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**Taxation of Non-resident Service Providers**

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## Taxation of Non-resident Service Providers

Development's Model Tax Convention on Income and on Capital ('OECD Model Convention')<sup>2</sup> will also be discussed.

Under the UN Model Convention, the following articles are relevant:

- x Articles 5 and 7 – business profits;
- x Article 8 – international transport income;
- x Article 14 – income from independent personal services;
- x Article 15 – employment income;
- x Article 16 – directors' fees and remuneration of top-level managers;
- x Article 17 – income of artistes and sportspersons;
- x Article 19 – remuneration from government services;
- x Article 20 – payments to students, business trainees and apprentices.

Services are dealt with in the same articles of the OECD Model Convention, other than Article 14, which was deleted in 2000. Independent personal services are now dealt with in the OECD Model Convention under Articles 5 and 7.

Treaties of many developing countries also include other provisions, not found in either apo7(Model )TJ-10.24

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establishment (so called ‘limited force of attraction’)<sup>7</sup>. However, this latter provision is not widely adopted in actual treaties.

The administrative requirements for establishing entitlement to exemption, or for taxing profits attributable to a fixed place of business PE, are not substantially different in the case of service provider enterprises to those applicable to other business activities. Since these issues are covered in a separate paper<sup>8</sup>, it is not proposed to discuss these further in this paper.

Difficulties faced by tax administrations in applying Articles 5 and 7 to other profits derived by service provider enterprises include:

- identification of non-resident enterprises carrying on service activities in the country;
- application of time thresholds;
- determination of attributable profits.

In treaties that provide for limited force of attraction, difficulties may also be encountered in identifying service activities being carried on in the country and in determining whether the activities are the same or similar to those effected through a permanent establishment.

## **1.2 Article 8 – International transport**

Article 8 of the UN Model Convention offers two alternative tax treatments for profits from international transport activities. Alternative A adopts the same approach as the OECD Model Convention in providing that profits from the operation of ships or aircraft in international traffic are taxable only in the country in which the enterprise has its place of effective management. Alternative B provides the same treatment for profits from aircraft operations in international traffic, but provides for limited source taxing rights over profits from shipping activities in the source state that are more than casual. In such case, the source state may tax an ‘appropriate allocation of the overall net profits’ from the shipping operations, with the source tax being reduced by an agreed percentage.

Profits from the operation of boats in inland waterways transport are taxable only in the country in which the enterprise has its place of effective management. Exemption from source taxation applies

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even if the profits are derived from inland waterways transport between two points in the source country.

Where it provides exemption from source taxation, Article 8 alleviates the compliance and administrative difficulties, as well as the risks of double taxation that would result from source taxation in the many countries where an international transport enterprise operates. As noted in the Commentary on Article 8 of the UN Model Convention, even countries that wish to retain source taxing rights over shipping profits recognize that ‘considerable difficulties were involved in determining a taxable profit in such a situation and allocating the profit to the various countries concerned in the course of the operation of ships in international traffic’.<sup>9</sup>

### 1.3 Article 14 – Independent personal services

The general rule under treaties for independent services income derived by non-residents is that such income is exempt from source taxation unless it is either:

- attributable to a fixed base of the service provider in the source state; or
- derived from activities performed in the source state if the service provider is present in that state for at least 183 days in a 12-month period.

The application of this article raises a number of issues for tax administrations, including:

- characterization of income from ‘professional services or other activities of an independent character’;
- determination of whether the service provider has a fixed base in the source country or has been present, or is intending to be present, in the country for at least 183 days;
- determination of income attributable to a fixed base, or derived from activities performed in the country;
- collection of tax, particularly where it is not known whether the service provider is likely to be present in the country for the requisite number of days.

Under a few treaties, source taxation is also permitted where the income exceeds an agreed monetary threshold.

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<sup>9</sup> Paragraph 3 of the Commentary on Article 8 of the UN Model Convention.





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- identification of directors and high-level managers;
  - characterisation of income derived in their capacity as director or high level manager;
  - imposition and collection of tax.

