

**Comments of the Business and Industry Advisory Committee (BIAC) to the OECD  
on the Revised Draft Changes to the Commentary on  
Paragraph 2 of Article 15 of the OECD Model Tax Convention**

**June 30, 2007**

**General**

BIAC appreciates the opportunity to provide comments on the OECD revised draft changes to the Commentary on Paragraph 2 of Article 15 of the Model Tax Convention.

We appreciate the intention reflected in the draft to provide for more clarity with respect to the interpretation of Paragraph 2 Article 15, and in particular the interpretation of the term “employer”. It is a fact that countries’ views and practices differ with regard to the meaning of that term (legal or economic interpretation) and that such differences have led to uncertainty about the tax consequences of short-term assignments in many cases. The situation has become somewhat random and chaotic and the Commentary changes do not provide an effective premise to address these situations.

These difficulties should in our view, however, be solved by a common understanding of both contracting states of the meaning to be given to the term “employer” in Paragraph 2 Article 15, either in the tax treaty negotiations, or in a mutual agreement procedure at a later stage. The consideration mentioned in the commentaries could be used as guidance in these situations.

The following paragraphs outline the specific concerns and views of OECD business with respect to the current OECD Discussion Draft:

**Specific Issues of Concern**

***New Commentary Rules will Lead to Uncertainty and Unnecessary Administrative Burdens***

The proposed Commentary sections work well in laying out the questions that arise in short term assignments. They purport to resolve them, however, in ways that will lead to a shift of the taxing right for short-term assignments from the country of residence to the country where the services are exercised. BIAC is concerned that this shift will in fact create complications and new administrative obstacles, not only for the taxpayers, but also for employers and tax authorities of both states concerned. We are disappointed that we have not been able jointly to solve this very practical set of problems

Quoting from Paragraphs 6.2 of the existing Commentaries to Article 15, we note that the objective and purpose of subparagraphs b) and c) of Paragraph 2 are “...to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the state of source...” As a justification of such a principle, Paragraph 6.2 indicates that imposing source deduction requirements could constitute an excessive administrative burden in such cases. The Commentaries were revised a number of years ago to remove certain abuses

caused by hiring-out of labour. However, the new proposed revisions will extend source taxation of short-term employments to many more cases, where there is no abuse whatsoever.

Short-term assignments are increasingly common as are outsourcing to other providers and hiring-out of labour to cover temporary vacancies. The new approach would have profound consequences for these practices and arrangements. Instead of being regarded as non-resident employees of a non-resident company rendering personal services on a temporary basis (less than 183 days in a twelve months period) to a client or an affiliate in the other state, such persons would, if the conditions mentioned in the new Commentaries were fulfilled, be deemed to be the employees of the company in the other state and would become taxable in that state.

Thus, both the shift of the taxing right to the source country and the administrative complications for internationally mobile taxpayers are not in the interest of OECD countries, as it will ultimately create administrative obstacles for cross-border transactions between the OECD countries.

### **Compliance**

We fully agree that in abusive situations, when a contract for rendering of services is in fact an employment relationship, a re-qualification is appropriate. We also agree with the approach that cases of doubts should be resolved having regard to certain principles given in the Commentaries, by using, as it is mentioned, the mutual agreement procedure (Paragraph 8.12).

We doubt, however, that the criteria given in Paragraphs 8.13-8.15 and the examples in Paragraphs 8.16-27 are sufficiently clear to oblige a country of residence to give up its taxing right and subscribe to the interpretation given by the country of source. In our view, there should be no automatic acknowledgement of the qualification of the state of source, based on the wording of the new Commentaries only.

Hiring-out of personnel for the provision of specialized services represents a very significant type of business arrangement, and its importance will surely increase considerably in the future. An enterprise hires a temporary service and not a specific person, and the employer, therefore, has the choice as to whom he would send. In our understanding, this is a clear indication that no employee-employer relationship should be deemed to exist.

The conditions listed in Paragraphs 8.13 and 8.14, which should guide the tax authorities of two treaty states in cases in which they do not agree, are the normal rules used in the area of hiring-out of labour and temporary engagements of specialists.

Paragraph 8.15 of the draft dealing with financial arrangements is formulated in a rather ambiguous way (“not necessarily conclusive”, “only one of the subsidiary factors that are relevant”), although in our view the fact that an arm’s length profit element is charged in addition to the overall costs of the employee is a clear indication for the existence of a contract for the hiring-out of personnel.

We can only stress that these are common business activities and that there is no element of abuse in such transactions that are clearly not tax-motivated (contrary to the situations referred to in existing paragraph 8 of the Commentaries). Following the new interpretation, as set forth in the proposed amendments to the Commentaries under Article 15, the taxing jurisdiction of the country where the services are being rendered would be considerably extended, without any clear legal basis in support of this in the applicable tax treaty.

