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I. INTRODUCTION

In this article we will consider the interpretation of Art. 15 (2) (b) of the OECD Model Tax Convention on Income and Capital (hereafter "the OECD Model") in particular in cases of cross-border secondment of employees.

We will only consider cases of bona fide cross-border secondment. The situation which often occurs between affiliated companies of a group is where an employee is seconded by an employer in his state of residence (the employer continues to pay the salary while the employee is on secondment) to work less than 183 days on behalf of a permanent establishment or an affiliated company in the work state, that bears his salary cost through intercompany invoicing.

Article 15 of the OECD Model concerns the taxation of income from employment (dependent personal services).¹ Under the general rule laid down in the first part of Art. 15 (1) of the OECD Model, the residence state of the employee has the exclusive right to tax the remuneration for dependent services, unless the employment is exercised in a state other than the residence state, in which case, subject to the conditions laid down in Art. 15 (2), a right to tax is granted to the work state. The Commentary to the OECD Model, as revised in November 1997, makes it clear that employment is exercised in the place where the employee is physically present² when performing the activities for which the employment income is paid.³ When a right to tax is allocated to the work state, the residence state should avoid double taxation by applying its relief method, i.e. credit or exemption.⁴

Art. 15 (2) of the OECD Model concerns employment of short duration by dependent personnel outside the residence state of such personnel. It is often referred as the "183 days" rule. It decides under what circumstances the work state is prevented from taxing the remuneration received in respect of services rendered there by an employee who is a resident of the other contracting state. Pursuant to Art. 15 (2) the work state should refrain from taxing and the right to tax reverts exclusively to the residence state of the employee if each of the three following conditions is fulfilled: **(a)** the employee is not present for more than 183 days in the work state during any 12-month period commencing or ending in the fiscal year concerned,⁵ **(b)** the remuneration is

1 paid by, or on behalf of, an employer who is not a resident of the work state, and (c)
2 the remuneration is not borne by a permanent establishment or a fixed base which the
3 employer has in the work state.⁶

4
5 When the work state applies the treaty, because its right to tax is limited by Art. 15 of
6 the treaty, it must determine whether in the above factual pattern the remuneration is
7 paid by, or on behalf of, an employer who is not resident in the work state. None of
8 the terms "paid by, or on behalf of" and "employer" is defined in the OECD Model.
9 Accordingly, pursuant to the general treaty rule for the interpretation of undefined
10 treaty terms (Art. 3 (2) of the OECD Model), it may be argued that the state applying
11 the treaty⁷ may construe those terms in accordance with their meaning under its
12 domestic law. A unilateral interpretation in accordance with the (income tax) laws of
13 the state applying the treaty is, however, only acceptable under Art. 3 (2) of the
14 OECD Model if the context of the treaty does not otherwise require. As a result of an
15 amendment adopted by the OECD Council on September 21, 1995, the current
16 version of Art. 3 (2) reads as follows: "As regards the application of the Convention at
17 any time by a Contracting State, any term not defined therein shall, unless the context
18 otherwise requires, have the meaning that it has at that time under the law of that State
19 for the purposes of the taxes to which the Convention applies, any meaning under the
20 applicable tax laws of that State prevailing over a meaning given to the term under
21 other laws of that State".⁸

22
23 According to the general rule of treaty interpretation laid down in Art. 31 of the
24 Vienna Convention on the Law of Treaties ("the Vienna Convention"), in case of
25 uncertainty about the exact interpretation of an undefined treaty term, such term "shall
26 be interpreted in good faith in accordance with the ordinary meaning to be given to
27 the terms of the treaty in their context and in the light of its object and purpose".⁹ The
28 Australian Administrative Appeals Tribunal in a case involving the interpretation of
29 Art 15 (2) (b) of the U.S.A.-Australian tax treaty expressly recognized this principle.¹⁰

30
31 The examples that will be discussed in this article make it clear that if the above terms
32 are construed according to the domestic laws of the state applying the treaty,
33 conflicting legal concepts or interpretations between the work state and the residence
34 state may lead to opposite views on whether or not the employee qualifies for

1 exemption in the work state. Issues of potential double taxation arise where the
2 residence state of the employee argues that the employer and payer of the salary is the
3 formal employer based in such residence state and the work state argues, first, that the
4 person in its state to which the employee is assigned has become an employer and,
5 secondly, that the payment by the legal employer in the residence state was made on
6 behalf of an employer in the work state. Whether such conflicting interpretations lead
7 to effective double taxation depends, of course, on the system for relieving double
8 taxation in the employee's state of residence. Situations of potential double exemption
9 also arise in practice: one of them is the practice known as international hiring-out of
10 labour, which is discussed in detail below.¹¹ Under such a structure, a user wishing to
11 employ non-resident labour for a period of less than 184 days recruits personnel
12 through an intermediary established abroad who purports to be the employer and
13 usually enters into a formal employment agreement with the worker. The intermediary
14 pays the salary to the worker and hires the labour out (i.e. seconds the worker) to the
15 user for consideration. Double exemption may occur where the work state does not
16 consider the user to be an employer and the residence state of the employee grants
17 relief for double taxation by way of exemption and considers the user as an employer
18 on whose behalf the salary has been paid by the intermediary.

19
20 The topic of this article is a variation of certain of the issues that we discussed in our
21 article on credit and exemption for differing categorisation of income.¹² Here, rather
22 than being a case of characterisation of income, two states may take a different view
23 of who is the employer and/or on whose behalf the remuneration is paid. We will
24 discuss below the interpretation of the three undefined terms used in Art. 15 (2) (b) of
25 the OECD Model, i.e.: "employer", "paid by/on behalf of" and "or". As we are
26 considering the situation where the work is performed outside the residence state of
27 the employee and Art. 15 (2) of the treaty limits the work state's right to impose tax,
28 we will first examine the meaning of these terms according to the domestic law of the
29 work state and see whether the context of the treaty prohibits such interpretation
30 according to domestic law (see II below). We will then discuss possible
31 interpretations of Art. 15 (2) by the residence state (see III below).

32 33 **II. INTERPRETATION OF ART. 15 (2) (b) BY THE WORK STATE.**

1 The main issue to be addressed when analyzing the terms of Art. 15 (2) (b) in a case
2 of cross-border secondment of an employee to an affiliated company or another
3 person outside the residence state of the employee, is whether such a company or
4 person qualifies as "an employer" of the seconded employee.

5
6 We shall address this issue first (see A). Once it is decided who, in a case of cross-
7 border secondment, is for the purposes of Art. 15 to be regarded as an employer of the
8 seconded employee, the question of "paid by or on behalf of" is of secondary
9 importance. If payment to the employee is by an employer within the meaning of Art.
10 15, the salary is "paid by" an employer. If somebody else pays the salary, it is paid
11 "on behalf of" an employer (see B). The word "or" is used to cover two distinct
12 factual situations, i.e. direct payment by an employer ("paid by") and indirect payment
13 by an employer ("on behalf of") (see C).

14 15 **A. The term "an employer"**

16
17 In the absence of a treaty definition of the term an employer, the work state, when
18 ascertaining whether it has a right to tax such salary, will, pursuant to Art. 3 (2) of the
19 OECD Model, apply its own domestic law in determining whether the entity resident
20 in such work state that pays, or on whose behalf some other person pays, the salary
21 cost, is to be regarded as "an employer" within the meaning of Art. 15 (2) (b).

22
23 For the purposes of Art. 3 (2), unless the context otherwise requires, the meaning of
24 any term not defined in the treaty may be ascertained by reference to the meaning it
25 has for the purpose of any relevant provision of the domestic law of a contracting
26 state, whether or not a tax law. The current version of Art. 3 (2)¹³ makes it clear that
27 where a term is defined differently for the purposes of different laws of a contracting
28 state, the meaning given to that term for the purposes of income tax laws shall prevail
29 over all others, including those given for the purposes of other tax laws.

30
31 The OECD Commentary¹⁴ states that there has been a general and consistent
32 understanding of the OECD member states that the meaning of undefined terms could
33 be derived from non-tax laws of the contracting state applying the treaty and that the
34 amended wording of the article is merely to conform the text of the article more

1 closely with that understanding. If this is the case, presumably the OECD member
2 states will interpret treaties that have the older wording of Art. 3 (2) in accordance
3 with this general understanding.¹⁵

4
5 a. Domestic law meaning of "employer"

6
7 It seems, from the countries represented by the group of authors, that a number of
8 countries do not have a tax law definition of the term "employer". Such countries
9 include Belgium, the Netherlands, Italy, France, Germany, Japan, Sweden and
10 Switzerland.¹⁶ Accordingly, they will normally use their general non-tax (very often
11 labour law) definition of employer when interpreting such term in Art. 15 (2) (b).¹⁷

12
13 The situation is not significantly different in Canada, the United States, Australia or
14 the United Kingdom.¹⁸ Although the Canadian Income Tax Act includes definitions of
15 terms such as "employment", "employer", "employee", such definitions do not
16 provide for a set of rules for determining "employer" status but make reference to
17 common law.¹⁹ Hence, in Canada the general law meaning of "employer" will be used
18 for tax treaty purposes. In the United States, the Internal Revenue Code and the
19 regulations thereunder require that the definition of "employee" is generally
20 determined at common law, but the Code designates certain workers as employees,
21 without regard to their status at common law.²⁰ In Australia, when the new "Pay As
22 You Go" tax collection system will be implemented on 1 July 2000, "employer" will
23 take its general meaning derived from labour law for all income tax purposes.²¹

24
25 It is clear that in order for "employer" status to be found in all of the countries
26 represented a formal (written) employment agreement is not required. In several
27 countries, even, written employment agreements are unusual. Each time a country-by-
28 country analysis will be required based upon all facts and circumstances surrounding
29 the case. However, as appears from the materials quoted above in most countries
30 represented, the control test seems to be more important than the integration test.
31 Therefore the issues which the work state will most likely address are: whether the
32 seconded employee is bound to obey the orders and instructions of the local affiliate
33 when working there; whether he performs such activities under the direction and
34 control of the management or the board of that affiliate; whether such management or

1 board has issued the job description for the period of secondment; whether he reports
2 to such management or board; whether the local affiliate has the right to terminate the
3 secondment; which of the group entities has the right to fire the employee while he is
4 on secondment etc.. As integration in the master's business is not the primary factor in
5 determining whether the affiliate qualifies as an employer, we believe that the
6 shortness of the stay in the work state (in any event less than 184 days) and the
7 eventual resulting lack of integration in the business of the affiliate there, should not
8 be decisive.

9
10 Likewise, the fact that the assigned employee is often in a senior position should not
11 be decisive. As a senior executive, he is still required to abide by the instructions of
12 the chief executive officer or the board of the company to which he committed to
13 supply his services. An executive director may in certain jurisdictions even act in two
14 capacities, one as a board member personifying the company that gives the
15 instructions and the other as an employee of such company subject to control.²²
16 Remuneration paid to such an executive director in his capacity of employee is
17 governed by Art. 15 of the OECD Model.²³

18
19 If the employee works exclusively for the enterprise to which he is seconded and is
20 released for that period by his employer in the state of residence, the enterprise in the
21 work state will quite likely be regarded as an employer, even if only a short stay in the
22 work state is required.²⁴ Even if the employer in the residence state does not release
23 the secondee from his duties, the entity to which the employee is seconded could
24 qualify as an employer and, thus, the employee may have two employers. This could
25 be, for instance, the case if the employee has two distinct functions for which he
26 reports to each group enterprise separately, e.g. if he is working part time in his state
27 of residence on the affairs of the local company and part time on unrelated affairs of
28 an affiliate in the other state.²⁵

29
30 Where employees are temporarily seconded to the other state in order to install or
31 service equipment which has been sold by their employer in the residence state or to
32 perform after sales services, the purchaser of the equipment is unlikely to qualify as
33 an employer as such employees continue to work under the authority of the employer
34 of the residence state. The relationship here is a seller/customer relationship, not an

1 employment relationship between the customer and the employee. The same will in
2 our opinion be true, if the employee is seconded temporarily to an affiliate in the other
3 state to perform a job which benefits solely his employer in the residence state and for
4 which he is controlled by and reports to the latter. This would be the case for example
5 if the employer seconds an internal auditor or counsel to carry on an audit or to
6 perform due diligence at the premises of a subsidiary in the other state in anticipation
7 of a sale of the subsidiary's shares.

8
9 Where the domestic tax laws of the source state contain "deemed employment"
10 provisions, such as in France for senior officers of corporations or in the Netherlands
11 for supervisory directors (commissarissen), such definitions are to be used for tax
12 treaty purposes pursuant to Art. 3 (2) of the OECD Model.²⁶

13
14 Several countries have broad domestic tax law definitions of "employer" for
15 withholding tax purposes.²⁷ In our view, the exception included in Art. 3 (2) of the
16 OECD Model ("unless the context otherwise requires") precludes the use of such
17 definitions for purposes of construing the term "employer" in Art. 15 of the OECD
18 Model as such domestic law definitions start from the assumption that an employment
19 relationship exists and subsequently go on to define the person who is liable to
20 withholding tax (the withholding agent), rather than the employer.²⁸

21 22 b. OECD Commentary

23
24 In paragraph 8 of the Commentary, the OECD expands on the interpretation of the
25 term "employer" in Art. 15 of the OECD Model. It recognizes that Art. 15 (2) of the
26 OECD Model has given rise to several cases of abuse through the adoption of the
27 practice called "international hiring-out of labour".²⁹ Under such a structure, the
28 worker prima facie fulfills the three conditions laid down by Art. 15 (2) and claims
29 exemption from taxation in the country where he is temporarily working.³⁰

30
31 A radical solution to a number of problems arising in this field would be to exclude
32 income earned by hired-out personnel altogether from the scope of paragraph 2 of Art.
33 15. The result of such exclusion would be that the work state is entitled to tax the

1 worker's remuneration. The OECD, however, considered this to be an inappropriate
2 solution.³¹

3
4 Instead, the OECD Commentary formulates a number of criteria to determine "the
5 real employer" with respect to cases of perceived abuse in the field of international
6 hiring-out of labour. The OECD recognizes that in international hiring-out of labour
7 structures, the functions of the employer are split between two persons, i.e. the
8 intermediary and the user and that in order to prevent abuse, substance should prevail
9 over form. Therefore the OECD recommends that each case should be examined on
10 its own merits to see which one of the two parties involved exercises the main
11 functions of employer. For that purpose the term "employer" should, according to the
12 OECD Commentary, be interpreted in the context of Art. 15. The "real employer" is
13 defined as: "the person having rights on the work produced and bearing the relative
14 responsibility and risks".³² In the case of international hiring-out of labour, these
15 functions are, according to the OECD Commentary, exercised to a large extent by the
16 user, who, therefor, should be qualified as "the real employer" for purposes of Art. 15
17 (2) (b).³³

18
19 The Danish tax authorities took the same view in a 1983 Circular Letter and denied,
20 for the purposes of Art. 15 (2) of the OECD Model, "employer" status to the
21 intermediary that hired out non-Danish resident employees to a Danish principal.³⁴
22 According to the Circular Letter the principal is to be regarded as employer for the
23 purposes of Art. 15.³⁵ After criticism, the Danish authorities changed their position
24 pursuant to mutual agreements reached with the United Kingdom and the Netherlands
25 (except for Dutch residents working in the Continental Shelf area).³⁶ Certain
26 commentators argued that, in the absence of a legal basis for the opinion of the
27 authorities under Danish domestic tax law, the resolution with the United Kingdom
28 and the Netherlands should apply to residents of all other countries having signed an
29 OECD-type Art. 15 with Denmark.³⁷

30
31 Hence, according to the OECD Commentary, in the context of Art. 15 of the OECD
32 Model, "employer" means the person who obtains the benefit of the work and bears
33 the risks in relation thereto. It is believed that this is not a complete definition of
34 "employer" as the elements to which the OECD Commentary refers, do not reflect

1 two very important characteristics of an employment relationship, i.e. control and
2 integration in the master's business. While the definition of the OECD Commentary
3 may have value in cases of abuse of international hiring-out, where substance should
4 prevail over form, in bona fide cases of cross-border secondment it tends to lead all
5 too quickly to the conclusion that the entity to which the employee is seconded and
6 that bears one way or another the cost of the remuneration is to be regarded as an
7 employer for the purposes of Art. 15 (2) (b), thereby defeating the purpose of the
8 exception of Art. 15 (2) OECD Model.³⁸ For instance, in the following case there is a
9 risk that the work state which strictly applies the OECD guidelines, could regard the
10 affiliate as an employer: a company resident of State R enters into a management
11 agreement with an affiliated company in State W; assigns an employee of State R to
12 State W for less than 184 days to perform managerial functions on behalf of the
13 affiliate and bills the services to the affiliate on the basis of the employee's salary cost
14 plus a mark-up. Undoubtedly, the affiliate is entitled to and benefits from the
15 employee's services. However, can one say that the employee committed himself to
16 work as an employee for the affiliate in State W? One needs to consider whether the
17 employee performs services under instruction and authority of the State W affiliate
18 and whether he reports to that affiliate or to his employer in State R .