### 1.6 Article 17 – Artistes and sportspersons

Tax treaties provide that income of artistes and sportspersons in respect of their activities as such may be taxed in the country where the activities are exercised. The source country may also tax the income from their activities if it accrues to another person, such as a team, management company or a star-company.<sup>10</sup>

Since the treaty does not limit the source tax that may be imposed, the issues that tax administrations are most likely encounter will concern claims by taxpayers that their income is not covered by the article. The main administrative issues faced by tax authorities will be:

- determination of the character of the income;
- identification of entertainment activities exercised in the jurisdiction;
- imposition and collection of tax.

### 1.7 Article 19 – Government service

The Government Service article is unique in that it provides for exclusive taxation in the paying state for salaries, wages and other similar remuneration paid in respect of services rendered by an individual to that state. This accords with longstanding rules of international courtesy.

The country of which the individual is a resident may only tax the remuneration if the activities are exercised in that country and the person is either a national of that country or did not become a resident solely for the purpose of rendering the services. In these circumstances, the remuneration may not be taxed in the paying State.

Exemption from taxation in the paying state will depend on a determination that:

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<sup>10</sup> See paragraphs 11, 11.1 and 11.2 of Commentary on Article 17 of the OECD Model Convention, and paragraph 2 of the Commentary on Article 17 of the UN Model Convention quoting paragraphs 11, 11.1 and 11.2 of Commentary on Article 17 of the OECD Model Convention.

the services are rendered in the other treaty partner country;

the individual is a resident of that other country who is either a national of that other country or had reasons for becoming a resident other than just to perform the governmental services.

### **1.8 Article 20 – Students**

In accordance with Article 20, payments received from abroad by visiting foreign students, business trainees or apprentices for their maintenance, education or training are exempt from tax in the country visited. For purposes of application of the article, in countries that would otherwise tax such payments, it is necessary to determine:

whether the recipient is a student, business trainee or apprentice;

whether the recipient is visiting the country solely for the purpose of his education or training;

whether the payments are for the purpose of maintenance, education or training of that person; and

whether the source of the payments was abroad.

### **1.9 Other treaty provisions**

Many tax treaties, particularly treaties entered into by developing countries, include additional provisions relating to fees for technical services and/or for remuneration of teachers. While these provisions are not currently found in the UN Model Convention, the UN Committee of Experts on International Cooperation in Tax Matters ('UN Committee of Experts') is exploring whether additional provisions should be included with respect to fees for technical services<sup>11</sup>. The Commentary on Article 20 of the UN Model Convention also discusses a number of issues relating to the possibility of an independent article to deal with visiting teachers<sup>12</sup>.

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<sup>11</sup> See paragraph 17 of the Introduction to the UN Model Convention. See, also, United Nations, Economic and Social Council, Committee of Experts on International Cooperation in Tax Matters, Report on the eight session (15-19 October 2012), Chapter III, Section D, at page 11 (available at [http://www.un.org/ga/search/view\\_doc.asp?symbol=E/2012/45&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=E/2012/45&Lang=E)).

<sup>12</sup> See paragraphs 10, 11 and 12 of the Commentary on Article 20 of the UN Model Convention.

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Although, in the absence of a model provision, current articles dealing with fees for technical services or remuneration of visiting teachers necessarily differ, the discussion below is based on the most common forms of such articles found in existing treaties.

Where a special provision dealing with \_\_\_\_\_ or technical assistance is included in a tax treaty, it commonly treats the fees as, or in the same way as, royalties which, under the UN Model Convention, may be taxed at source at a limited rate agreed by the treaty partners. The scope of the provision and rate limits vary from treaty to treaty. However, the provisions are reasonably consistent in providing:

that the fees are deemed to arise in the country of which the payer is a resident, or if borne by a permanent establishment or fixed base, in the country in which the permanent establishment or fixed base is situated;

the fees may be taxed in that country on a gross basis, albeit the rate of tax is limited where the fees are beneficially owned by a resident of the treaty partner country;

business profits treatment will apply if the fees are attributable to activities carried on through a permanent establishment or a fixed base of the service provider situated in the source country.