The new Paragraph 8.28 of the revised draft is intended to give guidance to the tax authorities on how to avoid compliance difficulties. When one looks at the advice given to the tax authorities (clear and understandable domestic rules and practices, possibility to quickly adjust the amount of

tax withheld in the country of residence) one realises immediately that the tax authorities are well aware of the practical problems the new proposal would raise.

### ***Impact on Distinct Nature of Labour Contracts***

Previous comments submitted by BIAAC of a more fundamental nature (shift of the taxing right for short-term assignments, distinction between service contracts and employment contracts) are not adequately reflected in the new draft.

For example, BIAAC is concerned that the distinction between typical contracts for rendering services and employment contracts are blurred by the new interpretation, which will result in a shift of the taxing right from the country of the service provider to the deemed employer in the source country.

### ***Upholding Established Tax Principles***

As mentioned earlier, BIAAC remains concerned that the OECD Discussion Draft contradicts well-established principles incorporated in nearly every bilateral tax treaty. If adopted, the new Commentary language will be an open invitation to tax authorities in host/source countries to extend their tax jurisdiction to the detriment of the international mobility of labour.

This is in particular important for services rendered within an international business group. The new example 6 in Paragraph 8.26 is helpful in that respect, although it only covers one typical situation (central group functions that are charged out to the other group members). Our members rightly remark, however, that in practice the situations will often be far more complex, and that tax authorities could unduly be tempted to question, e.g. the functions performed or the compensation paid for such services.

Despite the fact that a common interpretation in the Commentaries would make it easier to avoid cases of double taxation, we prefer to stick to the well-established taxation principles for short-term assignments and the use of the mutual agreement procedure in cases of doubts. Countries that do not wish to follow the interpretation given in the Commentaries must have the possibility to do so, and taxpayers should be allowed to contest their taxation in a given country in a mutual agreement procedure.

### **Specific Comments on Examples in the OECD Discussion Draft**

BIAAC agrees in **Examples 1 and 2** that the final results, in both cases, would appear to point to the sending company as the “real” employer. We do not, however, concur with the reasons given in the draft for arriving at the appropriate result.

In **Example 3**, the facts are not very clear. It is stated that Fco pays a management fee to Eco. Nothing is mentioned regarding a profit element or the legal basis for the payment. Is there an underlying contract between both companies or is there only a cost transfer from one company to the other? If an effective contract exists which includes a profit element, both countries have to accept the fact that Eco is the employer. If the remuneration is not at arm’s length it can be adjusted by Eco.

Regarding **Examples 4 and 5**, we strongly disagree with the conclusion that the host country company is, in these cases, the “real” employer. In both instances, there exist contracts between the entities. These contracts represent the legal basis for the payments made to the home country entity. The conclusion of the draft is based mainly on the fact that the host country company is benefiting from the individuals’ services, since they are integrated into the business of the host

country entity. We can only stress again that if the OECD countries would follow this line of thinking, they would have to accept that in most cases involving hiring-out of personnel or intra-group secondments the taxing right would get shifted to the other state. This would mean that the existing contractual relationships (providing of services, employment contract) would have to be disregarded. It is evident that this cannot be the result when the provisions of a tax treaty are applied.

We appreciate that **Example 6** reflects a BIAAC request, to cover typical intra-group situations. We agree with the result that the taxing right should not be given to the country where the employee temporarily works. As in examples 4 and 5 we think, however, that the factor whether the activities performed by X in the host country are integrated into the business of the host country entity cannot be a decisive factor.

This example therefore removes some of the concerns and also serves to help clarify the position in respect of double taxation for employees of multinational companies and the compliance issues arising. However, this still leaves the issue of conflicting interpretations and potential double withholding with eventual double tax relief etc., to consider.

## **Conclusions**

**For these reasons, BIAAC recommends that the Revised Draft Changes to Commentary on Paragraph 2 of Article 15 not be adopted.**

The basis for this BIAAC recommendation is that we believe that the proposed revised draft Commentary creates new problems for both taxpayers and tax authorities alike. The current text does not adequately clarify nor simplify relevant issues. The potential creation of heavy administrative burdens with attendant costs, uncertainties for employee and employer, and conflicting taxation requirements of the countries involved should be strongly considered and regarded. We believe that any concerns about tax avoidance and abuse should be addressed by the current anti-abuse rule. Finally, any conflicting interpretations of the term “employer” should be addressed in tax treaty negotiations or in subsequent mutual agreement procedures.

Principal points on which to frame a revised Commentary for Paragraph 2 of Article 15 would be:

- Concentrate exclusively on cases of abuse;
- Explicitly provide mechanisms for an effective and immediate prohibition of double taxation, in case of both employer and employee;
- Better support international labour mobility.