19
20 However, to a certain extent the OECD Commentary seems to recognize that "the
21 person who has rights on the work produced" and "who bears the risks thereof" are
22 not the only possible indications of who is the employer. The OECD Commentary
23 goes on to say that in settling disputes, competent authorities may have regard to other
24 circumstances such as "whether the authority to instruct the worker lies with the user;
25 whether the work is performed at a place that is under the responsibility and control of
26 the user; whether the remuneration is based on time utilized; whether the user is
27 putting tools and materials at the disposal of the worker; and whether the number and
28 qualifications of the employees are not solely determined by the hirer ". These criteria
29 seem to have been taken from what can now be found in Appendix 2 to the
30 Agreement between the Nordic Countries on Mutual Assistance and the 1996
31 Convention between the Nordic Countries for the Avoidance of Double Taxation with
32 respect to Taxes on Income and Capital These two Agreements do not materially
33 differ.³⁹ If such criteria are satisfied, substance should, according to the Commentary,

1 prevail over form and the user will be regarded in substance as being an employer for
2 purposes of Art. 15 OECD Model.

3
4 Thus, the OECD Commentary also relies on control and integration to determine who
5 is the "real employer", but oddly enough it suggests that control and integration and
6 the other additional criteria are to be used only within a mutual agreement procedure.

7
8 One can formulate other points of criticism on paragraph 8 of the OECD
9 Commentary. First, the Commentary seems to proceed from the theory that there can
10 be only one employer (see e.g.: "... for him to be considered as the employer within
11 the meaning of paragraph 2 ... enabling them to establish that the real employer is
12 ..."), while Art. 15 (2) (b) refers to "an_employer", clearly suggesting, as some of the
13 examples discussed above demonstrate, that an employee may have more than one
14 employer. Therefore, to achieve the result desired by the OECD Commentary, it
15 would be necessary to deny employer-status to the formal employer.

16 Secondly, the Commentary appears to suggest that the criteria for determining
17 "employer-status" should be used only in cases of abuse (known as international
18 hiring-out of labour). As a result, it could be argued that they cannot be applied to
19 genuine situations such as a bona fide secondment between affiliated companies. One
20 wonders about the basis of a legal principle which allows one to give the term
21 employer one meaning, suggested in the OECD Commentary, if the case is deemed to
22 be an abuse and another meaning to that same term if the case is bona fide. If the
23 meaning of the term employer is to be derived from the context of Art. 15, as is stated
24 in the OECD Commentary, it is difficult to see that such meaning should only be
25 relevant in cases of abuse and why it should not be applied generally.⁴⁰

26
27 The wording of paragraph 8 of the Commentary is ambiguous. One should thus
28 consider what the Commentary means by abuse in the context of that paragraph. Such
29 paragraph could be read as saying that it only applies where parties enter into complex
30 arrangements designed to exploit Art. 15 (2) in an artificial way, such as where the
31 alleged employer has no real substance or where use is made of fictitious employment
32 agreements. However, the same paragraph could also be read as suggesting that every
33 structure of cross-border hiring out of labour or employment agency meeting the
34 particular criteria laid down in the Commentary is abusive for the sole reason that the

1 employee is not subject to tax in the state of the user if he is not working there for
2 more than 183 days. It is not in the interest of uniform treaty interpretation that the
3 OECD Commentary includes such an ambiguity. It is suggested that it be reworded to
4 remove all ambiguity.

5
6 c. Application of the OECD Commentary to bona fide cases of cross-border
7 secondment

8
9 Although the OECD Commentary is ambiguous as to whether paragraph 8 applies to
10 bona fide cases, it appears that certain countries apply the suggested
11 employerdefinition to bona fide cases, even beyond the scope of international hiring-
12 out of labour and employment agencies, such as secondment within an international
13 group of companies. In June 1995, the UK Inland Revenue stated that in its view the
14 OECD Commentary means that the context of the provision concerning the exemption
15 for short stay employees requires that it is the economic employer and not the formal
16 employer, who should be considered as an employer for the purposes of applying Art.
17 15 of the OECD Model. Hence, from 1 July 1995 the Revenue, on the basis of the
18 new OECD Commentary, does not accept claims for exemption where the United
19 Kingdom is the work state and the cost of an employee's remuneration is borne by a
20 UK company which acts as economic employer.⁴¹ The OECD Commentary does not
21 use the terms formal employer and economic employer – but real employer - so the
22 Revenue's position is not crystal clear.

23
24 The Financial Secretary to the Treasury further clarified the Revenue's position during
25 a debate on the 1996 UK/Argentina treaty. According to the Financial Secretary, the
26 term economic employer describes the case where an employee works in a business of
27 a UK company, so that the UK company obtains the benefits and bears any risks in
28 relation to the work that is undertaken by the employee, that company is treated as his
29 employer for the purposes of Art. 15. On the other hand, the U K company would not
30 be regarded as the employer where the employee continued to work in the business of
31 the non-resident company, even though working at the premises of the U K company.
32 The example of an employee who is sent to the UK company to service equipment
33 that has been supplied by the non-resident company was given to illustrate the latter
34 case. According to the Financial Secretary, in the case of short-term secondees, it is

1 unlikely that an employee would be sufficiently integrated into the business of the UK
2 company for that company to be regarded as his employer.⁴² As a practical matter, the
3 Inland Revenue takes the view that a UK company should not be treated as an
4 employer for the purpose of Art. 15 where the employee is present in the United
5 Kingdom for less than 60 days in a tax year and that period does not form part of a
6 more substantial period when the taxpayer is present in the United Kingdom.⁴³

7
8 The British approach differs significantly from the official point of view of the
9 international division of the Swiss Federal tax administration. As Switzerland has
10 taken the view that the economic approach referred to in the OECD Commentary
11 should be reserved for cases of abuse of international hiring-out of labour,⁴⁴ it is
12 highly unlikely that it will apply a purely economic test and tax the employee
13 seconded to a Swiss affiliated company based on the mere fact that the employee is
14 working in Switzerland and that the salary cost is ultimately borne by that Swiss
15 enterprise. However, it should be pointed out that the official view of the Swiss
16 Federal tax authorities may not always be followed by the various cantonal tax
17 administrations who are in charge of applying not only cantonal, but also federal
18 income tax provisions (including tax treaties). For instance, in the canton of Geneva a
19 non-resident employee of Switzerland is reported to escape Swiss taxation only if he
20 is carrying on activities for the direct benefit of the foreign parent company in
21 Switzerland, such as an internal audit.

22
23 The UK Inland Revenue applies the current OECD Commentary to Art. 15 to all
24 existing treaties whether concluded before or after the 1992 Model, thereby following
25 (in a case where the text of the Model has remained unaltered) the approach set out in
26 the Introduction to the OECD Commentary on the application of subsequent
27 commentaries.⁴⁵ Following this approach, a change can be much more quickly
28 effected by changing the Commentary rather than by altering the text of the Model
29 and of each individual treaty. The prevailing view amongst British authors is that the
30 situation of the taxpayer under an earlier treaty cannot, in law, be adversely affected
31 by a subsequent change in the Commentary on the basis that it was not the expressed
32 understanding of the treaty negotiators at the time the earlier treaty was concluded.⁴⁶

33

1 It is interesting to note that the courts in different countries have recently reached
2 different conclusions with respect to the use of the OECD Commentary in interpreting
3 tax treaties signed before such Commentary has been settled.

4
5 The Supreme Austrian Administrative Court took the view that a tax treaty should be
6 construed on the basis of the Commentary that was available to the parties when the
7 treaty was signed.⁴⁷ The view that subsequent commentaries should usually not be
8 referred to has further been expressed by the Dutch Supreme Court,⁴⁸ the Tax Court of
9 Canada,⁴⁹ the Canadian Federal Court of Appeal⁵⁰ and the United States Tax Court⁵¹
10 (although the latter did finally rely on subsequent commentaries on very specific
11 grounds) and in 1999 by the US Court of Federal Claims.⁵² This is also likely to be
12 the view in Australia. Recently, the Federal Court of Australia held that the use of the
13 Commentary at the time the treaty was concluded was the appropriate course, though,
14 like the United States Tax Court, it then referred to later texts on the basis that they
15 did not reflect any significant change and were based on an interim report that was
16 available at the time the treaty was concluded.⁵³

17
18 On the other hand, the Norwegian Supreme Court relied recently on the 1992
19 Commentary to interpret the tax treaty between Norway and Denmark, concluded in
20 1958, thus even before the publication of the first OECD Model and its Commentary
21 in 1963.⁵⁴ In the Commerzbank case, an English court quoted from the 1977 OECD
22 Commentary in construing the 1964 UK/Germany treaty.⁵⁵

23 .
24 d. Suggestion for modification of the OECD Model and the Commentary

25
26 The OECD is considering whether to move the definition of employer within
27 paragraph 8 of the Commentary on Art. 15 to clarify that it applies to the entire article
28 and whether the definition needs to be revised.⁵⁶ We suggest, however, that such
29 definition should be included in the OECD Model itself, rather than in the
30 Commentary.⁵⁷

31 The Commentary should in any event remove any ambiguity as to whether paragraph
32 8 has a general application and applies to other than cases of abuse. If the
33 Commentary makes it clear that it applies generally, it should further clarify that each
34 case of secondment requires the work state to make a proper analysis of for whom and

1 under whose instruction the employee is performing the services required by the job
2 for which he is seconded. The Commentary should also make it clear that, rather than
3 determining which party benefits from or has rights over the work produced by the
4 seconded employee, the work state should, based on a "facts and circumstances" –test,
5 determine whether the resident entity to which the employee is seconded, acts in
6 substance as an employer for the job for which the employee is assigned to such state.
7 Relevant issues to be addressed for a facts and circumstances determination are:
8 whether the job description for the assignment has been provided by the entity in the
9 work state; whether the employee abides by the orders and instructions of the
10 management or board of the entity in the work state; whether he reports to such
11 management or board; whether the entity in the work state has the right to terminate
12 the assignment; whether such entity can terminate its relationship with the employee
13 while on secondment etc.. In this respect, the Commentary should also state clearly
14 whether the criteria listed therein to determine the employer/employee relationship can
15 be used outside the mutual agreement procedure. Finally, the Commentary should be
16 brought into line with the language of Art. 15 (2) (b) ("an employer") and address the
17 issue of two or more employers

18

19 **B. The terms "paid by/on behalf of"**

20

21 **a. Discussion**

22

23 We first consider the text of Art. 15 (2) (b) of the OECD Models of 1963 and 1977.⁵⁸
24 The official English text of the 1963 and 1977 OECD Models uses the words "paid
25 by, or on behalf of, an employer". The same wording appears in both the United
26 Nations Model and the US Model.⁵⁹ The official French text of the 1977 OECD
27 Model reads "*payées par ou pour le compte d'un employeur*". It is worthwhile to note
28 that such French text differs from the 1963 formulation, which read "*payées par ou au*
29 *nom d'un employeur*". Presumably, the French text was changed to bring it into line
30 with the English text. In our opinion it follows from the use of the terms "*pour le*
31 *compte de*", that such terms and their English counterpart "on behalf of" put emphasis
32 on the economic aspect, i.e. refer to the party assuming the cost of the remuneration.⁶⁰
33 The unofficial German text of the OECD Model reads: "*von einem Arbeitgeber oder*
34 *für einen Arbeitgeber gezahlt*" (the latter notion indicating that the payer pays the cost

1 for somebody else) and does not seem to confirm nor to contradict this conclusion.
2 The unofficial Dutch language used in both the Belgian and Dutch double tax treaties
3 reads "*betaald door, of namens, een werkgever*". It seems that such Dutch translation
4 is still based on the French text of the 1963 OECD Model "*au nom de*". A correct
5 translation of the French text of the OECD Model should read "*door, of voor*
6 *rekening van, een werkgever*".^{61 62}

7
8 Pursuant to Art. 15 (2) (c) the work state cannot assert taxing rights on the
9 remuneration if the remuneration is not borne by a permanent establishment which the
10 employer has in such State. The objective of Art. 15 (2) (c) is to grant a right to tax to
11 that state which recognizes the cost of the remuneration as a deduction from taxable
12 profit. Art. 15 (2) (b) and (c) form part of the same paragraph in the same article and
13 thus have the same context. Hence, it is our view that the rationale behind Art. 15 (2)
14 (c) is the same as that behind Art. 15 (2) (b). As is now clearly confirmed by the
15 recent OECD Partnership Report, the intent and purpose of Art. 15 (2) (b) and (c) are
16 common: the work state is entitled to tax the remuneration if the cost thereof is
17 allowed as a deductible expense in such state.⁶³ This occurs, and a right to tax is
18 granted to the work state, if the employer's permanent establishment in the work state
19 has borne the cost of the salary or if an employer in the work state has borne such
20 salary cost, either through a direct payment to the employee ("paid by an employer
21 resident of the work state") or indirectly, when somebody else paid the salary, through
22 an intercompany charge ("paid on behalf of an employer resident of the work state").