Countries that seek to include these provisions will often have specific domestic law rules for the taxation of fees for technical services or assistance provided by non-residents. Many developing countries apply withholding tax to payments for such services. For these countries, the main issues that arise in administering the treaty provision relate to the determination of the services to which the treaty provision apply (if the scope of the treaty provision is different from their domestic law provision) and to identification of the beneficial owner of the fees for purposes of determining whether any reduction in source taxation is applicable<sup>13</sup>. Other issues arise for tax administrations of countries that do not apply withholding tax to such payments. These include identification of relevant payments, and application of tax rate limitations based on the gross amount of the payment.

Under the UN Model Convention, remuneration of \_\_\_\_\_ is dealt with under different articles, depending on the capacity in which the teaching services are performed, i.e. Article 14 for

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<sup>13</sup> Issues relating to beneficial ownership are discussed in Brian Arnold, Overview of Major Issues in the Application of Tax Treaties; Joanna Wheeler, Persons Qualifying for Treaty Benefits; and Jan de Goede, Taxation of Investment Income and Capital Gains; Papers 1-A, 2-A and 7-A respectively of this collection.

independent teaching services, Article 15 for employed teachers, or Article 19 for teachers employed by a government. Some countries, however, prefer to encourage cultural relations and the exchange of knowledge by including a special article in their treaties that provides an exemption from source taxation for the remuneration of teachers (including professors and, sometimes, researchers) who visit the country for less than a specified period (often 2 years).

While no specific provision dealing with remuneration of teachers is included in the UN Model Convention, the Commentary discusses a number of issues that should be considered in bilateral negotiations when drafting such a provision<sup>14</sup>. For example, to avoid double non-taxation, the treaty may provide that exemption is conditional on the remuneration being subject to tax in the teacher's country of residence. The exemption may also be conditional on the teaching activities being performed at recognized teaching institutions and/or not being for private benefit.

Nevertheless, teachers' articles are notoriously difficult to administer. Competent authorities or tax administrations are commonly called upon to determine whether remuneration derived from teaching activities that exceed the specified period should be taxed from the beginning of the visit or only from the expiry called upon to administer. Conno9dbrequibilapplt exoration derivede exp to

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## 2. Administrative issues

It is obvious from the discussion above that treaties do not provide a consistent approach to tax treatment of income from services. In determining the correct tax treatment applicable under a treaty provision, tax administrations may need to consider one or more of a number of different factors. These include:

- whether the income is derived by a resident of a treaty partner country who is entitled to treaty benefits;
- the character of the income, i.e. the type of services provided, and whether provided by an individual or a legal person;
- whether service activities are sourced in the country e.g. exercised in that country or paid by a resident;
- whether any applicable threshold for source taxation has been met;
- the amount of income that may be taxed in the source country;
- the method of imposing or collecting tax.

### 2.1 Residence of service provider

Treaties apply to persons who are residents of one or both of the treaty partner countries.<sup>15</sup> For tax authorities, therefore, the first step in deciding whether treaty benefits are available in respect of income from services derived from sources in one country is to determine whether the service provider is a resident of the other country for treaty purposes. The issues relating to determination of residence for treaty purposes are dealt with in a separate paper<sup>16</sup>.

For certain categories of services income, a service provider who is a resident of a treaty partner country must fulfill additional criteria for entitlement to treaty benefits in respect of that income.

For purposes of Article 7, the service provider must be carrying on an enterprise. The term ‘enterprise’ is not defined in itself in the UN Model Convention.<sup>17</sup> It is clear, however, that source

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<sup>15</sup> Article 1 of the UN Model Convention, Article 1 of the OECD Model Convention

taxation is only permitted if the non-resident service provider is carrying on business in that country through a permanent establishment. The term 'business' is not defined in the UN Model Convention and is defined in the OECD Model Convention only to include professional and other independent services. Tax authorities should determine whether or not the service provider is carrying on an 'enterprise' or a 'business' by reference to domestic law.

Under \_\_\_\_\_, treaty benefits (i.e. exemption from source taxation) will only be available if the place of effective management of the transport enterprise is outside the source country. Determination of the 'place of effective management' can be a complex matter, involving the consideration of factors such as where the enterprise is actually managed and controlled, where its board of directors meets, where the highest level of decision-making takes place.

