



**REVISED DRAFT CHANGES TO THE  
COMMENTARY ON PARAGRAPH 2 OF ARTICLE 15**

*Revised public discussion draft*

*12 March 2007*

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### *Revised public discussion draft*

In April 2004, Working Party No. 1 on Tax Conventions and Related Questions<sup>1</sup> released for public comments the draft proposals for changes to the Commentary on paragraph 2 of Article 15 that a small group of delegates had drafted in order to clarify the scope of the paragraph when services are provided through intermediaries.

The Working Party wishes to thank the individuals and organizations that have sent comments on the discussion draft. It examined carefully all the comments received and mandated a small drafting group to review the draft proposals in light of these comments.

Following a suggestion by that group, a public consultation meeting with business representatives and other interested parties was held on 30 January 2006. The tax administrations from 9 countries (Australia, Austria, Belgium, Germany, Greece, Hungary, Norway, Switzerland and the United Kingdom) and participants from Belgium, France, Germany, India, Italy, Luxembourg, the Netherlands, Sweden, the United Kingdom and the United States were present at the meeting. The purposes of the meeting were to better explain the draft changes, discuss practical cases in light of current country practices and allow participants to present their views.

After that meeting, revised proposals were prepared in light of the written comments received and the discussions at the meeting. At its subsequent meetings of February and September 2006, the Working Party examined these revised proposals, made a number of changes to them and decided that they should be publicly released for comments with a view to continuing the discussion of these proposals in light of comments from interested parties.

The revised proposals appear below. The Annex includes a marked-up version of these proposals that shows the changes that have been made to the discussion draft released in April 2004.

The Working Party invites interested parties to send their comments, **before 1 July 2007**, on these revised proposals, which it intends to finalize at its September 2007 meeting. Comments should be sent to:

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Please note that, unless otherwise requested at the time of submission, comments submitted to the OECD in response to this invitation may be posted on the OECD website.

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<sup>1</sup> That Working Party is the sub-group of the OECD Committee on Fiscal Affairs which is responsible for updating the OECD Model Tax Convention.

**PUBLIC DISCUSSION DRAFT ON REVISED CHANGES TO THE COMMENTARY ON  
PARAGRAPH 2 OF ARTICLE 15**

**Proposals for changes to the Commentary on Article 15**

1. Replace existing paragraph 1 of the Commentary on Article 15 by the following (additions to the existing text of the paragraph appear in *bold italics*)

“1. Paragraph 1 establishes the general rule as to the taxation of income from employment (other than pensions), namely, that such income is taxable in the State where the employment is actually exercised. *The issue of whether or not services are provided in the exercise of an employment may sometimes give rise to difficulties which are discussed in paragraphs 8.1 ff.* Employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid. One consequence of this would be that a resident of a Contracting State who derived remuneration, in respect of an employment, from sources in the other State could not be taxed in that other State in respect of that remuneration merely because the results of this work were exploited in that other State.”

2. Replace existing paragraph 8 of the Commentary on Article 15 by the following new paragraphs:

"8. There is a direct relationship between the principles underlying the exception of paragraph 2 and Article 7. Article 7 is based on the principle that an enterprise of a Contracting State should not be subjected to tax in the other State unless its business presence in that other State has reached a level sufficient to constitute a permanent establishment. The exception of paragraph 2 of Article 15 extends that principle to the taxation of the employees of such an enterprise where the activities of these employees are carried on in the other State for a relatively short period. Subparagraphs *b*) and *c*) make it clear that the exception is not intended to apply where the employment services are rendered to an enterprise the profits of which are subjected to tax in a State either because it is carried on by a resident of that State or because it has a permanent establishment therein to which the services are attributable.

8.1 It may be difficult, in certain cases, to determine whether the services rendered in a State by an individual resident of another State, and provided to an enterprise of the first State (or that has a permanent establishment in that State), constitute employment services, to which Article 15 applies, or services rendered by a separate enterprise, to which Article 7 applies or, more generally, whether the exception applies. While the Commentary previously dealt with cases where arrangements were structured for the main purpose of obtaining the benefits of the exception of paragraph 2 of Article 15, it was found that similar issues could arise in many other cases that did not involve tax-motivated transactions and the Commentary was amended to provide a more comprehensive discussion of these questions.

8.2 In some States, a formal contractual relationship would not be questioned for tax purposes unless there were some evidence of manipulation and these States, as a matter of domestic law, would consider that employment services are only rendered where there is a formal employment relationship.