23
24 As different language is used in Art. 15 (2) (b) and (c), it could be argued that (b) and
25 (c) serve different purposes. Art. 15 (2) (b) refers to "an employer" and "paid by, or on
26 behalf of" whereas Art. 15 (2) (c) uses the terms "the employer" and "borne by".
27 There may be at least two explanations for this different language, a semantic and
28 legal one. The difference in language can be explained as a matter of linguistic style
29 by the context in which the words appear. When the first time something is introduced
30 in the text of the treaty, it is described by the indefinite article ("an") and thereafter it
31 is referred to by the definite article ("the").⁶⁴ The difference between "an" employer
32 and "the" employer may also be explained by the fact that a permanent establishment
33 is not a legal person and can therefore, not, as such act as a separate employer in the
34 work state by whom or on whose behalf the remuneration is paid.⁶⁵ In Art. 15 (2) (c)

1 there is, by definition, only one employer as the permanent establishment is part of the
2 enterprise and is not a separate legal entity which can act as employer. In case of
3 secondment between two separate legal entities and, for example, an employee
4 exercising two functionally different jobs, one in the residence state and one in the
5 work state, the enterprise in the work state to which the employee is
6 temporarily seconded, is a separate legal entity, and can qualify as an employer
7 distinct from the employer in the residence state. The use of the term "an employer" in
8 Art. 15 (2) (b) clearly suggests the possibility of dual employeeship. The difference in
9 the terms "paid by, or on behalf of" and "borne by" can be explained on the basis of
10 the difference between a permanent establishment and a separate legal entity that
11 qualifies as an employer. In the case of a permanent establishment the only way to
12 determine which country has the right to tax, is to examine whether a charge is to be
13 attributed to (borne by) the permanent establishment for the salary of the employee.
14 As compared to the head office, a permanent establishment cannot act independently
15 in legal transactions and as a result the expression "paid by or on behalf of" is not
16 appropriate for a permanent establishment.⁶⁶

17
18 Remuneration is "borne by" a permanent establishment if it is expensed directly by
19 such establishment and deducted from its profits because it compensates the employee
20 for the services rendered by the employee for its specific benefit.⁶⁷ The remuneration
21 is also "borne by" a permanent establishment and such permanent establishment will
22 be entitled to claim a deduction for such remuneration, if it is paid to the employee by
23 the foreign head office which enters such payment in its accounts, regardless of
24 whether such head office charges the cost thereof to the accounts of the permanent
25 establishment on whose behalf the employee is working. Such deduction by the
26 permanent establishment is always conditional on the services of the employee
27 concerned also being attributable, in fact, to the permanent establishment.⁶⁸ If so, in
28 both instances, the permanent establishment assumes the burden of the remuneration
29 and deducts such cost from its taxable profits because it constitutes the payment for
30 services rendered to satisfy its own specific needs.⁶⁹ The deductibility of the
31 remuneration as a business expense of the permanent establishment provided for by
32 Art. 7(3) of the OECD Model is thus, in conjunction with Art. 15 (2) (c), related to the
33 taxation of that remuneration in the work state and is effectively a condition for such
34 taxation in the hands of the employee.

1
2 From case law available in New Zealand it appears to be decisive that the permanent
3 establishment actually bears the cost of the remuneration, not that it should have done
4 so or that such cost should have been attributed to it. As the salaries were not recorded
5 in the accounts of the New Zealand permanent establishment and no actual deduction
6 was claimed by the New Zealand permanent establishment, the Court ruled that the
7 employees were not taxable in New Zealand under Art. 15 (2) (c) of the New
8 Zealand-US treaty and rejected the arguments of the Commissioner that the treaty
9 should be interpreted to take account of the overall economic effect of the
10 transactions.⁷⁰

11
12 We disagree with this decision. In order to decide whether the remuneration is "borne
13 by" a permanent establishment, it seems appropriate to make the connection with the
14 attribution of profit rules of Art. 7 (2) and (3) of the OECD Model.⁷¹ If according to
15 such profit allocation rules, the salary cost is correctly attributable to the permanent
16 establishment, we believe that the country where the permanent establishment is
17 situated can impose tax on the salaries by virtue of Art. 15 (2) (c), whether or not the
18 salaries have actually been charged to the permanent establishment⁷² and regardless of
19 whether the permanent establishment chooses to claim the deduction to which it is
20 entitled under Art. 7 of the OECD Model. In a recent decision the Dutch Supreme
21 Court failed to make that connection.⁷³ In answering the question whether the salaries
22 were borne by the Dutch permanent establishment, the Court considered to be
23 decisive the fact that the salaries were accounted for in separate branch accounts that
24 the enterprise kept at its head office in Germany. We believe that, taken on its own,
25 such a formal criterion is inappropriate for the purposes of applying Art. 7 (2) and (3)
26 of the OECD Model. Rather than deciding the case solely on the issue of the
27 bookkeeping entries at the German head office, the Court should have referred the
28 case to a lower court directing it to examine whether the services rendered by the
29 employees were functionally beneficial ("attributable") to the Dutch permanent
30 establishment and whether the salaries recorded in the head office's accounts related
31 to such services. To make that determination some weight could be given to the
32 accounting treatment, but that treatment may not amount to an overriding
33 consideration.⁷⁴

34

1 b. Conclusion

2
3
4 Both the recent OECD Report on Partnerships⁷⁵ and a number of court decisions
5 confirm that. Art. 15 (2) (b) and (c) serve a common purpose, i.e. to compensate for
6 the loss of tax revenue through a deduction of the salary cost as business expenses in
7 the work state. Such purpose is, however, expressed in different terms but these serve
8 only to reflect different legal situations.⁷⁶

9
10 The German Bundesfinanzhof in its decision of 21 August 1985 recognized the
11 relationship between Art. 15 (2) (b) and (c) and ruled that the purpose of both
12 provisions is to grant taxing rights to the work state when the salary cost is deducted
13 in the computation of taxable profits in such state.⁷⁷ Some years earlier, a lower
14 German Tax Court applied the same reasoning.⁷⁸ The Australian Tribunal in the case
15 referred to above⁷⁹ applied in our opinion a similar reasoning of "who assumed the
16 cost", but it added that "paid on behalf" requires some degree of formality, which it
17 qualified as "something like an agency agreement".

18
19 An approach similar to the German one is found in the treaty practice of the United
20 States. For instance, in the Technical Explanation of the US Model Income Tax
21 Convention, dealing with Art. 15, it is stated: "Conditions (b) and (c) are intended to
22 ensure that a Contracting State will not be required to allow a deduction to the payer
23 for compensation paid and at the same time to exempt the employee on the amount
24 received. Accordingly, if a foreign person pays the salary of an employee who is
25 employed in the host State, but a host State corporation or permanent establishment
26 reimburses the payer, with a payment that can be identified as a reimbursement,
27 neither condition (b) nor (c), as the case may be, will be considered to have been
28 fulfilled".⁸⁰

29
30 It appears from the above that the issue of "on whose behalf remuneration is paid"
31 turns on the question in which state the remuneration reduces the taxable income of
32 the taxpayer bearing the cost thereof, provided that such taxpayer qualifies as an
33 employer. Accordingly, it seems that "paid by" and "paid on behalf of" are not
34 synonymous but cover two distinct situations:⁸¹

1
2 - "paid by" refers to an employer actually paying the remuneration and also
3 bearing the cost thereof because the employer claims a deduction of the salary as a
4 business expense. "Paid by" thus embraces a formal test in Art. 15 (2) (b) (i.e. the fact
5 of payment);

6 - "paid on behalf of" refers to an employer ultimately bearing the salary cost
7 where somebody else (e.g. a paying or payroll agent or an affiliated company) paid
8 such salary to the employee. If an agent pays on behalf of his principal, the payment is
9 automatically the liability of the principal and thus reduces his tax base. If an affiliate
10 pays on behalf of another group member, the charge will be passed on and will reduce
11 the tax base of the latter. Hence, "paid on behalf of" includes an economic test in the
12 same Art. 15 (2) (b).

13 Several court decisions support this distinct meaning of "paid by" and "paid on behalf
14 of".⁸²

15
16 According to our interpretation, based on the common intent and purpose of Art. 15
17 (2) (b) and (c), the remuneration is taxable in the work state if the work state
18 recognizes that cost of remuneration as a deduction in computing taxable profits either
19 (i) of an employer who is resident in the work state because such employer paid the
20 salary himself or somebody else paid it on his behalf (Art. 15 (2) (b)), or (ii) of a
21 permanent establishment of the employer in the work state (Art. 15 (2) (c)).⁸³

22
23 If our interpretation of Art. 15 (2) (b) and (c) is correct, we suggest for the sake of
24 clarity that the OECD should (i) either amend Art. 15 (2) (b) as follows: "the
25 remuneration is not borne by an employer who is resident of the other state" or (ii),
26 even better, include the current (b) and (c) in one provision: "the remuneration is not
27 borne by an employer who is resident of the other state or by a permanent
28 establishment which the employer has in the other state".⁸⁴

29
30 c. Some other issues

31
32 If it is correct that the general policy thrust of Art. 15 (2) (b) and (c) is to give a right
33 to tax to the country where the salary payments are deductible, a number of other
34 questions arise.

1
2 1. Salary: expensed or capitalized?
3

4 The first issue is whether the salary cost needs to be "expensed" in the work state or
5 whether it is sufficient that it is "capitalized". An example might be an engineer who
6 is on the payroll of an employer in his residence state and who is seconded to an
7 affiliate to perform duties, which are related to the design and installation of an item
8 of machinery and equipment. It is assumed that the affiliate qualifies as "an employer"
9 within the meaning of the laws of the work state. The payer in the residence state
10 charges the salary cost through to the affiliate. Under the tax laws of the work state,
11 such salary cost is not immediately deductible but should be depreciated over time
12 together with the other costs of the machinery. Is the salary "paid on behalf of" an
13 employer of the work state? In the case of a permanent establishment, depreciation is
14 an expense which is "borne by" the permanent establishment in the meaning of Art.
15 15 (2) (c). Having regard to the common purpose of Art. 15 (2) (b) and (c), it can be
16 argued that the salary cost is borne by an employer of the work state and hence that
17 the employee is taxable in the work state. This view is supported by the 1996 US
18 Model Technical Explanation and US case law.⁸⁵
19

20 2. Employer resident of the work state
21

22 A different issue is whether the work state is entitled to tax the remuneration if the
23 employer resident in the work state is, for instance, a tax exempt entity that is not in a
24 position to claim a tax deduction for the salary cost. The question to be addressed here
25 is whether the tax exempt entity qualifies as a resident for the purposes of the treaty.
26 The concept of residence in Art. 15 (2) (b) is defined, as for other treaty purposes, by
27 Art. 4 (1) of the OECD Model, according to which a resident of the work state means
28 any person (individual, company or any other body of persons) who is, under the laws
29 of that state, liable to tax therein by reason of his domicile, residence, place of
30 management or any other criterion of a similar nature.⁸⁶ In other words, the domestic
31 laws of the work state determine whether the employer is a resident there for purposes
32 of Art. 15 (2) (b). Residence in a contracting state does not necessarily imply that the
33 person is actually subject to taxation in such state. We have suggested that the
34 definition of residence in Art. 4 of the OECD Model is intended to refer to those

1 factors (such as domicile, residence, place of management and any other criteria of a
2 similar nature) connecting the person with a contracting state that are used by that
3 state to impose unlimited taxation, but that it is not a requirement that the person who
4 qualifies as a resident actually be subject to unlimited taxation if the domestic law
5 relieves him of some or all of the tax on his income under special provisions.⁸⁷ If the
6 employer cannot be considered as a resident of the work state under its domestic laws
7 because the employer is not liable to tax in the work state, the latter state's tax
8 revenues will not be reduced by the remuneration paid. Is it therefore appropriate that
9 the state of residence of the employee retains the exclusive right to tax such
10 remuneration?⁸⁸ We do not believe so.

11

12 One has to recognize that the text of Art. 15 (2) (b) of the OECD Model contains such
13 a clear reference to the payment by, or on behalf of, an employer who is resident in
14 the work state, that, if the employer is liable to tax in the work state, but does not
15 claim a (full) tax deduction for the remuneration paid (because all or part of his
16 income is not actually subject to tax, for example because he is enjoying a tax holiday
17 or for another reason), the employee is taxable in the work state even though there is
18 no loss of tax revenue in the work state. This would, for instance, be the case of an
19 employee who is not a resident of Belgium and who has an employment relationship
20 with a Belgian non-profit organisation for less than 184 days. Although the non-profit
21 organisation is not entitled to claim a tax deduction for the salary cost under Belgian
22 domestic law, the entity is liable to Belgian tax on worldwide income (albeit actually
23 subject to tax on very limited items of income). The employer is, thus, a Belgian
24 resident for treaty purposes; hence, the salary is paid by an employer who is a
25 resident of Belgium. Consequently, the employee is taxable in Belgium on such salary
26 pursuant to Art. 15 (2) (b) of the OECD Model.⁸⁹

27

28 The issue of residence also arises with respect to a partnership that is treated as a
29 transparent entity by a contracting state. Because of its transparent status, such
30 partnership does not qualify as a resident of a contracting state under Art. 4 of the
31 OECD Model as it is not itself liable to tax in that contracting state. The issue whether
32 such partnership can be regarded as "an employer who is not resident of the work
33 state" within the meaning of Art. 15 (2) (b) of the OECD Model has recently been
34 addressed by the OECD Partnership Report.⁹⁰ The Report recognizes that such a

1 partnership could qualify as "an employer", but that the application of such a
2 condition at the level of the partnership (regardless of the situation of the partners)
3 would render it meaningless since the partnership cannot possibly qualify as a resident
4 by virtue of its transparent status.

5
6 The OECD has resolved the issue in view of the common object and purpose of Art.
7 15 (2) (b) and (c) discussed above, i.e. taxation of the salary should take place in the
8 work state if the salary is a deductible expense of an employer or permanent
9 establishment situated there. On that basis, the OECD concludes that in order to
10 achieve a meaningful interpretation that accords with the context and the object of
11 Art. 15, subparagraph 2 (b) should be considered to refer to the partners of a
12 transparent partnership. Thus, the OECD favours an interpretation where the terms
13 "employer" and "resident" are applied at the level of the partners, rather than at the
14 level of the entity. Difficulties created by this interpretation where partners reside in
15 different countries are, according to the Report, to be resolved by mutual agreement in
16 favour of the country where the greatest part of the deduction is claimed (i.e. where
17 the majority of the partners reside or, in our opinion, have a permanent
18 establishment). The Report suggests an amendment should be made to the OECD
19 Commentary on Art. 15 accordingly.

20 21 3. Employer resident of a third state

22
23 Finally, it should be noted that there is still no full correlation between the
24 deductibility of the remuneration in a given state and the taxation of the employee in
25 that state. Take the example of an employee who is a resident of state A who has an
26 employment contract with an employer, resident of state B, and who works less than
27 184 days in state C where that employer has no permanent establishment. The
28 employer pays the salary to the employee and there is no recharging of the salary cost
29 to a person in state C. It is clear that the employer in state B will claim a tax deduction
30 for the salary cost. Nevertheless state A is still entitled to tax the salary in the hands of
31 the employee pursuant to Art. 15 (1) and (2) of the treaties between state A and state
32 C and between state A and state B.