Many countries prefer to assign exclusive taxing rights under the treaty to the country of which the shipping or airline enterprise is a resident, rather than the country where its place of effective management is located.<sup>18</sup> This may be a policy preference, or may reflect concerns about administrative difficulties in determining the place of effective management, especially in countries where this concept does not have a domestic law equivalent. Tax administrations will generally have few difficulties in obtaining the information necessary to verify that an enterprise is a resident of one or other country. Similarly, international transport enterprises that are residents of a State would have little difficulty in obtaining a certificate of residence to that effect in their home country when claiming treaty benefits.

For purposes of \_\_\_\_\_ provisions, only a resident of a treaty

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a national of that other country; or

did not become a resident of that other country solely for the purpose of rendering the services.

This exemption commonly applies to locally-engaged staffs who are employed by foreign diplomatic missions or consular posts in a country. The tax authorities of the paying country will ordinarily have few difficulties in determining whether the recipient is a resident and national of the other country. However, where the government employee is not a national of the treaty partner country, determining that person's reasons for becoming a resident of that country may sometimes present difficulties, particularly when the date of the employ

The application of the more specific provisions generally depends on the nature of the services provided. Under some articles, the classification of the service provider, e.g. as a director or as a teacher, may also be relevant. Some of the more common characterization issues are discussed below.

### 2.2.1 Nature of the services

applies to ‘profits from the operation of ships or aircraft in international traffic’. A challenge for tax authorities is to determine which activities would fall within the scope of the provision. In addition to the carriage by ship or aircraft in international traffic of passengers or cargo, enterprises may carry on a range of related activities, such as baggage handling, maintenance, ground transport, container leasing etc. Notwithstanding the guidance in the Commentaries<sup>22</sup>, the exact scope of Article 8 in its application to profits from non-transport activities carried on by these enterprises is not always clear.

The definition of ‘royalties’ in of the UN Model Convention includes payments for information concerning industrial, commercial or scientific experience (know-how). While fees for technical services and assistance are generally not regarded as coming within the scope of this definition,<sup>23</sup> the UN Commentary notes that ‘some countries tend to regard the provision of brain-work and technical services as the provision of “information concerning industrial, commercial or scientific experience” and to regard payment for it as royalties’<sup>24</sup>. Countries that take this view should clarify this during negotiations.

In some treaties, the term ‘royalties’ in is specifically extended to cover fees for technical services or technical assistance, or a separate article, which follows the basic form of the royalties article, is included.

Difficulties are often encountered in determining whether payments should be characterised as fees for technical services or assistance, so as to come within the scope of the provision. Although the

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<sup>22</sup> Paragraphs 4–14 of Commentary on Article 8 of the OECD Model Convention, and paragraphs 10 and 11 of the Commentary on Article 8 of the UN Model Convention quoting paragraphs 4–14 of Commentary on Article 8 of the OECD Model Convention.

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terms are not usually defined, 'technical services' often include, explicitly or by interpretation, any services of a technical, managerial or consultancy nature. The term 'technical assistance' is often used in the context of services connected with the development and/or transfer of technology. However, the precise meaning of these terms is not clear and understanding of the scope of each term differs from country to country. Where possible, tax authorities should seek an agreed understanding of the term through the mutual agreement procedure.

The application of \_\_\_\_\_ requires a determination of whether activities constitute 'professional services or other activities of an independent char

the person who is regarded as employer under domestic tax or labour law). Difficulties can especially arise where the services, while performed under a formal contract of employment between the individual and a non-resident enterprise, are rendered to a person who is a resident. Guidance on these difficult issues can be found in the Commentaries.<sup>29</sup>

applies to services provided by State employees in the course of their employment, and to pensions from such employment. It does not apply to independent personal services provided to a State (which would fall within the scope of Article 14 of the UN Model Convention).<sup>30</sup> Nor do the provisions apply to services rendered in connection with a business carried on by a government. The usual rules provided with respect to income from dependent or independent personal services, or entertainment activities, apply to remuneration from services rendered in connection with a government business.<sup>31</sup>

### 2.2.2 Qualification of service provider

A number of articles characterise income according to the qualification of the person deriving the income, e.g. income derived by a director or top-level manager (Article 16), an artiste or sportsperson (Article 17), a student, business trainee or apprentice (Article 20) or a teacher or professor (teachers' article).<sup>32</sup> In each case, the recipient of the income must derive the relevant income from the performance of services in their capacity as such a person.

