (31 August 1989), Austria (8 May 1985), Bangladesh (20 April 1997), Belgium (16 October 1978, enterprise has a place of effective management in a contracting state), Bulgaria (16 June 2000), Canada (11 April 1984), China (27 October 1986), Czechoslovakia (12 February 1994), Denmark (23 February 1998), Finland (25 April 1985), France (27 December 1974, enterprise has a place of effective management in a contracting state), Germany (10 July 1967, enterprise has a place of effective management in a contracting state), Hungary (18 May 1989), India (22 March 1985; including interest on funds connected with the operation of ships or aircraft in international traffic), Indonesia (25 March 1981), Israel (22 January 1996), Italy (22 December 1977), Japan (7 April 1990), Korea (26 August 1974), Laos (20 June 1997), Luxembourg (6 May 1996), Malaysia (29 March 1982), Mauritius (1 October 1997), Nepal (2 February 1998), Netherlands (11 September 1975), Norway (9 January 1964), Pakistan (14 August 1980), Philippines (14 July 1982), Romania (26 June 1996), Singapore (15 September 1975), South Africa (12 February 1996), Spain (14 October 1997), Sri Lanka (14 December 1988), Sweden (19 October 1988), Switzerland (12 February 1996), United States (26 November 1996), and Vietnam (23 December 1992).

<sup>1435</sup> Double taxation agreements (including signing dates) with: Australia (11 May 1979, shall not exceed the lesser of 1.5 percent of the gross revenues derived from sources in that state), Austria (9 April 1981), Belgium (protocol signed 11 March 1996), Canada (11 March 1976, 1.5 percent), China (P.R.C.) (18 November 1999), Czechoslovakia (13 November 2000), Denmark (30 June 1995), Finland (13 October 1978), France (9 January 1976), Germany (22 July 1983), India (12 February 1990, tax shall not exceed 40 percent), Israel (9 June 1992), Italy (5 December 1980, 1.5 percent), Japan (13 February 1980, tax shall not exceed 60 percent), Korea (R.O.K.) (21 February 1984, 1.5 percent), the Netherlands (9 March 1989, 1.5 percent), New Zealand (29 April 1980, 1.5 percent), Norway (9 July 1987, 1.5 percent), Pakistan (22 February 1980, 40 percent), Poland (9 September 1992, 1.5 percent), Romania (18 May 1994, 1.5 percent), Russia (26 April 1995, 1.5 percent), Singapore (1 August 1977, 1.5 percent), Spain (14 March 1989, 1.5 percent), Sweden (24 June 1998, 1.5 percent), Switzerland (24 June 1998, 1.5 percent), Thailand (14 July 1982), and United States (1 October 1976, 1.5 percent).

assessment of whether the activities are "casual," and an allocation of profits on the basis of "appropriateness." However, the ASEAN provision results in double taxation only being partially eliminated.

Capital gains on the disposition of ships and aircraft may only be taxed in the state where the enterprise that operates them is resident.<sup>1436</sup> Employees aboard a ship or an aircraft may be taxed on their income from dependent personal services only in the resident state of the transport enterprise.<sup>1437</sup>

## 6. Corresponding Adjustments

The ASEAN model article on associated enterprises does not include a rule on corresponding adjustments.<sup>1438</sup> Article 9 of the OECD and U.N. models allows for a correction of an enterprise's profit in the case of transactions between associated enterprises that are not at arm's length. Paragraph 2 of article 9 requires the other state to carry out a corresponding adjustment.

Developing countries are reluctant to carry out corresponding adjustments. Transfer pricing corrections are most likely to occur in countries where the tax authorities have strong audit resources and highly trained officials. ASEAN members are more likely to find themselves on the other, corresponding end of the transaction, and will be required to carry out adjustments under article 9(2).<sup>1439</sup>

OECD members have different opinions regarding excluding article 9(2) from tax treaties. Some treaty partners think that double taxation resulting from transfer pricing adjustments serves the taxpayer right.<sup>1440</sup> Other countries see it differently and point out that fines and other administrative or even judicial measures exist to penalize the taxpayer, and double taxation should not play any role in the process.