1 The OECD Commentary states, in this respect, that countries may consider that it is
2 inappropriate to extend the exception of paragraph 2 to cases where the employer is
3 not a resident of the state of residence of the employee, as state A might face
4 administrative difficulties in determining the income of the employee or difficulties in
5 enforcing withholding obligations on the employer. The "exchange of information"
6 clause in the treaty between A and C and A and B will play a predominant role in
7 solving such difficulties. Of course, if State A has no treaty with state B, state A may
8 face problems in obtaining the necessary information from the employer to assess the
9 employee correctly. The OECD recommends the contracting states that share the view
10 expressed in the OECD Commentary to adopt the following alternative wording of
11 subparagraph 2 b) in their treaties: "the remuneration is paid by, or on behalf of, an
12 employer who is a resident of the first mentioned state, and ...".⁹¹

13
14 Accordingly, if such language is adopted in the treaty between state A and state C, in
15 the above example a right to tax the income is granted to the work state C, while no
16 deduction of the salary is claimed in state C. A solution is thus achieved which is not
17 in line with the common object and purpose of Art. 15 (2) (b) and (c), i.e. that taxation
18 of the remuneration occurs where the deduction of the salary is claimed. However,
19 state C might have exactly the same administrative difficulties in determining the
20 taxable income of the employee and the same difficulties in enforcing the withholding
21 tax obligation on the employer as the residence state of the employee has in the
22 standard/current version of Art. 15 (2) (b). These difficulties are invoked in the
23 OECD Commentary as a justification for not attributing the taxing right to the
24 residence state. Again, these difficulties can be overcome if the treaties between A
25 and C and B and C include an "exchange of information" clause.

26 27 4. Dual resident employer

28
29 Another example of a potential frustration of the purpose of Art. 15 (2) involves a
30 dual resident employer. Take the case of an employee resident in state A, who works
31 less than 184 days for an employer who is a dual resident incorporated in B (and
32 resident there for the domestic laws of B) but effectively managed in C (and under
33 Art. 4 (3) of the B-C treaty, resident in C for purposes of the B-C treaty). If one
34 accepts that such dual resident company continues to be a resident of state B for the

1 purposes of the A-B treaty, B (work state) may tax the salary even if the profits of the
2 dual resident employer are not taxable and the employee's salary is not deductible
3 there (but in A). If, however, one is of the opinion that the second sentence of Art. 4
4 (1) of the OECD Model precludes the employer from being recognized as a resident
5 of the work state also for the purposes of the A-B treaty, B (work state) may not tax
6 the employee's salary. In the latter view, which is the official Dutch opinion, taxation
7 will occur in the residence state of the employee (i.e. state A), not in the state where
8 the salary is deducted as an expense (i.e. state C).

10 C. The term "or"

12 We now turn to the interpretation of the word "or" in conjunction with "paid by" and
13 "on behalf of".

15 We believe that the drafters of Art. 15 of the OECD Model have deliberately used the
16 disjunction "or" (instead of the conjunction "and") in order to cover two distinct and
17 specific situations in which salaries are paid to employees, i.e. directly or indirectly by
18 the employer:

20 (i) "paid by an employer who is not a resident of the work state" refers to an
21 employer who is resident of another state who effectively pays the salary to
22 the employee and assumes the cost thereof (formal test);

24 (ii) "paid on behalf of an employer who is not a resident of the work state" refers
25 to the case where somebody other than an employer in the other state pays the
26 salary, but the cost of such salary is ultimately borne by such employer in that
27 other state (economic test). The following Belgian Court decision is an
28 illustration of the latter situation: French artistes who had employment
29 agreements with a French employer performed services on a tour in Belgium.
30 Wages paid to such dependent artistes are governed by Art. 11 (2) of the
31 Belgian-French treaty.⁹² The wages were paid by a French paying agent of the
32 employer to the artistes, the salary cost being ultimately assumed by the
33 French employer. The Court held that the artistes were not taxable in Belgium.

34 ⁹³

1
2 We believe that if such interpretation is applied, the disjunction "or" is explained in its
3 ordinary meaning, in light of the treaty context in which the word is used and by
4 giving particular consideration to the object and purpose of the treaty and of Art. 15 in
5 particular, viz. taxation of the salary should occur in the country where an employer
6 has assumed the salary cost and is entitled to claim a tax deduction therefor and the
7 taxing powers between the two contracting states should be allocated in a way that
8 avoids double taxation.

9
10 We thus reject any interpretation of the term "or" in Art. 15 (2) (b) as meaning "and"
11 and believe that there is no need to replace "or" by "and" in such article to remove any
12 ambiguity or interpretation problems. If from the work state's point of view, there is
13 no resident employer, the work state cannot tax (i) if the remuneration is paid by an
14 employer resident in another state who has no permanent establishment in the work
15 state, or (ii) if the payment is made by a person in the work state (even if that person
16 is also an employer), he does so on behalf of an employer resident in another state,
17 and the employee is present in the work state for less than 184 days.

18

19 **D. Mode of recharging the salary cost to an employer in the work state**

20

21 We now turn to the question whether the salary cost should be recharged by the
22 employer of the residence state of the employee to the employer in the work state "as
23 such" - i.e. specifically as salary - or whether an indirect method of recharging is
24 acceptable, for example by means of incorporating the said cost together with other
25 costs in the pricing of commercial transactions (such as the sale of goods or the supply
26 of services) or in a management fee charged by the payor of the salary to the
27 beneficiary of the services performed by the employee.

28

29 There can be little room for argument that the work state is entitled to tax the salary
30 where a specific method of recharging is applied provided, of course, the entity of the
31 work state that assumes the salary cost qualifies as an employer from the point of
32 view of the work state. We do not believe that the Court of Brussels ruled to the
33 contrary in its 1993 decision. In that case there was a specific recharging of the salary
34 cost by the Belgian employer of a Belgian resident employee to the Dutch affiliate

1 where the employee had been working and the court did not allow the exemption of
2 Belgian taxes for that part of the salary that was charged back because the taxpayer
3 failed to demonstrate that the Dutch entity qualified as his employer.⁹⁴

4
5 From an analysis of the case law available in the countries represented by the authors,
6 we have not found that courts find that the remuneration is paid on behalf of an
7 employer who is a resident of the work state, when the salary cost is included in the
8 pricing for the sale of goods or the supply of services by the employer of the resident
9 state to the entity in the work state where the employee worked temporarily or when it
10 is included in a lump-sum charge.

11
12 In the oldest reported case, a 1983 decision of the Court of Amsterdam, the Court did
13 not reject the recharging to the Belgian employer of the remuneration relating to the
14 employee's activities performed in Belgium via the pricing of goods sold by the Dutch
15 employer to the Belgian employer as a matter of principle, but finally held against the
16 taxpayer (a Dutch resident) because he had not demonstrated that his remuneration
17 was included in the intercompany pricing.⁹⁵ In all later reported decisions involving
18 indirect recharging,⁹⁶ courts in the residence state of the employee held against the
19 employee on the basis of the argument that no employment relationship existed
20 between the employee and the entity in the work state, even if the latter sometimes
21 instructed the employee, and that the recharging had its cause in a sales or service
22 agreement between the employer in the resident state of the employee and the entity
23 in the work state that is the customer of the former. This case law is generally accepted
24 by legal doctrine⁹⁷ and has been followed by the German tax authorities in an official
25 ruling.⁹⁸

26
27 By itself the mere inclusion of salary costs in a fee or the price for sales of goods or
28 services is not indicative of an employment relationship and in none of the reported
29 cases did the work state take the view that the entity resident there qualified as
30 employer. However, where the salary cost is clearly included in a management fee
31 under correct transfer pricing rules and the work state entity qualifies as employer, we
32 see no reason why the work state should not tax the salary

1 Another issue is whether the work state may tax the remuneration where it was paid
2 by the employer in the state of residence of the employee and has not been recharged
3 to the entity in the work state, but should have been recharged pursuant to a correct
4 application of the arm's length principle (Art. 9 OECD Model), always on the
5 assumption that the person that should have borne the salary cost qualifies as an
6 employer. To our knowledge no court has decided this issue in the framework of Art.
7 15 (2) (b). The Belgian tax authorities, at least in relation to the "permanent
8 establishment" clause of Art. 15 (2) (c) are of the opinion that where the permanent
9 establishment is situated in Belgium, Belgium has the right to tax the salary when the
10 remuneration should have been borne by the permanent establishment.⁹⁹ There is no
11 reason why they would hold differently in a case of secondment of an employee of the
12 other contracting state to a Belgian employer.¹⁰⁰ On the other hand, as mentioned
13 above, a New Zealand Court ruled in the context of Art. 15 (2) (c) that what matters is
14 that the local permanent establishment actually bears the salary cost, not whether it
15 should have done so.¹⁰¹

16

17 In Belgian and Dutch legal doctrine it has been argued that when the accounts of the
18 employer in the work state have been properly adjusted under Art. 9 of the OECD
19 Model, the remuneration becomes taxable in the work state.¹⁰² We agree when the
20 work state is entitled to tax if remuneration is effectively recharged to an entity that
21 qualifies as employer: the same should apply in case it is not charged back but ought
22 to be under a correct application of the arm's length principles and profits could have
23 been adjusted according to such principles.

24

25 **III. INTERPRETATION OF ART. 15 (2) (B) BY THE RESIDENCE STATE.**

26

27 There are two possible interpretations of Art. 15 (2) (b) of the OECD Model from the
28 point of view of the residence state of the employee. The first is that the residence
29 state must apply its own understanding of who is the employer and who has paid the
30 remuneration and give relief for double taxation only if its interpretation coincides
31 with that of the work state (see A). The second is that the residence state is required to
32 give relief for the tax charged in the work state so long as that tax is in accordance
33 with the provisions of the treaty as seen from the point of view of the work state. This
34 does not require the residence state to consider whether the work state has applied the

1 treaty in the way the residence state would have done if it had been the work state (see
2 B). We shall examine each of these interpretations in turn.

3

4 **A. The residence state applies its own understanding of who is the employer and**
5 **who is the payer of the salary**

6

7 Application of its own understanding of the undefined terms in Art. 15 (2) (b) by the
8 employee's residence state may give rise to interpretations that conflict with the views
9 of the work state. This could result in double taxation and double exemption
10 depending upon the relief method applied by the residence state of the employee.

11

12 **a. Double taxation**

13

14 There are several practical examples amongst the countries represented by the
15 authors¹⁰³ of the residence state applying its own understanding of who the employer
16 is and whether "the remuneration is paid by, or on behalf of, an employer who is not a
17 resident of the other state". As a result, a situation of double taxation can, for instance,
18 arise in a common case of cross-border secondment. In the residence state, the tax
19 authorities may interpret "paid by, or on behalf of, an employer" with emphasis on the
20 payment by the legal employer in that state. This enables the residence state to
21 exercise its exclusive right to tax the remuneration of the employee. In doing so, the
22 tax authorities of the state of residence construe the notion of "employer" in Art. 15
23 (2) (b) by reference to the party with whom the worker has entered into a contract of
24 employment and who actually pays the salary and does not take into consideration
25 whether the entity in the work state to which the employee is seconded qualifies as an
26 employer for the job for which the employee has been seconded. However, the tax
27 authorities of the work state may argue, first, that the local affiliate to which the
28 employee is seconded qualifies as an employer and, secondly - this seems to follow
29 automatically from the way in which the employee is paid - that the payment by the
30 employer in the residence state was made on behalf of the employer in the work state.

31

32 Hence, double taxation may arise (i) when the work state considers first that the
33 person in its state to which the employee has been seconded is an employer and,
34 secondly, that the payment by the employer in the residence state was made on behalf

1 of such an employer in the work state and (ii) when the residence state relies on the
2 formal aspect (i.e. the effective payment of the salary by the person based in the
3 residence state with whom the employee has entered into an employment agreement),
4 without considering whether the entity in the work state qualifies as an employer for
5 the assignment for which the employee has been seconded to the work state. If the
6 residence state applies such reasoning it may conclude that the work state should not
7 have taxed the remuneration and thus that it should not give relief by way of
8 exemption or credit for taxes paid by the employee in the work state.

10 It is basically the use of the word "or" in conjunction with the terms "paid by" on the
11 one hand, and "on behalf of" on the other hand that causes such conflicting
12 interpretations and the double taxation resulting therefrom. It leads the contracting
13 states to view both terms as distinct, alternate criteria for allocating the taxing rights
14 between them: the residence state considers itself as having the exclusive right to tax
15 based on the "paid by" test and the use of the word "or", while the work state claims
16 the right to tax also based on the word "or" and the fact that the salary cost is borne by
17 an employer there.

19 The risks of double taxation is aggravated if countries interpret the same treaty
20 expressions according to one version (e.g. formally) if it is to their benefit, and apply
21 another (e.g. substance) interpretation if the former one results in a loss of their taxing
22 rights. As shown in the examples given in footnote 103 certain countries adopt a
23 substance view for inbound secondments of who is "the employer" and characterize
24 the entity resident in their countries as "an employer" merely because the salary cost
25 is recharged to an entity resident in their country, while they take a formal view on
26 outbound secondments. This, of course, leads inevitably to conflicts of qualification
27 between two countries taking such a view, regardless of the direction of the
28 secondment. There is no basis for such inconsistent approach in the OECD Model as
29 it defeats the very purpose of a tax treaty. While the OECD Report on international
30 hiring-out of labour indicates that certain countries may be bound to take a formal
31 approach, while others may take a substance approach, there is no suggestion that
32 countries should take one view or the other as it suits them.¹⁰⁴

34 **b. Double exemption**

1

2 An example of a situation where no tax is paid is in the "international hiring-out of
3 labour" structures.¹⁰⁵ Although many cases of tax fraud are reported in the field of
4 hiring-out of labour (e.g. the non-reporting of the salary by the worker in his residence
5 state; or the setting up of fictitious contracts with non-existing intermediaries)¹⁰⁶,
6 double exemption may occur in bona fide situations where the work state does not
7 consider the user to be the employer and the residence state grants relief for double
8 taxation by way of exemption and considers the user as an employer on whose behalf
9 the salary has been paid by the intermediary.

10

11 As indicated supra, the OECD takes the view that the intermediary with whom the
12 employee entered into a formal employment agreement cannot be regarded as the
13 employer for the purposes of Art. 15. It has formulated in its Commentary a number
14 of criteria to determine the "real employer", which is typically the user, in cases of
15 hiring-out of labour.

