Economic Employer

OECD Revised draft changes to the commentary on paragraph 2 of Article 15
Response by The Chartered Institute of Taxation

1. Introduction

1.1 This paper sets out the comments of the Chartered Institute of Taxation (CIOT) on the OECD Revised public discussion draft issued on 12 March 2007.

1.2 In commenting, the CIOT will use the UK as the host state, ie where the work is being carried out by the employee, “Mr A”, and Germany as the home state, ie Mr A normally works for a company based in Germany. We will refer to the home state company as BRD Ltd and the host state “deemed employer” as DUK Ltd.

2. The commentary

2.1 The latest commentary sets out examples of when Article 15 can be accepted and when it can be ignored by Member Tax Authorities in determining whether to charge UK tax (host state) on the earnings of Mr A when temporarily working in the UK.

2.2 Article 15(2) already sets out clear guidelines as to when a claim for exemption from tax will be allowed in a temporary workplace. It is generally accepted that there has been in the past “abuse” of the provisions so that tax has been avoided in the UK for short-term workers in the UK and the CIOT accepts that Tax Authorities need to review the way that their treaties are interpreted in line with changes in the way that employers operate when posting workers to work temporarily in other countries.

2.3 Whilst the OECD commentary effectively leaves it up to each state to determine whether an employment is in existence, in accordance with its own laws, this is of little assistance to a worker or for a company in determining its requirement to withhold and report taxable income, if it has first to determine whether an individual is, or is not, employed in the UK. This requirement is
clearly signalled in paragraph 8.4 of the commentary.

2.4 What if the home state does not agree with the fact that the host state has determined that there is an employment in the host state (ie, what if the home state will not give tax credit relief)? Paragraphs 8.14 and 8.15 provide some factors that will be relevant in determining whether there will be an employment in the host state. These factors are not capable of being applied to every case with clarity and certainty, and the commentary fails to tell the reader how to take them into account. The six examples at paragraphs 8.16 onwards may be reasonably clear but they are only helpful in resolving the particular issues given in the examples. Also, they do not address the over-riding principle of when the host country should be required to cede its rights for taxes in all cases.

In many cases, an employer will be unable to determine whether his employee, when seconded temporarily to another state to provide services for the benefit of an enterprise in that other state, has become an employee of the enterprise in the other state. The fact that there is no black and white dividing line means that employers are offered no more guidance over taxing rights than before.

2.5 Furthermore, the commentary takes no account of the cost to business, and the inconvenience to both the employer and employee, of having to process the paperwork. For instance, when UK residents work overseas there is a system to prevent double withholding but it requires documentation which is so cumbersome that by the time it is put in place double taxation has already arisen.

3. Key issue

3.1 The issue causing the greatest debate over the last 10 years has been the concept of the “economic employer”. This phrase does not exist in either the wording of the treaty or in UK law, but has been adopted through common usage. It has become used to describe the position when Mr A comes to the UK for a short period of time, remains employed by BRD Ltd but works for DUK Ltd. The revised commentary simply acknowledges that some states adopt the economic employer concept (eg paragraphs 8.8 and 8.9). The conditions for relief under Article 15(2) are usually:

1. That Mr A is employed by a company based outside the UK (BRD Ltd);
2. That Mr A is in the UK for less than 183 days in any 12 month period (a question of fact but assumed to be true for this response); and
3. That the remuneration is not recharged by BRD Ltd to any permanent establishment (PE) which BRD Ltd has in the UK (again assumed to be true for this response).

Therefore, the key point in the debate about “economic employer” is whether Mr A is employed by BRD Ltd or by DUK Ltd whilst working in the UK.

3.2 The word “employed” is not defined in the treaties or by the OECD model treaty, leading to the discussion on what the term employed means. This led to the debate, which has become necessary primarily as a result of the increased number of people working across country borders. The EU “free movement of
people” has allowed people to live in one country and work in another without any intervention from the state, and that has allowed business to move people around far more freely than before. The provision of cheap and efficient transportation systems also allows for workers to work temporarily in another country and large numbers are doing this.

3.3 Paragraph 8 of the most recent OECD model treaty commentary has been considering whether Mr A has become “economically” employed by DUK Ltd, so that the treaty can allow the Tax Authorities to ignore the existing legal employment arrangements and interpret the arrangements so that Mr A is only employed by DUK Ltd. It is argued that the legal employment status can be ignored.