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<sup>1436</sup> Article 13(3) ASEAN model; *see also* below.

<sup>1437</sup> Article 15(3) ASEAN model.

<sup>1438</sup> Article 9(2) OECD model.

<sup>1439</sup> Qureshi, IFA Seminar, 1979, p. 40.

<sup>1440</sup> Namely countries who do not agree to including article 9(2) in the tax treaty: Czechoslovakia, Finland, Hungary, Mexico, Norway, and Switzerland made a reservation to the OECD model on this issue. Belgium, France, Hungary, Poland, and Portugal reserved the right to specify in their conventions that they will proceed to a correlative adjustment if they consider the adjustment justified.

## 7. Interest

Article 11(3) of the ASEAN model provides that interest which arises in a contracting state and is paid to the government of the other contracting state (including certain listed institutions and government banks) is exempt from withholding tax.

Furthermore, the ASEAN model does not include an autonomous definition of "interest." The OECD and the U.N. models do. Payments that are not deemed interest under the OECD model, such as interest or currency swaps, may be treated as interest under the ASEAN model if the domestic law of the contracting state that applies the treaty qualifies the income as interest.

The OECD commentary includes the possibility of referring to a domestic law definition of interest.<sup>1441</sup> Most ASEAN members have adopted this provision in their treaty practice,<sup>1442</sup> including Indonesia,<sup>1443</sup> Malaysia,<sup>1444</sup> the Philippines,<sup>1445</sup> Singapore,<sup>1446</sup> and Thailand.<sup>1447</sup>

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<sup>1441</sup> OECD Commentary, 11/21.

<sup>1442</sup> Van der Bruggen, E., "Are International Payments for Interest-Rate and Currency Swaps Subject to Withholding Tax in Thailand?," *Thai Journal of International Taxation*, Vol. 1, Issue 10, p. 12, 13, 15.

<sup>1443</sup> Double taxation agreements (including signing dates) with: Australia (22 April 1992), Austria (24 July 1986), Bulgaria (11 January 1991), Canada (1979 protocol signed 1 April 1998), Czechoslovakia (4 October 1994), Egypt (13 May 1998), Finland (15 October 1987), Germany (30 October 1990), Italy (18 February 1990), Jordan (12 November 1996), Korea (R.O.K.) (10 November 1988), Kuwait (23 April 1997), Luxembourg (14 January 1993), Mongolia (2 July 1996), Philippines (18 June 1981), Poland (6 October 1992), Romania (3 July 1996), South Africa (15 July 1997), Spain (30 May 1995), Sri Lanka (3 February 1993), Sudan (10 February 1998), Switzerland (29 August 1988), Syria (7 June 1997), Ukraine (11 April 1996), United States (protocol signed 24 July 1996), and Vietnam (22 December 1997).

<sup>1444</sup> Double taxation agreements (including signing dates) with: Australia (protocol signed 2 August 1999), Bangladesh (19 April 1983), Canada (15 October 1976), Fiji (19 December 1995), Finland (28 March 1984), Germany (8 April 1977), India (25 October 1976), Italy (28 January 1984), Korea (R.O.K.) (20 April 1982), Philippines (27 April 1982), Romania (26 November 1982), Switzerland (30 December 1974), and Thailand (29 March 1982).

<sup>1445</sup> Double taxation agreements (including signing dates) with: Australia (11 May 1979), Belgium (protocol signed 11 March 1996), Brazil (29 September 1983), Canada (11 March 1976), Finland (13 October 1978), Germany (22 July 1983), Hungary (13 June 1997), Israel (9 June 1992), Italy (5 December 1980), Korea (R.O.K.) (21 February 1984), Netherlands (9 March 1989), New Zealand (29 April 1980), Pakistan (22 February 1980), Poland (9 September 1992), Romania (18 May 1994), Russia (26 April 1995), Singapore (1 August 1977), Switzerland (24 June

## 8. Royalties

Royalties may be taxed in the resident state under the ASEAN model, as well as in the source state, but the withholding tax in the source state may not exceed 15 percent. Thus, the ASEAN model follows the U.N. model, although the latter leaves the percentage open to bilateral negotiations.