16

17 During the discussion of the taxation issues arising in the field of international hiring-
18 out of labour, some members of the OECD Committee on Fiscal Affairs expressed
19 their concerns as to the practical avoidance of double taxation resulting from the
20 introduction of these criteria. The Report in paragraph 77 states in this respect: "... In
21 order to avoid double taxation the workers – residents of the other Contracting State –
22 would approach their tax authorities which would only have to check that the workers
23 have been effectively employed in the State of source and that tax was levied
24 there".¹⁰⁷

25

26 A ruling of the Dutch Supreme Court in the so-called "Cyprus-route" is in accordance
27 with the OECD view, although it does not refer to the OECD Commentary and the
28 Report on the subject. Dutch resident employees who worked temporarily in non-
29 treaty countries that do not levy tax on non-resident labour (e.g. certain Middle
30 Eastern countries) entered into an employment agreement with a Cypriot company
31 (subsidiary of the Dutch employer). Salary for the foreign activity was paid by such
32 Cypriot company and subject to a notional tax in Cyprus.¹⁰⁸ The employees claimed
33 exemption from Dutch tax on such salary on the basis of the Dutch internal provision
34 for avoidance of international double taxation. On the basis of the principle of *fraus*

1 *legis*, the Dutch Supreme Court held that such structure was an abuse of Dutch tax
2 law and denied "employer" status to the Cypriot intermediary.¹⁰⁹

3
4 **B. The residence state should give relief if the work state has taxed in**
5 **accordance with the provisions of the treaty**

6
7 If the work state has taxed the remuneration because it considered a resident entity to
8 be an employer and determined that the salary was paid by that employer, or, if paid
9 by somebody else, on behalf of that employer, the provisions of Art. 23 of the OECD
10 Model (methods for elimination of double taxation) are controlling in the residence
11 state of the employee. In exemption countries, Art. 23A (1) applies,¹¹⁰ while in
12 countries providing for relief of double taxation by credit, Art. 23B is applicable. In
13 both cases, however, the OECD Model provides: "Where a resident of a Contracting
14 State derives income or owns capital, which in accordance with the provisions of this
15 Convention, may be taxed in the Other Contracting State ...", the residence state must
16 give relief by way of credit or exemption.

17
18 The question to be addressed by the residence state of the employee under Art. 23 of
19 the OECD Model is whether the source state (i.e. the work state) has taxed the
20 remuneration "in accordance with the provisions of the Convention", rather than any
21 question of characterisation of income or, as in the case at hand, of "who is an
22 employer" and "who paid, or on whose behalf the remuneration was paid".¹¹¹ As both
23 Contracting States have agreed to include Art. 3 (2) in their treaty, it has been argued
24 that the residence state cannot properly deny the right of the source state to apply its
25 domestic law definition in imposing tax on residents of the residence state.¹¹² When
26 considering relief for the source state's tax, the only argument that the residence state
27 can put forward to refuse to grant such relief is that such taxation is not "in
28 accordance with the provision of the Convention". This implies that the work state has
29 misinterpreted or misapplied the provisions of its domestic laws or of the treaty.¹¹³

30
31 As we have argued on other occasions, the question whether the source state has taxed
32 the income in accordance with the provisions of the Convention is not one with which
33 Art. 3 (2) of the OECD Model is concerned in the residence state.¹¹⁴ The expression
34 "income ... which, in accordance with the provisions of this convention, may be taxed

1 in the Other Contracting State" does not contain any undefined term and certainly not
2 one which has a meaning under the domestic tax law of the residence state of the
3 employee. Because of the undefined terms in Art. 15 of the OECD Model, it is the
4 source state (i.e. the work state) which applies Art. 3 (2) and its domestic law. There
5 is no reason why the residence state, when considering granting relief for double
6 taxation, should do the same (apply Art. 3 (2) and its own domestic law definitions to
7 undefined treaty terms in Art. 15) because the residence state is concerned with Art.
8 23 only and there are no undefined terms requiring definitions in Art. 23.

9
10 According to the general rule of treaty interpretation laid down in Art. 31 of the
11 Vienna Convention, a treaty must be interpreted in good faith in accordance with the
12 ordinary meaning to be given to the terms of the treaty in their context and in the light
13 of its object and purposes. In a case of cross-border secondment where income is
14 generated as result of employment outside the residence state of the employee and the
15 treaty grants, under certain conditions, a right to tax to the work state, the ordinary
16 meaning of the terms in their context indicate that whether "income ..., which, in
17 accordance with the provisions of this convention, may be taxed in the other
18 Contracting State" is a question for the source state (i.e. the work state) only.

19
20 The object and purpose of the treaty is, amongst others, to prevent double taxation and
21 tax evasion. This points to the residence state not applying its own definitions and
22 characterisation of certain undefined treaty terms if they are likely to be different from
23 those of the source state. According to the wording of the OECD Model, it can be
24 strongly argued that the residence state should refrain from using its own definitions
25 and characterisations in determining whether it would have taxed a type of income in
26 the way it was taxed by the source state as this defeats the above-mentioned purposes
27 of the tax treaty .It could lead to double taxation or, in an exemption state, to no
28 taxation at all. This argument is even stronger where the relief article in a particular
29 tax treaty itself states that "double taxation should be avoided where a resident of ...
30 derives income ... which, in accordance with the provisions of this convention, may
31 be taxed in the other Contracting State".¹¹⁵ It is suggested that an interpretation which
32 has the opposite effect cannot be in accordance with the object and purpose of the
33 treaty.

34

1 Pursuant to Art. 32 of the Vienna Convention recourse may be had to supplementary
2 means of interpretation, including preparatory works of the treaty and the
3 circumstances of its conclusion, in order to confirm the meaning resulting from Art.
4 31 of the Vienna Convention. The view expressed above is supported in general by
5 the OECD Commentary in its making of a cross-reference to the credit article in
6 discussing credit for dividend and interest and by the lack of any statement in the
7 Commentary about the danger of double taxation in cases of differing
8 characterisation.¹¹⁶ In particular, it is also supported by the OECD Report on the
9 taxation issues relating to international hiring-out of labour.¹¹⁷ Such conclusion is
10 further confirmed by the OECD Report on Treaty Overrides which recognizes that
11 any interpretation that achieves the avoidance of double taxation, the prevention of tax
12 evasion and the equitable allocation of tax revenues amongst Contracting States is far
13 more preferable than one leading to double taxation or an inappropriate double
14 exemption.¹¹⁸

15

16 The view expressed above is strongly supported by the OECD's Report on
17 Partnerships and this report has proposed amendments to the OECD Commentary on
18 Art. 23 to reflect this view properly.¹¹⁹ Prof. Vogel, who has for a long time disagreed
19 with this view, now acknowledges it.¹²⁰

20

21 However, as indicated in the group's article on credit and exemption in cases of
22 differing characterisation of income, a number of countries (e.g. Belgium, France,
23 Switzerland, Germany) do not accept the arguments set out above and apply their own
24 characterisation of income, despite the fact that their treaties do use the language of
25 Art. 23 of the Model and adopt in the relief article the wording "double taxation shall
26 be avoided".¹²¹ It is worthwhile noting, with the exception of the Netherlands and
27 Switzerland, no countries have made reservations to the amendments proposed by the
28 Partnership Report to paragraph 32 of the Commentary on Art. 23. Switzerland made
29 a reservation only in order to avoid the residence state becoming dependent on the
30 source state when the latter changes its domestic law after entering into the treaty with
31 a view to increasing its taxing rights. The Netherlands announced that they will apply
32 the amendments only if it is explicitly stated so in a tax treaty as a result of a mutual
33 agreement procedure or as unilateral policy.¹²²

34

1 **IV. CONCLUSION**

2

3 Since in cases of a cross-border secondment between affiliated enterprises, the work is
4 performed outside the residence state of the employee and since Art. 15 (2) of the
5 OECD Model limits the work state's rights to tax, it is our view that the undefined
6 terms used in Art. 15 ("employer", "paid by or on behalf of") are to be construed
7 according to the domestic law of the work state. The context of the treaty does not
8 preclude such interpretation according to domestic law, except where it would result
9 in the work state applying very broad domestic tax law definitions used for
10 withholding purposes, which define the withholding agent, rather than the employer.

11

12 Since both contracting states have agreed to include Art. 3 (2) in their tax treaty, the
13 residence state of the employee cannot deny the source state (i.e. the work state) the
14 right to apply its domestic tax law definition in imposing tax on residents of the other
15 state. The residence state is, however, entitled to refuse relief for the work state's tax if
16 such taxation is not in accordance with the provisions of the treaty; in other words
17 when the work state has misinterpreted or misapplied the provisions of its domestic
18 law or the treaty. This view is confirmed by the OECD Partnership Report and it is
19 known that the Commentary on Art. 23 of the OECD Model will be amended to
20 reflect this.

21

22 Since the OECD Commentary is of great assistance in the application and
23 interpretation of tax treaties and, in particular, in avoiding or settling disputes, it is
24 suggested that the Commentary on Art. 15 (2) be amended. First, paragraph 8 of the
25 Commentary should remove any ambiguity as to whether it has a general application,
26 e.g. to cross-border secondments between affiliated enterprises or whether it applies
27 only to cases of abuse. Secondly, if it applies generally, the Commentary should not
28 define "employer" by reference to "the party having rights on the work produced by
29 the seconded employee and bearing the relative responsibility and risks". Rather it
30 should formulate a "facts and circumstances" test – whereby control should be a
31 decisive factor – allowing the work state to determine whether the entity resident
32 there, to which the employee is seconded, qualifies in substance as an employer of the
33 seconded. Several criteria for applying this test have been suggested in this article.

1 Also, the OECD Commentary should be brought into line with the text of Art. 15 (2)
2 (b) ("an employer") and address the issue of dual employers.

3
4 Finally, the OECD Commentary should make it clear that the correct application of
5 transfer pricing rules affects the application of Art. 15: remuneration, which is paid by
6 an employer in the residence state of the employee for work performed in the other
7 state and which should have been recharged to an employer or a permanent
8 establishment in the work state pursuant to a correct application of the arm's length
9 principles of Art. 7 (2) and (3) and of Art. 9 of the OECD, should be taxable in the
10 work state.

11
12 In view of paragraph 35 of the Introduction to the OECD Commentary¹²³ and of the
13 Recommendation of the OECD Council concerning the OECD Model,¹²⁴ it is believed
14 that the Contracting States will take into consideration the suggested amendments to
15 the OECD Commentary on Art. 15 and Art. 23 and come to a more uniform
16 interpretation of the term "employer". Accordingly, the number of disputes resulting
17 from differing qualifications between the work state and the residence state of the
18 employee should decrease.

19
20 A more uniform interpretation would be achieved by applying the OECD
21 Commentary but as such Commentary is not always binding on the courts, the
22 taxpayer may always take the Contracting State to court to test its views. If his
23 residence state is an exemption state, an employee could do so, for instance, to obtain
24 a double exemption, i.e., where the work state does not consider the affiliate to which
25 he is seconded an employer and the residence state, by using its own definitions, does.
26 With a view to reducing such a risk, contracting states may, pursuant to Art. 25 (3) of
27 the OECD Model enter into "interpretative" mutual agreements in order to complete
28 or clarify the meaning of treaty terms.¹²⁵ Such subsequent agreements are, according
29 to Art. 31 (3) of the Vienna Convention to be taken into account for treaty
30 interpretation purposes. However, it should be conceded that the binding effect of
31 such interpretative agreements is disputed in many countries.¹²⁶ This, however, does
32 not exclude correct interpretation decisions taken during mutual agreement procedures
33 from being observed by courts in different countries.¹²⁷

34

¹ In 2000 the OECD decided to delete Article 14 (Independent Personal Services) of the OECD Model. As a result, a number of changes are made to other provisions of the OECD Model. Amongst others, the title of Article 15 of the OECD Model "Dependent Personal Services" will be changed into "Income from Employment" and the reference to "fixed base" in Article 15 (2) (c) will be deleted. As a result also a number of changes are made to certain parts of the OECD Commentary, amongst others, to the paragraphs 3, 7.1, 17 and 21 of the Commentary on Article 15.

² Compare, however, to a decision of a French Court, holding that the activity performed by the head of the Paris branch of a U.S. news agency in Europe and in Asia, could not be separated from its French activities. Accordingly, the person was taxable in France on all of his remuneration (Trib. Adm. Paris, February 8, 1978, *Revue Droit Fiscal*, 1978, n° 45, 1116).

³ Paragraph 2 of Art. 15 of the OECD Commentary has been amended to make it clear that a director of a company may also serve in the capacity of an employee. In such case of dual capacity, having regard to the broad wording of Art. 15 (2) (a), it is clear that days during which the employee is present in the work state to perform services there in his capacity of director of the company, are also to be taken into consideration for the computation of the 183 day-presence in the work state. A paragraph 2.1 has been added to the Commentary in 1997 to clarify that the term "salary, wages and other similar remuneration" includes benefits in kind received in respect of employment.

⁴ In France and Switzerland, in the absence of a double tax treaty, there is no relief method for double taxation.

⁵ This is the version of Art. 15 (2) (a) as applicable since the publication of the 1992 OECD Model. Before 1992, the exclusive right to tax remains with the state of residence of the employee if the employee's presence in the work state does not exceed 183 days within the fiscal year concerned. Under the pre-1992 version of the OECD Model, an employee may be present in the work state for e.g. 250 days, divided over periods in two consecutive fiscal years and still not be taxable in the work state as long as he is not present in the work state during more than 183 days in a particular year (confirmed by a decision of the Swiss Federal Court, June 22, 1990, ASA 60 (1991/1992), 373). Under the post-1992 version of the OECD Model this is no longer true. We will hereafter refer to an employee being present in the work state for less than 184 days, notwithstanding the different versions of the OECD Model.

⁶ This is the version of Art. 15 (2) (c) as applicable until the deletion of the term "fixed base" as a result of the changes made in 2000 to Art. 15 as a consequence of the deletion of Art. 14 of the OECD Model; see footnote 1.

⁷ Differences of opinion exist concerning the meaning of the term "application" in Art. 3 (2). According to one of the co-authors there is "application" only where treaty limits a contracting state in the application of its domestic tax laws, i.e. when a state uses the treaty provision to reach a different taxation result from that under domestic law (Avery Jones, J., *Qualification conflicts: The Meaning of "Application" in art. 3 (2) OECD Model in Festschrift for K. Beusch*, at 47). Others take the view that the treaty is applied each time that there is a decision by a tax authority or court on a tax question for which the treaty is considered or should be considered and maintain that "application" should read as "interpretation" (Vogel, K., *On Double Taxation Conventions*, Kluwer, 3rd ed., at 211-212 (m.n. 65 & 65a)).

⁸ Prior to September 21, 1995, Art. 3 (2) of the OECD Commentary read as follows: "As regards the application of the Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies".

⁹ Both Art. 3 (2) of the OECD Model and Art. 31 of the Vienna Convention refer to "context". Whereas the OECD Model does not clarify of what the "context" consists, Art. 31 (2) of the Vienna Convention does such in an objective way.