8.3 If States where this is the case are concerned that such approach could result in granting the benefits of the exception provided for in paragraph 2 in unintended situations (e.g. in so-called “hiring-out of labour” cases), they are free to adopt bilaterally a provision drafted along the following lines:

Paragraph 2 of this Article shall not apply to remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and paid by, or on behalf of, an employer who is not a resident of that other State if:

- a) the recipient renders services in the course of that employment to a person other than the employer and that person, directly or indirectly, supervises, directs or controls the manner in which those services are performed; and
- b) those services constitute an integral part of the business activities carried on by that person.

8.4 In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services). That distinction keeps its importance when applying the provisions of Article 15, in particular those of subparagraphs 2 *b*) and *c*). Subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise, it is a matter of domestic law of the State of source to determine whether services rendered by an individual in that State are provided in an employment relationship and that determination will govern how that State applies the convention.

8.5 In some cases, services rendered by an individual to an enterprise may be considered to be employment services for purposes of domestic tax law even though these services are provided under a formal contract for services between, on the one hand, the enterprise that acquires the services, and, on the other hand, either the individual himself or another enterprise by which the individual is formally employed or with which the individual has concluded another formal contract for services.

8.6 In such cases, the relevant domestic law may ignore the way in which the services are characterized in the formal contracts. It may prefer to focus primarily on the nature of the services rendered by the individual and their integration into the business carried on by the enterprise that acquires the services to conclude that there is an employment relationship between the individual and that enterprise.

8.7 Since the concept of employment to which Article 15 refers is to be determined according to the domestic law of the State that applies the convention (subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise), it follows that a State which considers such services to be employment services will apply Article 15 accordingly. It will, therefore, logically conclude that the enterprise to which the services are rendered is in an employment relationship with the individual so as to constitute its employer for purposes of subparagraph 2 *b*) and *c*). That conclusion is consistent with the object and purpose of paragraph 2 of Article 15 since, in that case, the employment services may be said to be rendered to a resident of the State where the services are performed.

8.8 Other States arrive at similar results through a different analysis. These States focus on the express wording of the conditions that need to be met for the exception of paragraph 2 of Article 15 to apply. They consider that, regardless of any domestic law meaning of “employer”, that term, when used in the context of sub-paragraph *b*) and *c*) of paragraph 2 of article 15, must be interpreted according to the object and purpose of paragraph 2. They note that it would be

contrary to that object and purpose to provide a tax exemption for what is in substance the ordinary work force of enterprises of these States.

8.9 These States therefore conclude that the term employer, as used in subparagraphs *b*) and *c*), cannot apply to a person who is a formal employer where the main functions assumed by a normal employer are exercised by an enterprise carried on by a resident (or an enterprise carried on by a non-resident which has a permanent establishment through which these functions are performed). That approach is not affected by, and does not affect, the domestic law view of the relationship between an individual providing services and the enterprise to which these services are rendered. It seeks to ensure that the term employer is not interpreted in a way that would allow the exception provided for by paragraph 2 to apply in unintended situations, i.e. where the services rendered by the employee are more integrated to the business activities of an enterprise carried on by a resident than to those of his formal employer.

8.10 Both approaches described above ensure that relief of double taxation will be provided in the State of residence of the individual even if that State does not, under its own domestic law, consider that there is an employment relationship between the individual and the enterprise to which the services are provided. Indeed, to the extent that the State of residence acknowledges that the concept of employment in the domestic tax law of the State of source or the approach in paragraphs 8.8 and 8.9 allows that State to tax the employment income of an individual in accordance with the convention, it must grant relief for double taxation pursuant to the obligations incorporated in Articles 23A and 23B (see paragraphs 32.1 to 32.7 of the Commentary on these articles)

8.11 Both approaches must, however, be applied on the basis of objective criteria. Under the first approach, for instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises. Similarly, in such a case, a State could not rely on the approach described in paragraphs 8.8 and 8.9 above to deny, for purposes of subparagraphs 2 *b*) and *c*), the status of employer to the enterprise that formally employs an individual through which such services are provided. The relief provided under paragraph 2 of Article 15 would be rendered meaningless if States were allowed to deem services to constitute employment services in cases where there is clearly no employment relationship or to deny the quality of employer to an enterprise carried on by a non-resident where it is clear that that enterprise provides services, through its own personnel, to an enterprise carried on by a resident. Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer; this could be relevant, for example, for purposes of determining whether that enterprise has a permanent establishment at the place where the individual performs his activities.

8.12 It will not always be clear, however, whether services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises. Any disagreement between States as to whether this is the case should be solved having regard to the following principles and examples (using, where appropriate, the mutual agreement procedure).