The ASEAN model follows the U.N. model in defining royalties. Article 12(3) of the ASEAN model specifically mentions consideration for the use, or the right to use "films or tapes used for radio or television broadcasting."

The ASEAN model also includes in the definition of royalties, consideration for the use, or the right to use industrial, commercial, or scientific equipment. Until 1992, payments for the right to use industrial, commercial, or scientific equipment (rent, operational leases) were included in the royalty article of the OECD model, and still feature in the royalty article of the 2001 U.N. model. Many ASEAN members think that payments for the use of equipment constitutes rent and belongs under the royalty article.<sup>1448</sup>

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1998), Thailand (14 July 1982), United Kingdom (10 June 1976), and United States (1 October 1976).

<sup>1446</sup> Double taxation agreements (including signing dates) with: Belgium (a protocol signed 10 December 1996), Bulgaria (13 December 1996), Canada (6 March 1976), Cyprus (24 November 2000), Finland (23 October 1981), France (9 September 1974), Germany (19 February 1972), Israel (27 September 1971), Italy (29 January 1977), Korea (R.O.K.) (6 November 1979), Mexico (9 November 1994), Netherlands (19 February 1971), Poland (23 April 1993), Sri Lanka (29 May 1979), Switzerland (25 November 1975), and United Arab Emirates (1 December 1995).

<sup>1447</sup> Double taxation agreements (including signing dates) with: Australia (31 August 1989; not mentioned, premiums and prizes attaching to securities and penalty charges for late payment are not regarded as interest for the purpose of this article), Austria (8 May 1985), Bulgaria (16 June 2000), Canada (11 April 1984), China (27 October 1986), Czechoslovakia (12 February 1994), Finland (25 April 1985), France (27 December 1974), Germany (10 July 1967), Hungary (18 May 1989), India (22 March 1985), Israel (22 January 1996), Italy (22 December 1977), Japan (7 April 1990), Laos (20 June 1997), Malaysia (29 March 1982), Mauritius (1 October 1997), Nepal (2 February 1998), Netherlands (11 September 1975), New Zealand (22 October 1998), Philippines (14 July 1982), Poland (8 December 1978), Romania (26 June 1996), Singapore (15 September 1975), South Africa (12 February 1996), Sri Lanka (14 December 1988), Switzerland (12 February 1996), United Kingdom (18 February 1981), United States (26 November 1996), Vietnam (23 December 1992), and Uzbekistan (23 April 1999).

<sup>1448</sup> Pichart Gesaruang, *Tax Treaty Linkages (Thailand)*, OECD, Paris, 1996, p. 101.

Although some ASEAN members, including Malaysia, apply source taxation to technical fees or payments for technical assistance, the ASEAN model does not contain this provision.

## **9. Capital Gains**

Surprisingly, the capital gains article of the ASEAN model is closer to the OECD than to the U.N. model. Gains derived from the alienation of immovable property, or movable property that forms a part of a PE (or a fixed base), may be taxed in the source state. Gains derived from the alienation of ships or aircraft operated in international traffic, however, are only taxable in the residence state of the enterprise that operates the ships or aircraft.<sup>1449</sup>

Gains from the alienation of shares of a company, whose property principally consists, directly or indirectly, of immovable property situated in a contracting state, may be taxed in that state. However, there is no source taxation of capital gains on other shares, which is provided for under article 13(5) of the U.N. model in case a certain shareholding is exceeded.