This group of authors has submitted that using "context" in the limited and objective sense of Art. 31 of the Vienna Convention for the purposes of interpreting Art. 3 (2) of the OECD Model has the effect of overriding the additional tools of treaty interpretation which the Vienna Convention itself indicates as useful, such as the subsequent agreements between the contracting states regarding treaty interpretation or supplementary means of interpretation (Art. 31 (3) (a) and 32 of the Vienna Convention). It has therefore been submitted that "context", as used in Art. 3 (2) OECD Model, should mean anything that can normally be taken into account or to which one may have recourse in interpreting a treaty (Avery Jones, J., et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3 (2) of the OECD Model* [1984] B.T.R. 104). The Canadian Supreme Court observed that in ascertaining the goals and intentions of the drafters of a tax treaty, a court may refer to extrinsic materials which form part of the legal context (emphasis added), without the need first to find any ambiguity before turning to such

materials. According to the Court such materials include accepted model conventions and the official commentaries thereon, which the Court qualified as being of "high persuasive value in terms of defining the parameters of the Convention": *The Queen v. Crown Forest Industries Ltd.* et al., 95 D.T.C., 5389, at 5396 & 5398. The reference to "legal context" and the lack of necessity to find an ambiguity might imply that the Court was using the OECD Commentary as part of the general rule of interpretation under Art. 31 of the Vienna Convention and not as a supplementary means of interpretation under Art. 32. Indeed, Art. 32 stipulates that "recourse may be had to supplementary means of interpretation to confirm the meaning resulting from the application of Art. 31 or to determine the meaning when the interpretation according to Art. 31 : (a) leaves the meaning ambiguous or obscure ...": Ward, D., et al., *A Resident of a Contracting State for Tax Treaty Purposes : A Case Comment on Crown Forest* (1996) 44 Canadian Tax Journal at 412-413.

¹⁰ AAT Case 6172 (1990) 21 ATR 3630.

¹¹ See *infra*, II.A.b and III.A.b).

¹² Avery Jones, J.F. et al., *Credit and Exemption Under Tax Treaties in Case of Differing Income Characterization*, E.I., 1996, 118 et seq. and [1996] B.T.R. 212 et seq.

¹³ For the former and current version of Article 3 (2) see *supra* at footnote 8.

¹⁴ OECD Commentary, edition 1997, Art. 3, para. 13.1.

¹⁵ Ward, D., *Ward's Tax Treaties*, 1996-97, Carswell, Toronto, at 45.

¹⁶ In a decision of May 9, 1996, the Court of Amsterdam (FED 1997/563) addressing the issue whether a Dutch resident employee was entitled to an exemption for remuneration pertaining to activities in the work state, first examined whether the domestic tax laws of the Netherlands include a definition of *employer*. After having found that this was not the case, the Court held that it can reasonably be said that "employer" for tax purposes means the person who is the co-contracting party under a civil law employment agreement (*een privaatrechtelijke arbeidsovereenkomst*) of a person who has undertaken to perform labour services. Hence, according to the Court, the residence state may apply its internal law definition of the term "employer" when considering whether the employee is entitled to an exemption of foreign source income.

Dutch and Belgian labour laws impose three tests : obligation to work; obligation to pay a salary and a subordination or control requirement (master/servant relationship).

The same tests are applied under French, German and Swiss law (for a Swiss tax case, see Commission of Vaud, January 12, 1976, *Revue Fiscale* 32, p. 323; for a definition of employment relationship under Swiss law, see Höhn, E., Waldburger, R., *Steuerrecht*, Band II, 1999, p. 218; for a German tax case see Bundesfinanzhof, March 24, 1999, *IstR* 2000, 83).

In Italy the notion of "employee" is defined in art. 2094 of the Civil Code as "a person who avails himself for a remuneration to cooperate in the enterprise by contributing his intellectual skills or manual work in the employment and under the management of an entrepreneur" (see Supreme Court of Italy, December 9, 1971, no. 3568, *Giur. It.* 1971, Vol. I, at 967; Letter Ruling, July 17, 1996, n° 5-1437).

¹⁷ The Belgian Supreme Court has ruled that the term "employment" used in Art. 15 of the Belgian-Dutch tax treaty refers to Belgian labour law and implies a link of subordination between master and servant (Supreme Court, March 18, 1994, *Pas.*, I, 1994, 283).

¹⁸ The U.K. applies a common law-test based on the particular facts of the case but control seems to play a less significant role than e.g. in the U.S. and Canada (see Wilson, B.J., *The Employment Status under the Income Tax Act*, 1991, Can. Tax. F. Corporate Management Conference Report, at 2 : 39 et seq.). The U.K. has adopted specific measures to deal with problems of determining employment status of specific categories of workers.

The general law in the United Kingdom may categorize a person in different ways for different purposes. In *Secretary of State for Trade & Industry v. Bottrill* [1999] IRLR 326, the Court of Appeal, while deciding on the facts of the case that a managing director of a company of which he was a sole shareholder was entitled to a redundancy payment when dismissed by a receiver, left open the possibility that on the facts of other cases such a person might not be so entitled, even though he would have been liable to income tax and social insurance contributions as an employee.

Also under Swiss law, a contractual relationship may be characterized in different ways for different purposes. For instance, remuneration paid by a company to a board member who is not at the same time an employee of the corporation is characterized for social security purposes as remuneration for employment. For income tax purposes it is sometimes characterized as remuneration for an independent activity and sometimes as remuneration for a dependent activity. For V.A.T. purposes it is characterized as payment of a fee under a mandate (Behnisch, V., *Verwaltungshonorare als*

unselbständiges Erwerbseinkommen – ein bundesgerichtlicher Wink mit dem Zaunpfahl an die Mehrwertsteuerbehörden, *Zeitschrift für juristische Ausbildung und Praxis*, 1995, p. 255).

¹⁹ Wilson, B.J., *Employment Status under the Income Tax Act* (see footnote 18) at 2 : 13; Magee, J.E., *Whose business is it ? Employees v. independent contractors* (1997) 45, *Canadian Tax Journal*, at 584. In Canada a number of tests have evolved in order to determine the nature of employment (namely the Control Test; Integration Test; Economic Reality-Test involving : (i) control; (ii) ownership of tools; (iii) chance of profit and (iv) risk of loss and the Specified Result Test) that may be applied to the relevant facts of each situation. Before the Wiebe Door case (87 DTC 5025 (FCA)), it was generally recognized that no single test was decisive or universally correct. Each test was generally regarded as being quite distinct and some tests - the Control & the Integration Tests - were more important than others. In its decision in Wiebe Door the Canadian Federal Court of Appeal held that the Integration Test is part of a four-in-one test also involving (i) control; (ii) ownership of tools and (iii) chance of profit or (iv) risk of loss, with emphasis on the combined force of the whole scheme of operations. It further held that the integration test needs to be addressed from the perspective of the employee, not from that of the employer : the main question is whether the employee is in business for himself. According to the above quoted authors, it is not clear that Revenue Canada (now called "Canada Custom & Revenue Agency" ("CCRA")) has embraced the Wiebe Door decision. It continues to treat the tests established before Wiebe Door as separate tests, rather than looking at them as subordinates to a general "four-in-one" test of the whole relationship. CCRA applies such tests for treaty purposes but still gives particular weight to the factor who effectively directs the employee on a day to day basis : "In regards to the question of whether an employee/employer relationship exists between an individual and an entity, the determining factor has been established to be the question of who effectively directs the employee on a day to day basis rather than who pays the employee's salary. Where a U.S. parent sends its U.S. employees to Canada to perform a predetermined task (i.e. internal audit; equipment servicing etc.) the non-resident would not normally be regarded as an employee of the Canadian subsidiary and would not therefore be subject to Canadian tax given the lack of direction and control in Canada" (95 ITC 337 of CCRA Reference Materials on Dafco Internet Service).

²⁰ The common law test in the U.S.A. for determining employment status, as set out in the Regulations, focuses on the question of who has the right to control and direct the individual worker. The right to control test considers the overall right to control the objectives and performance of the employee as to the details of execution of his or her job (Wilson, B.J. (see footnote 18) 33 et seq.). The IRS has published 20 factors that it may rely on in analyzing whether there exists a sufficient degree of control over the worker to conclude that the worker is an employee and not an independent contractor (Rev. Ruling, 87-41, 1987-1, CB 296). Although there is no consistent ranking of the various factors in order of importance, the courts lean toward seven factors as being the most important :

- the degree of control exercised over the details of the work;
- which party invests in the facilities used in the work;
- the worker's opportunity for profit and risk of loss;
- whether the principal has the right to discharge the worker;
- whether the work is an integral part of the principal's regular business;
- the permanency of the relationship; and
- the type of relationship that the principal and the worker believe they are creating (Employees and Independent Contractors, Vol. 1, CCH, para. 211.01).

²¹ The Australian Income Tax Act 1936 S 221 A contains a definition of "employer" for the purposes of the "Pay As You Earn" tax collection system (PAYE). This withholding tax definition was subsequently used for other purposes, such as the fringe benefits tax and was expanded beyond employment as normally understood. The pre-2000 expanded definition is, however, largely reliant on labour law concepts (see e.g. Ruling IT 2129, *World Book (Aust) Pty Ltd. v. FCT* (1992) 23 ATR 412; *Vabu Pty Ltd. v. FCT* (1996) 33 ATR 537, *FCT v. De Luxe Red & Yellow Cabs Co-operative Ltd.* (1998) 38 ATR 609). Under Australian law control is most important, but integration is also of significance. The 1936 definition ceases to have effect on July 1, 2000 when the new "Pay As You Go" tax collection system will become effective.

²² This point comes out clearly in *Lee v. Lee's Air Farming Ltd.* [1960] 3 All ER420, a U.K. Privy Council decision on appeal from New Zealand. See also the decision of a French Court of June 6, 1957 referred to in a Minister's answer to a question asked by a member of Parliament, *Réponse Ministerielle*, February 8, 1958.

²³ OECD Commentary, edition 1997, Art. 15, para. 2.

²⁴ Bundesfinanzhof, August 21, 1985, *Bundessteuerblatt*, 1986, II, at 6. The German Bundesfinanzhof examined whether the German resident employee who was seconded by his German employer to a

Spanish affiliated company (Y-S.A.), to which part of his salary cost was recharged and who claimed exemption from German tax, had an employment relationship with the Spanish company : "In any case, the service relationship between the plaintiff and Y-S.A. has the substantial characteristics of an employment relationship. The plaintiff was due to perform his labour activities for this company, has been employed under its supervision and was subjected to abide to its instructions". This definition has been accepted by the German tax authorities and is applied for treaty purposes. See letter of January 5, 1994 of Bundesministerium der Finanzen, Bundessteuerblatt, I, at 11. In its March 24, 1999 decision the Bundesfinanzhof held that the holding of 1986 with respect to the German-Spanish treaty cannot be applied for German domestic tax purposes (Bundesfinanzhof, March 24, 1999, IstR 2000, 83).

This issue has also been discussed in a number of Belgian, Dutch and Swiss cases, but contrary to the German Bundesfinanzhof-decision, the taxpayer, when trying to obtain an exemption in his residence state, failed to demonstrate that the entity, resident in the work state, that assumed his salary cost, qualified as "an employer" (see e.g. Court of Appeal Brussels, October 7, 1993, F.J.F. 94/75; Court of Appeal Brussels, May 18, 1995, A.F.T., 1995, 405; Court of Amsterdam, May 9, 1996, n° 94/5017, FED 1997/563; Administrative Court of the Canton of Zurich, May 9, 1995, Steuerentscheid 1995, A 31.4 n° 4).

²⁵ This seems to have been indirectly admitted in two Swedish cases, RÅ 1986, not. 250 & R Å 1986, not. 251 decided by the Supreme Administrative Court.

²⁶ However, most Dutch tax treaties exclude such supervisory directors from Art. 15 and include them in Art. 16 ("Directors' fees"). French tax treaties do, however, not include such senior executives in Art. 16 and hence, unlike the Netherlands, the French domestic deeming provision does apply for tax treaty purposes.

²⁷ In the United States, e.g., Section 3401 (d) (1) of the Internal Revenue Code provides that where one party controls the payment of wages and another party is the recipient of the worker's services, the party who controls the payment will be treated as "employer" for withholding tax purposes.

Such broad provisions can also be found under the tax laws of, inter alia, Belgium (Art. 270 Income Tax Code); the Netherlands (art. 3, 6 and 7 of the Dutch Wages Tax Act); Sweden (Chapter I, Section 6 Tax Payment Act); the United Kingdom (Income Tax (Employments) Regulation 1993), Switzerland (Art. 85 of Federal Income Tax Law) and France (Art. 182 CGI).

²⁸ It should, however, be conceded that the 1999 OECD Report on Partnerships may lead to a different conclusion (The Application of the OECD Model Convention to Partnerships, OECD, Issues in International Taxation, 1999, n° 6, at para. 89, hereafter *OECD Partnership Report*).

²⁹ This practice is described under I.

³⁰ OECD Commentary, edition 1997, Art. 15, para. 8.

³¹ See Taxation issues relating to international hiring-out of labour in : OECD, Trends in International Taxation, 1985, para. 66 et seq..

Not all OECD (and non OECD) Member States accept this official OECD view point. According to Germany and Norway, Art. 15 (2) does not apply to situations of international hiring-out of labour (OECD Commentary, edition 1997, Art. 15, para. 16). Those countries have therefore preserved the right to include an express exclusion in Art. 15 of income earned by hired-out personnel of one state working in the other state. Germany, for instance, has included such reference in its recent treaties with Kazakhstan (1997); Sweden (1992) and Denmark (1995). In its treaty with France (Art. 13 (6)), Germany expressly provided that both the work state and the residence of the employee, may tax the remuneration, but the residence state should give a credit for the work's state tax. In the German treaties with Denmark and Sweden it is expressly provided that competent authorities should conclude arrangements necessary to avoid double taxation and to ensure the tax claims of both states.

The 1996 Convention between Nordic Countries for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital (concluded between Denmark; the Faroe Islands; Finland; Iceland, Norway and Sweden) also excludes hiring-out of labour from the scope Art. 15 (2) of the Convention. In Part V.1 of the Protocol to the Convention it is stated that "employees resident in a Contracting State shall be deemed to be hired out if they are placed at another person's disposal by a person (the employment agent) to carry out work in the business of such other person (the principal), situated in another Contracting State, provided that the principal is resident or has a permanent establishment in that other State, and that the employment agent has no responsibility and does not bear any risk in respect of the result of the work".

Part V.2 of the Protocol goes on saying that "in determining whether an employee shall be deemed to be hired out, a comprehensive review shall be carried out, with particular reference to whether :

(a) the ultimate control over the work rests with the principal;

- (b) the work is performed at a place which is at the disposal of the principal and for which he has responsibility;
- (c) the remuneration of the employment agent is computed according to the time utilised or with reference to any other relationship between the remuneration and the wages received by the employee;
- (d) most tools and materials are supplied by the principal; and
- (e) the employment agent does not decide unilaterally on the number of employees or their qualifications".

In a recent article, a Dutch tax official took the position that the OECD approach is not effective to combat fraud in the field of international hiring-out of labour and that the latter should be excluded from Art. 15 OECD Model : de Cock, J., International Hiring-Out of Labour : Field Experience in the Netherlands, Bulletin for International Fiscal Documentation, 1999, 243 et seq., at 247.

³² OECD Commentary, edition 1997, art. 15, para. 8.

