

Tax Treaty Treatment of Termination Payments
Public discussion draft
Response by Carlos Rosado

Dear Sirs:

Below are the comments prepared by me in connection with the abovementioned public discussion draft.

2. Payment for unused holidays or sick leave

Paragraph 9. In order to avoid double taxation issues, I believe that the draft should attempt to clarify what would be the tax treaty treatment applicable to payments made by the employer (during the year of employment) for previous years' unused holiday / sick days, that were already taxed on an accrual basis in other States where the employee's activities were performed.

4. Severance payments

Paragraph 16. In my opinion, the proposed addition to the Commentary on Article 15, should mention that the solution would not preclude allocating the payment to previous years of employment where the facts and circumstances would make that possible and appropriate.

5. Payment of damages for unlawful dismissal

Paragraph 19. According to the draft, payments for punitive damages or damages awarded on grounds such as discriminatory treatment or injury to one's reputation, would typically fall under article 21, although they could also constitute a capital gain covered by article 13 under the definition of capital gains in some States.

Resorting to the States' definitions to determine the tax treatment applicable to this type of payments might result in a double taxation issue, in those cases where the corresponding States adopted different criteria relative to such payments.

The draft should attempt to commit to a final position in this regard.

6. Non-competition payment

Paragraph 22. This paragraph states that there are cases in which non-competition payments made after the termination of employment are in substance remuneration for activities performed during the employment and should be treated as such. As an example, the paragraph mentions that those payments made to an ex-employee where it was clear, at the time when the employer agreed to make such a payment, that the non-competition obligation of that ex-employee had little or no value for the employer.

The Group recommends the following addition to the Commentary on Article 15:

....."Where, however, such a payment made after the termination of employment is in substance remuneration for activities performed during the employment (which might be the case where, for example, the obligation not to compete has little or no value for the ex-employer), the payment should be treated in the same way as remuneration received for the work performed during the relevant period of employment".....

I believe that the purpose of the Comments to the MTCIC is not to qualify the nature or substance of the transactions, but to clarify, standardize and confirm the tax treaty treatment applicable to certain types of income.

Therefore, in my opinion, such proposed addition is not the appropriate mechanism to deal with this form of abuse of tax treaties.

8. Deferred remuneration

Paragraphs 27 to 29. According to the draft, payments made after the termination of employment pursuant to various deferred remuneration arrangements, should be treated as income covered by Article 15.

In my opinion, the concept of payments made pursuant to deferred remuneration arrangements is too broad and therefore, it would be convenient to delimit such concept, as well as to provide some examples of this type of payments.

11. Compensation for loss of earnings on or after termination following injury or disability

Paragraph 38. The Group concluded that payments made because the employee has legal grounds for claiming damages from his employer with respect to a work-related sickness or injury, would typically fall under Article 21 although it could also constitute a capital gain covered by Article 13 under the definition of capital gains in some States.

As already mentioned, resorting to the States' definitions to determine the tax treatment applicable to this type of payments might result in a double taxation issue, in those cases where the corresponding States adopted different criteria relative to such payments.

The draft should attempt to commit to a final position in this regard.

12. Compensation for loss of future commissions

Paragraph 42. According to the draft, payments made pursuant to a provision of the employment contract according to which the salesperson has a right to commissions on any future sales to a client that the salesperson brought to the employer, should be dealt with as remuneration for the employment services.

I believe that the draft should address the tax treaty treatment applicable to payments made to a salesperson for commissions on future sales to a client that the salesperson brought to the employment, in those cases in which such payment is not covered in the employment contract.

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Should you have comments in connection with the foregoing, please do not hesitate to contact me.

Sincerely,

Carlos Rosado