8.13 The nature of the services rendered by the individual will be an important factor since it is logical to assume that an employee provides services which are an integral part of the business

activities carried on by his employer. It will therefore be important to determine whether the services rendered by the individual constitute an integral part of the business of the enterprise to which these services are provided. For that purpose, a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual's work. Clearly, however, this analysis will only be relevant if the services of an individual are rendered directly to an enterprise. Where, for example, an individual provides services to a contract manufacturer or to an enterprise to which business is outsourced, the services of that individual are not rendered to enterprises that will obtain the products or services in question.

8.14 Where a comparison of the nature of the services rendered by the individual with the business activities carried on by his formal employer and by the enterprise to which the services are provided points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:

- who has the authority to instruct the individual regarding the manner in which the work has to be performed;
- who controls and has responsibility for the place at which the work is performed;
- the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below);
- who puts the tools and materials necessary for the work at the individual's disposal;
- who determines the number and qualifications of the individuals performing the work.

8.15 Where an individual who is formally an employee of one enterprise provides services to another enterprise, the financial arrangements made between the two enterprises will clearly be relevant, although not necessarily conclusive, for the purposes of determining whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. For instance, if the fees charged by the enterprise that formally employs the individual represent the remuneration, employment benefits and other employment costs of that individual for the services that he provided to the other enterprise, with no profit element or with a profit element that is computed as a percentage of that remuneration, benefits and other employment costs, this would be indicative that the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. That should not be considered to be the case, however, if the fee charged for the services bears no relationship to the remuneration of the individual or if that remuneration is only one of many factors taken into account in the fee charged for what is really a contract for services (e.g. where a consulting firm charges a client on the basis of an hourly fee for the time spent by one of its employees to perform a particular contract and that fee takes account of the various costs of the enterprise), provided that this is in conformity with the arm's length principle if the two enterprises are associated. It is important to note, however, that the question of whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided is only one of the subsidiary factors that are relevant to determine whether services rendered by that individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises.

8.16 *Example 1:* Aco, a company resident of State A, concludes a contract with Bco, a company resident of State B, for the provision of training services. Aco is specialised in training people in the use of various computer software and Bco wishes to train its personnel to use

recently acquired software. X, an employee of Aco who is a resident of State A, is sent to Bco's offices in State B to provide training courses as part of the contract.

8.17 In that case, State B could not argue that X is in an employment relationship with Bco or that Aco is not the employer of X for purposes of the convention between States A and B. X is formally an employee of Aco whose own services, when viewed in light of the factors in paragraphs 8.13 and 8.14, form an integral part of the business activities of Aco. The services that he renders to Bco are rendered on behalf of Aco under the contract concluded between the two enterprises. Thus, provided that X is not present in State B for more than 183 days during any relevant 12 month period and that Aco does not have in State B a permanent establishment which bears the cost of X's remuneration, the exception of paragraph 2 of Article 15 will apply to X's remuneration.

8.18 *Example 2:* Cco, a company resident of State C, is the parent company of a group of companies that includes Dco, a company resident of State D. Cco has developed a new worldwide marketing strategy for the products of the group. In order to ensure that the strategy is well understood and followed by Dco, which sells the group's products, Cco sends X, one of its employees who has worked on the development of the strategy, to work in Dco's headquarters for 4 months in order to advise Dco with respect to its marketing and to ensure that Dco's communications department understands and complies with the worldwide marketing strategy.

8.19 In that case, Cco's business includes the management of the world-wide marketing activities of the group and X's own services are an integral part of that business activity. While it could be argued that an employee could have been easily hired by Dco to perform the function of advising the company with respect to its marketing, it is clear that such function is frequently performed by a consultant, especially where specialised knowledge is required for a relatively short period of time. Also, the function of monitoring the compliance with the group's worldwide marketing strategy belongs to the business of Cco rather than to that of Dco. The exception of paragraph 2 of Article 15 should therefore apply provided that the other conditions for that exception are satisfied.

8.20 *Example 3:* A multinational owns and operates hotels worldwide through a number of subsidiaries. Eco, one of these subsidiaries, is a resident of State E where it owns and operates an hotel. X is an employee of Eco who works in this hotel. Fco, another subsidiary of the group, owns and operates an hotel in State F where there is a shortage of employees with foreign language skills. For that reason, X is sent to work for 5 months at the reception desk of Fco's hotel. Fco pays the travel expenses of X, who remains formally employed and paid by Eco, and pays Eco a management fee based on X's remuneration, social contributions and other employment benefits for the relevant period.