³³ It seems that the OECD Commentary takes a more substantive approach to this question, than the European Court of Justice ("ECJ") in social security matters. In two decisions, the ECJ did not rule out the possibility for the intermediary to be regarded as an employer, on whose behalf the labour force performed its services : ECJ, Case 19/67 (*Van der Vecht*), December 5, 1967, ECR, 1967, 345; ECJ, December 17, 1970, Case 35/70 (*Manpower*), ECR, 1970, 1251.

³⁴ A similar position has been taken by the German tax authorities in the absence of a specific treaty provision (Ruling BMF, January 5, 1994, Bundessteuerblatt I, 11); see also footnote 31.

³⁵ Circular Letter n° 70 of June 3, 1983.

³⁶ Resolution N° SD-340-486-1023, Skar N° 10 (1987) at 745.

³⁷ Dik, B.P., Tax Liability of Non-Residents Hired out to Work effected by Tax Treaty Provisions, E.T., 1988, 48.

³⁸ This is recognized by de Cock, J., (see footnote 31) at 246-247.

³⁹ OECD, Trends in International Taxation, 1985, Annex II; Protocol to the 1996 Convention between the Nordic Countries for the Avoidance of Double Taxation with respect to Taxes on Income and Capital, V (see footnote 31).

⁴⁰ The potential general application of paragraph 8 of the Commentary could be inferred from the Swiss observation on that paragraph. Switzerland observed that in its view such paragraph 8 only applies to abusive cases of international hiring-out of labour (Luthi, D., Kolb, A., Überblick über die Erste Teilrevision des OECD-Musterabkommens von 1977, ASA 61 (1993) 509). This casts some doubt on whether the Commentary only envisages abusive situations. On the other hand, it is difficult to deny that para. 8 clearly refers to the three party arrangements between intermediary/worker and user and that it further states, inter alia "To prevent such abuse, in situation of this type, the term "employer" should be interpreted ... In this respect, ... In this context, substance should prevail over form ...".

⁴¹ [1995] Tax Bulletin, at 221. Consequently, the former mutual agreement between Germany and the U.K., where parties agreed on the *formal approach* (see Fin.Min. Nds S 1301-305-33-2 v. 23.02.1990, RIW 1990, at 421) was amended. Also in relation to Germany the UK now applies the *economic test* (BMF May 7, 1996, Bundessteuerblatt, I, 1996, at 621).

⁴² This also seems to be the official position of the Italian tax authorities; see Letter Ruling, July 17, 1996, no. 5-1437. It should, however, be noted that in a Circular Letter of February 26, 1999, n° 53 (determining the conditions under which payments due by the assignee under an assignment of labour agreement are not subject to V.A.T.), the Minister of Finance took the view that very likely the assignee cannot be regarded as employer if the authority to instruct the seconded employee continues to be exercised by the assignor. The Inland Revenue position is supported by a decision of the Court of Amsterdam, May 9, 1996, n° 94/5017, FED 1997/563 : "The fact that the petitioner, while working abroad, abode by the instructions of the foreign enterprise does not allow to conclude that he entered into an employment relationship with that enterprise. The commitment to perform a temporary duty, as is the case here, in accordance with the instruction of the principal does not necessarily result in the existence of a link of subordination which is typical for an employmentship, all the more since the employment relationship with the Dutch company remained in place". This judgment is not free of criticism as there can exist an employment relationship with two masters.

⁴³ J.D.B.O. [1997] B.T.R. 1-2; [1996] Tax Bulletin, at 358.

⁴⁴ See footnote 40.

⁴⁵ OECD Commentary, edition 1997, Introduction, paras. 33-36. See in particular para. 35 : "Needless to say, admendments to the Articles of the Model Convention and changes to the Commentaries that are a direct result of these admendments are not relevant to the interpretation or application of *previously* concluded conventions where the provisions of those conventions are different in substance from the

amended Articles. However, other changes or additions to the Commentaries are normally applicable to the interpretation and application of conventions concluded before their adoption, because they reflect the consensus of the OECD member countries as to the proper interpretation of existing provisions and their application to specific situations". For the use by Courts in a number of countries of the Commentary in interpreting tax treaties, see Ward, D., *Ward's Tax Treaties*, 1996-97, Carswell, Toronto, at 39.

⁴⁶ J.D.B.O. [1995] B.T.R., 531; and [1997] B.T.R., 2. A similar concern was expressed by certain OECD Member States with respect to the application of "*a substance over form*" concept to abusive cases of international hiring-out of labour. According to certain delegates it would be legally impossible for their tax authorities to apply this concept under existing treaties concluded prior to the change of para. 8 of the Commentary on art. 15 of the OECD Model. A large majority of delegates expressed, however, their willingness to consider inserting in any new treaty, provisions defining under what conditions the employer for purposes of Art. 15 (2) (b) is the user of the labour (OECD, *Trends in International Taxation*, 1985, para. 78 at 46).

⁴⁷ Supreme Administrative Court of Austria, July 31, 1996, Decision 92/13/0172; Lang, M., *Later Commentaries of the OECD Committee on Fiscal Affairs Not To Affect the Interpretation of Previous Concluded Tax Treaties*, Intertax, 1997, at 7.

⁴⁸ Hoge Raad der Nederlanden, October 11, 1978, BNB 1978/300 and September 2, 1992, BNB 1992/379.

⁴⁹ *Specialty Manufacturing Ltd. v. Her Majesty the Queen*, 97 D.T.C. 1511 affirmed by the Federal Court of Appeal, 99 D.T.C. 5222 without reference to the Commentary. The Tax Court of Canada refused to rely on the 1992 OECD Commentary and the 1987 OECD Thin Capitalization Report in interpreting Art. IX (1) of the 1980 Canada-US Treaty and the 1942 Canada-US Treaty and held that "The intention of the parties to a treaty at the time of its conclusion is of primary importance in its subsequent construction. A tax treaty must be interpreted in the manner in which the State parties to the treaty had intended. There is no indication that any concerns had been raised regarding thin capitalization at any time prior to the drafting of the 1942 Treaty. In fact, it seems that any such concerns would not have been raised much earlier than 1966, when the report of the Royal Commission on Taxation was released".

⁵⁰ In *Cudd Pressure Control v. the Queen*, 98 DTC 6630 at 6635, McDonald, J.A. while quoting subsequent OECD Commentary commented that its relevance "becomes somewhat suspect". In particular, it cannot be used to determine the intent of the drafters of an earlier treaty.

⁵¹ *The Taisei Fire & Marine Insurance Co. Ltd. et al. v. Commissioner of Internal Revenue*, US Tax Court, 104 US Tax Court Reports, at 535 : "Generally, we would have reservations about interpreting a convention, ratified in 1971, on the basis of the Commentary adopted in 1977, that contradicts the literal language of the commentary in effect at the time of ratification (i.e. the 1963 OECD Commentary). However, in light of the extensive analysis by the previously cited commentators and the confirmation of such analysis by our own research, we are persuaded that the criteria in the later commentary reflects the original intention of the commentary to the 1963 Model and that the 1963 model should be interpreted as having a disjunctive ("or") meaning".

⁵² *National Westminster Bank v. U.S.*, 44 Fed Cl. 120; Hartwell, O., Kane, M., *National Westminster Bank Plc v. United States* [2000] B.T.R. 44 et seq.

⁵³ *Lamesa Holdings B.V. v. FCT* (1997) 35ATR 239. The decision was affirmed by the Full Federal Court (1997) 36ATR589, but without reference to this point.

⁵⁴ Norwegian Supreme Court, April 29, 1997, Case 25/1997, 281/1995; Anderson, P., *Assistance in Performing Contract Concluded by Resident Subsidiary Constituted PE for Non-Resident Company*, E.T., 1997, 388.

⁵⁵ *R. v. Inland Revenue Commissioners, ex p. Commerzbank AG* [1991] S.T.C. 271, at 276. However, in the passage quoted (para. 10 of the Commentary on Art. 24), there were only two minor changes compared with the 1963 version, having in themselves no substantial effect.

⁵⁶ Fuller, I., in *Tax Treaties, Linkages between OECD Member Countries & Dynamic Non Member Economies*, 1996, Vann, R., editor, at 45; Background papers on Seminar A, *The OECD Model Convention – 1998 & beyond*, 1998 IFA Congress London, at 40.

⁵⁷ If such definition is to have any effect in Canada, the term should be defined in the particular tax treaty because the Income Tax Convention Interpretation Act mandates that domestic tax law definitions of undefined treaty terms must be used, unless the context otherwise requires (Ward, D., *Ward's Tax Treaties*, 1996-97, Carswell, Toronto, at 80).

⁵⁸ Art. 15 (2) (b) has not been amended since 1977.

⁵⁹ See Doernberg, R., Van Raad, K., *U.S. Tax Treaties*, Kluwer, 1991, at 491.

⁶⁰ Also Kooi, J., Wederom door of namens, M.B.B., n° 11, november 1985, at 285. The Swedish unofficial translation "*ersättningen betales av arbetogivare*" or "*på dennes vägnar*" closely follows the English text, clearly pointing to the party that bears the cost of the salary. The unofficial Italian language used in Italian bilateral treaties is "*pagate da o per conto di un datore di lavoro*", which reflects the English and French version of the OECD Model.

⁶¹ Also Hinnekens, L., The salary split and the 183-day exception rule in the OECD Model and Belgian tax treaties, *Intertax*, 1988, at 325.

⁶² In Art. 5 (5) of the OECD Commentary Convention the term "on behalf of" is used. Strangely enough it is translated in the official French text as "*au nom de*" (in the name of). In the official Dutch text of the treaty it is translated as "*namens*".

⁶³ The application of the OECD Model Tax Convention to Partnership Report, OECD, Issues in International Taxation, 1999, n° 6, at para. 90.

⁶⁴ Compare with Art. 15 (1) ("an employment ... unless the employment ...").

⁶⁵ Bundesfinanzhof, August 21, 1985, *Bundessteuerblatt*, 1986, II, at 5; Bundesfinanzhof, January 29, 1986, *Bundessteuerblatt*, 1986, II, 513; Hinnekens, L. (see footnote 61) at 326; Vogel, K. (see footnote 7) at 899 (m.n. 27b); contra: Viersen, A., Door of namens, M.B.B., n° 12, december 1984, at 297.

⁶⁶ Kooi, J., (see footnote 60), at 286.

⁶⁷ The U.S.-Canadian treaty uses "borne by" instead of "paid by or on behalf of" also in relationship to "employer" in Art. 15 (2) (b). "Borne by" means "allowable as a deduction in computing taxable income" (Canada-U.S. Tax Convention, Technical Explanation, 1984, Article XV, at 2023; see also National Office Technical Advice Memorandum, August 13, 1987, Code Section 894, CCH, 8748082 and Revenue Canada Reference Manual on Tax Treaties 95 ITC 336). Simply referring to deduction overlooks the case where the payment may be attributable to a permanent establishment but not deductible, e.g. where the permanent establishment is tax exempt. Tax exempt U.S. universities conducting courses at a Canadian permanent establishment have relied on the statement in the U.S. Technical Explanation on the Canada-U.S.A. tax treaty to deny Canada a right to tax salaries of their professors on the basis that no tax deduction is claimed in Canada. Canadian tax authorities have refused this exemption at least if the U.S. resident employee is assigned to work for less than 184 days in Canada for a Canadian tax exempt charity (Decision of September 28, 1990, document n° ACC 9609, 1999 CCH Canadian Limited, August 1999, p. 1). Revenue Canada held that salary was taxable in Canada because the charity was required to compute its income and the salary was allowable as a deduction in computing the charity's income; although the charity's net taxable income was ultimately exempt from tax pursuant to a specific statutory provision.

⁶⁸ OECD Commentary, edition 1997, Art. 7, para. 16; Bundesfinanzhof, February 24, 1988, *Bundessteuerblatt*, II, 1988, 819; BMF, April 21, 1981, *Bunderssteuerblatt*, I, 1981, 337. "borne by the permanent establishment" requires that the salary cost as such is charged to the permanent establishment. See also Court of Appeals of Liège, October 21, 1998, *Fiskoloog Internationaal* 1998, at 7, regarding the Belgium-France tax treaty. Under such treaty the right to tax is given to the state of residence of the employee if the salary is "borne by" an employer in the residence state of the employee. The Court held that the employer in the residence state did not bear the salary cost if it was reinvoiced to an affiliated company in the work state for which the employee had been working.

⁶⁹ Vogel, K. (see footnote 7) at 902-903 (m.n. 32-33); Official commentary on Belgian tax treaties, at 7/321-333 and 15/17.

⁷⁰ *Commissioner of Inland Revenue v. JFP Energy Inc.* (1990) 14 TRNZ 617 involving the interpretation of the 1983 New Zealand-U.S. Treaty. JFP Energy Inc. was involved in oil drilling in New Zealand territorial waters. The company employed United States based crew whose salaries were taxable in New Zealand pursuant to the treaty unless, pursuant to Article 15 (2) (c) of the treaty, "the remuneration [was] not borne by a permanent establishment or a fixed base" that JFP Energy Inc. had in New Zealand. It was conceded that JFP Energy Inc.'s drilling was a permanent establishment in New Zealand. JFP Energy Inc. paid the salaries directly into the United States bank accounts of its employees, or by cheque sent to the employees' addresses. The expenses were recorded in the accounts of the JFP corporate office in Texas, and deducted for United States tax purposes. They were not recorded in the account books that related to the oil rig in New Zealand, nor were they deducted in calculating income in the tax returns that JFP lodged for purposes of New Zealand taxation in respect of its permanent establishment (because the permanent establishment was running at a loss). (Prebble, J., Interpretation of Double Taxation Conventions, New Zealand Report, Cah. Dr. F. Int., LXXXVIII, 1993 at 478-479).

⁷¹ According to such articles, profit is attributable to the permanent establishment as if it were a distinct enterprise dealing on arm's length terms with its head office and there shall be allowed as deductions,

expenses which are incurred for the purposes of the permanent establishment whether in the State where the permanent establishment is situated or elsewhere.

⁷² van Raad, K., Construction project PE in the Netherlands and taxation of employment income borne by PE – Netherlands Supreme Court decision of December 9, 1998, Bulletin for International Fiscal Documentation, 1999, at 321-325.

Contra : Vogel, K. (see footnote 7) at 902 (m.n. 32).

⁷³ Netherlands Supreme Court, December 9, 1998, no. 32700, BNB 1999/267.

⁷⁴ van Raad, K. (see footnote 72), at 325.

⁷⁵ The application of the OECD Model Tax Convention to Partnerships, OECD, Issues in International Taxation, 1999, n° 6, at para. 90.

⁷⁶ See supra, II.B.a.; also : Hinnekens, L., (see footnote 61), at 326.

⁷⁷ Bundesfinanzhof, August 21, 1985, Bundessteuerblatt, 1986, II at 6; also : Finanzgericht Rheinland-Pfalz, 23 April 1993, EFG, 1994, n° 3, at 141 : "The taxing rights belong to the State which economically bears the cost as a result of the deductibility of the remuneration as a business expense. The tax deduction of the remuneration as a business expense without concomitant personal taxation of the remuneration in Germany would lead to a revenue loss in favor of the French Republic".