## **10. Independent Personal Services**

The ASEAN model provides a novel way for the source state to tax income from independent personal services. The ASEAN model does not adopt the notion of fixed base, which is remarkable because the term fixed base is used throughout the ASEAN model, except for article 14.

Instead, the source state may tax the income of nonresident providers of independent personal services, if the nonresident stays in the source state for a period (or periods aggregating) more than 183 days in any 12-month period, or if the remuneration for their activities in the source state is paid by a resident of the state (or borne by a PE or a fixed base) and exceeds US \$10,000.

The OECD model, prior to the deletion of article 14, permitted the source state to only tax income from independent personal services when the service provider had a fixed base in the source state. The 1980 U.N.

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<sup>1449</sup> Article 13(3) ASEAN model.

model added two other possibilities: if the service provider stays in the source country for a period (or periods aggregating) more than 183 days; or if the income paid exceeds a threshold amount.

The 2001 U.N. model deleted the provision relating to threshold amount.<sup>1450</sup> The U.N. Group of Experts pointed out that the provision has not been widely adopted, referring to a study carried out by Professor Wijnen in 1997.<sup>1451</sup> The study also noted that because of inflation, currency thresholds eventually become meaningless.<sup>1452</sup>

The "borne-rule" is popular among ASEAN members. Thailand<sup>1453</sup> has included the rule in most of its tax treaties (41 in force) without providing for any minimum amount. Malaysia,<sup>1454</sup> the Philippines,<sup>1455</sup> Indonesia,<sup>1456</sup> and Singapore<sup>1457</sup> have also adopted the rule in many of their tax treaties.

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<sup>1450</sup> "Developing Countries and the Removal of Article 14 from the OECD Model," *Bulletin for International Fiscal Documentation*, Vol. 55, No. 12, 2001, p. 601-607.

<sup>1451</sup> Report of the Secretary General of the Eighth Meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters: U.N. Doc: E/1998/1. Wijnen, W., and Magenta, M., "The UN Model in Practice," *Bull. I.F.D.*, 1997, 581.

<sup>1452</sup> U.N. Doc: E/1996/1 p. 4-5.

<sup>1453</sup> Double taxation agreements (including signing dates) with: Australia (31 August 1989), Austria (8 May 1985), Belgium (16 October 1978), Canada (11 April 1984), China (27 October 1986), Denmark (23 February 1998), Finland (25 April 1985), France (27 December 1974), Germany (10 July 1967), Hungary (18 May 1989), India (22 March 1985), Indonesia (25 March 1981), Israel (22 January 1996), Italy (22 December 1977), Japan (7 April 1990), Korea (26 August 1974), Luxembourg (6 May 1996), Malaysia (29 March 1982), Nepal (2 February 1998), Netherlands (11 September 1975), Norway (9 January 1964), Pakistan (14 August 1980), Philippines (14 July 1982), Poland (8 December 1978), Romania (26 June 1996), Singapore (15 September 1975), South Africa (12 February 1996), Sri Lanka (14 December 1988), Sweden (19 October 1988), Switzerland (12 February 1996), and United States (26 November 1996).

<sup>1454</sup> Double taxation agreements (including signing dates) with: Albania (24 January 1994), Australia (protocol signed 2 August 1999; in personal services article), Austria (20 September 1989; in personal services article), Bangladesh (19 April 1983), Canada (15 October 1976), China (23 November 1985), Czechoslovakia (8 March 1996), Egypt (14 April 1997), Fiji (19 December 1995), Finland (28 March 1984), France (protocol signed 31 January 1991), Germany (8 April 1977), Hungary (22 May 1989), Italy (28 January 1984, in personal services article), Jordan (8 August 1994), Korea (R.O.K.) (20 April 1982), Malta (3 October 1995), Mauritius (23 August 1992; in personal services article), Mongolia (27 July 1995), Myanmar (9 March 1998), Netherlands (protocol signed 4 December 1996, in personal services article), New Zealand (19 March 1976, personal services article), Pakistan (29 May 1982), Papua New Guinea (20 May 1993), Philippines (27 April 1982), Poland (16 September 1977), Romania (26 November 1982), Sri Lanka (16 September 1997), Sudan (7