Tax authorities must first determine whether the person qualifies as the relevant kind of service provider. Although the various terms are not defined in treaties, the Commentaries provide guidance on the meaning of several of them. In other cases, the tax authority would need to determine qualification through mutual agreement with the competent authority of the treaty partner country, or by reference to domestic law.

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<sup>29</sup> Paragraphs 8.1 to 8.28 of the Commentary on Article 15 of the OECD Model Convention, and paragraph 1 of the Comm

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In determining which company officials would qualify as a top-level manager for purposes of of the UN Model Convention, the Commentary notes that ‘the term “top-level managerial position” refers to a limited group of positions that involve primary responsibility for the general direction of the affairs of the company, apart from the activities of the directors. The term covers a person acting as both a director and a top-level manager’.<sup>33</sup>

The Commentaries on of the UN and OECD Model Conventions provide guidance on the meaning of ‘artiste’ and ‘sportsman’ or ‘sportsperson’. The article applies to performers whose

## 2.3 Source of income

Under many treaty provisions, the right to tax on a source basis will depend on the services being performed within the country. However, this is not always the case. Source taxing rights may also be allocated to a country under some treaty provisions where the payer is a resident of that country (e.g. in the case of directors' fees, or fees for technical services). Services income that is attributable to a permanent establishment or fixed base situated in a country may also be taxed in that country. In applying a treaty provision with respect to income from services, tax authorities should, therefore, be aware of the basis on which a source taxing right is allocated and determine whether the relevant nexus exists.

It should be noted that, whatever the treaty rule may be for allocating taxing rights, countries may only exercise that right to the extent that their domestic law permits. The allocation of a taxing right under the treaty does not authorize a country to tax income that would otherwise not be subject to tax under domestic law. Accordingly, in applying source taxing rights allocated under the treaty, tax authorities should also take into account whether the income would be regarded as having a source in their country under domestic law.

### 2.3.1 Place of performance

Under the UN Model Convention, the place in which the services are performed is relevant to the application of Article 5, Article 8, Article 14, Article 15, Article 17 and Article 19.

For purposes of the deemed services permanent establishment provision in \_\_\_\_\_ of the UN Model Convention, tax authorities will need to determine whether activities involving the furnishing of service continue 'within a Contracting State' for the requisite period. \_\_\_\_\_ also requires that the services be 'performed' in the source state, while \_\_\_\_\_ and \_\_\_\_\_ refer respectively to employment and personal activities 'exercised' in that state. \_\_\_\_\_ refers to services 'rendered' in a state. Notwithstanding the different terminology used in these articles, it is

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countries, however, do not agree with this interpretation. India, for example, takes the view that ‘physical presence of an individual is not essential’<sup>38</sup>. Under this latter interpretation, services performed outside the relevant state may be regarded as having been furnished within that state, e.g. if they are performed for the benefit of a resident. The OECD’s alternative provision deeming a services PE<sup>39</sup> explicitly provides that the services must be ‘performed’ in the source state. The Commentary further states as a principle that source taxation ‘should not extend to services performed outside the territory of a State’.<sup>40</sup>

In applying \_\_\_\_\_, as well as \_\_\_\_\_ and \_\_\_\_\_, the main challenge for tax authorities is in identifying when services are being performed in their territory, particularly in the case of mobile services activities. Information concerning service activities performed in a country

In neither case does the treaty specifically provide that services must be performed in the state in which the fixed place of business or fixed base is situated. While services provided through a fixed place of business or fixed base would usually be performed in the country in which that fixed place or fixed base is situated, countries take different views as to whether income from services performed outside their jurisdiction could be attributed to a fixed place of business or fixed base.<sup>42</sup> Whatever view tax authorities take on this matter, source tax may only be imposed in a country if the income would otherwise be subject to tax in that country (e.g. because it is regarded as having a source in that country) in accordance with domestic law. Countries that seek to attribute to a fixed place of business, or a fixed base, income from services performed in another country, are likely to encounter practical difficulties in identifying those services, particularly where the services are provided to a non-resident.