8.21 In that case, working at the reception desk of the hotel in State F, when examined in light of the factors in paragraphs 8.13 and 8.14, may be viewed as forming an integral part of Fco's business of operating that hotel rather than of Eco's business. Under the approach described in paragraphs 8.4 to 8.7 above, if, under the domestic law of State F, the services of X are considered to have been rendered to Fco in an employment relationship, State F could then logically consider that Fco is the employer of X and the exception of paragraph 2 of Article 15 would not apply. Also, under the other approach described in paragraphs 8.8 and 8.9, State F could consider that the employer, for purposes of the exception of paragraph 2 of Article 15, is not Eco and that the exception therefore does not apply.

8.22 *Example 4:* Gco is a company resident of State G. It carries on the business of filling temporary business needs for highly specialised personnel. Hco is a company resident of State H which provides engineering services on building sites. In order to complete one of its contracts in State H, Hco needs an engineer for a period of 5 months. It contacts Gco for that purpose. Gco recruits X, an engineer resident of State X, and hires him under a 5 month employment contract. Under a separate contract between Gco and Hco, Gco agrees to provide the services of X to Hco during that period. Under these contracts, Gco will pay X's remuneration, social contributions, travel expenses and other employment benefits and charges.

8.23 In that case, X provides engineering services while Gco is in the business of filling short-term business needs. By their nature the services rendered by X are not an integral part of the business activities of his formal employer. These services are, however, an integral part of the business activities of Hco, an engineering firm. In light of the factors in paragraphs 8.13 and 8.14, State H could therefore consider that, under the two approaches described in paragraphs 8.4 to 8.9 above, the exception of paragraph 2 of Article 15 would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.

8.24 *Example 5:* Ico is a company resident of State I specialised in providing engineering services. Ico employs a number of engineers on a full time basis. Jco, a smaller engineering firm resident of State J, needs the temporary services of an engineer to complete a contract on a construction site in State J. Ico agrees with Jco that one of Ico's engineers, who is a resident of State I momentarily not assigned to any contract concluded by Ico, will work for 4 months on Jco's contract under the direct supervision and control of one of Jco's senior engineers. Jco will pay Ico an amount equal to the remuneration, social contributions, travel expenses and other employment benefits of that engineer for the relevant period, together with a 5% commission. Jco also agrees to indemnify Ico for any eventual claims related to the engineer's work during that period of time.

8.25 In that case, even if Ico is in the business of providing engineering services, it is clear that the work performed by the engineer on the construction site in State J is performed on behalf of Jco rather than Ico. The direct supervision and control exercised by Jco over the work of the engineer, the fact that Jco takes over the responsibility for that work and that it bears the cost of the remuneration of the engineer for the relevant period are factors that could support the conclusion that the engineer is in an employment relationship with Jco. Under the two approaches described in paragraphs 8.4 to 8.9 above, State J could therefore consider that the exception of paragraph 2 of Article 15 would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.

8.26 *Example 6:* Kco, a company resident of State K, and Lco, a company resident of State L, are part of the same multinational group of companies. A large part of the activities of that group are structured along function lines, which requires employees of different companies of the group to work together under the supervision of managers who are located in different States and employed by other companies of the group. X is a resident of State K employed by Kco; she is a senior manager in charge of supervising human resources functions within the multinational group. Since X is employed by Kco, Kco acts as a cost centre for the human resource costs of the group; periodically, these costs are charged out to each of the companies of the group on the basis of a formula that takes account of various factors such as the number of employees of each company. X is required to travel frequently to other States where other companies of the group have their offices. During the last year, X spent 3 months in State L in order to deal with human resources issues at Lco.

8.27 In that case, the work performed by X is part of the activities that Kco performs for its multinational group. These activities, like other activities such as corporate communication, strategy, finance and tax, treasury, information management and legal support, are often centralised within a large group of companies. The work that X performs is thus an integral part of the business of Kco. The exception of paragraph 2 of Article 15 should therefore apply to the remuneration derived by X for her work in State L provided that the other conditions for that exception are satisfied.

8.28 Where, in accordance with the above principles and examples, a State properly considers that the services rendered on its territory by an individual have been rendered in an employment relationship rather than under a contract for services concluded between two enterprises, there will be a risk that the enterprises would be required to withhold tax at source in two jurisdictions on the remuneration of that individual even though double taxation should ultimately be avoided (see paragraph 8.10 above). This compliance difficulty may be partly reduced by tax administrations making sure that their domestic rules and practices applicable to employment are clear and well understood by employers and are easily accessible. Also, the problem can be alleviated if the State of residence allows enterprises to quickly adjust the amount of tax to be withheld to take account of any relief for double taxation that will likely be available to the employee.”