3.4 The CIOT believes that, from a UK perspective, when Mr A is temporarily working in the UK, it will be a question of UK law as to whether he is employed by DUK Ltd or not. (Although we query whether the home state, here Germany, would necessarily form the same conclusion on the facts).

3.5 The revised commentary is, effectively, proposing a treaty definition of “employer” based on the object and purpose of the Article 15(2) exemption (paragraphs 8.13-8.15). However, as the Model OECD Treaty itself has no definition of the word “employer”, there is usually a provision in existing treaties that provides that any definition that is not contained within the treaty shall be decided upon by the law of the host country, ie the UK. Therefore, if there is a need for definitions to be made within treaties the CIOT would prefer to see a definitions sub-Article so that words that are used can be defined for the purposes of the treaty. This would prevent the current confusion as to whether the words “employer” and “employment” can be defined by OECD commentary when the treaty already provides for UK domestic law to provide for those definitions.

3.6 There have been numerous employment law cases in recent years to determine whether an individual is employed by a particular company when he already has an existing contract of employment with another company. In our example, Mr A has a contract of employment with BRD Ltd, so the question is whether, as a matter of UK law, that contract has been superseded by, or runs in parallel with, a notional contract with DUK Ltd. This notional contract would be regarded as being an “implied” contract because there would be no “express” contract of employment between Mr A and DUK Ltd.

However, we would also point out that the most recent judicial comment in the UK on the possibility of a “notional” contract is contained in the Employment Appeal Tribunal case of Jones v Greenwich Council [2006] UKEAT/0006/06/ZT. This said that such cases will be uncommon: “It will be a rare case where there will be evidence entitling the Tribunal to imply a contract between the worker and the end user.”

If there is both an implied contract of employment and an express contract of employment, the former between Mr A and DUK Ltd and the latter between Mr A and BRD Ltd, then we would query whether treaty relief should still be available in any event, as Mr A will still be employed by BRD Ltd. In order for the “economic employer” concept to be valid, would not the contract with BRD Ltd have to be treated, under employment law, as having ceased and having been superseded by a single contract with DUK Ltd? This point is not examined or discussed in the latest OECD commentary and is an omission that
is regretted. Nor is the legal basis for an interpretation of “employer” as extending to “economic employer”. In these circumstances the CIOT is of the view that, if finalised in its current form, the Article 15 commentary will be open to further debate and will not give employers, tax authorities or the courts sufficient clarity or direction to give the results that the OECD appears to want.

3.7 The CIOT is concerned that the tax position does not appear to cross-refer to the EU directives for posted workers. The Posted Workers directive (96/71/EC) accepts that when a person is sent by his existing employer to work in another state the position of the posted worker is protected by the legal employment contract becoming subject to any additional statutory rights that exist for employments in the other state. The directive does not rule that a notional employment exists. This approach is at odds with the OECD approach.

In addition, the EC legislation on social security and mobility of persons within the EC (1408/71/EEC) generally provides that employees seconded from employment in their home state to work in another member state for a period of not more than 12 months should remain in the home state social security system. The CIOT would question why the tax system cannot follow the same broad approach, albeit limited by tests around the 183 day rule and recharges of costs to any PE? Such alignment in the general approach would make life much easier as far as business is concerned.

The CIOT therefore suggests that these points be further considered before the new commentary is finalised, particularly the point that the commentary should not ascribe a meaning to the word “employer”, other than as contractual employer, without there being a definition of “employer” included in the Model OECD Treaty.

4. Summary

4.1 The revised draft changes to the commentary do not resolve the position for either employers or employees, and the commentary takes no account of the costs to business of having to process the paperwork or the inconvenience to both employer and employee. There will also be the knock-on effects of this for the various OECD tax authorities.

In particular, there will still be much uncertainty as to whether the host state employer has become the “employer for tax purposes” and must, therefore, apply statutory withholding taxes, where applicable, or whether the home state must give credit or exemption. Also, the employee will not understand whether or not to make a treaty claim for exemption in the host state or a claim for tax credit relief in the home state.

The OECD should look at ways of finding cost effective methods of resolving which state has taxation rights.

The Chartered Institute of Taxation
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