Source taxation of employment income under depends, in the first instance, on whether the employment is exercised in a country, although the residence of the payer (employer) is also relevant to determination of entitlement to source tax exemption in the case of certain short-term visits. If the employment is not exercised in a country, a non-resident employee is entitled to exemption from taxation in that country on that remuneration. Determination of where employment is exercised may not always be a simple matter, especially if the employee is not required to provide his or her services at a particular workplace such as an office. However, an employee who seeks exemption from taxation in the country where employment is exercised may be expected to keep detailed records of where his or her employment duties were performed.

For purposes of , the place in which the transport services are performed is relevant in that it is necessary to determine whether ships or aircraft are operated 'in international traffic'. The term 'international traffic' is defined in Article 3 **General Definitions** of the UN Model Convention to mean any transport by ship or aircraft operated by an enterprise that has its place of effective management in a treaty partner country, unless the ship or aircraft is operated solely between places in the (source) country. As a result of this broad definition, the rules provided in Article 8 apply not only to profits from international transport between countries, but also to profits from domestic transport within the country in which the enterprise has its place of effective management, or from domestic transport within a third country.

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<sup>42</sup> Ariane Pickering, **Enterprise Services** General Report, in International Fiscal Association, vol 97a Cahiers de droit fiscal international (Sdu Uitgevers, The Hague, The Netherlands, 2012) at p.56.

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The source state, in deciding whether to exempt the profits in accordance with Article 8 (alternative A) or to reduce its tax in accordance with Article 8 (alternative B), must determine whether, on the particular voyage that gave rise to those profits, the ship or aircraft on which the transport was provided was being operated in international traffic. Tax authorities will therefore need to determine, in relation to each voyage of each ship or aircraft operated by a foreign enterprise, whether that voyage was confined to places within their country.<sup>43</sup> If the ship or aircraft was being operated solely between places in the country, then Article 7, and not Article 8, will apply with respect to the income. The foreign enterprise should be able to produce shipping records of each voyage in respect of which exemption from tax is claimed under Article 8. However, the compliance and administrative burden involved in identifying whic

of that country. The allocation of a taxing right under the treaty would not, in these circumstances, give rise to a tax liability.

The residence of the payer of the income is also relevant for determining source of services income that falls under                    or a                    treaty provision. Under these provisions, the income is deemed to arise in the country of which the payer is a resident, or if the fees are borne by a permanent establishment or fixed base, in the country where the permanent establishment or



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Particular difficulties in the administration of Article 15 can arise in cases where an employee is in a formal contractual employment relationship with a non-resident enterprise but whose services are provided for the benefit of a resident enterprise. It is important therefore to correctly identify who is the ‘employer’ for purposes of applying the exemption under Article 15(2).<sup>44</sup>

Also, to be exempt under Article 15(2), the remuneration must not be borne by a permanent establishment situated in that State. While the accounts of any permanent establishment of the employer would generally reflect whether or not this is the case, again this information may not be available to an employee who is seeking treaty benefits under this article. It should, however, be accessible by the tax authorities.

For purposes of \_\_\_\_\_, payments received by students, trainees and apprentices will only be exempt if the payments ‘arise from sources outside’ the visited country. Payments made from abroad will normally be from sources outside the country. However, the Commentary makes it clear the payments made by or on behalf of a resident of the visited country, or borne by a permanent establishment situated in that country, are not considered to arise from sources outside that country.<sup>45</sup>

## 2.4 Thresholds

Some treaty provisions allow source taxation of certain types of services income without any minimum threshold conditions, e.g. Article 16, Article 17 and Article 19. Other provisions dealing with income from services provide a variety of threshold conditions for source taxation. These include:

- existence of a fixed place of business or fixed base;
- a time threshold, which may relate to presence of the service provider in the source country or periods during which services are provided in that country;
- level of business activities;
- monetary threshold.

Conversely, exemption from source taxation may only apply where thresholds are not exceeded, or where other conditions are met.