## ANNEX

### CHANGES MADE TO THE APRIL 2004 DISCUSSION DRAFT

All changes made to the previous version of the proposed changes, released in April 2004, appear in **bold italics** for additions and ~~strike through~~ for deletions

1. Replace existing paragraph 1 of the Commentary on Article 15 by the following (additions to the existing text of the paragraph appear in **bold italics**)

“1. Paragraph 1 establishes the general rule as to the taxation of income from employment (other than pensions), namely, that such income is taxable in the State where the employment is actually exercised. ***The issue of whether or not services are provided in the exercise of an employment may sometimes give rise to difficulties which are discussed in paragraphs 8.1 ff.*** Employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid. One consequence of this would be that a resident of a Contracting State who derived remuneration, in respect of an employment, from sources in the other State could not be taxed in that other State in respect of that remuneration merely because the results of this work were exploited in that other State.”

2. Replace existing paragraph 8 of the Commentary on Article 15 by the following new paragraphs:

"8. There is a direct relationship between the principles underlying the exception of paragraph 2 and Article 7. Article 7 is based on the principle that an enterprise of a Contracting State should not be subjected to tax in the other State unless its business presence in that other State has reached a level sufficient to constitute a permanent establishment. The exception of paragraph 2 of Article 15 extends that principle to the taxation of the employees of such an enterprise ~~whose employment~~ ***where the activities of these employees*** are carried on in the other State for a relatively short period. Subparagraphs ~~(b)~~ and ~~(c)~~ make it clear that the exception is not intended to apply where the employment services are rendered to an enterprise ~~that is the profits of which are~~ ***subjected to tax in a State either because it is carried on by*** a resident of that State or because it has a permanent establishment therein to which the services are attributable.

8.1 It may be difficult, in certain cases, to determine whether the services rendered in a State by an individual resident of another State, and provided to an enterprise ~~that is resident~~ of the first State (or that has a permanent establishment in that State), constitute employment services, to which Article 15 applies, or services rendered by a separate enterprise, to which Article 7 applies or, more generally, whether the exception applies. While the Commentary previously dealt with cases where arrangements were structured for the main purpose of obtaining the benefits of the exception of paragraph 2 of Article 15, it was found that similar issues ~~could arise~~ ***arose*** in many other cases that did not involve tax-motivated transactions and the Commentary was amended to provide a more comprehensive discussion of these questions.

8.2 In some ~~countries~~**States**, a formal contractual relationship would not be questioned for tax purposes unless there were some evidence of manipulation and these ~~countries~~**States**, as a matter of domestic law, would consider that employment services are only rendered where there is a formal employment relationship.

8.3 ***If States where this is the case*** ~~States where this is the case and which~~ are concerned that such approach could result in granting the benefits of the exception provided for in paragraph 2 in unintended situations (e.g. in so-called “hiring-out of labour” cases), ***they*** are free to adopt bilaterally a provision drafted along the following lines:

"Paragraph 2 of this Article shall not apply to remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and paid by, or on behalf of, an employer who is not a resident of that other State if:

(a) the recipient renders services in the course of that employment to a person other than the employer ~~who~~ and ***that person***, directly or indirectly, supervises, directs or controls the manner in which those services are performed; and

(b) ~~the employer is not responsible for carrying out the purposes for which the services are performed~~ ***those services constitute an integral part of the business activities carried on by that person.***"

8.43 In many ~~countries~~**States**, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of services) from cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services). That distinction keeps its importance when applying the provisions of Article 15, in particular those of subparagraphs 2 (b) and (c). ***Subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise***, it is a matter of domestic law of the State of source to determine whether services rendered ***by an individual*** in that State are provided in an employment relationship ~~or under a contract for services between two separate businesses~~, and that determination will govern how that State applies the ~~C~~convention.

8.45 In some cases, services rendered by an individual to an enterprise may be considered to be employment services for purposes of domestic tax law even though these services are provided under a formal contract for services between, on the one hand, the enterprise that acquires the services, and, on the other hand, either the individual himself or another enterprise by which the individual is formally employed or with which the individual has concluded another formal contract for services.

8.56 In such cases, the relevant domestic law may ignore the way in which the services are characterized in the formal contracts. It may prefer to focus primarily on the nature of the services rendered by the individual and their integration into the business carried on by the enterprise that acquires the services to conclude that there is an employment relationship between the individual and that enterprise.