The ASEAN model lists "computer software and hardware engineers" among the professional service providers of article 14(2).<sup>1458</sup>

## 11. Artists and Athletes

As is the case under the OECD and U.N. models, income derived by an artist or an athlete from performing personal services, may be taxed in the state where the services are performed. Even if, and again in conformity with both the OECD and U.N. models, that income accrues to another person, including a rent-a-star company, it may still be taxed in the state where the performance took place.

The ASEAN model adds a provision that is comparable, but not identical, to a provision suggested in the OECD commentary regarding events supported by public funds,<sup>1459</sup> and which aims at exempting the income of

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October 1993, in personal services article), Switzerland (30 December 1974), Taiwan (23 July 1996), Thailand (29 March 1982, personal services article), United Arab Emirates (28 November 1995, in personal services article), Uzbekistan (6 October 1997), Vietnam (7 September 1995; in personal services article), and Zimbabwe (28 April 1994).

<sup>1455</sup> Double taxation agreements (including signing dates) with: Brazil (29 September 1983), Italy (5 December 1980; in personal services article), Singapore (1 August 1977, in personal services article), and Thailand (14 July 1982, in personal services article).

<sup>1456</sup> Double taxation agreements (including signing dates) with: Malaysia (12 September 1991), Pakistan (7 October 1990), Switzerland (29 August 1988), Thailand (25 March 1981), and Venezuela (27 February 1997).

<sup>1457</sup> Double taxation agreements (including signing dates) with: Australia (a protocol signed 16 October 1989, in personal services article), Belgium (a protocol signed 10 December 1996, in personal services article), Canada (6 March 1976, in personal services article), Finland (23 October 1981, in personal services article), France (9 September 1974, in personal services article), Germany (19 February 1972, in personal services article), Israel (27 September 1971, in personal services article), Italy (29 January 1977, in personal services article), Korea R.O.K. (6 November 1979; in personal services article), Luxembourg (6 March 1993, in personal services article), Netherlands (19 February 1971, in personal services article), New Zealand (21 August 1973; in personal services article), Pakistan (13 April 1993; in personal services article), Papua New Guinea (19 October 1991), Sri Lanka (29 May 1979, in personal services article), Sweden (a protocol signed 28 September 1983), Switzerland (25 November 1975, in personal services article), and Taiwan R.O.C. (30 December 1981, in personal services article).

<sup>1458</sup> See on this issue, van der Bruggen, E., "Source taxation of fees for technical services and know how," *Asia-Pacific Tax Bulletin*, Vol.7, No. 3, 2001, p. 47.

<sup>1459</sup> OECD Commentary, 17/14 (added in 1992).

artists and athletes from tax in the state where the event takes place. The tax exemption is available when "the visit to the state is substantially supported by public funds of the other contracting state or a political subdivision or a local authority or a statutory body thereof."<sup>1460</sup> The provision is widespread among treaties between ASEAN members. Almost all the original members have included it in their tax treaties.

## **12. Teachers and Researchers**

The ASEAN model adopts another rule recommended by the OECD commentary.<sup>1461</sup> Article 21 of the ASEAN model exempts visiting professors, and the like, from tax in the country where they are teaching for a period of up to two years. Professor Van Raad, commenting on an identical provision in the Dutch model treaty, notes that many questions remain regarding the application and interpretation of the rule.<sup>1462</sup> The provision has become widely used among developing countries, particularly in Asia. Many ASEAN members have adopted it.