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<sup>44</sup> See paragraphs 8.1 to 8.28 of the Commentary on Article 15 of the OECD Model Convention and paragraph 1 of the Commentary on Article 15 of the UN Model Convention quoting paragraphs 8.1 to 8.28 of the Commentary on Article 15 of the OECD Model Convention.

<sup>45</sup> Paragraph 4 of the Commentary on Article 20 of the OECD Model Convention, and paragraph 2 of the Commentary on Article 20 of the UN Model Convention quoting paragraph 4 of the Commentary on Article 20 of the OECD Model Convention.

### 2.4.1 Fixed place of business or fixed base

Source taxation under [redacted] depends on the existence of a permanent establishment in that country. A permanent establishment is created under [redacted] where the service provider has a fixed place of business through which the activities are performed. Similarly, [redacted] allows source taxation where the service provider has a fixed base available to him for the purpose of performing his independent personal services.

The need to establish the existence of a permanent establishment or fixed base is also relevant to taxation of services income under [redacted] in that the exemption provided under paragraph 2 of that article will not apply if the employment remuneration is borne by a permanent establishment. For treaties that tax services income under [redacted] or a [redacted] article, the permanent establishment and fixed base concepts are relevant to determination of source. Furthermore, those provisions do not apply to income which is effectively connected with a permanent establishment or fixed base.

The administrative challenges involved in determining the existence of a fixed place of business permanent establishment are discussed in a separate paper<sup>46</sup> and will not be discussed further in this paper.

The same considerations would also apply to the determination of a fixed base. Although a few countries consider there is a difference between the concept of permanent establishment and that of fixed base, the two are generally regarded as identical.<sup>47</sup> The Commentary on former Article 14 of the OECD Model Convention notes that ‘there were no intended differences between the concept of permanent establishment ... and fixed base’.

### 2.4.2 Time threshold – Presence of service provider

The amount of time the service provider spends in a country may be relevant to determination of taxation in that country.



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passengers<sup>55</sup>, which is likely to cover virtually all co

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Although the Commentary on Article 14 states that expenses should be allowed in determining the income attributable to a fixed base<sup>57</sup>, this practice is not followed in all countries. Some countries tax income from independent personal services on a gross basis.<sup>58</sup> No guidance is provided in the Commentaries on the other articles as to whether deductions must be allowed in respect of expenses incurred in deriving the relevant income. In these cases, the domestic law of the source country will determine the extent, if any, to which deductions are allowed for expenses.<sup>59</sup>

### 2.5.2 Limitations

Under , only profits that are 'attributable to' a permanent establishment may be taxed in the country in which the permanent establishment is situated. In treaties that include the force of attraction provisions of the UN Model Convention, profits that are attributable to service activities carried on in that country that are similar to those carried on through the permanent establishment may also be taxed.

Difficulties are often encountered in determining how much profit is attributable to the permanent establishment. While these are not significantly different in the case of services PEs from the problems of determining the profits attributable to services performed through a fixed place of business PE, they are nevertheless issues of concern to tax administrations. Attribution of profits to a permanent establishment is a complex issue and is beyond the scope of this paper. Tax authorities should follow the guidance provided by the Commentary on Article 7 of the UN Model Convention or, if Article 7 of the OECD Model Convention (as of 2010) is adopted in a treaty, the guidance

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<sup>57</sup> Paragraph 3 of the former Commentary on Article 14 of the OECD Model Convention and paragraph 10 of the Commentary on Article 14 of the UN Model Convention quoting paragraph 3 of the former Commentary on Article 14 of the OECD Model Convention.

<sup>58</sup> Ariane Pickering, *Enterprise Services* General Report, in International Fiscal Association, vol 97a Cahiers de droit fiscal international (Sdu Uitgevers, The Hague, The Netherlands, 2012) at p.45.

<sup>59</sup> See paragraph 10 of the Commentary on Article 17 of the OECD Model Convention and paragraph 2 of the Commentary on Article 17 of the UN Model Convention quoting paragraph 10 of the Commentary on Article 17 of the OECD Model Convention.