8.67 Since the concept of employment to which Article 15 refers is to be determined according to the domestic law of the State that applies the convention (***subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise***), it follows that a State which considers such services to be employment services will apply Article 15 accordingly. It will, therefore, logically conclude that the enterprise to which

the services are rendered is in an employment relationship with the individual so as to constitute ~~it's~~ **the individual's** employer for purposes of subparagraph 2 (b) and (c). That conclusion is consistent with the object and purpose of paragraph 2 of Article 15 since, in that case, the employment services may be said to be rendered to a resident of the State where the services are performed.

8.78 Other ~~countries~~ **States** arrive at a similar results through a different analysis. These ~~countries~~ **States** focus on the express wording of the conditions that need to be met for the exception of paragraph 2 of Article 15 to apply. They consider that, regardless of any domestic law meaning of ~~what is an~~ “employer”, that term, when used in the context of sub-paragraph b) and c) of paragraph 2 of article 15, must be interpreted according to the object and purpose of paragraph 2. They note that it would be contrary to that object and purpose to provide a tax exemption for what is in substance the ordinary work force of ~~resident~~ enterprises **of these States**.

8.89 These ~~countries~~ **States** therefore conclude that the term employer, as used in subparagraphs b) and c), cannot apply to a person who is a formal employer where the main functions assumed by a normal employer are exercised by ~~an resident~~ enterprise **carried on by a resident** (or ~~an non-resident~~ enterprise **carried on by a non-resident** which has a permanent establishment through which these functions as performed). That approach is not affected by, and does not affect, the domestic law view of the relationship between an individual providing services and the enterprise to which these services are rendered. It seeks to ensure that the term employer is not interpreted in a way that would allow the exception provided for by paragraph 2 to apply in unintended situations, i.e. where the services rendered by the employee are more integrated to the business activities of ~~an resident~~ enterprise **carried on by a resident than that** to those of his formal employer.

8.10 ***Both approaches described above ensure that relief of double taxation will be provided in the State of residence of the individual even if that State does not, under its own domestic law, consider that there is an employment relationship between the individual and the enterprise to which the services are provided. Indeed, to the extent that the State of residence acknowledges that the concept of employment in the domestic tax law of the State of source or the approach in paragraphs 8.8 and 8.9 allows that State to tax the employment income of an individual in accordance with the convention, it must grant relief for double taxation pursuant to the obligations incorporated in Articles 23A and 23B (see paragraphs 32.1 to 32.7 of the Commentary on these articles).***

8.911 ***Both approaches described above*** must, however, be applied on the basis of objective criteria. Under the first approach, for instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises. Similarly, in such a case, a State could not rely on the approach described in paragraphs 8.78 and 8.89 above to deny, for purposes of sub-paragraphs 2 b) and c), the status of employer to the enterprise that formally employs an individual through which such services are provided. ***The relief provided under paragraph 2 of Article 15 would be rendered meaningless if ~~countries~~ States were allowed to deem services to constitute employment services, or to deny the quality of employer to an enterprise, in cases where there is clearly no employment relationship or to deny the quality of employer to an enterprise carried on by a non-resident where it is clear that that enterprise provides services, through its own personnel, to an enterprise carried on by a resident. Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded***

*between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer; this could be relevant, for example, for purposes of determining whether that enterprise has a permanent establishment at the place where the individual performs his activities.*

8.12 It will not always be clear, however, whether services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises. Any disagreement between States as to whether this is the case should be solved having regard to the following principles and examples (using, where appropriate, the mutual agreement procedure).

8.13 The nature of the services rendered by the individual will be an important factor since it is logical to assume that an employee provides services which are an integral part of the business activities carried on by his employer. ~~Where that factor points to an employment relationship that is different from the formal contractual relationship, the following factors may be relevant to determine whether this is the case. [rest moved to paragraph 8.14]~~ ***It will therefore be important to determine whether the services rendered by the individual constitute an integral part of the business of the enterprise to which these services are provided. For that purpose, a key consideration will be which enterprise bears the responsibility or risk for the results produced by the individual's work. Clearly, however, this analysis will only be relevant if the services of an individual are rendered directly to an enterprise. Where, for example, an individual provides services to a contract manufacturer or to an enterprise to which business is outsourced, the services of that individual are not rendered to enterprises that will obtain the products or services in question.***

***8.14 Where a comparison of the nature of the services rendered by the individual with the business activities carried on by his formal employer and by the enterprise to which the services are provided points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:***

- who has the authority to instruct the individual ***regarding the manner in which the work has to be performed;***
- who controls and has responsibility for the place at which the work is performed;
- ~~— who bears, in an economic sense, the cost of the remuneration paid to the individual;~~
- ***the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below);***
- who puts the tools and materials necessary for the work at the individual's disposal;
- who determines the number and qualifications of the individuals performing the work.