⁷⁸ Munich Lower Tax Court, October 13, 1982, EFG 1983, 241; Dusseldorf Lower Tax Court, January 17, 1980, EFG 1980, 447; see also Kooi, J (see footnote 60) at 286.

⁷⁹ See footnote 10.

⁸⁰ Technical Explanation of the U.S. Model Treaty, Article 15, para. 215. It is believed that, with regard to condition (b), this explanation goes beyond the text of the provision by equating an employer with the payer of a payment that can be identified as a reimbursement (also Doernberg, R., Van Raad, K., The 1996 U.S. Model Income Tax Convention, Kluwer, 1997, at 130). Nevertheless, the Technical Explanation believes this interpretation of Art. 15 (2) (b) to be consistent with the text and the intent of Article 15 (Technical Explanation of the U.S. Model Treaty, Article 3, last paragraph).

⁸¹ Goedkoop, A., Kuijlaars, M., (H)oezo door of namens, WFR, 1996, at 1230; Van Gennep, C., Art. 15 van het OECD Modelverdrag van 1977 (niet-zelfstandige arbeid), WFR, 1989, at 1176; contra : Roelofs, P., De grensoverschrijdende dienstbetrekking in het Verdrag Nederland-Duitsland, WFR, 1996, at 340.

⁸² Indeed, after having found that the salary was "paid by an employer" of the residence state of the employee, Courts in the following cases examined whether such payment had not been made "on behalf of an employer" of the work state : Court of Amsterdam, April 19, 1983, n° 3292/1 V-N, 1984, p. 1393; Court of Appeals Brussels, May 18, 1995, A.F.I., 1995, 405; Court of Appeals Mons, March 8, 1984, F.J.F. 85/3; Bundesfinanzhof, August 21, 1985, Bundessteuerblatt, 1986, II, 4.

⁸³ Hinnekens, L., (see footnote 61), at 326; Van Gennep, C., (see footnote 81), 1176; Kooi, J., (see footnote 60), at 286; Goedkoop, A. en Kuijlaars, M., (H)oezo door of namens, WFR, 1996, at 1229; de Cock, J., De heffing van loonbelasting bij terbeschikkingstelling van arbeidskrachten door een buitenlands intermediair, WFR, 1994, 674; Van Gennep, C., Niet door of namens ?, M.B.B., n° 3, 1992, at 74 et seq.; Schoueri, L.E., The Residence of the Employer in the "183 days-clause" (Article 15 of the OECD's Model Double Taxation Convention), Intertax 1993, at 27-28; Vogel, K. (see footnote 7), at 901 (m.no. 30 & 32).

⁸⁴ This is the wording used in the U.S.-Canada Treaty.

⁸⁵ U.S. Model Technical Explanation, 1996, Art. 15, para. 216; Indopco Inc. v. Commissioner 503 US 79 (1992); Doernberg, R., Van Raad, K., The 1996 U.S. Model Income Tax Convention, Kluwer, 1997, at 130.

⁸⁶ Schoueri, L.E., (see footnote 83) at 21; for a discussion of the term "liable to tax", see the comment on the Canadian Supreme Court decision in Crown Forest by this group of authors : Ward, D., et al., A Resident of a Contracting State for Tax Treaty Purposes : A Case Comment on Crown Forest Industries, (1996) 44 Canadian Tax Journal, in particular at 418 et seq..

⁸⁷ Ward, D., et al (see footnote 86) at 418-419.

⁸⁸ Compare to the case of the Canadian permanent establishments of the U.S. universities and the Canadian charities cited in footnote 67.

⁸⁹ It should be noted, however, that a Belgian non-profit organisation is required to report the payment of the salary on official salary slips. If it fails to do so, it will be taxable on the salary payments.

⁹⁰ The Application of the OECD Model Tax Convention to Partnerships, OECD, Issues in International Taxation, 1999, n° 6, at para. 88-92 and Annex I, para. 7.

⁹¹ OECD Commentary, edition 1997, art. 15 para. 7. The first mentioned state is the residence state of the employee, see e.g. Belgian treaties with France, Singapore and Thailand.

⁹² Which is similar to Art. 15 (2) of the OECD Model, except that "paid by, or on behalf of" of an employer of the residence state is substituted by "borne by".

⁹³ Court of Appeal of Mons, March 8, 1984, F.J.F. 85/3.

⁹⁴ Court of Appeal Brussels, October 7, 1993, F.J.F. 94/75.

⁹⁵ Court of Amsterdam, April 19, 1983, VN 1984/1393. In this case it was conceded that the employee had an employment relationship with the Belgian affiliate.

⁹⁶ All reported cases involve countries avoiding double taxation through an exemption system (i.e. the Netherlands, Belgium and Germany. In countries avoiding double taxation by credit, this is not an issue):

*Netherlands Supreme Court, June 19, 1996, VN 1996/2782 confirming Court of Amsterdam, 8 November 1994, *Beslissingen in belastingzaken*, 1996/369, 3004 (recharging of concern fees including various costs of the Dutch B.V. to affiliates in Spain and U.K. determined in function of the affiliates' turnover, apparently including part of the salary of an employer of the Dutch B.V. that related to services performed on behalf of such affiliates);

* Court of Amsterdam, May 9, 1996, n° 94/5017, FED 1997/563 (an hourly rate was charged to five foreign affiliates covering the salary of the Taxation Manager of a Dutch company performing services for such affiliates as well as other costs of the Dutch company);

* Court of Amsterdam, October 31, 1995, VN 1996/1065 (50% of the salary of the manager of a Dutch company is charged back to U.S., Belgian and Italian affiliates on the basis of their turnover and personnel capacity);

* Court of Appeal Brussels, May 18, 1995, A.F.T., 1995, at 405 (the salary of an employee of the Belgian employer was included in the pricing for the sale of goods and supply of services to U.S. and U.K. customers of the Belgian employer);

* Finanzgericht Rheinland Pfalz, April 23, 1993, EFG, 1994, at 140 (the salary of an employee of the German employer was included in the pricing for installation services, plus mark-up, in the U.S.).

* compare also : Bundesfinanzhof, February 24, 1988 in footnote 68.

⁹⁷ Vogel, K., (see footnote 7) at 902-903 (m.n. 32); Goedkoop, A.S., Kuylaars, M.A., (see footnote 81) at 1231 et seq.; Viersen, A., Naschrift, M.B.B., n° 11, 1985, at 290; Hinnekens, L., A.F.T., 1994, at 96. This author seems to have changed his view : compare to Hinnekens, L., (see footnote 61) at 330.

⁹⁸ BMF, January 5, 1994, Bundessteuerblatt, 1994, I, at 12.

⁹⁹ Official Commentary on Belgian tax treaties, at 7/321 and 15/17.

¹⁰⁰ According to Hinnekens, L., (see footnote 61) at 329, the Belgian tax authorities take such position also under Art. 15 (2) (b).

¹⁰¹ See supra footnote 70.

¹⁰² Hinnekens, L., (see footnote 61) o.c., *Intertax*, 1988, at 329; Goedkoop, A.G., Kuylaars, M.A., o.c., *W.F.R.*, 1996, at 1232. According to the latter authors the work state is entitled to tax the remuneration if it ought to be recharged, even if no profit adjustment has been made on the basis of Art. 9 OECD Model.

¹⁰³ See e.g. : * The approach of the Belgian tax authorities : when a Belgian resident employee is seconded by his Belgian employer (who continues to pay the salary) to work for the benefit of an entity in the work state that assumes the salary cost through recharging, the Belgian tax authorities argue that the salary is paid by an employer based in Belgium to assert their taxing rights. However, if a non-resident employee works in Belgium for the benefit of a Belgian affiliate that assumes the salary cost through a recharging from the non-resident employer of such employee, the Belgian tax authorities claim to have taxing rights on the basis of the argument that the local Belgian affiliate is an employer on whose behalf the salary is paid (Official Commentary on Belgian Tax Treaties, at 15/16).

* The case mentioned in Dutch literature of a Dutch resident who was seconded to France for a period of less than 184 days by a Dutch company with which he had an employment agreement and which continued to pay his remuneration but recharged it to a French company. The French tax authorities argued that the remuneration was paid on behalf of a French employer and concluded that the employee was taxable in France. On the other hand, the Dutch authorities argued that the remuneration was paid by his Dutch employer and for that reason was taxable in the Netherlands. According to the same Dutch authorities the remuneration would also have been taxable in the Netherlands in the reverse situation, in which it would have been paid by the French company, which recharged its cost to the Dutch company, irrespective of the fact that the French authorities would consider that the test of the payment by the French company would then become decisive for their taxing rights (quoted by Kooi, J., (see footnote 60) at 283).

¹⁰⁴ OECD, *Trends in International Taxation*, 1985, para. 78.

¹⁰⁵ See supra at II.A.b.

¹⁰⁶ The following is a citation from the OECD Report "Taxation issues relating to international Hiring-Out of Labour" (published in OECD, Trends in International Taxation, 1985, p. 29-63) : "A typical "international" situation is one where an intermediary, who is resident of country I, recruits labour from country L, and hires it out to a user enterprise in country U. Several variants of this situation exist involving evasion (non-reporting, false invoicing), or avoidance of domestic taxes, or else making use of loopholes in the interplay of domestic laws and bilateral conventions.

In the case of the "*Koppelbazen*" (a Dutch expression for "labour broker"), the whole system may function in the "underground", none of three parties involved making its activities public. Recruitment may take place from abroad sometimes by means of advertisements and the authorities of country L are normally not aware of it. Authorities in country I are not informed of any activities of the intermediary, nor those of country U as the user firm will be frequently in an irregular situation itself and will usually not, in the present case, declare that it is using manpower without respecting the social legislation in the country. The major problem for tax authorities of countries L, I and U will therefore be one of being informed of such illegal practices and of the related tax evasion. An interesting feature is that any evasion here will be associated with others (either upstream or downstream) through faking of accounts to make them look correct."

For other examples of tax fraud in the field of international hiring-out of labour in the Netherlands, see de Cock, J, (see footnote 31) at 244-245.

¹⁰⁷ OECD, Trends in International Taxation, 1985, p. 46, para. 77.

¹⁰⁸ Memorie van Toelichting to the Law of September 4, 1985, 1983-84-18371, n° 3, p. 4, al. 4 and p. 5, al. 3.

¹⁰⁹ Netherlands Supreme Court, October 15, 1986, note by Van Brunschot, F., BNB 1987/72 confirming Court of The Hague, February 27, 1985; also Court of The Hague, October 19, 1988, BNB 1989/328.

¹¹⁰ It is strictly incorrect to describe a country as an exemption country as there are always some types of income for which a credit is granted even under an exemption system (under the OECD Model e.g. dividends and interest, but in practice this is often extended to royalties and other income categories).

¹¹¹ Avery Jones, J., et al., Credit & Exemption under Tax Treaties in cases of differing characterization of income, E.T., 1996, 118 et seq. (especially at 142-143) and [1996] BTR212 et seq. (especially at 253).

¹¹² Déry, J.M., Ward, D., Interpretation of Double Taxation Conventions, Canadian Report, Cah. Dr. Fisc. Int., XXVIIIa, 1993, at 281-282.

¹¹³ Unlike the Model, a large number of credit countries giving relief for remuneration types of income by way of credit, make relief in their double tax treaties subject to internal law relief rules and do sometimes not refer to "income ... which in accordance with the provisions of the convention, may be taxed in the other contracting state". A reference to internal law provisions makes the question whether credit is given in cases of differing characterisation primarily an issue of internal law, rather than of treaty interpretation. This does not mean that the residence state cannot question whether the source state has correctly interpreted the treaty because its internal law is likely to provide that credit is given only if the tax was legally payable in the source state (Avery Jones, J., et al. (see footnote 111), o.c., E.T., 1996, at 120 and [1996] BTR 214; Déry, J.M., Ward, D., (see footnote 112) at 282).

¹¹⁴ Avery Jones, J., et al. (see footnote 111), Credit & Exemption under Tax Treaties in cases of differing income characterization, E.T., 1996, 118 et seq. (especially at 143) and [1996] BTR, 255-257; Ward, D., Ward's Tax Treaties 1996-97, Carswell, Toronto, at 45-46.

¹¹⁵ See e.g. the relief articles included in the tax treaties by certain exemption states (Belgium, France, Germany, Switzerland) and one credit state (Italy) represented by this group of authors.

¹¹⁶ Avery Jones, J., et al. (see footnote 111), o.c., E.T., 1996, at 143 and [1996] BTR, 256-257.

¹¹⁷ See supra footnote 108.

¹¹⁸ OECD, Tax Treaty Overrides, 1982, para. 19.

¹¹⁹ The Application of the OECD Model Tax Convention to Partnerships, OECD, Issues in International Taxation, 1999, n° 66, para. 102-117 and Annex I, para. 8-12.

¹²⁰ Vogel, K., Tax Treaty News, Bulletin International Bureau for Fiscal Documentation, 1999, No.8/9, at 319.

¹²¹ Avery Jones, J., et al. (see footnote 111), o.c., E.T., 1996, at 143 and [1996] BTR, 258-261.

¹²² The Application of the OECD Model Tax Convention to Partnerships, OECD, Issues in International Taxation, 1999, n° 6, Annex II, para. 27. Hence Switzerland, as residence state, shares the views of the Partnership Report and will thus accept the qualification under the internal laws of the source state, but only to the extent such laws existed at the time the treaty was concluded.

¹²³ See footnote 45.

¹²⁴ Recommendation of the OECD Council concerning the Model Tax Convention on Income and Capital, adopted by the Council on October 23, 1997 : "1. Recommends the Governments of Member Countries : ... 3. that their tax administrations follow the Commentaries on the Articles of the Model Tax Convention, as modified from time to time, when applying and interpreting the provisions of their bilateral tax convention that are based on these Articles".

¹²⁵ OECD Commentary, edition 1997, Art. 25, para. 32 et seq.

¹²⁶ Vogel, K., Prokisch, R., Interpretation of double taxation conventions, Cah. Dr. Fisc. International, Vol. LXXVIIIa, 1993 Florence Congress, at 70-71; citing examples taken from German (Bundesfinanzhof, February 1, 1989, BStBl, II, 1990, 4), Austrian (Verwaltungsgerichtshof, August 27, 1991, Beilage zur Östz, 1992, 127) and Italian (Corte di Cassazione, May 24 1988, Diritto e Pratica Tributaria, 1989, 547) case law. For Belgian court cases that have refused to apply interpretative agreements : see Court of Appeal Antwerp, June 29, 1982, J.D.F., 1983, 353; Court of Appeal Gent, June 20, 1996, A.F.T., 1996, 461 and E.T., 1997, 20.

¹²⁷ E.g. in the United States (*Xerox Corp v. Commissioner*, 41 F.3d 647, 94-2 U.S. T.C., # 50623, 74 AFTR 2d 94_5664 (Fed. Cir. 1994)) and the Dutch, Swedish and Norwegian cases cited by Avery Jones, J., The relationship between the mutual agreement procedure and internal law, EC Tax Review, 1999, at 6-7.