An appropriate allocation of the profit must also be agreed. This could be done as part of the treaty negotiations, e.g. in an interpretive Protocol annexed to the treaty. It could also be agreed, either



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but in others taxpayers are given the option of taxation by assessment upon filing a tax return (or other prescribed form).

### **2.6.2 Withholding tax**

Developing countries commonly require payers to withhold tax on a wide variety of payments under domestic law. For many such countries, withholding tax represents the only effective way of collecting tax on payments to non-residents. If, as is often the case under domestic law, the resident payer (or permanent establishment of a non-resident payer) is personally liable if they fail to withhold the appropriate tax, there is a significant

#### Article 14

In some countries, non-residents providing independent personal services in a country are required to register with the tax authorities. Nevertheless, most countries impose interim or final withholding tax on payments by residents and permanent establishment in respect of such services as a way of effectively collecting tax.

#### Article 16

Most countries require the paying company to withhold tax on directors' fees and remuneration of top-level managers. However, in some countries, the income will only be regarded as having a source (and therefore taxable therein) if the activities are performed in that country. In these countries, it is necessary to determine where and when the director's or top level manager's services are performed.

#### Article 17

Practice amongst countries differs on how entertainment income is taxed. In most countries, given the difficulties for tax administrations in knowing when an artiste or sports person is performing entertainment activities in the country, an obligation is imposed on the promoter of the entertainment or sporting event to withhold tax on payments to entertainers. This tax may be imposed on a final or non-final basis. Where the tax is a final tax based on the gross amount paid to the artiste or sports person, the rate imposed is generally relatively low. In some countries, an option for taxation on a net basis is provided under domestic law or under a treaty.

Even with a withholding tax, collection of tax liabilities of non-resident entertainers often presents problems. For example, enforcement of the obligation to withhold is particularly difficult where the promoter is a non-resident. While treaties can help in this regard through the inclusion of provisions for assistance in collection of tax<sup>66</sup>, few treaties negotiated by developing countries include such provisions.

#### Technical fees

Technical fees paid to non-residents are often subject to a final withholding tax under domestic law. When Article 12 and Fees for Technical Services provisions apply to such payments, the source country has the right to continue to tax the fees through a final withholding tax on the gross amount

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<sup>66</sup> Article 27 of the OECD Model Convention and Article 27 of the UN Model Convention.

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of the payment. If, however, the fees are derived through a permanent establishment or fixed base situated in the source state, they must be taxed in accordance with the rules applicable to business profits, i.e. on a net basis. In countries where the fees would otherwise be taxed on a withholding basis under domestic law, mechanisms may not exist for applying net basis taxation to the fees. Tax administrations will need to ensure that procedures are in place to refund to service providers, who claim the benefit of this treaty provision and who provide information to enable determination of their net profit from the service activities, any tax withheld in excess of the tax payable on that profit.

Under the domestic law of many countries, however, fees for technical services or assistance are not a separate category of income or are not subject to withholding tax. In these countries, there may be further difficulties in applying special treaty provisions. If the domestic law does not distinguish for tax purposes between technical and other services, there are likely to be difficulties in identifying the services to which the treaty provision applies. It may also be difficult to apply a gross tax rate limit if the fees are ordinarily included in taxable income and taxed on a net basis in the source country.

### **2.6.3 Application of treaty limits**

The OECD Commentary on Article 1 notes that ‘each State is free to use the procedure provided in its domestic law in order to apply the limits provided by the Convention’. The method that is ‘highly preferred’ is to limit the tax that is levied to accord with the limits provided under the treaty.<sup>67</sup>

This can be problematic, however. For purposes of \_\_\_\_\_, for example, a withholding agent may not know how long the service provider will be present in the country and so will not be able to determine the service provider’s entitlement to exemption. Furthermore, if withholding agents are liable for underpaid tax (as is commonly the case when the withholding tax represents the final tax liability of the service provider), the agent is unlikely to refrain from collecting that tax unless a waiver is issued by the tax authorities. In a few countries, the possibility exists for a taxpayer to apply in advance for such a waiver. However, tax authorities would need to be convinced that the

under the treaty. Countries that follow this latter approach should ensure that they have in place procedures that will allow the refund to be made without any undue delay.<sup>68</sup>

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<sup>68</sup> Ibid.