***8.15 Where an individual who is formally an employee of one enterprise provides services to another enterprise, the financial arrangements made between the two enterprises will clearly be relevant, although not necessarily conclusive, for the purposes of determining whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. For instance, if the fees charged by the enterprise that formally employs the individual represent the remuneration, employment benefits and other employment costs of that individual for the services that he provided to the other enterprise, with no profit element or with a profit element that is computed as a percentage of that remuneration, benefits and other employment costs, this would be indicative that the remuneration of the individual is directly charged by the formal employer to the enterprise to***

*which the services are provided. That should not be considered to be the case, however, if the fee charged for the services bears no relationship to the remuneration of the individual or if that remuneration is only one of many factors taken into account in the fee charged for what is really a contract for services (e.g. where a consulting firm charges a client on the basis of an hourly fee for the time spent by one of its employee to perform a particular contract and that fee takes account of the various costs of the enterprise), provided that this is in conformity with the arm's length principle if the two enterprises are associated. It is important to note, however, that the question of whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided is only one of the subsidiary factors that are relevant to determine whether services rendered by that individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises.*

~~8.42~~**16** *Example 1:* Aco, a company resident of State A, concludes a contract with Bco, a company resident of State B, for the provision of training services. Aco is specialised in training people in the use of various computer software and Bco wishes to train its personnel to use recently acquired software. X, an employee of Aco who is a resident of State A, is sent to Bco's offices in State B to provide training courses as part of the contract.

~~8.43~~**17** In that case, State B could not argue that X is in an employment relationship with Bco or that Aco is not the employer of X for purposes of the convention between States A and B. X is formally an employee of Aco whose own services, when viewed in light of the factors in paragraphs ~~8.11~~ **8.13 and 8.14**, form an integral part of the business activities of Aco. The services that he renders to Bco are rendered on behalf of Aco under the contract concluded between the two enterprises. Thus, provided that X is not present in State B for more than 183 days during any relevant 12 month period and that Aco does not have in State B a permanent establishment which bears the cost of X's remuneration, the exception of paragraph 2 of Article 15 will apply to X's remuneration.

~~8.44~~**18** *Example 2:* Cco, a company resident of State C, is the parent company of a group of companies that includes Dco, a company resident of State D. Cco has developed a new worldwide marketing strategy for the products of the group. In order to ensure that the strategy is well understood and followed by Dco, which sells the group's products, Cco sends X, one of its employees who has worked on the development of the strategy to work in Dco's headquarters for 4 months in order to advise Dco with respect to its marketing and to ensure that Dco's communications department understands and complies with the worldwide marketing strategy.

~~8.45~~**19** In that case, Cco's business includes the management of the world-wide marketing activities of the group and X's own services are an integral part of that business activity. While it could be argued that an employee could have been easily hired by Dco to perform the function of advising the company with respect to its marketing, it is clear that such function is frequently performed by a consultant, especially where specialised knowledge is required for a relatively short period of time. Also, the function of monitoring the compliance with the group's worldwide marketing strategy belongs to the business of Cco rather than to that of Dco. The exception of paragraph 2 of Article 15 should therefore apply provided that the other conditions for that exception are satisfied.

~~8.46~~**20** *Example 3:* A multinational owns and operates hotels worldwide through a number of subsidiaries. Eco, one of these subsidiaries, is a resident of State E where it owns and operates an hotel. X is an employee of Eco who works in this hotel. Fco, another subsidiary of the group, owns and operates an hotel in State F where there is a shortage of employees with foreign

language skills. For that reason, X is sent to work for 5 months at the reception desk of Fco's hotel. Fco pays the travel expenses of X, who remains formally employed and paid by Eco, and pays Eco a management fee based on X's remuneration, social contributions and other employment benefits for the relevant period.

~~8.17~~<sup>21</sup> In that case, working at the reception desk of the hotel in State F, when examined in light of the factors in paragraphs ~~8.11~~ **8.13 and 8.14**, may be viewed as forming an integral part of Fco's business of operating that hotel rather than of Eco's business. Under the approach described in paragraphs ~~8.34~~ to ~~8.67~~ above, if, under the domestic law of State F, the services of X are considered to have been rendered to Fco in an employment relationship, State F ~~could~~<sup>should</sup> then logically consider that Fco is the employer of X and the exception of paragraph 2 of Article 15 would not apply. Also, under the other approach described in paragraphs ~~8.78~~ and ~~8.89~~, State F could consider that the employer, for purposes of the exception of paragraph 2 of Article 15, is not Eco and that the exception therefore does not apply.