**Related to these points, BIAAC recommends that the OECD in any revised changes to the Commentary:**

- **Specifically limit any shift of the taxing right to the country where the services are performed only to situations of abuse;**
- **Provide that conflicting interpretations of the term “employer” be dealt with in the tax treaty negotiations or in subsequent mutual agreement procedures.**

## APPENDIX

### **Compilation of Individual Comments Received by BIAC for Further Illustration of Points Raised in the BIAC Paper**

“The new proposals will result in a considerable **extension of source country taxation**. It is acknowledged elsewhere in the commentary that source taxation of short-term working would result in an excessive administrative burden and this is clearly the case. The administrative burdens will include the need to much more closely review cases as well as setting up payrolls for individuals only performing short periods of work, dealing with double withholding, tax returns. All of this will in most cases result in no extra tax for the authorities after double tax relief, but a substantial increase in cost for business because of the administrative burdens and fees for professional advice.”

“Businesses (and employees) do, in general, not think in legal entity terms for their daily business purposed, but they think of an e.g. European or Global entity. Employees also work very much across legal entities. For businesses that are part of the same group we would question whether contracts always exist between legal entities for the services of an individual in the way assumed in the draft commentaries. Depending on the circumstances there may be high-level agreements (service level agreements) in place, but these may be pretty general (and not necessarily between legal entities). There may well be letters from the formal employer to the employee, although some (short term) overseas working particularly around Europe is very informally organised. Most of the examples given are not really relevant/applicable to such circumstances and are based on an unrealistic view of how international business operates.”

“In our daily business, we have noticed that short term assignments are booming, as well as situations where employees are performing activities on different territories (head office functions). It is an enormous administrative burden for the employees and the employer in case they have to comply with the tax formalities in several countries for the in most cases very limited period of time that the employees have spent abroad. We notice that, within many business units, this is becoming a huge barrier for sending employees on short term assignment.”

“It should be recognised that allocating the right to tax under a DTA to the country where the employment is exercised provides for administrative burdens. Not only is there taxation for the employee which gives the potential for there to be filing requirements of the individual (i.e. a tax return and forms related to arrival, departure and payment of taxes not withheld) there is also the requirement for the employer to withhold employment taxes.

“Withholding taxes causes significant problems for employers as regards tracking of employees, tracking relevant earnings paid in the other country, and withholding both tax and social security, depending upon the circumstances. For cash paid and benefits provided during the period that the work is actually performed, this is a challenge. When one has to consider incentive compensation plans and share related payments, which may be paid after the employee has returned home and is no longer present in the country where the employment was exercised, the position becomes more complex.”

“The main objective for employers is not to avoid taxation, but to comply with the rules as cost effectively as possible. It is common sense that it is administratively easier to pay taxes and social security to one country than to two or more. “

“From the perspective of a global enterprise, not only short term assignments, but also “business visitors” could have a problem with the proposed new Commentary. Conceptually I could see that the OECD statements may also allow Tax Authorities to claim the principles apply equally to short term business visitors. To give an example, say that a functional business manager has teams in two locations outside his home location. He may well visit each of these locations, say, 30 days in

a particular year. Due to his role whilst he is there he may not just act for the home locations business but also perform services that help the host locations in generating revenues (i.e. act in a role which is an integral part of the most business). In these circumstances the new interpretation would catch him although there is no secondment arrangement and he is simply a business visitor.”

“Besides the real difficulty of excessive administrative burdens there is also the problem that judgement calls would be required. If people are moving on short term assignments then in order to know whether host country taxes will apply there needs to be a judgement call as to whether they have become integral to the host country business. To do this sufficient knowledge will be required of the individual's role together with technical knowledge of Article 15(2). Where there is a requirement to deduct tax from the individual's salary from day one then this decision needs to be made before he arrives on his short-term assignment. Once the decision is made then there will be an administrative burden re payroll etc, but I would see that first there needs to be a technical decision based on the tests in 8.14 and other factors. This decision in itself will be hard to arrange for a global business and bound to cause conflict with employees (plus reduce international mobility). “

“If the commentary is also meant to apply to business visitors in mentioned above then the process would be almost unworkable in practice. Should we track every business traveller and find out what they do? Plus how can we make a decision on day one (for locations which withhold tax) when we do not even know the number of days the individual will travel? If we get it wrong then it is hard to go back and deduct the tax at a later date?”

“We would argue that for Article 15 to be workable in practice, where the contractual arrangements of the employment accurately reflect the business and commercial reality then they should be respected by the treaties. Only where tax avoidance is intended should the relief in Article 15 not apply, and the current commentary already achieves this.”