## **13. Tax Sparing Credit**

Unlike the OECD or even the U.N. model, the ASEAN model contains a tax sparing credit that is formulated in broad terms:

For the purpose of allowance as a deduction against tax in a Contracting State the tax paid in the other Contracting State shall be deemed to include the tax which is otherwise payable in that other State but has been reduced or exempted in accordance with the special incentive laws designed to promote economic development in that other State.<sup>1463</sup>

The fact that in the course of the 2001 revision, a tax sparing credit was not included in the U.N. model, must have been disappointing to

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<sup>1460</sup> Article 17 (3) ASEAN model.

<sup>1461</sup> During the 7th meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters, in 1996, the introduction was considered, but it does not appear in the revised draft U.N. model of 2001: U.N., E/1996/62 ECOSOC. It does exist in article 20 of the Dutch model tax treaty (Nederlands Standaard Verdrag).

<sup>1462</sup> Van Raad, C., *International Belastingrecht*, Chapter III, p. 511 in Mobach, M e.a., *Cursus Belastingrecht*.

<sup>1463</sup> Article 23(3) ASEAN model.

developing countries,<sup>1464</sup> and the ASEAN model is the only model tax convention in use that includes a tax sparing credit.

#### **14. Concluding Remarks**

The ASEAN model is not binding on ASEAN members. Moreover, most ASEAN members are not able to obtain all of their tax treaty objectives when negotiating with developed countries. Therefore, the ASEAN model will not be adopted throughout the region in its original form.

In addition, there are some oddities in the ASEAN model that do not enhance its value. Farms and plantations are mentioned in the PE article, while income from agriculture is still covered under article 6. "Fixed base" is mentioned throughout the model while it was omitted from article 14.

On the other hand, the ASEAN model has important merits. It is the first step for ASEAN member states toward harmonizing their international tax policies. If ASEAN succeeds in partially harmonizing the tax treaty policies of its members, then the potential for harmonizing South-East Asian income taxation is no longer merely an academic subject. The EU has not yet achieved such tax treaty harmonization.

Tax treaties among ASEAN members are likely to be concluded along the lines of the ASEAN model. ASEAN is actively promoting the conclusion of double taxation conventions in South- East Asia based on the model.

The newest members of ASEAN have concluded only a few tax treaties; however, the ASEAN model may have an important influence on their tax treaty negotiations. Also, the original members are bound to refer to the model in their tax treaty renegotiations.

Furthermore, the ASEAN model includes some novel solutions that are not found in other models, or at least not in exactly the same form. The agreement of a large Asian trading bloc on controversial tax treaty issues, including a tax sparing credit, an agent PE that habitually secures orders, and a 50/50 sharing of income from international sea transport, may help

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<sup>1464</sup> Van der Bruggen, E., "A Preliminary Look at the 2001 UN Model Tax Convention," *British Tax Review*, 2002, p.119-134.

developing countries in their treaty negotiations with developed countries as well as contribute to harmonization among ASEAN members.

Although the ASEAN model is less influential than the U.N. model, and will remain so, the U.N. model has been criticized for not going far enough in helping developing countries.<sup>1465</sup> The ASEAN model, which includes a tax sparing credit and an extended concept of PE, will appeal to developing countries beyond South-East Asia.

The ASEAN model is an important and positive first step toward creating unity in the tax treaty policy of member states.

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<sup>1465</sup> Figueroa, IFA Sem., Vol. 15, p. 9 -- "On the other hand, however, they [industrialized countries] are victimizers when they harm the interests of developing countries by insisting on leveling the total tax burden by imposing this kind of model conventions that curb legitimate fiscal resources of poorer countries under the pretext of facilitating the establishment of an instrument to encourage flows to these countries".; Dornelles, F.N., "The tax treaty needs of developing countries with special reference to the UN Draft Model," IFA Seminar, 1979, p. 27-30 -- "However, in spite of the significant improvements provided for in the UN draft, there still remain some substantial elements which do not reflect adequately all the special fiscal needs of developing countries"; and Qureshi, N.M., "Tax treaty needs of developing countries," IFA Sem. 1979, p. 34 -- "the UN Model Draft Convention still do not fully meet the tax-treaty requirements of the developing countries."