~~8.18~~<sup>22</sup> *Example 4:* Gco is a company resident of State G. It carries on the business of filling temporary business needs for highly specialised personnel. Hco is a company resident of State H which provides engineering services on building sites. In order to complete one of its contracts in State H, Hco needs an engineer for a period of 5 months. It contacts Gco for that purpose. Gco recruits X, an engineer resident of State X, and hires him under a 5 month employment contract. Under a separate contract between Gco and Hco, Gco agrees to provide the services of X to Hco during that period. Under these contracts, Gco will pay X's remuneration, social contributions, travel expenses and other employment benefits and charges.

~~8.19~~<sup>23</sup> In that case, X provides engineering services while Gco is in the business of filling short-term business needs. By their nature the services rendered by X are not an integral part of the business activities of his formal employer. These services are, however, an integral part of the business activities of Hco, an engineering firm. In light of the factors in paragraphs ~~8.11~~ **8.13 and 8.14**, State H could therefore consider that, under the two approaches described in paragraphs ~~8.34~~ to ~~8.89~~ above, the exception of paragraph 2 of Article 15 would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.

~~8.20~~<sup>24</sup> *Example 5:* Ico is a company resident of State I specialised in providing engineering services. Ico employs a number of engineers on a full time basis. Jco, a smaller engineering firm resident of State J, needs the temporary services of an engineer to complete a contract on a construction site in State J. Ico agrees with Jco that one of Ico's engineers, who is a resident of State I momentarily not assigned to any contract concluded by Ico, will work for 4 months on Jco's contract under the direct supervision and control of one of Jco's senior engineers. Jco will pay Ico an amount equal to the remuneration, social contributions, travel expenses and other employment benefits of that engineer for the relevant period, together with a 5% commission. Jco also agrees to indemnify Ico for any eventual claims related to the engineer's work during that period of time.

~~8.21~~<sup>25</sup> In that case, even if Ico is in the business of providing engineering services, it is clear that the work performed by the engineer on the construction site in State J is performed on behalf of Jco rather than Ico. The direct supervision and control exercised by Jco over the work of the engineer, the fact that Jco takes over the responsibility for that work and that it bears the cost of the remuneration of the engineer for the relevant period are factors that ~~would~~ support the conclusion that the engineer is *in* an employment relationship with Jco. Under the two approaches described in paragraphs ~~8.34~~ to ~~8.89~~ above, State J could therefore consider that the

exception of paragraph 2 of Article 15 would not apply with respect to the remuneration for the services of the engineer that will be rendered in that state.

**8.26** *Example 6: Kco, a company resident of State K, and Lco, a company resident of State L, are part of the same multinational group of companies. A large part of the activities of that group are structured along function lines, which requires employees of different companies of the group to work together under the supervision of managers who are located in different States and employed by other companies of the group. X is a resident of State K employed by Kco; she is a senior manager in charge of supervising human resources functions within the multinational group. Since X is employed by Kco, Kco acts as a cost centre for the human resource costs of the group; periodically, these costs are charged out to each of the companies of the group on the basis of a formula that takes account of various factors such as the number of employees of each company. X is required to travel frequently to other States where other companies of the group have their offices. During the last year, X spent 3 months in State L in order to deal with human resources issues at Lco.*

**8.27** *In that case, the work performed by X is part of the activities that Kco performs for its multinational group. These activities, like other activities such as corporate communication, strategy, finance and tax, treasury, information management and legal support, are often centralised within a large group of companies. The work that X performs is thus an integral part of the business of Kco. The exception of paragraph 2 of Article 15 should therefore apply to the remuneration derived by X for her work in State L provided that the other conditions for that exception are satisfied.*

**8.28** *Where, in accordance with the above principles and examples, a State properly considers that the services rendered on its territory by an individual have been rendered in an employment relationship rather than under a contract for services concluded between two enterprises, there will be a risk that the enterprises would be required to withhold tax at source in two jurisdictions on the remuneration of that individual even though double taxation should ultimately be avoided (see paragraph 8.10 above). This compliance difficulty may be partly reduced by tax administrations making sure that their domestic rules and practices applicable to employment are clear and well understood by employers and are easily accessible. Also, the problem can be alleviated if the State of residence allows enterprises to quickly adjust the amount of tax to be withheld to take account of any relief for double taxation that will likely be available to the employee.”*